Zambia

Diagnostic Trade Integration Study

(Trade Component of Private Sector Development Program for Zambia)

October 10, 2005

Foreword

The Government of Zambia requested the Diagnostic Trade Integration Study (DTIS) in order to support the incorporation of the trade agenda into its broader development agenda. The DTIS builds on the recommendations of the Private Sector Forum held in Livingstone in June 2004, and complements the work of the Zambia Business Forum. The study will be submitted to the leaders from Zambia's public and private sectors, non-governmental organizations and donor organizations for discussion at a National Validation Workshop in Lusaka. The Workshop will identify the priority reforms and trade-related technical assistance programs to overcome the constraints to expansion and diversification of exports.

The study was prepared by a team led by Fahrettin Yagci and Robert Kirk. The team consisted of Ihsan Ajwad, Jorge Balat, Philip English, Scott Jacobs, Takako Ikezuki, Rene Meeuws, Deborah Porte, Guido Porto, Mine Sabuncuoglu, Ahmet Soylemezoglu, Philip Schuler, and Zoe Vatzos.

Thanks are due to government officials particularly to Dorothy Tembo, Director Foreign Trade and the Chief Negotiator, Ministry of Commerce, trade and Industry, and the many persons interviewed by the team for their time; and to the Work Bank resident mission for its hospitality, guidance and inputs. Particular thanks are due to Maureen Mwikisa for arranging all the meetings and many other logistics in Zambia.

Contents

Acronyms

ACBF	African Capacity Building Foundation
ACP	African, Caribbean, and Pacific
AGOA	African Growth and Opportunities Act
BLNS	Botswana, Lesotho, Namibia and Swaziland
BOZ	Bank of Zambia
CET	Common External Tariff
CIF	Cost, insurance and freight
COMESA	Common Market for Eastern and Southern Africa
DDA	Doha Development Agenda
DFID	Department for International Development
DTIS	Diagnostic Trade Integration Study
DRC	Democratic Republic of Congo
EBA	Everything But Arms
EDF	European Development Fund
EIB	European Investment Bank
EPA	Economic Partnership Agreement
EPZ	Export Processing Zone
ESA	Eastern and Southern Africa
EU	European Union
FDA	Food and Drug Agency
FDI	Foreign Direct Investment
FIAS	Foreign Investment Advisory Service
FOB	Free On Board
FTA	Free Trade Agreement
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
GOZ	Government of Zambia
GSP	Generalized System of Preferences
HIPC	Heavily Indebted Poor Country
HIV/AIDS	Human Immunodeficiency virus/acquired immunodeficiency syndrome
HS	Harmonized System
HYV	High Yielding Variety
IAF	International Accreditation Forum
IF	Integrated Framework
IFC	International Finance Corporation
ILAC	International Laboratory Accreditation Cooperation
IMF	International Monetary Fund
ITC	International Trade Center
JITAP	Joint Integrated Technical Assistance Program
LDC	Least Developed Country
MATEP	Market Access, Trade & Enabling Policies Project
MCTI	Ministry of Commerce, Trade and Industry
METR	Marginal Effective Tax Rates

MFN	Most Favored Nation
MFNP	Ministry of Finance and National Planning
MHML	Mpulungu Harbor Management Limited
MMTZ	Malawi, Mozambique, Tanzania, Zambia
MTS	Multi Trading System
NWGT	National Working Group on Trade
NAMA	Non Agricultural Market Access
OPPA	Organic Producers & Processors Association
PMMU	Program Management and Monitoring Unit
PRSP	Poverty Reduction Strategy Paper
PSD	Private Sector Development
PSF	Private Sector Forum
PSI	Pre Shipment Inspection
PTA	Preferential Trade Area
RISDP	Regional Indicative Strategic Development Plan
RIZES	Revenue Institutions in Zambia Enhanced Support Project
ROADSIP	Road Sector Investment Program
ROO	Rule of Origin
RPED	Regional Program on Enterprise Development
RSZ	Railway System of Zambia
SAA	Sub-Saharan Africa
SACU	Southern African Customs Union
SADC	Southern African Development Community
SANAS	South African Accreditation Services
SEED	Support for Economic Expansion and Diversification Project
SHEMP	Smallholder Enterprise Marketing Project
SMP	Staff-Monitored Program
SPS	Sanitary and Phytosanitary Standards
SQAM	Quality Assurance Accreditation & Metrology
TAZARA	Tanzanian-Zambia Railways System
TBT	Technical Barriers to Trade
TFP	Total Factor Productivity
TCB	Trade Capacity Building
TCZ	Tourism Council in Zambia
USAID	US Agency for International Development
UNCTAD	United Nations Center for Trade and Development
VAT	Value Added Tax
WTO	World Trade Organization
ZABS	Zambian Bureau of Standards
ZACCI	Zambia Association of Chambers of Commerce & Industry
ZAMTIE	Zambian Trade and Investment Enhancement Project
ZATAC	Zambian Agribusiness Technical Assistance Center
ZBC	Zambia Business Council
ZBF	Zambian Business Forum
ZBS	Zambia Bureau of Standards
ZCGA	Zambia Coffee Grower's Association
ZEGA	Zambia Export Growers Association
ZEPRA	Zambia Export Processing Zone Authority

ZIC	Zambia Investment Center
ZIPAR	Zambian Institute for Policy Analysis & Research
ZNFU	Zambia National Farmers Union
ZNTB	Zambia National Tourism Board
ZPA	Zambia Privatization Agency
ZRA	Zambia Revenue Authority
ZRL	Zambia Railroad Limited
ZRS	Zambian Revenue Service
ZSC	Zambian Sugar Company

Executive Summary and Action Matrix

The Diagnostic Trade Integration Study (DTIS) reviews Zambia's trade policies and performance, assesses its potential for export diversification, identifies the main constraints to increasing exports, and develops an action matrix which summarizes the policy reforms and technical assistance needed to remove these constraints. It supports the Government of Zambia to (a) build national consensus around the reforms, (b) mainstream trade priorities into its development and poverty reduction strategies, and (c) enhance trade capacity in and outside government to formulate and implement trade policies, to negotiate trade agreements, and to tackle supply-side challenges in responding to new market access opportunities. The Action Matrix, presented at the end of this executive summary, provides the basis for effectively coordinating donor support and mobilizing additional resources for trade related technical assistance.

The Executive Summary follows the structure of the main report. It is organized into six sections. Section 1 provides an overview and presents the main conclusions of the report. Section 2 reviews the main trends in Zambia's integration in global markets, with section 3 examining external and internal barriers to integration in terms of market access, trade policies, customs administration, transport, meeting quality and safety standards, the business enabling environment, and export credit. Section 4 assesses Zambia's potential for export diversification in non-traditional products and reviews sectoral policies. Section 5 focuses on trade capacity and policy coordination, and section 6 reviews the links between trade policies and poverty. The main trade-related recommendations are presented in the Action Matrix with priority rankings and a timeframe for implementation.

1. Overview and main conclusions

Road to sustained high economic growth

Now that macro stability is largely within reach, expansion of non-traditional exports and private sector development are the two important pillars for sustaining increased economic growth in Zambia. With more than two-thirds of the population living on less than $1 a day (1998), Zambia's domestic market is too small to support the sustained high growth in production and employment necessary to make a marked reduction in poverty. Therefore, exports must be a priority for generating future growth in Zambia. There are strong complementarities between export promotion and private sector development. While effective export promotion requires a dynamic private sector, a dynamic and competitive private sector cannot flourish if it produces only for a small domestic market.

