REPORT OF THE COMMITTEE ON ECONOMIC AFFAIRS AND LABOUR FOR THE SECOND SESSION OF THE TENTH NATIONAL ASSEMBLY APPOINTED ON WEDNESDAY 16TH JANUARY, 2008

Consisting of:

Mr G Lubinda, MP (Chairperson); Mr B M M Ntundu, MP; Mr B E Chimbaka, MP; Mr C W Kakoma, MP; Dr C A Njovu, MP; Mr H H Hamududu, MP; Mr M M Mabenga, MP; and Mrs R M Musokotwane, MP.

There was a change in the composition of your Committee following the death of Dr C A Njovu, MP who was replaced by Mr C Mulenga, MP.

The Honourable Mr Speaker
National Assembly
Parliament Buildings
LUSAKA

Sir,

Your Committee have the honour to present their Report for the year 2008.

Functions of the Committee

2.0 In addition to any other duties conferred upon them by the Honourable Mr Speaker, or any other order of the House, the functions of your Committee are to-

(i) study, report and make recommendations to the Government through the House on the mandate, management and operations of the Government ministries, departments and /or agencies under their portfolio;
(ii) 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 the Government;
(iii) make, if considered necessary, recommendations to the Government on the need to review certain policies and/or certain existing legislation; and
(iv) consider any Bills that may be referred to them by the House.

Meetings of the Committee

3.0 Your Committee held seventeen (17) meetings. In order to familiarise themselves with the topical issues, your Committee sought both written and oral submissions from various stakeholders.

Programme of Work

4.0 Your Committee adopted the programme of work for 2008 to consider the following matters:

a) the macroeconomic stability in Zambia: Its benefits to the ordinary Zambians and major challenges;

b) Zambia's Debt Management in the Post-HIPC era;

c) the role of the Multi-Facility Economic Zones in enhancing the competitiveness of Zambia's industries;

d) consideration of the Zambia-European Community Country Strategy Paper; and

e) tours relevant to the matters above.

Report of your Committee

5.0 This Report is in six parts. Part I deals with the Macroeconomic stability in Zambia and its benefits to the ordinary Zambians while part II, highlights Zambia's Debt Management in the post HIPC period. In Part III, the report details the role of the Multi-facility Economic Zones in enhancing the competitiveness of Zambia's industries. Part IV deals with the Zambia-EC Country Strategy Paper and Part V specifies the findings from the tours. Part VI is the Conclusion.

PART I

6.0 MACROECONOMIC STABILITY IN ZAMBIA: BENEFITS TO THE ORDINARY ZAMBIANS AND MAJOR CHALLENGES.

During the 2008 Budget Address, Parliament was informed that the economy performed well in 2007 and that a single digit inflation rate was achieved for the second year running. As at end-December 2007, annual inflation was at 8.9% and projected at 7% in 2008. In addition, GDP growth was at 6.2 % at the end of the year and was projected for 7% in 2008. The exchange rate, though high, was fairly stable.

Despite these positive pronouncements on the economy, there were concerns that benefits were not trickling down to the ordinary Zambians. In the Budget Speech for 2008, it was admitted that rural poverty continues to be high. There were further concerns that the current gains in the economy could be eroded if the current hydropower shortage in the country, the unstable supply of oil and the anticipated increase in the international oil prices were not adequately addressed. In addition, the effects of climate change, as evidenced by the devastating floods and droughts, would negatively affect agricultural production thereby reducing food supply and pushing food prices upwards. This could exert inflationary pressure on the economy.

In view of these challenges, your Committee resolved to investigate how Government was positioning itself in order to sustain the current macroeconomic stability and ensure that the benefits trickled down to the ordinary Zambians.

In order to ensure that your Committee gathered enough information on this subject, your Committee sought written memoranda and oral submissions from:

- the Zambia Business Forum (ZBF);
- the Economics Association of Zambia (EAZ);
- the Jesuit Centre for Theological Reflection (JCTR);
- Caritas Zambia;
- the Zambia National Farmers Union (ZNFU);
- the University of Zambia (UNZA);
- the Ministry of Finance and National Planning (MOFNP);
- the Bankers Association of Zambia (BAZ); and
- the Bank of Zambia (BOZ).

The summary of the findings of your Committee are set out below.

6.1 Zambia's Macroeconomic Environment from 2005 to 2007

Your Committee were informed that Zambia's macroeconomic environment from 2005 to 2007 had been favourable as evidenced by the single digit inflation outturn for 2006 and 2007, sustained positive real Gross Domestic Product (GDP) growth, stability of the exchange rate and a viable external sector (Table1).

Zambia's Macro Economic indicators (2005-2007) - Table 1

	YEARS		
INDICATORS	**2005**	**2006**	**2007**
General Economic Performance			
Real GDP growth (%)	5.2	6.2	5.7*
Agriculture (%)	(4.0)	3.0	(0.6)
Metal Mining (%)	7.1	9.0	2.5
Construction (%)	21.2	14.4	12.2
Communications (%)	23.5	40.5	34.7
Prices			
Inflation Rate (%)	15.9	8.2	8.9
Lending Rates (%)	33.9	27.9	24.4
Exchange Rate(US$/ZMK)	3509	4406	3865
External Sector			
Current Account Deficit (% of GDP excluding grants)	(10.2)	(0.8)	(10.2)
External Debt (% of GDP)			
Gross International Reserves (Months of Import)	1.5	2.2	3.6
Public Finance			
Domestic Financing (% of GDP)	1.8	1.5	0.95*

Source: Ministry of Finance and National Planning
*** preliminary data**

Your Committee were further informed that the favourable performance was a result of Government's role in the economy of sustaining the macroeconomic environment through the implementation of prudent policies. Macroeconomic objectives over the period under review are as follows:

(a) sustained positive and higher real GDP growth;
(b) reducing inflation to single digit;
(c) safeguarding the economy against domestic and external shocks;
(d) maintaining a viable external sector position; and
(e) removing various bottlenecks that impede private sector growth.

In addition, your Committee was informed that the policies undertaken during this period indicated an appreciable level of success as evidenced by the outturn in the key macroeconomic indicators. Generally, economic growth had been robust, prices had declined, the performance of the external sector had been favourable, fiscal performance had been solid, and the overall condition of the banking and financial system had been satisfactory (Table 1).