Accordingly, in formulating Zambia's macroeconomic, structural and sectoral policies, and institutional reforms, the focus should be on creating the necessary conditions for increasing and diversifying exports and promoting private sector development. With domestic savings averaging 7-8 percent of GDP, particular emphasis should be placed on attracting foreign direct investment (FDI) into Zambia to ensure levels of investment that are necessary to accelerate GDP growth.

Until the early 1990s, Zambia's development policies were not conducive to export diversification and private sector development, and the economy remained dependent on copper exports. In 1992, confronted with falling copper prices and export revenues, the government began to implement a trade reform program as part of broader structural reforms. As a result, the policy environment became more conducive to export diversification and private sector development. Non-traditional exports (NTE) responded strongly to improved incentives. Led by private domestic and foreign initiative, significant export diversification has ensued since 1995, stimulating overall economic growth despite falling copper prices.

There is potential for much more export diversification particularly in sectors such as floriculture, horticulture, agro-processing, textiles and garments, gemstones, and tourism. Realizing these opportunities requires a refocusing of the reforms in a more comprehensive and consistent policy package so as eradicate the binding constraints to private sector development and export promotion.

Priorities in trade policies

Improved trade policies including the elimination of anti-export bias are necessary for accelerating export growth. However, they are not sufficient. It is also necessary to ensure macroeconomic stability, efficient infrastructures, a positive private sector enabling environment to encourage private investment in export-oriented sectors, and a more effective supply-side response to trade policies. Therefore, a sound policy package to accelerate export growth would include a combination of the above priority measures as well as trade policies. It is also necessary to note that increasing exports should not be viewed as an end in itself. It is a precondition for strengthening the private sector, accelerating growth, and reducing poverty.

This report focuses on identifying the trade-specific constraints to export-led growth and priority policies to remove these constraints. Policy priorities concerning macroeconomic management, business environment, and private sector development were discussed in earlier reports[1] and during the Private Sector Development (PSD) Forum in Livingstone in June 2004. They are summarized in this report. This report also makes a number of sector-specific recommendations in areas where further export potential exists.

The main priority areas in trade policy are:

- **Making export incentives work for exporters.** Streamline the operating procedures for the duty drawback scheme. Ensure full and timely reimbursement of actual duties paid. Prepare standard operating guidelines and a procedures manual prior to implementing the Export Processing Zone Act;

- **Improving trade facilitation.** Improve efficiency in customs administration through upgrading the customs infrastructure (equipment, procedures, physical and human infrastructure), integrating the border agencies, and developing a single processing and payment window for all border agencies. Reduce border clearance times by undertaking a Cargo Release-Time study and implementing its recommendations, improving transit and clearance procedures, and establishing a 'fast-track' facility. Reduce transport costs through augmenting capacity in the transport industry with training in regulations, logistics, financial management and marketing. Improve the standards infrastructure through

[1] Ministry of Commerce, Trade and Industry 2004, "Private Sector Development Strategy", FIAS 2003, "Zambia: Administrative Barriers to Investment"; World Bank 2003, "Zambia: The Challenge of Competitiveness and Diversification"; World Bank 204, "Zambia: Country Economic Memorandum-Policies for Growth and Diversification", World Bank 2004. "Zambia: Investment Climate Assessment"

amending the Standards Act to separate standards testing from the regulatory functions of the Zambia Bureau of Standards (ZBS) and increasing the role of the private sector in testing and certification.

- **Enhancing capacity to formulate, coordinate and implement trade policy, and negotiate trade agreements**. Establish a trade policy analysis unit in the Ministry of Commerce, Trade and Industry (MCTI). Expand and train trade staff in and outside government. Support establishment of Zambian Institute for Policy Analysis and Research (ZIPAR) with a dedicated trade economist. Incorporate trade issues explicitly into the interagency policy formulation and implementation mechanism set up following the Livingstone Forum;

While further liberalization of imports is not as high a priority, duties on imported capital goods should be removed to stimulate private investment. Zambia has liberalized its imports significantly since the early 1990's. Additional tariff reform should be considered as a medium-term objective to be addressed on a most favored nation (MFN) basis in the context of negotiations for an Economic Partnership Agreement (EPA) with the EU.

Market access is not currently a binding constraint to export growth. Most of Zambia's existing exports face zero or low tariffs and qualify for preferential access to the major developed country and regional markets. However, Zambia needs to participate actively in global and regional trade negotiations to ensure that its longer-term interests are adequately safeguarded in the outcome.

Key requirements for effectively implementing Zambia's trade strategy

Effective implementation of an export oriented trade strategy requires:

High-level political commitment. Achieving export-oriented growth led by the private sector requires political commitment at the highest level. Confronted with economic challenges, the government has demonstrated its resolve in re-orienting the focus of its development strategy towards economic diversification and private sector development. The Livingstone Forum assigned responsibility for overseeing implementation of the PSD action plan to the Zambia Business Council (ZBC), chaired by the President.

Mainstreaming trade policy. Export promotion should be placed at the center of Zambia's development and poverty reduction strategy and be reflected in the main policy documents of the government. The Livingstone Forum called for action to "Develop a national export strategy, mainstream trade policy, and place export strategy/promotion/diversification at the center of national development policy". Following up on this recommendation, the government should make export-oriented private sector-led growth the overriding objective of its economic policies and incorporate this objective into the new Poverty Reduction Strategy Paper (PRSP) and the National Development Plan (NDP).[2]

Coordination within government. Various ministries and agencies share the responsibility of formulating and implementing trade policies, but interagency coordination is weak. Incorporating trade issues explicitly and fully into the interagency implementation mechanism created in the aftermath of the Livingstone Forum (ZBC, PSD Steering

[2] ITC is assisting the government in preparing an export strategy.

Committee, and the Program Management and Monitoring Unit-PMMU) would be a good option to ensure coordination within government.

Effective public-private partnership. An effective public-private partnership is essential to create an enabling environment to accelerate the export-oriented growth. It is important to build on the momentum of the PSD strategy which was prepared in close cooperation with the private sector. The Zambia Business Forum (ZBF), the ZBC, the PSD Steering Committee and the National working Group on Trade (NWGT), all provide opportunities to strengthen the public-private partnership.

Coordination of export promotion and private sector development programs. It is essential that trade promotion and private sector development programs are closely coordinated in order to leverage the complementarities. The PSD Action Plan recognizes the close relationship between private sector development and export growth. To ensure effective integration on the two complementary fronts, responsibility for dealing with both private sector and trade issues should rest with the same implementing agencies. It is, therefore, essential to ensure coordination between the steering committees for the Integrated Framework (IF) and PSD and broaden the scope of the PMMU to cover trade issues.

Enhanced trade capacity. Perhaps the greatest challenge is to increase the capacity of the government, the private sector and broader civil society to cope with the growing set of trade policy issues and negotiations. The government has recently taken steps to strengthen trade capacity within and outside the government. The MCTI appointed a Chief Trade Negotiator. Also, a proposal has been developed for the creation of the Zambian Institute for Policy Analysis and Research (ZIPAR), a think tank that will be devoted to policy-oriented analysis directly relevant to the government. It is strongly advised that a trade unit is created within ZIPAR with appropriate technical assistance. Technical assistance will also be needed to further enhance the analytical capacity of MCTI and other agencies within and outside government.

Donor coordination. Zambia receives donor assistance for trade from a variety of bilateral and multilateral sources. With a new wave of donor projects now starting or underway (EU, USAID, DFID, World Bank, JITAP, IF, etc.) there is an urgent need to improve donor coordination to avoid overlap. Donor assistance for trade should be integrated into the wider Harmonization in Practice (HIP) Action Framework that Zambia recently signed with the donor community. At the working level, the IF Program will play a coordinating role. The findings of the DTIS provide the basis for identifying priorities and determining the division of labor between donors in mobilizing resources to support Zambia's export-oriented private sector-led development strategy.

2. What are the trends in integration?

<u>Economic background</u>

Following the introduction of multiparty democracy in 1991, Zambia embarked on a comprehensive program of macroeconomic and structural reforms aimed at transforming a heavily protected state led economy into a market-oriented economy that encourages private sector development and export diversification.

Much has been achieved since the early 1990s. Fiscal, monetary, and financial management has improved, the role of the private sector has strengthened, price controls have been removed, interest rates have been liberalized, the exchange rate is determined by the market, and the trade regime has been transformed into one of the most open in Africa.

The reforms succeeded in arresting and reversing the chronic economic decline. Indeed, after three decades of decline, real per capita income began to increase as of the late 1990s. Since 1999, per capita income grew at an average rate of about 2 percent. The growth was broad based - almost all sectors experienced growth each year. Substantial increase in a wide range of non-traditional exports played an important role in the turnaround.

Future growth requires Zambia to build on the earlier reforms by further improving macroeconomic management and reducing the volatility of the exchange rate through. Improvements are also required in trade policies, the business environment, physical and human infrastructure, and sector specific policies to promote activities with a strong comparative advantage.

<u>Trade performance</u>

The past decade has witnessed three main changes in Zambia's trade performance.

First, the share of NTE in total exports increased from 8 percent in 1990 to 38 percent in 2003. Substantial increases have been achieved particularly in primary agricultural commodities, floricultural products, horticultural products, and processed foods. The strong reaction from the NTE to improvement in the policy environment and progress in creating a dynamic private sector indicate that the economy is responsive to changes in incentives.

Second, despite the substantial increase in NTE, Zambia's share in world exports declined from 0.038 percent to 0.014 between 1990 and 2003 due mainly to the decline in copper prices[3].

Third, while the EU's importance as a trading partner has decreased, SADC countries now account for 37 percent of total exports and provide over 75 percent of total imports, with South Africa accounting for almost 70 percent of this amount. Zambia's major regional exports are cotton (both ginned cotton and cotton yarn) to South Africa, and processed and unprocessed food to its neighbors. The potential for increasing regional trade depends on improvements in transportation and trade facilitation.

The main objective of the trade policy should be to reverse Zambia's declining share in world exports by accelerating export diversification and regional trade.

[3] Copper prices have recently recovered and copper production in Zambia increased substantially led by the private sector.

3. What are the external and internal barriers for integration?

Market access

The web of preferences provides Zambia with duty free access for most of its existing exports. These benefits will decrease as the trading partners reduce their MFN tariffs as part of the Doha negotiations and offer similar preferences to other developing countries. Because it cannot stop the erosion of these preferences, Zambia should focus on realizing improvements in non-tariff aspects of these arrangements (rules of origin, trade facilitation, aid for trade, etc.), strengthening its trade and behind the border policies (macroeconomic policies, administrative and regulatory environment affecting business), and removing supply-side constraints (physical and human infrastructure) to increase its competitive strength.

Though market access presently is not a binding constraint to export growth, Zambia should actively participate in regional and global trade negotiations to ensure that its longer-term trade interests are adequately reflected in these agreements. During the course of the next five years, Zambia will make a series of important policy decisions regarding trade agreements. It needs to decide whether to conclude an EPA with the EU, whether to participate in regional customs unions, and how to engage in the ongoing WTO multilateral trade negotiations. Identifying best interests across competing trade negotiations requires a national trade policy that clearly articulates the key objectives of promoting export-oriented and private sector led growth in Zambia.

Regarding the Doha Development Round WTO negotiations, Zambia should utilize its limited resources to focus especially on agricultural subsidies (cotton and sugar in particular), trade facilitation, and issues concerning Special and Differential Treatment (SDT).

Maintaining market access to the EU does not require Zambia to sign an EPA unless it offers benefits beyond those provided by the EU's Everything-But-Arms (EBA) Initiative. However, if designed and implemented in a development-friendly form, an EPA could have a profound positive impact on trade and growth in Zambia.

To achieve a development-friendly EPA, Zambia should press for: (a) improvements in the EBA and the Cotonou rules of origin (RoO), (b) increased financial assistance to address the supply side bottlenecks and offset the revenue loss from lower tariffs on imports from the EU, (c) adequate flexibility in EPA design to accommodate differing conditions among the countries in the ESA group, and (d) EU's technical support for reducing intra-regional barriers to trade and deepening regional integration.

Zambia has benefited indirectly from the apparel provision of the Africa Growth and Opportunity Act (AGOA) of the US by increasing exports of cotton yarn to South Africa as inputs into apparel for exports to the US. The main direct beneficiaries under AGOA are the wooden panels and leather sectors. Increasing the benefits from AGOA requires Zambia to address many of the supply-side constraints that influence competitiveness.

Zambia does not have to move towards a customs union with either COMESA or SADC to maintain access to regional markets. Prior to embarking upon more complex trade arrangements or MFN reductions in tariffs, Zambia should first focus on strengthening the existing free trade arrangements (FTA) and enhancing the supply-side response. Specifically, this could include improving rules of origin (RoO), reducing the transaction costs of cross border trade, harmonization of policies and overlapping trade agreements, promotion of joint infrastructure projects, and addressing the supply-side constraints.

Trade policy and incentives for exports

Zambia has one of the most open trade regimes in Africa with a rating of 2 on the IMF's restrictiveness scale ranging from zero to 10, 10 being the most restrictive. The simple average MNF tariff in Zambia is 13.4 percent with a coefficient of variation of 0.7, indicating modest dispersion of tariff rates. Ad valorem tariffs comprise four bands: 0, 5, 15, and 25 percent. Specific rates apply to a few items. The industries facing the highest duties are fishing and light manufactures such as wood products, manufactured food, beverages and tobacco, textiles, and leather.

Following substantial tariff reform in the mid 1990's, further reform on an MFN basis is not an immediate priority. The priority in further reforming the trade regime in the near term should be placed on ensuring that export incentives operate effectively, trade facilitation (customs administration, transport, quality and safety standards) is strengthened, tariffs on capital goods are eliminated after compensatory revenue raising measures are taken, and capacity to formulate and implement trade policies, and negotiate trade agreements is enhanced.

Zambia has four export incentive programs to overcome the anti-export bias inherent in its import regime: the duty drawback system, manufacturing under bond (which is not widely used), removal in bond (RIB), and export processing zones (EPZs) (which are not being implemented).

- The duty drawback system reimburses exporters for the customs duties and other taxes paid on imported inputs thus allowing producers access to inputs at world prices. The main weaknesses in implementing the duty drawback system include the requirement of detailed and comprehensive input-output coefficients and the time taken by the Zambian Revenue Authority (ZRA) to make the repayments. Measure to improve the duty drawback system include: streamlining the operating procedures of the system, setting targets for reimbursement of duties, and fully reimbursing exporters for actual duties paid and in the same currency in which they were paid.