Further, your Committee were informed that the favourable economic performance over the period 2005-2007, had largely been driven by strong performance in the *metal mining*, *construction* and *communication* sectors. Metal mining had been rejuvenated following massive investments in existing mines, the opening up of new mines and an increase in copper prices since 2003 that had facilitated re-investments into the sector.

The Committee also learnt that the growth in the *construction* industry over the period was due to massive construction works by mining companies such as Lumwana and the Konkola Deep Mining Project (KDMP), as well as the upswing in residential and commercial housing projects.

Regarding the *agricultural sector*, your Committee was informed that growth during the review period generally fluctuated. This was due to changes in weather patterns resulting in overall poor output. This reflected the structural bias in the sector where production by most small-scale farmers, who are in the majority, was largely rain-fed.

Your Committee was further informed that a tight monetary policy and a strong fiscal policy, reducing the budget deficit to less than 1 percent of GDP in 2007 from 1.8 percent of GDP in, 2005, and a strong Kwacha, helped reduce inflation to a single digit. The expected benefit of such an outturn was to unlock resources in the banking system for use by the private sector.

Regrettably, your Committee was informed that the lending rates had only reduced marginally, especially between 2006 and 2007 (Table 1). This tended to constrain the rate at which lending to the private sector had been growing, with a decline in the growth of credit to the private sector of 19.8 percent in 2007 compared to a robust growth of 25.6 percent recorded in 2006. However, it was heartening to note that banks had diversified the portfolio of services that they were offering to their clients with a view to increasing financial intermediation.

For the period 2005 to 2007, the committee heard that the price of the Kwacha relative to major currencies such as the United States dollar had been resilient. This could be attributed to, in part, the favourable performance of the external sector. Over the review period, the external debt position had been sustainable on account of both the Highly Indebted Poor Countries Initiative (HIPC) and the Multi-lateral Debt Relief Initiative (MDRI). Further, Gross International Reserves (GIR) had increased by more than 100 percent from 1.5 months of imports in 2005 to over three months of imports in 2007, reflecting a stable supply of foreign exchange on the market due to the favourable metal prices.

The Committee was further informed that ultimately, Zambia's favourable external sector, favourable metal prices and debt relief combined with enhanced fiscal and monetary policy implementation had led to a favourable macroeconomic environment over the period 2005-2007.

6.2 Zambia's poverty levels from 2005 to 2007 segregated into urban and rural

Your Committee were informed that based on the latest poverty survey, the 2006 Central Statistical Office (CSO) Living Conditions Monitoring Survey (LCMS), 64 per cent of the Zambian population lived below the poverty datum line. Segregated into rural and urban areas, poverty was higher in rural areas at 80 percent, while urban poverty was at 34 percent. The results of the survey showed that female headed households had a higher incidence of poverty than male-headed ones.

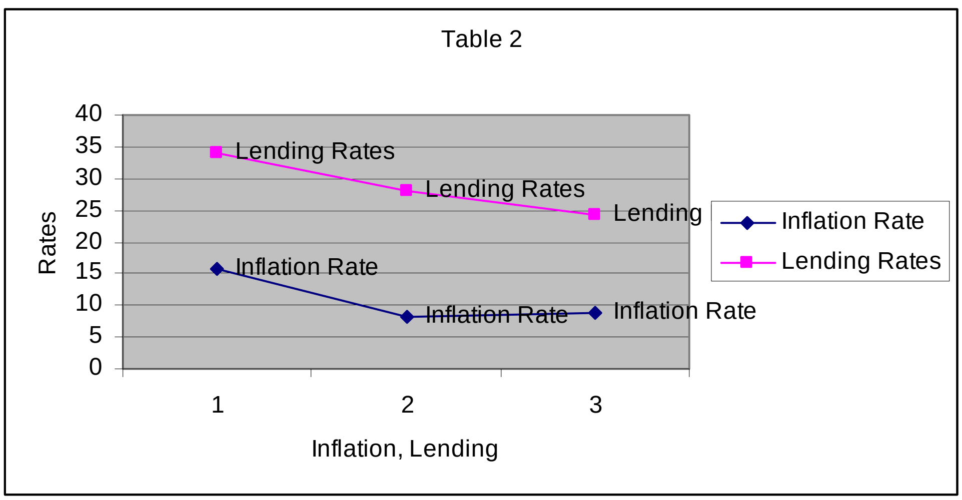
6.3 The relationship between Zambia's single digit inflation and the high interest rates

Your Committee were informed that a single digit inflation rate had been eluding the country for three decades. However, Zambia's economic reforms had led to the achievement of a single digit inflation rate in April 2006.

Further, it was explained that continued commitment in the medium to long-term goals had led to sustained and successful implementation of the necessary reforms to lower inflation and achieve positive growth rates in the economy. In this vein, overall annual inflation declined to 15.9% in December 2005 from 17.5% in December 2004. Owing to successful economic reforms, Zambia attained the enhanced HIPC Initiative Completion Point in April 2005. In April 2006, inflation fell to a single digit of 9.4% and remained in single digits of 8.2% at end- December 2006 and 8.9% at end December 2007.

Your Committee were also informed that one of the intractable variables in Zambia seemed to be the commercial bank lending interest rate which had been exhibiting considerable stickiness downwards. With inflation rates having been reduced to single digit, lending interest rates should be much lower than what they were.

It was also explained to the Committee that the irony was that while commercial bank interest rates on deposits could be below the inflation rate, lending rates were far higher than the inflation rate (Table 2). This created a huge disparity between interest rates on savings and those on investment loans. Business institutions, including the Bankers Association of Zambia, argued that after adding several other charges, the effective rate on loans could be higher than what was currently obtaining. This situation had the effect of eroding the purchasing power of the ordinary Zambian's meagre savings while raising the cost of doing business for even the big producers. It was a strong disincentive for both savers and investors.



Your Committee were, however, informed that the lending rates had been declining but that the decline had not been in line with the decline in inflation (Table 2). In real terms, the lending rates remained high. It was observed that the situation was attributed to the failure of liberalization and market forces, though the Government had not proposed any steps to address the problem.