- Under the manufacturing under bond system imported inputs are kept under bond until used in the production of the good to be exported, and the producer only pays customs duties on the inputs if the final product is sold on the domestic market instead of being exported. The advantage of this scheme over a duty drawback system is that exporters do not first pay duties and then wait for reimbursement. Furthermore they do not need to devote staff time to computing input-output coefficients. The government should encourage the use of this system, especially by established companies.

- The RIB program allows a company to place newly imported products into a bonded warehouse and pay customs duties only when removed from bond. This delays payment of customs duties until the imported product is used. There are claims that this program has been abused (bonded goods leaking into the domestic market). To avoid the abuse, effective enforcement of the existing rules and regulations governing transit trade and bonded warehouses is necessary.

- The EPZs have been used very effectively since 1980s in many countries (Mauritius in Africa). In Zambia, the EPZ Act became operational in January 2003, but was then suspended because of revenue concerns. In November 2004, a revised EPZ Act was tabled to the Cabinet and once the amendments have been enacted, the program is expected to continue. Effective implementation of the EPZ requires transparent approval and monitoring processes that eliminate discretionary decision-making. This requires: precise language in the regulations that define transparent criteria for evaluating existing and new investments, establishing criteria for evaluating export ratios, determining minimum standards for EPZ development, and preparing a regulatory framework for private sector industrial parks.

Customs administration

The customs and excise department of the Zambia Revenue Authority (ZRA) is responsible for all customs-related issues. Since the establishment of the ZRA as an autonomous body in 1993, Zambia has pursued a policy of modernizing customs procedures through introducing risk assessment, adopting the WTO customs valuation, and actively participating in regional programs of customs cooperation and modernization. Despite significant improvements, the private sector complains of excessive checking, physical inspection and redundant control procedures. Problems with long clearance times, inadequate information sharing between border control agencies, unnecessarily complicated procedures requiring redundant information, and inadequate use of risk assessment, increase costs and uncertainty and create incentives for corruption.

Improving efficiency in customs administration requires: upgrading the equipment and customs infrastructure, integrating the border agencies, developing a single processing and payment window for all border agencies, reducing border clearance times through undertaking a Cargo Release-Time study, improving transit and clearance procedures, and establishing a 'fast-track' facility. It further requires establishing clear performance indicators and making them publicly available, strengthening ZRA's training unit, and public-private dialogue on trade facilitation. Harmonizing the legal and regulatory framework to conform to the Kyoto Protocol and SADC and COMESA agreements is also necessary.

Transport

As a landlocked country, Zambia faces long routes to international ports in South Africa, Tanzania and Mozambique and stands to gain from international and regional initiatives in transport infrastructure and regulation. Transport costs and the quality of infrastructure are important determinants of international competitiveness, with transport costs representing a larger barrier to export markets than import tariffs. Improving efficiency throughout the logistics chain is central to increasing exports and sourcing more competitively priced imports.

Historically, the physical transport infrastructure (roads and railways) was developed to link Lusaka and the Copper belt with the main north-south routes. The absence of good access roads throughout Zambia continues to constrain smallholder participation in the production of high value cash crops, such as baby vegetables and cut flowers. Non-traditional agricultural exports are primarily concentrated within a 100-mile radius of Lusaka. Virtually all the fresh vegetables and cut flowers are air freighted to international markets. Further development of these industries requires good access roads and more reliable, higher frequency air freight, and lower air freight rates.

Reliable and cost effective transport requires Zambia to engage in international transport agreements particularly with neighboring countries, accelerate investment in transport infrastructure and improve the management of the transport system. The required measures include: transposing international transport agreements to national legislation, preparing a transit strategy, promoting public-private partnerships for financing investment in infrastructure, facilitating investment in inter-modal infrastructure and bonded warehouses, revising the Transport Act to remove the quantitative criteria for licensing commercial haulage, liberalizing foreign air carrier landing rights, setting-up a legal framework for the licensing of clearing agents, bonded warehouses, terminal operators, and multi-modal transport operators, and strengthening the technical and enforcement capacity of staff involved in transport regulation and administration.

Quality and Safety Standards

Exporters of 'high standard' fresh vegetables and cut flowers rely on relatively high-priced quality testing regimes in Europe, and they benefit from production and transport arrangements that are only available around Lusaka. The absence of suitably accredited testing services in Zambia is a constraint to augmenting and diversifying agricultural exports (this is also a priority identified by the PSD Forum).

Three bottlenecks in testing and conformity certification services have the potential to constrain export growth. The quantity of testing services is insufficient to support a major increase in volume. The quality and range of testing services is too narrow. The prices of testing services are relatively high by international standards (although this still remains a minor cost item) and, owing to the lack of international certification, it is necessary for the tests to be redone in the country of export. These will become important issues as exports diversify further.

The standards infrastructure in Zambia continues to be driven largely by state intervention and public sector control. While the Zambia Bureau of Standards (ZBS) is the main government body responsible for setting, reviewing, monitoring and implementing technical standards for all industries including agriculture, the Food and Drug Agency and the Ministry of Agriculture also set standards, and they are not required to notify the ZBS. Regulatory fragmentation, in conjunction with a dearth of clearly defined boundaries between the three standard setting bodies, needs to be addressed. The ZBS does not retain a comprehensive database of existing standards scattered across a wide range of legal instruments.

There is a need to commercialize the public laboratories and to begin to establish a fully commercial market for testing and assessment services. The Government should:

- Clearly separate the roles of the public and private sectors in setting standards and providing quality control, conformity assessment, and certification services;
- Strengthen the capacities for setting and enforcing standards for domestic markets that converge with regional and international standards;
- Commercialize the public laboratories by ensuring transparent and arms length relations with the public sector;
- Establish a regulatory framework for private testing and certification services.

Business enabling environment

Private sector growth requires an enabling environment that provides incentives for investment, risk taking and innovation. Despite significant progress made in improving the business environment since the early 1990s, the perception of the business community of the investment climate in Zambia remains poor. This is reflected in declining inflows of foreign capital. Recent international indices confirm this perception. The international business community places Zambia near the bottom of the UNCTAD Inward FDI Potential Index (in 134th place). The Heritage Foundation Index of Economic Freedom gives Zambia a 4 on a scale of 1 to 5, with lower scores representing a more favorable environment.

The Zambian Government has recently launched a Private Sector Development (PSD) Reform Program, prepared jointly by the MCTI and the private sector with support from the donor community. The program aims to strengthen the momentum already created for production and export diversification led by the private sector by implementing an Action Plan for enhancing Zambia's business environment and restoring investor confidence. The Livingstone PSD Forum in June 2004 endorsed the program and agreed on an implementation structure through establishing the ZBC (chaired by the President), PSD Steering Committee and the PMMU.

Export credit

Established exporters do not seem to be constrained by the availability of credit **for working capital**. Exporters have long been preferred borrowers from financial institutions. However, the small size of the Zambian banking sector prevents it from meeting the longer-term credit needs of exporters **for investment**. The depth of the financial sector in Zambia (measured by the ratio of broad money supply to GDP), is about half of the sub-Saharan African average.

Interest rates in Zambia for kwacha-denominated facilities have been quite high both in real and nominal terms. The levels of interest rates on Kwacha have essentially made Kwacha lending for the long-term impossible. However, for those companies that can borrow in foreign exchange, the rates are LIBOR plus two to four percent, which compares well with other emerging economies.

Data from implementation of the IDA Enterprise Development Project show that agriculture based exporters have been the largest recipients of finance; and firms of all sizes have access to export finance from the formal financial sector.

4. What are the potentials for export diversification and greater integration?

Zambia has the potential to realize much more export diversification with a comparative advantage in natural resource- and labor-intensive activities such as agriculture, agro-processing, tourism, textiles and garments, and light manufacturing.

Agriculture

With only 14 percent of cultivable land and 10 percent of the country's water resources currently utilized, Zambia has considerable untapped potential for agricultural development. Agriculture and agro-processing industries provide the greatest potential for export diversification. The priority agricultural products include floriculture and fresh vegetables, cotton, tobacco, coffee and paprika.

Zambia's trade arrangements provide ample export opportunities for many agricultural and agro-processing products in regional and international markets. Therefore, demand is not a constraint on the rapid expansion of agricultural production. The main constraints are on the supply side and include (a) lack of access to water, fertilizer, high yielding variety (HYV) seeds, extension services, and markets; (b) a customary land tenure system that does not allow secure land rights and long term investment in land development; and (c) inadequate infrastructure (rural roads, storage facilities, marketing infrastructure, power and telecommunication services). In addition to these cross-cutting constraints, each agricultural product has its own product-specific set of constraints, which are highlighted below.

Cotton is Zambia's largest cash crop for smallholders. By planting cotton, smallholders gain access to credit through the distributor system for purchasing inputs and also benefit from a guaranteed market for cotton. In 2001, cotton accounted for almost 20 percent of Zambia's total agricultural exports. Most of the cotton is exported to South Africa and the EU. There is potential to increase yields through improving input use and extension services.

Tobacco accounted for 10 percent of total agricultural exports (1995-2001). The bulk of the tobacco is sold through Zimbabwe and Malawi, where there are established auction and processing facilities. The recent instability and uncertainty over tobacco production in Zimbabwe has resulted in a substantial increase in tobacco production in Zambia. Tobacco yields could be improved through improving extension services and using modern inputs.

Zambia is a low cost producer of high quality Arabica **coffee**. Coffee accounts for about six percent of total agricultural exports, is grown by large commercial farmers, and the industry has been modernized with financial support from the World Bank's Coffee II funds and the EU's Export Development Program. Given Zambia's abundant land resources and excellent climatic conditions, there is considerable potential for increasing coffee production.

Paprika is mainly produced by commercial farms with irrigation facilities and provides high returns on a per hectare basis. Zambia supplies two percent of world demand for paprika and has the potential to increase production. Side-selling is widespread and undermines the out-grower system. Currently, the Agribusiness Forum is developing a database of farmers who have pledged crops to out-grower associations. A well-established out-grower system can provide extension services and disseminate information on paprika crop characteristics that will increase quality.

<u>Floriculture and fresh flowers</u>

Floriculture and fresh vegetables are mainly grown on approximately three dozen farms in an irrigated area of 5,000 hectares close to Lusaka's international airport. Two of the largest growers handle most of the exports and purchase the produce of the others. Small out-growers are now beginning to produce cut roses and pre-packaged vegetables, including sugar peas, green beans, baby corn and carrots. From 1990-2002 the value of floriculture and horticulture exports increased from $5.6m to $75.2m and now accounts for 38 percent of total agricultural exports. Europe is the largest market, accounting for 80 percent of total output. Major constraints to expansion include the high costs of air freight, high interest rates, poor physical road infrastructure restricting access for smallholders, and an absence of irrigation facilities.

Textile and garments

Cotton and poly-cotton yarn account for over 90 percent of Zambia's textile exports. Zambia exports textiles and apparel to South Africa duty free under the SADC Trade Protocol using the MMTZ special rule, which permits single stage transformation. Zambia has a strong interest in vertically integrating textile and garments production.

Processed foods

Processed foods are dominated by sugar and account for 10 percent of NTE (2003). Zambia produces 230,000 MT per year, selling half into the domestic market, and is the fourth lowest-cost sugar producer in the world. Virtually all the processed foods are sold within eastern and southern Africa, with the DRC being the largest single destination. The potential for increasing these exports will depend on strengthening transport, transit arrangements and customs administration, harmonizing policies and standards, addressing technical barriers to trade, and accelerating the implementation of the SADC and COMESA free trade areas. Upgrading products and packaging to meet the standards of major distribution chains within the region would encourage expansion.

Tourism

Tourism, as measured by volume and expenditure, increased at an annual rate of 13 percent and amounted to $145 m during 1997-02. Following the adoption in 1997 of the tourism sector strategic action plan for 2000-2005, the tourist sector was deemed a priority. An absence of coordination between the various government agencies responsible for implementation has constrained growth. Further development of the tourism sector requires additional physical infrastructure and an improved business/investment climate. Raising awareness about the positive aspects of Zambia will counter negative perceptions based on health and security criteria. Increasing the number of tourists will increase the number of flights, which in turn will benefit those NTE that rely on air cargo.

Gemstones

Zambia is one of the world's three largest producers of emeralds and has large quality reserves of tourmalines, aquamarines, amethysts, citrines and garnets. Official exports of $23 m (2003) underestimate the value of the trade. Zambia has issued approximately 450 ten-year gemstone-mining licenses and 430 two-year 'artisan' licenses. Recent review results indicate that the sector has the potential to rapidly increase output, although this is constrained by the regulatory environment. Lax government oversight, administration and coordination have led to inadequate security and inadequate infrastructure within the sector. This has resulted in unauthorized mining and has served to depreciate the reputation of Zambia as a reputable market for gemstones. The recent establishment (December 2004) of the Zambia Gemstone Exchange aims to provide an equitable marketing system and seeks to stabilize the sector. Government authorities should review all the bureaucratic procedures in the sector, professionalize record keeping, and establish systems for enforcing compliance with mining legislation.

Engineering products

In 2003, engineered metal products accounted for seven percent of NTE. Using locally produced copper as the main input, the sector is dependent on efficiency in the mining sector. The successful privatization of the mining sector is expected to improve efficiency in mining and strengthen the competitiveness of this sector. Virtually all production is destined for regional markets and is traded under either COMESA or SADC rules.

5. How can enhanced trade capacity and coordination help increase integration?

Enhancing trade policy formulation and implementation requires increased analytical capacity within and outside government, more regular and informed dialogue between government and key stakeholders, improved coordination between Ministries and agencies, and cooperation between the donors to address short, medium- and long-term priorities.

The recent creations of the ZBC, PSD Steering Committee, and the NWGT consisting of members from the private sector and government are a welcome development. The NWGT is intended to provide oversight for a whole series of working groups focusing on each of the trade agreements, as well as for donor programs. Given the scarce technical capacity to service multiple committees, there should only be four sub-committees within NWGT – agriculture, services, manufacturing and trade facilitation.

To ensure consistency and avoid duplication, the NWGT needs to liaise with the ZBF, the PSD Steering Committee, and the PMMU. We recommend donor support for the Secretariat of the NWGT, to ensure that there is substantive analysis and preparation for each of the meetings.

It is necessary to improve inter-governmental co-ordination on trade negotiations. Incorporating trade issues explicitly and fully into the interagency implementation mechanism created in the aftermath of the Livingstone Forum (ZBC, PSD Steering Committee, and PMMU) would be a good option to ensure cooperation within government.