A Bank of Zambia review of interest rates in 2003 showed that inflation was not the only determinant of the cost of borrowing. The findings indicated that other key determinants of commercial banks' interest rates, particularly the lending rate, were the yield rates on

Government securities, level of statutory reserves requirements, weak policy credibility and high default risks on loans.

In addition, it was explained to the Committee that the expected path of future inflation tended to make banks and other suppliers of credit apprehensive about the future value of their loans at maturity. In this regard, banks tended to increase their lending rates taking into account inflationary expectations in order to maintain the value of their loans. In practice, if lending rates went up, inflationary expectation was also likely to go up leading to higher lending rates, since inflation rate was a component of lending rate. In general, developments in inflation had been reflected in the levels of lending rates in Zambia besides other factors. From June 1994 to December 2007, lending rates had generally tracked inflation. Prior to this period, high yield rates on the Government securities, particularly the Treasury Bills, drove the levels recorded in lending rates.

Your Committee were also informed that the Central Bank was cognisant of the fact that the benefits of single digit inflation had not been fully reflected in the lending rates, which were considered to be high. However, it was hoped that once the country sustained the single digit inflation over a reasonable period of time, the benefits would be fully passed on to borrowers. Sustained stable and single digit inflation rate would lower inflationary expectations thereby lowering lending rates.

6.4 The relationship between Zambia's macroeconomic stability and employment creation, including poverty reduction

The Committee was informed that high inflation and a slow growing economy are major sources of concern to most countries in the world as these pose threats to economic development. In this regard, Zambia's current macroeconomic stability is a key ingredient in the country's quest for the creation of productive employment and poverty reduction. Among the major benefits of macroeconomic stability had been an increase in investment, growing confidence in both the economy and local currency as well as improving external competitiveness. All these were important preconditions for waging a successful fight against poverty.

It was thus explained to the committee that the macroeconomic stability the country was enjoying had not only attracted increased investment in the country's priority sectors, but also boosted growth in the secondary and service sectors. The increase in investment from both local and foreign sources had in-turn led to preservation of employment levels and creation of additional employment opportunities for the Zambian people.

6.5 The role of energy in maintaining a stable macroeconomic environment in Zambia

Your Committee were informed that maintaining a stable macroeconomic environment in the wake of an energy crisis would be a great challenge. The country would have to vigorously pursue a pro-active approach to meet this challenge. There was need to hedge against the persistent rise in fuel prices and fuel shortages. Secondly, there was need to find ways of scaling up investment and efficiency in the electricity sector and adopt alternative methods of producing energy.

Given that Zambia did not produce any oil, your Committee were informed that the rise in the price of oil has adverse implications in supporting growth and containing inflation. The increase in the oil prices, along with power outages, would constrain growth. This is because major players in the economy, who were the mines, depended heavily on energy for their operations.

Furthermore, high fuel costs would translate into increased transport costs, a key input in the production process and this would eventually be reflected in the final cost of commodities.

With respect to electricity supply, your Committee were informed that the unstable supply of electricity to the industry would reduce capacity utilisation and lower output. Furthermore, the unstable electricity supply would, among others, result in inefficiency and reduced production in the economy which might lead to inadequate supply of essential commodities and eventually bring about inflation.

The explanation to the Committee for the causes of power shortage was given to be the increase in investment in the country and lack of investment in hydropower. The country had recorded significant investments in areas such as mining, agriculture and tourism. These developments had resulted in high demand for power which was unmatched by supply. The demand had grown from 1000MW in 2000 to over 1400MW in 2007.

6.6 Government's strategy to mitigate the current power supply and forestall the unstable supply of petroleum products

Your Committee were informed that the Government had taken several measures to mitigate the current power shortfall which included short term and long term measures. These measures are set out hereunder.

a) A combination of rehabilitation and up-rating of existing power stations, development of small hydropower stations and load management was being undertaken. Currently, the Power Rehabilitation Project (PRP) was being undertaken by the Zambia Electricity Supply Corporation (ZESCO), whereby a total of 210MW would be added to the system by the rehabilitation and up-rating the existing Kafue Gorge and Kariba Power Stations. The current total secured capacity was 1,650MW out of which 450 MW was out for rehabilitation.

b) The Government was considering the rehabilitation of the small hydro power stations located at Lusiwasi (12MW), Musonda Falls (95MW), Chishimba Falls (6MW) and Lunzua (0.75MW) which would significantly mitigate the impact of load shedding in Northern and Luapula Provinces. Currently, these power stations were operating well below their designed capacities and required urgent repairs. It was estimated that US$15 million was required to rehabilitate the four small hydropower stations.

c) The Government was pursuing the development of new small hydropower stations around the country through both public and private sector funding mechanisms. These projects were the Lusiwasi extension (40MW), Chikata Falls (3.5MW), West-Lunga (3MW), and Chavuma (10MW). From these and other small hydro stations, close to 70 MW would be harnessed.

d) The Ministry of Energy and Water Development and ZESCO had embarked on a programme to encourage the public and industries to use energy efficient bulbs and equipment as a way of minimising demand. It was estimated that the total power demand could be saved by as much as 70MW simply by using energy efficient bulbs.

Regarding the long term solution to the current power short fall, your Committee were informed that the Government planned to build new stations in the country as following:

(i) Kafue Gorge Lower (900MW) estimated cost of US$1 billion;
(ii) Kariba North extension (360MW) estimated to cost about US$360 million;
(iii) Kalungwishi (210MW) to be developed by Lunzua Power Authority; and
(iv) Itezhi Tezhi (120MW), estimated to cost US$150 million, a partnership between; ZESCO and TATA has been signed for this project.

Regarding petroleum feedstock, your Committee were informed that the Government had taken steps to stabilise the supply to Indeni Refinery. A two year supply arrangements had been put in place and about 1.44 million metric tones would be supplied. Further, your Committee were informed that the supply was not an issue as the country had sufficient stocks to meet the market demand.

Alongside the stabilisation of supply, there were efforts to increase the operational capacity of the Refinery through a US$65 million Re-investment programme by the current shareholders, namely, Total and the Government of the Republic of Zambia.