It is also necessary to strengthen the analytical capacity of government officials and the private sector to evaluate the economic development implications of trade policies. It is recommended that a trade policy analysis unit is created in the MCTI, the training of staff within and outside government be expanded, and trade policy analysis capacity be developed with the proposed ZIPAR.

6. How can increased integration reduce poverty?

Zambia is one of the poorest countries in the world, with more than 70 percent of the total population living in poverty (1998). Poverty is much higher in rural areas than in urban areas. Accelerating exports, particularly of agricultural products, is necessary for inducing growth and reducing poverty.

In rural areas, trade opportunities can impact on household income through two main channels: (a) households can switch from subsistence farming to cash crop farming, and (b) household members may earn a wage on other farms. The gains from international trade are calculated using a model that estimates the incremental income from planting an additional hectare of a cash crop. The results show that switching to cash crops and earning a wage on farms impacts positively on poverty reduction. If households reduced their subsistence production and switched to tobacco, they could increase income between 71-104 percent. Switching to hybrid maize has the potential to increase income between 55 -100 percent.

DTIS Action Matrix

The Action Matrix includes the main trade-related constraints and actions only. Actions covered under the PSD program are summarized in the main text but not included in the matrix to avoid the risk of revising priorities already agreed under the PSD and other initiatives. The matrix also includes a ranking of actions in term of priorities (1, 2, 3) and a timeframe for implementation as suggestions for the consideration of the stakeholders. The policy priorities and sequencing of actions will be determined by the government and stakeholders during the National Validation Workshop.

DTIS ACTION MATRIX (Main Actions in Core Trade Policy Areas)

Objectives	Recommended Actions	Technical Assistance Needs	Funding Agencies	Priority (1- 3) Timeframe
	Trade Policy			
Policies Directly Affecting Exports				
Develop Export Strategy	• Finalize drafting and approval of Trade Policy and Export Strategy		ITC	1,2005,Q4
Enable exporters to obtain inputs at world prices	• Streamline operating procedures for the duty drawback scheme; set targets for reimbursement of duties	Paper on best practices	IF Trust Fund	1, 2005 Q4
	• Improve management of bonded warehouse and RIB	Implementation of AYSCUDA will address this issue		2, 2005 Q4
	• Operationalize procedures manual and operating guidelines prepared by MCTI prior to implementing the newly revised Export Processing Zone Act	TA required to make Act operational.	IF Trust Fund	1, 2005 Q4
Policies Directly Affecting Imports				
Tariff Reform	• Establish the Tariff Commission	TA required to make the Commission operational	IF Trust Fund	2, 2005 Q4
Allow for contingent protection to address disruptive import surges as tariffs are lowered	• Implement the new legislation on safeguards consistent with the WTO, COMESA and SADC Agreements	Training to develop public/private capacity to effectively use safeguards legislation		3, longer-term
	Trade Facilitation			
Customs Modernization				
Upgrade equipment and infrastructure of ZRA	• Support investment in the customs infrastructure and equipment at key border posts and improve performance	Assess needs and prepare TA projects		2, 2006
Integrate border agencies	• Introduce integrated software management system for all border agencies; develop a single processing and payment window for all border agencies			2, 2006
Reduce border clearance times while ensuring integrity and increased compliance	• Undertake a Cargo Time Release Study to quantify the time involved in customs clearances		IF Trust Fund	1, 2005 Q4
	• Strengthen the training unit in ZRA to train staff and the private sector including clearing agents and forwarders			3, medium-term
	• Request TA to look at the performance of AYSCUDA on the tax elements			3, medium-term
	• Review and improve transit procedures			2, 2006
	• Simplify procedures for consolidated shipments			2, 2006
	• Establish fast track clearance for 'blue chip' traders			1, 2006
	• Strengthen the capacity to implement post clearance audits			2, 2006

	• Introduce and develop advance declaration processing • Decentralize the clearance of goods • ZRA to establish and make publicly available performance indicators on effectiveness and efficiency			2, 2006 3, longer-term 1, 2006
Implement trade facilitation agreements	• Harmonize legal and regulatory framework to conform to the Kyoto Protocol and SADC and COMESA agreements			3, longer-term
Transportation Logistics				
Improved regulatory framework for transport/transit logistics/efficiency/costs	• Revise the Transport Act to remove the quantitative criteria for licensing commercial haulage; liberalize foreign air carrier landing rights; separate criteria for regulating passenger vs. freight transport on roads • Set-up legal framework for licensing of clearing agents, bonded warehouses, terminal operators, and multimodal transport operators (and provide training) • Strengthen technical and enforcement capacity of staff involved in transport regulation and administration • Transpose international transport agreements to national legislation			2, 2006 2,2006 2,2006 2,2006
Reduce transit costs	• Prepare a transit strategy			1, 2006
Accelerate investment in new transport infrastructure	• Develop a program to promote public-private partnerships for financing investments • Facilitate investments in transport and inter-modal infrastructure and (bonded) warehouses	PSD to plan priorities and incentives		3, longer-term 3, longer-term
Augment capacity in transport industry	• Organize training in regulations, logistics and financial management, financial management, and marketing for providers of logistics services, including road transport operators and clearing agents.			1, 2006
Safety & Quality Standards				
Improve standards setting procedure, administration and international conformity	• Amend the Standards Act (1994) to separate standards testing from the regulatory functions of ZABS	Legal and regulatory reform particularly for Mount Makulu and FDA	EDP9	1, 2005 Q4
Foster a private testing and certification industry	• Create regulatory regime: licensing, taxation, etc. • Provide incentives for a competitive private testing lab market • Develop multi-year transition plan for commercialization of public testing labs • Train staff in public and private sectors		EDP9	2, 2006 2, 2006 2,2006
Reorganize and strengthen ZABS	• Coordinate standards set by FDA, Ministry of Agriculture, etc. • Develop system of standards conforming with international criteria		EDP9	1, 2005 Q4 2, 2006

	Trade Capacity and Policy Coordination			
Trade Institutions				
Improve the technical skills of officials with trade related responsibilities	• Create a trade policy analysis unit in the MCTI. Expand and train trade staff in and outside government working on trade policy issues			1, 2005 Q4
Increase understanding and the level of discourse on trade issues	• Use NWGT to commission applied economic research from Zambian researchers/institutions collaborating with international researchers (such as the WBI, the ACBF) • Support establishment of Zambian Institute for Policy Analysis and Research (ZIPAR) with a dedicated trade economist	Support agencies outside government working on trade issues		2, 2006 2, 2006
Facilitate intergovernmental coordination of trade-related policies and programs	• Incorporate the trade issues explicitly and fully into the interagency policy formulation and implementation mechanism created in the aftermath of the Livingstone Forum (ZBC, PSD Steering Committee, PCU) • Closely coordinate export promotion and PSD strategies	Support interagency activities with increased capacity to the Secretariat	JITAP	1, 2005 Q4 1, 2005 Q3
Deepen public-private dialogue on trade-related issues	• Strengthen ZBF as an umbrella mechanism that can bring together the various private sector associations so that they speak with a common voice on common interests • Promote NWGT link with ZBF, ZBC, PSD Steering Committee, and PCU; organize new sub-committees along sectoral lines • Include customs clearance and trade facilitation issues as a standing agenda item for NWGT.	Strengthen dialogue between APEX body and various member groups Support for technical staff and training	DFID, USAID	2, 2005-6 1, 2005 Q3 1, 2005 Q3
Mainstream trade into development policy	• Ensure trade policy is firmly integrated in the forthcoming Poverty Reduction Strategy Program (PRSP) and National Development Plan (NDP)	Prepare background notes or chapters on trade for PRSP and NDP		1, 2005 Q4
	Market Access			
Effective Participation in trade negotiations	• Improve understanding of Zambian trade negotiators and the private sector of WTO and other trade agreements. Prepare negotiating position papers for WTO, EPA, and other negotiations Identify products and markets of export interest	Train staff to support MCTI in their participation and implementation of trade agreements		2, continuous
WTO Government Procurement Agreement	• Evaluate the relative costs and benefits of implementation	Consultants for study		3, 2006
Compliance with TBT Agreement	• Strengthen the Notification and Enquiry Points	Training and equipment required		2, 2006
Ensure effective implementation of COMESA and SADC FTA	• Press for reduction of the non-tariff barriers to trade and liberalization of rules of origin • Develop regional supply chains based on comparative advantage in collaboration with SADC and COMESA	Support increased cooperation between SADC and COMESA regional secretariats		1, 2005 Q3 2, 2006

1. Overview and Main Conclusions

The objective of this report is to review Zambia's trade policies and performance, assess its potential for export diversification, identify the main constraints to expansion and diversification of exports, and develop an action matrix laying out policy reforms and technical assistance needs to remove these constraints. It aims to assist the government in augmenting Zambia's integration into the world economy by providing input into government efforts to (a) build national consensus around the reforms, (b) mainstream trade priorities into its development and poverty reduction strategies such as Poverty Reduction Strategy Programs (PRSP), and (c) build trade capacity in and outside government to formulate and implement trade policies, to negotiate trade agreements, and to tackle supply-side challenges in responding to new market access opportunities. The action matrix will provide the basis for effectively coordinating donor support and mobilizing additional resources for trade related technical assistance.

Road to sustained high economic growth

Promotion of non-traditional exports and private sector development are two main pillars of sustained high economic growth in Zambia. Accordingly, in formulating Zambia's policy and institutional reforms, the focus should be on creating the necessary conditions for increasing and diversifying exports and promoting private sector development. With more than two-thirds of the population living on less than $1 a day, Zambia's domestic market is too small to support the sustained high growth in production and employment necessary to make a marked reduction in poverty. Therefore, exports must be the focus for generating future growth in Zambia. There are strong complementarities between export promotion and private sector development. While effective export promotion requires a dynamic private sector, a dynamic and competitive private sector cannot flourish if it produces only for a small domestic market. With domestic savings at only an average of 7-8 percent of GDP, particular emphasis should be placed on attracting foreign direct investment (FDI) into Zambia to ensure levels of investment that are necessary to accelerate GDP growth. In the absence of adequate FDI, Zambia will continue to rely on foreign borrowing, thereby increasing its stock of foreign debt thereby threatening the debt sustainability that was achieved since reaching the HIPC completion point. FDI would also bring new technology, management techniques and marketing links.

Until the early 1990s, Zambia's development policies were not conducive to export diversification and private sector development. Confronted with falling copper prices and export revenues, diversification of exports away from copper has long been a key objective in Zambia. However, progress towards achieving this objective was very limited until the mid 1990s because Zambia failed to place export promotion at the center of its development strategy and failed to create a policy environment conducive to private sector initiatives to diversify production for domestic and export markets.

Non-traditional exports have responded strongly to improved incentives over the past 10 years. Since 1992, the government has implemented a trade reform program as part of broader liberalization, stabilization, and structural reforms, thereby improving the policy environment conducive to export diversification and private sector development. Non-traditional exports reacted favorably. Led by private domestic and foreign initiative, significant export diversification in non-traditional products has ensued, stimulating overall economic growth despite falling copper prices. Since 1998, GDP grew at an average rate of about 4 percent, constituting the first period in Zambia's history of uninterrupted growth in per capita income. The strong positive reaction of non-traditional exports to the improved policy environment, and a strengthened private sector in recent years clearly indicate that the economy is responsive to changes in incentives.

There is potential for much more export diversification and expansion of the private sector. Potential exists for export diversification particularly in sectors such as floriculture, horticulture, agro-processing, textiles and garments, gemstones, and tourism. Realizing these opportunities requires a refocusing of the reforms in a more comprehensive and consistent policy package so as eradicate the binding constraints to private sector development and export promotion.

Priorities in removing cross-cutting and sector constraints

Improved trade policies including the elimination of anti-export bias are necessary for accelerating export growth. However, they are not sufficient. It is also necessary to ensure macroeconomic stability, efficient infrastructures, and a positive private sector enabling environment to encourage private investment in export-oriented sectors and a more effective supply-side response to trade policies. This report focuses on identifying the trade specific constraints and priority policies to remove these constraints. Policy priorities concerning macroeconomic management, business environment, and private sector development were discussed in the earlier reports[4] and during the Private Sector Development (PSD) Forum in Livingstone in June 2004. They are summarized in this report. The report also makes a number of sector specific recommendations.

The main priority areas in trade policy are:

- **Making export incentives work for exporters.** Streamline the operating procedures for the duty drawback scheme. Ensure full and timely reimbursement of actual duties paid. Improve the management of bonded warehouses and the Removal in Bond facility. Prepare standard operating guidelines and a procedures manual prior to implementing the Export Processing Zone Act;

- **Improving trade facilitation.** Improve efficiency in customs administration through upgrading the equipment and infrastructure, integrating the border agencies, and developing a single processing and payment window for all border agencies. Reduce border clearance times through undertaking a Cargo Release-Time study, improving transit and clearance procedures, and establishing a 'fast-track' facility. Reduce transport costs through augmenting capacity in the transport industry with training in regulations, logistics, financial management and marketing. Improve the standards infrastructure through amending the Standards Act to separate standards testing from the regulatory functions of Zambia Bureau of Standards (ZBS) and increasing the role of private sector in testing and certification.

[4] Ministry of Commerce, Trade and Industry 2004, "Private Sector Development Strategy", FIAS 2003, "Zambia: Administrative Barriers to Investment"; World Bank 2004, "Zambia: The Challenge of Competitiveness and Diversification", World Bank 204, "Zambia: Country Economic Memorandum-Policies for Growth and Diversification", World Bank 2004. "Zambia: Investment Climate Assessment".

- **Enhancing capacity to formulate, coordinate and implement trade policy, and negotiate trade agreements**. Establishing a trade policy analysis unit in MCTI. Expand and train trade staff in and outside government. Support establishment of Zambian Institute for Policy Analysis and Research with a dedicated trade economist. Include customs clearance and trade facilitation issues as a standing agenda item for National Working Group for Trade. Incorporate trade issues explicitly into the interagency policy formulation and implementation mechanism set up following the Livingstone Forum;

While further liberalization of imports is not as high a priority, duties on imported capital goods should be removed to stimulate private investment. Zambia has liberalized its imports significantly since the early 1990's. Additional tariff reform should be considered as a medium-term objective to be addressed on a most favored nation basis in the context of negotiations for an Economic Partnership Agreement with the EU.