Another measure was the establishment of National Strategic Reserves. In 2005, Cabinet authorised the Ministry of Energy and Water Development to establish National Strategic Petroleum Reserves (SPR). The establishment of SPR was meant to ensure security of supply of petroleum products. Currently, the Energy Regulation Board (ERB), through its licence system, obliged Oil Marketing Companies (OMCs) to keep fifteen days stock. This stipulation had not been strictly adhered to by all OMC's due to high costs of holding stocks.

In addition, Cabinet authorised the creation of a Fuel Price Stabilisation Fund (FPSF) to be used for ensuring stability of the domestic fuel prices and cushion the impact of high and fluctuating international prices of petroleum products.

6.7 Committee's Observations and Recommendations

After careful consideration of the various submissions from the stakeholders, your Committee wish to make the observations and recommendations set out below.

i) Your Committee wish to commend the Government for maintaining macroeconomic stability that is currently obtaining in the country. They, however, observe that the Government is facing a challenge of ensuring that the positive macroeconomic gains trickled down to the ordinary Zambians. In this regard, your Committee recommend that the Government implements pro-poor policies that will ensure that ordinary people benefit from the current economic gains. The Government should, therefore, channel adequate resources to infrastructural development and productive and social sectors.

ii) Your Committee also observe that though inflation has fallen considerably, lending rates were still high, thereby, making it difficult for ordinary Zambians to access credit from the financial institutions. On the other hand, they observe that interest rates on savings are very low and that this is discouraging savings. Your Committee are aware of the various factors that affected the lending rates. They are also aware that more can be done to persuade financial institutions to reduce lending rates to acceptable levels. They, therefore, urge the Government, through the Bank of Zambia, to find a way of intervening in the financial sector so as to bring the gap between the lending rates and saving rates to acceptable levels, particularly in line with the inflation rates.

iii) Your Committee observe that power shortages and unstable supply of petroleum products negatively affected the macroeconomic stability. They, therefore, urge the Government to ensure that they implement the long-term and short term strategies meant to improve the oil supply and forestall power shortages. This will entail investing in new hydropower stations and up-rating of the existing hydropower stations. It will also include the implementation of the Fuel Stabilisation Fund (FSF) and the National Strategic Oil Reserves.

iv) Your Committee observe that the price of fuel is generally high in Zambia. They are aware of factors that affect the cost of fuel in Zambia such as procurement and transportation costs of feedstock, processing costs at Indeni Refinery and the distribution cost by the Oil Marketing Companies. Notwithstanding all these costs, your Committee observe that taxes on petroleum products are very high. They, therefore, urge the Government to further review the taxes on petroleum products with a view to revising them to bring the price of petroleum products to affordable levels.

PART II

7.0 ZAMBIA'S MANAGEMENT OF LOCAL AND EXTERNAL DEBT

Zambia attained the HIPC Completion Point in April, 2005, which led to substantial write off of over 86 per cent of her debt. This meant that the resources that were to be channelled to debt servicing would be directed to productive and social sectors of the economy. The challenge faced by Government, however, was to ensure that Zambia did not plunge herself into another debt trap. Regrettably, in the budget presentation to Parliament for 2008, it was highlighted that the stock of debt had been gradually increasing from 2006 to 2007.

In order to broaden their understanding on this matter, your Committee sought written and oral submissions from:

- the Ministry of Finance and National Planning (MOFNP);
- the Bank of Zambia (BOZ);
- the Jesuit Centre for Theological Reflection (JCTR);
- Caritas Zambia; and
- the Civil Society for Poverty Reduction (CSPR).

The summary of the findings of your Committee are set out below.

7.1 Zambia's Debt Management

Your Committee were informed that debt management was one of the anchors that supported macroeconomic stability and contributed to the acceleration of economic and social development of Zambia. In the post-HIPC era, the Government through the Ministry of Finance and National Planning had taken debt management as a priority within the framework of macroeconomic management in order to avoid accumulating unsustainable debt again. In support of this resolve, the Ministry of Finance and National Planning instituted reforms that were aimed at maintaining debt sustainability.

7.2 Post-HIPC Debt Management Objective

The Committee was informed that the overall debt management objective was to raise adequate levels of finance on behalf of the Government at minimum cost and risk, while pursuing strategies to ensure that national public debt was managed at sustainable levels over the medium to long term.

In line with the above objective, the Committee learnt that the Government's overall debt management strategy had been to maintain the public debt at sustainable levels in the medium term by ensuring that borrowing was kept within prudent levels and secured on best terms of utilisation and repayment. In support of the strategy, the Ministry had been implementing reforms to improve the debt management environment through effective coordination between debt management, fiscal and monetary policies, as well as building of institutional and operational capacities within the institutions that dealt with public debt.

7.3 Zambia's Policy on Debt Management

The Committee was informed that Zambia's policy on debt management was defined through the Loans and Guarantees (Authorisations) Act Cap 366 of the Laws of Zambia and agreements governing Zambia's relations with its cooperating partners. With regard to domestic debt management, the Bank of Zambia manages the portfolio as an agent of the Ministry of Finance and National Planning based on the fiscal and monetary policy considerations in relation to a predetermined level of the financing gap in the Medium Term Expenditure Framework (MTEF).

Furthermore, the Committee learnt that during the period 1999 to 2005, the period between Decision and Completion Points, debt management was mainly guided by Zambia's agreements with the International Monetary Fund (IMF) and the World Bank as enshrined in the IMF's supported economic programme. Thus far, the tenets were mainly anchored on:

(i) borrowing on highly concessional terms;
(ii) non-issuance of any forms of government guarantees;
(iii) strengthening public expenditure management and limiting domestic borrowing; and
(iv) developing well functioning domestic financial systems.

It was also explained to the Committee that in the post-HIPC era, Zambia continued to borrow on the above terms while strengthening its cost and risk management capacities that in the past had not been very effective.

Further, the Committee was informed that the Government's Aid Policy that was adopted in 2007, underpinned external resource mobilisation whose strategic objective were anchored around debt cancellation, preference for grants and highly concessional loans, preference for direct budget support, and alignment of aid delivery to Zambia's priorities as identified in the national plans.

7.4 Zambia's Debt Management in the Post-HIPC Period

It was explained to the Committee that the landscape of debt management in Zambia was redefined when Zambia received debt relief under the HIPC Debt Relief Initiative and Multilateral Debt Relief Initiative in 2005, which resulted in the reduction of Government debt stock from US$7.2 billion in 2004 to US$1.1 billion in 2007. Consequently, based on the World Bank/IMF Debt Sustainability Analysis Framework for Low Income Countries, external debt had been projected to be sustainable over the next twenty years. The freed debt service resources had created fiscal space for more pro-poor expenditures in line with the priorities in the Fifth National Development Plan.

The Committee was also informed that in the post-HIPC era, the overall challenge for Zambia was how to strike a balance between maintaining sustainable debt levels while accelerating socio-economic development, which required appropriate financing, whether through grants or new borrowing. In addressing this challenge, the Ministry of Finance and National Planning conducted an Annual Debt Sustainability Analysis to guide the levels of additional loans that the Government could contract and be able to maintain sustainability. The Government's strategy in debt sustainability was to spend more loan resources in economic growth areas such as infrastructure development and be able to create repayment capacity through widening the tax base.

It was further explained to your Committee that in order for the Government to maintain the momentum gained in ensuring debt sustainability, in 2007, Government commenced the process of developing a public debt management strategy that would set out a medium-term framework on how the Government would manage its debt at lower cost and minimum risk in order to maintain a fiscally sustainable path. Your Committee were informed that the draft strategy would be submitted to Cabinet for approval in 2008.

7.5 Zambia's debt stock in 2005, 2006 and 2007 segregated into external and local

Your Committee was informed that the investment and debt management department of the Ministry of Finance and National Planning was responsible for management of external debt as it related to public and publicly guaranteed debt. The Bank of Zambia was responsible for monitoring of parastatal and the private sector external debt. The Bank of Zambia was also responsible for effecting external debt service payments on behalf of the Government.

a) External Debt Stock

The Committee was informed that preliminary data indicated that Zambia's total stock of outstanding and disbursed external debt, comprising both public and private sector debt increased by 10.1% to US$2,082.9 million at end-2007 from the US$1,892.1 million recorded at end-2006 (Table 3). An analysis of the structure of Zambia's external debt revealed that at the end of December 2007, 52.9% was Government external debt while 47.1% was external debt contracted by the private sector.

It was also explained to the Committee that the stock of Government external debt increased by 5.9% to US $1,102.2 million in 2007, from US $990.2 million in 2006, mainly as a result of disbursements from the IMF under the Poverty Reduction Growth Facility (PRGF) and from the World Bank. Debt owed to multilateral creditors amounted to US $704.0 million, accounting for 33.8% of total debt, while debt owed to bilateral creditors amounted to US $286.8 million and accounted for 13.8%. The total external debt contracted by the private sector with various creditors increased by 8.7% to US $980.7 million as at end-2007 from US $901.9 million at end-2006. Since 2005, the amount of debt accumulated by the private sector had more than doubled as indicated in table 3.

TABLE 3: ZAMBIA'S DEBT STOCK BY CREDITOR, 2005-2007

Creditor	2005 US$ Mn	%share	2006 US$ Mn	%share	2007 US$ Mn	%share
Bilateral	**1,014.0**	**20.1**	**277.4**	**14.7**	**286.8**	**13.8**
Paris Club	807.0	16.0	204.2	10.8	212.6	10.2
Non Paris Club	207.0	4.1	73.2	3.9	74.2	3.6
Multilateral	**3,540.8**	**70.0**	**579.4**	**30.6**	**704.0**	**33.8**
IMF	591.1	11.7	32.5	1.7	81.7	3.9
World Bank Group	2,335.6	46.2	260.6	13.8	316.9	15.2
Others	614.1	12.1	286.3	15.1	305.4	14.7
Suppliers/Bank	**96.2**	**1.9**	**133.4**	**7.0**	**111.4**	**5.3**
Total Govt. Debt	**4,651.0**	**92.0**	**990.2**	**52.3**	**1,102.2**	**52.9**
Private Sector Debt	**404.7**	**8.0**	**901.9**	**47.7**	**980.7**	**47.1**
Total External Debt	**5,055.7**	**100.0**	**1,892.1**	**100.0**	**2,082.9**	**100.0**

*Sources: Ministry of Finance and National Planning, Bank of Zambia

b) Domestic Debt Stock in 2005-2007

The Committee learnt that total domestic debt stock increased in 2007, as compared to 2006. Table 4, shows the changes in the stock of domestic debt over the review period.

Table 4: Domestic Debt Stock (K' Billion) 2005-2007

Debt Category	**2005**	**2006**	**2007**	**%Change 2006/2007**
Government Securities	6,983.70	6,706.44	7,595.28	13.25
Bridge Loan	288.96	0.00	0.00	0.00
Domestic Arrears	509.26	515.30	223.06	(56.71)
Pension Arrears	414.00	386.50	302.70	(21.68)
Awards and Compensation	87.49	92.50	158.01	70.82
Total Debt Stock	8,283.41	7,700.74	8,279.05	7.51

* Source: Ministry of Finance and National Planning

It was also explained to the Committee that though the stock of domestic debt decreased from K8,283.41 billion in 2005 to K7,700.73 billion in 2006, the debt stock increased by 7.5% to K8,279.05 billion at end-December 2007 from K7,700.73 billion at end-December 2006. In the period under review, the level of government securities had been the major driver of the domestic debt stock. The decrease in the stock of domestic debt in the period 2005 to 2006 was mainly as a result of a decrease in government securities. The rise in government securities was largely due to expanded use of government securities for monetary policy operations.

7.6 Reasons leading to the accumulation of debt from 2005 to 2007

It was revealed to the Committee that in the period between 2005 and 2007, Government external debt had reduced by 76.3% to US$1,102.2 million as at end-December 2007 from US$4,651 million at end-2005. This reduction was a result of implementation of the HIPC Initiative debt relief following Zambia's accession to the Completion Point in 2005 as well as the debt relief provided under the Multilateral Debt Relief Initiative (MDRI) in 2006. The increase which is noted between 2006 and 2007 of US$112 million is due to disbursements on various loans and the fact that some bilateral creditors were yet to sign agreements for debt relief as part of the HIPC Initiative debt relief.

7.7 Proposed strategies for external debt management in 2008

In the context of achieving the objectives of long-term public debt management, which was to minimise debt costs at reasonable risk level, the Committee was informed that prudent debt management would continue to be an integral part of the management of public finances and Government's overall macro-economic programme. Some of the strategies that the Government was implementing in order to forestall the accumulation of the unsustainable debt were as set out hereunder.

a) Concessional Loan Contraction

Government had been conducting Debt Sustainability Analyses (DSA) for Zambia in order to ascertain Zambia's ability to repay the loans given the projected growth of its economy and exports. It was on the basis of the DSA that Government had been negotiating with the creditors for the rescheduling of the repayment terms and conditions, taking into account Zambia's available resources in a given year.

In order to ensure that Zambia's debt continued to be sustainable, Government's strategy on external borrowing had been to contract loans that were concessional with lending terms comparable to the IDA terms, that is, interest rate of 0.75 percent, repayment period of at least thirty years and grace period of at least 6 years.

b) Non-Concessional Borrowing

The recent DSA showed that Zambia's debt was sustainable over the next twenty years even with additional concessional borrowing of US$1.0 billion and a further non-concessional borrowing of US$1.0 billion. On this basis, the Government had an option to contract non-concessional loans within the sustainability framework. The Government would, therefore, contract non-concessional loans for the financing of economic projects that had an appreciably high internal rate of return such as the hydro-power generation stations and telecommunication infrastructure.

c) External debt restructuring to minimize costs and risks

As part of the strategy, the Government would endeavour to contract and conclude bilateral agreements with Paris Club creditors, that had not yet delivered their share of debt relief to Zambia, and non-Paris Club creditors, that had indicated willingness to provide relief on Paris Club comparable terms.

7.8 Strategies for domestic debt management in 2008

Zambia was currently undertaking a roll over strategy of all existing principal outstanding on government securities. With this strategy, the Government's long-term objective in domestic debt management was to undertake restructuring measures aimed at lengthening the maturity structure of the domestic portfolio in order to avoid risks associated with short term debt. This measure was expected to reduce the risk for refinancing debt as a result of increased interest rates and the possibility that the country might not be able to roll over due to ever increasing stock of debt. In pursuing the restructuring strategy, the Government would pay off a determined level of maturities on government securities as set out below.

a) Treasury Bills

In the MTEF period, the Government's strategy would be to reduce the weekly tender size for Treasury Bills. The rationale was to start reducing the short term higher cost instruments and begin utilising the balance that would be accumulating in the account for longer dated instruments.

b) Government Bonds

The Government's strategy regarding bond issuance would be to reduce bonds with two (2), three (3) and five (5) year tenure to longer dated bonds with seven (7), ten (10) and fifteen (15) year tenures. The rationale for this strategy was to firstly pay off any debt instrument that were issued by the Government without receiving the corresponding cash cover using funds raised from the market and secondly to greatly reduce the stock and cost of short term debt instruments. Thereafter, it would be prudent to align these funds with specific projects and programmes where the funds would be targeted.

c) Budgetary Provisions

As a strategy, the Government had been working towards reducing the share of domestic budget financing as a percentage of the Gross Domestic Product (GDP). In 2008, the Government had pegged the level of domestic financing at 1.2 percent of GDP. The rationale here was to start managing the debt stock and cost to lower levels and eventually reach an acceptable level of debt without disturbing macroeconomic stability. As the economy grows, government should begin to rely on domestic revenues to finance its development programmes.

7.9 Measures to strengthen debt management in Zambia

In this regard, the Committee was informed that in order to strengthen debt management capacity in Zambia's post HIPC period, the Government had been implementing a comprehensive Public Debt Management Reform Plan (PDMRP) covering the main areas set out below.

a) Legal and Regulatory Issues

The statutory provisions that guided loan contraction and management in Zambia were spread across various pieces of legislation. These included, among others, the *Loans and Guarantees (Authorisation) Act, the Ministry of Finance Incorporation Act, the Public Finance Act, the Public Procurement Act and the Bank of Zambia Act.*

The Government had also drafted a Public Debt Bill, which was intended to address the weaknesses in the previous laws and introduce new provisions that would strengthen the management of debt in Zambia. The draft Bill was planned to be introduced to Parliament in 2008, subject to the Attorney General's advice in the light of the Constitutional Review process.

b) Institutional Issues

The reform plan was also targeted at addressing weaknesses in the current institutional arrangement supporting debt management. The main thrust of this intervention was to strengthen the links between the Ministry of Finance and National Planning, the Bank of Zambia and the Attorney General's Chambers. The issues of parliamentary oversight were also being addressed.

In support of the above, the Ministry of Finance and National Planning would continuously update and validate the debt database and the technology infrastructure.

c) Public Debt Management Strategy

As part of the plan, the Government was developing a comprehensive debt management strategy that was intended to strengthen risk, cost management and analysis for effective debt management in line with the best practices in global debt management. The Ministry of Finance and National Planning planned to submit the strategy for endorsement by Cabinet in the second half of 2008.

8.0 Committee's Observation and Recommendation

After careful consideration of the various submissions from witnesses, your Committee observe that, after reaching the HIPC Completion Point, Zambia's debt was substantially reduced. They further observe with concern that the debt has been increasing thereafter. They are aware that part of the reasons for this problem is lack of adequate legislation to manage the contraction of debt. They, therefore, urge the Government to bring to Parliament for enactment the Public Debt Bill. This Bill should compel the Ministry of Finance and National Planning to seek parliamentary approval before contracting Government debt.

PART III

9.0 The Role of the multi-facility economic zones (MFEZs) in enhancing the competitiveness of Zambia's Industries

In the Speech to Parliament, marking the official opening of the Second Session of the Tenth National Assembly, it was explained that under the Triangle of Hope initiative, the Government was establishing the Multi-Facility Economic Zones. Two of these zones would be located in Lusaka and one in Chambishi. It was envisaged by the Government that this would stir economic growth through increased production.

In order to fully appreciate the role that these MFEZs played in enhancing the competitiveness of Zambia's industries, your Committee sought written and oral submission from:

- the Ministry of Commerce, Trade and Industry (MCTI);
- the Zambia Development Agency (ZDA);
- the Ministry of Finance and National Planning (MOFNP);
- the Citizens Economic Empowerment Commission (CEEC);
- the Zambia Business Forum (ZBF);
- the Civil Society for Trade Network of Zambia (CSTNZ); and
- the Economics Association of Zambia (EAZ).

The findings of your committee are summarized below.

9.1 The definition of an MFEZ

Your Committee were informed that an MFEZs was a zone incorporating various economic activities such as factories, housing, medical facilities, schools and even recreational facilities. Both domestic and foreign firms could operate in an MFEZ by supplying the domestic and the export market. A key feature of an MFEZ was that it had to operate under a set of rules and regulations.

9.2 The role of the MFEZ in improving the competitiveness of Zambia's industries

Your Committee was informed that the establishment of MFEZs in Zambia was meant to stimulate industrial development as laid out in the Fifth National Development Plan (FNDP). In this regard, the Government would offer fiscal incentives as provided for in the ZDA Act. The incentives would be as follows:

a) 0% tax rate on dividends of companies operating under the MFEZ for a period of five years of first declaration of dividends;
b) 0% tax on profits made by companies operating in the MFEZ for a period of five years from the first year profits were made. From the sixth to the eighth year, only 50% of the profits would be taxed while for the ninth and tenth year, 75% of the profits would be taxed;
c) 0% import duty on raw materials, capital goods and machinery, including trucks and specialised motor vehicles for the first five years; and
d) deferment of VAT on machinery and equipment, including trucks and specialised motor vehicles for investment in the MFEZ.

9.3 Benefits of MFEZ to ordinary Zambians

Your Committee were informed that the vision of the Government was to establish MFEZs in all districts in the country. Once fully operational, some benefits that the Government envisaged from the MFEZ included:

(a) improved infrastructure, such as telecommunications, schools and medical facilities in the zones;
(b) higher foreign exchange earnings;
(c) increased tax revenues after the expiry of the tax holiday provided under the *ZDA Act;* and
(d) attracting Foreign Direct Investments (FDIs).

9.4 Committee's Observations and Recommendations

After careful consideration of the various submissions from witnesses, your Committee wish to make the observations and recommendations set out here under.

i) The operationalisation of MFEZs across the country is not an easy task. It requires vast amounts of resources, land and infrastructure. Your Committee recommend that care is taken to ensure that the land acquired is not used by communities for farming or any other social, religious and economic activity.

ii) Industries operating in MFEZs have the ability to potentially affect the companies that are operating outside MFEZs. This is because they will be enjoying incentives which will reduce their cost of production. Your Committee, therefore, recommend that the operations of MFEZs should not be to the detriment of firms that are operating outside the MFEZs.

iii) The incentives to operate in an MFEZ as provided for in the ZDA Act are very generous. In the past, companies which were given such incentives relocated to other countries when the tax holiday came to an end. Your Committee urge the Government to avoid a repeat of such unfortunate situations.

iv) The MFEZ is an important initiative that will improve the competitiveness of Zambia's industries. However, there are no other companies that have applied to operate in the MFEZs apart from those of Chinese origin. They, therefore, recommend that other companies, particularly citizen influenced and citizen empowered companies, be allowed to compete freely in the Chambishi MFEZ area.

PART IV

10.0 THE ZAMBIA–EUROPEAN COMMUNITY (EC) COUNTRY STRATEGY PAPER

The Zambia-European Community Country Strategy Paper was an important document governing the relations between Zambia and the European Community (EC). The document was presented to Parliament by the European Community. Your Committee resolved to acquaint themselves with the contents of this important document whose highlights are set out below.

10.1 Relevance of the Country Strategy Paper to Zambia

The European Community Country Strategy Paper for Zambia outlined the agreed bilateral cooperation between the Zambian Government and the European Community for the 10th European Development Fund (EDF), covering the period 2008 to 2013. This cooperation was governed by the Cotonou Partnership Agreement between the ACP Countries (Africa–Caribbean-Pacific) to which Zambia belonged and the European Community represented by the European Commission in Brussels. Under this document, the EC had committed itself to contribute an amount of EURO 475 million for the period 2008-2013 to the development of the country, making it one of the most significant sources of external assistance during the period.

The Country Strategy Paper recognized the role of the Fifth National Development Plan (FNDP) and was aligned to the sector priorities outlined in the FNDP. With almost 50% of the support provided in the form of direct budget support (EURO 232 million), a considerable share of the EC assistance was helping the Government directly to implement the Plan. Assistance to the focal sectors of infrastructure (EURO 117 million) and Health (EURO 59 Million) was mainly provided in the form of sector budget Support.

The remaining support (EUR 67 million, 14% of the total), allocated to so called non focal sectors, included project measures in the fields of food security and agriculture diversification (EUR 30 million), governance (EUR 25 million), support to initiatives of non-state actors (EUR 5.5 million), trade related capacity-building support (EUR 2 million), and a technical cooperation facility (EUR 3 million) and other smaller measures (EUR 1.5 million). These measures had been jointly defined between the Government and the European Community and were fully in line with the programmes under the FNDP. The Country Strategy Paper only outlined the different sectors covered under the cooperation and the modes of aid delivery but it did not specify in detail the concrete measures to be undertaken. These would be defined in the course of 2008 and 2009, in close cooperation between the Planning and Economic Management Division of the Ministry of Finance and National Planning, the respective Government sector agencies, and the European Union Delegation. After having clearly defined the programmes, the Government would then sign individual Financing Agreements with the European Union which would govern the execution of these programmes. The first of the cooperation measures were expected to start in early 2009.

10.2 Consultative process in development of the Country Strategy Paper

The process of development of the Country Strategy Paper had been consultative among the cooperating partners belonging to the European Union and with the Government. From the start, the Government had been involved in the definition of the joint cooperation strategy through a series of meeting and exchange of written documents and direct requests.

The Ministry of Finance and National Planning coordinated inputs from sector ministries, especially agriculture, education, health, transport and infrastructure. The draft Country Strategy Paper was circulated for comments from relevant sector ministries.

10.3 Observation and Recommendation

After studying the Zambia-EC Country Strategy Paper, your Committee observe that it is an important document and that it required the input of various stakeholders including Parliament and Civil Society. Your Committee observe with concern that consultations with MPs and Civil Society were not undertaken. They, therefore, recommend that consultations should be extended to all major stakeholders, including Members of Parliament through the Committee on Economic Affairs and Labour.

PART V

11.0 TOUR OF MINING COMPANIES

Your Committee undertook a tour to mining companies at the invitation of the Chambers of Mines of Zambia. The objectives of the tour were to avail the Members of your Committee an opportunity to appreciate the challenges facing the mines and to appreciate the levels of investment that the companies had put in place. The companies that were visited were the Lumwana Mining Company; Chambishi Metals Plc, Chibuluma Mines Plc; Konkola Copper Mines; Kansanshi Mining Plc; NFC Africa Mining; and Mopani Copper Mines Plc.

The current investors in the mining industry which were visited by your Committee are set out in the Table 3 below.

Table: 3

COMPANY	INVESTOR
Konkola Copper Mines (KCM)	Vedanta Resources
Mopani (Mufulira and Nkana)	Glencore
Luanshya and Chambishi	J & W Investments
Bwana Mkubwa, Kansanshi and Frontier	First Quantum
Chambishi	NFC
Chibuluma	Metorex
Lumwana	Equinox

11.1 Copper production

Your Committee were informed that until 1980, the average copper production in Zambia was about 660,000 tonnes per year. However, the output started to decline until it reached an average of 290,000 tonnes per year just prior to privatization in 1998. In 2006 and 2007, output rose to

440,000 tonnes per year and 484,000 tonnes per year respectively. The target for 2009 was estimated to be 750,000 tonnes per year.

11.2 Corporate Social Responsibility

Your Committee noted that most of the mining companies that were visited were committed to corporate social responsibility. They were sponsoring different sports disciplines. They were also providing health and education facilities to members of staff and surrounding communities.

11.3 Employment

In their interaction with members of staff in the companies, your Committed noted that mining companies were employing a number of people in the field of engineering, geology, metallurgy and accounts. However, they were concerned that there were few Zambians in management positions.

The companies, on the other hand, bemoaned the lack of specialised skills in Zambia and requested the Government to allow them to bring people with such skills. This request came strongly from NFC and KCM who were undertaking major expansion projects.

11.4 Greenfield Investment

Your Committee appreciated the massive investments that Lumwana Mining Company was putting up. Lumwana, being a greenfield investment had the highest level of investment of all the companies that were toured. The company invested US$23 million in exploration, feasibility and technical studies. The project construction for the development of Lumwana started from 2006 to 2008 at an investment cost of US$762 million the largest single investment in the Zambian history. The copper production was planned to commence in the last quarter of 2008.

Your Committee were informed that the mining company under-took the decision to invest because of various factors. Firstly, the company announced its decision to invest in Lumwana and Zambia in 1996 after the new Mining Code and fiscal policy was announced by the Government in 1995. From 1996 to 2005 Equinox had spent approximately US$23 million in exploration drilling, metallurgical, mining studies which resulted in a detailed Bankable Feasibility Study (BFS) being produced for Lumwana’s Development. The BFS showed that the economics for Lumwana’s development were positive but were extremely sensitive to changes in the key input parameters such as capital, operating costs and taxes.

Over the period 2004 to 2006, Equinox assembled a multilateral lending group of debt finance. The financial risk was so great that it needed a large and diverse group of lenders to be assembled to provide financing. The cornerstone of this financing was the project financial model of which a signed Development Agreement with the Government of the Republic of Zambia was the key document to have the financing approved.

11.5 Other Investments

Your Committee noted that KCM was investing substantive funds in the mining operations. The Company was setting up a Sulphuric acid plant to reduce dependence on imports, opening up of a New Greenfield Oxide ore mine (Fitwaola), refurbishment of a tank house to improve the output and efficiency and the rehabilitation of a reclamation circuit for increased feed to oxide circuit and setting up a new discharge line. The company was also developing the Konkola Deep Mining Project (KDMP) which was estimated to cost about US$400 million.

Non-Ferrous Company (NFC) in Chambishi was also developing the west ore body with a total of US$150 million. The construction of the plant will take about three years and was likely to employ 800 Zambians in the construction phase.

11.6 Committee's Observation and Recommendations

After the tour of the mining companies, your Committee wish to make the following observations and recommendations:

i) there was massive investment taking place in the mining companies, they wish to make reference to the Greenfield investment in Lumwana as one such major investment. They observe that a new township is being constructed with decent accommodation. They further observe that most of the financing of the Lumwana project was a loan from various financiers. They also observe that despite all these investments, at the time of the visit, the company had not started to produce copper. Your Committee, therefore, recommend that flexibility should be exercised by the Government by giving the company incentives for them to complete major projects and be able to pay back their loans;

ii) the price of copper is currently high and mining companies are making huge profits. In this regard, your Committee wish to commend the Government for the move to introduce windfall taxes. They urge the Government to continue with the new tax regime which should be applied fairly across all companies, particularly those that are already producing; and

iii) specialised skills were genuinely missing among the local people and this adversely affected production in the mines. Your Committee recommend that a system be put in place to promote skills transfer from expatriates to the local Zambians for a stipulated period of time. Further, the Government should rise to the challenge by introducing and encouraging skills in universities that reflect the emerging needs of the mining industries.

PART VI

12.0 CONCLUSION

Your Committee wish to pay tribute to all stakeholders who appeared before them and tendered both oral and written submissions. They also wish to thank you, Mr Speaker, for affording them the opportunity to serve on the Committee for the year 2008. Your Committee also appreciate the services rendered by the office of the Clerk of the National Assembly. Your Committee are very hopeful that the observations and recommendations contained in this Report will go a long way in improving the economy of the country.

November 2008 — G Lubinda, MP

LUSAKA — **CHAIRPERSON**