At this time, market access is not a binding constraint to export expansion and diversification. Zambia has duty free non-reciprocal access to the EU and US markets under the Everything-but-Arms (EBA) Initiative of the EU, the Africa Growth and Opportunity Act (AGOA) of the US, and the Cotonou Agreement. It also has reciprocal duty-free access to the regional markets of COMESA and SADC. While these arrangements can be improved to maximize benefits for Zambia, they do not constrain the diversification and expansion of exports. In the medium-term, Zambia should focus on deepening its free trade arrangements under COMESA and SADC, such as improving trade facilitation and rules of origin, before moving towards more complex trade arrangements. Zambia also needs to determine its long-term trade interests, in order to develop a clear national strategy that will inform its participation in the ongoing WTO and Economic Partnership Agreement (EPA) negotiations with the EU.

Key requirements for effectively implementing Zambia's trade strategy

Effective implementation of an export oriented trade strategy requires:

High level political commitment. Achieving export-oriented growth requires political commitment at the highest level. Confronted with economic challenges, the government has demonstrated its resolve in re-orienting the focus of its development strategy towards economic diversification and private sector development. The Kitwe Economic Diversification Forum (2003) and the Livingstone Private Sector Forum (June 2004), which were attended by the President and the concerned Ministers, laid a strong foundation for export-oriented private sector led growth in Zambia. The Livingstone Forum assigned the responsibility for overseeing the implementation of the agreed action plan to the Zambia Business Council (ZBS), chaired by the President. A PSD Steering Committee was also established, to be co-chaired by the Economic Advisor to the President and the Deputy Secretary to the Cabinet, to guide implementation of the program by ministries and the PSD Reform Program Management and Monitoring Unit (PMMU), which is housed in the Ministry of Commerce, Trade and Industry (MCTI). It is essential that the political momentum is maintained toward implementation of the action plan.

Mainstreaming trade policy. Export promotion should be placed at the center of Zambia's development and poverty reduction strategy and be reflected in the main policy documents of the government. While the National Development Plan (NDP) and the Poverty Reduction Strategy Paper (PRSP) acknowledge the importance of export diversification and private sector development, they fall short of fully integrating these objectives into the development strategy. The Livingstone Forum calls for action to "Develop a national export strategy, mainstreaming trade policy, and placing export strategy/promotion/diversification at the center of national development policy". Following up on this recommendation, the government should make export-oriented private sector-led growth the overriding objective of its economic policies[5].

Coordination within government. The responsibility of formulating and implementing trade policies is shared by various ministries and agencies, but interagency coordination is weak. Each ministry deals with a different aspect of trade policy. The Ministry of Finance concentrates more on the revenue aspects, while the Ministry of Foreign Affairs views trade policies in the context of international relations and as an instrument to strengthen political ties. The MCTI, which has primary responsibility for trade policy formulation and implementation, focuses more on commercial aspects. Sectoral ministries have very little capacity to deal with the trade issues and are often not involved at all. There is a need for an effective interagency mechanism to balance these considerations and to determine trade policy and negotiate trade agreements. Incorporating the trade issues explicitly and fully into the interagency implementation mechanism created in the aftermath of the Livingstone Forum would be a good option to ensure cooperation within government.

Effective public-private partnership. An effective public-private partnership is essential to create an enabling environment for the planned re-orientation of the economy. Until recently, there has been no high-level mechanism for consultation between government and the private sector, and individual members of the business community have tended to use their personal connections with senior government officials to make their concerns heard. The situation is changing. The Livingstone Forum was organized under the auspices of the Zambia Business Forum (ZBF), which is an umbrella mechanism that can bring together the various private sector associations so that they speak with a common voice in their dialogue with government. The creation of the ZBC and the PSD Steering Committee with representation from the business community, is an important step to keep private sector issues on top of the agenda. The National Working Group on Trade has also been established to deal specifically with trade issues.

Coordination of export promotion and private sector development programs. It is essential that trade and private sector development programs are closely coordinated because of overlap and strong complementarities. The Action Plan adopted at Livingstone recognizes the close relationship between private sector development and export growth. It is important to proceed expeditiously to the next steps of implementation specifics, so that close alignment between progress on the two complementary fronts is maintained. In particular, the responsibility for dealing with the private sector and trade issues should be given to the same implementing agencies to ensure consistency. It is, therefore, essential to ensure coordination between the steering committees for the Integrated Framework (IF) and PSD and broaden the scope of the PMMU to cover trade issues.

[5] ITC is assisting the government in preparing an export development strategy.

Enhanced trade capacity. Perhaps the greatest challenge is to increase the capacity of the government and other stakeholders to cope with the growing set of trade policy issues and negotiations. This will require institutional knowledge of the WTO, EPA and regional arrangements, analytical capacity to conduct the necessary economic work, and the experience that can only be gained over time. The government has recently taken steps to strengthen trade capacity within and outside the government. The MCTI appointed a Chief Trade Negotiator who will be assisted by several trade specialists in the International Trade Department of the Ministry. Technical assistance may be needed to support these initiatives. Also, a proposal for a new semi-autonomous policy institute has been developed by the Ministry of Finance and approved by the African Capacity-Building Foundation (ACBF). The proposed name is the Zambian Institute for Policy Analysis and Research (ZIPAR). It would be devoted to policy-oriented analysis directly relevant to the government, serving as a local think tank. It is strongly advised that a trade unit is created within ZIPAR with technical assistance.

Donor coordination. Zambia receives donor assistance for trade from a variety of unilateral and multilateral sources. With a new wave of donor projects now starting or underway (EU, USAID, DFID, World Bank, JITAP, IF, etc.) there is an urgent need to improve donor coordination to avoid overlap and direct resources towards Zambia's priorities. Donor assistance for trade should be integrated into the aid coordination mechanism to be introduced with the Harmonization In Practice (HIP) Action Framework that Zambia recently signed with the donor community. At the working level, the Integrated Framework (IF) Program will play an important coordinating role. The findings of the DTIS would provide the basis for identifying priorities and determining the division of labor among donors in mobilizing resources to support Zambia's export-oriented private sector-led development strategy. As suggested above, monitoring and implementation of the trade program should be fully incorporated into the PSD Steering Committee and its PMMU.

The plan of the report

The rest of the report is organized as follows. Chapter 2 reviews the main trends in Zambia's integration in global markets. External and internal barriers to integration are examined in Chapter 3 in terms of market access, trade policies and behind the border policies. Chapter 4 accesses Zambia's potential for export diversification in non-traditional products. Chapter 5 focuses on trade capacity and policy coordination. Links between trade policies and poverty reduction are analyzed in Chapter 6.

2. What are the Trends in Economic Integration?

ECONOMIC BACKGROUND

After introducing a multiparty democratic system in 1991, Zambia adopted a comprehensive program of macroeconomic and structural reforms to transform a heavily protected economy with large scale government intervention to a more streamlined market economy with particular emphasis on diversification of exports away from copper and promotion of the private sector. The government has undertaken fiscal, monetary and financial reforms and liberalized the foreign exchange regime to stabilize the macroeconomy; it has reduced state control of markets, privatized most public enterprises and improved the regulatory/policy environment to promote private sector development; and it has liberalized imports and introduced financial incentives to encourage export diversification.

These efforts have been supported by the donor community. The grant resources from the donor community varied between five percent and 15 percent of GDP, averaging about eight percent since 1990.

Much has been achieved since the early 1990s. Fiscal, monetary, and financial management has been improved. The market orientation of the economy has been strengthened and the presence of the private sector in the economy has been significantly extended. Price controls have been largely removed. Interest rates have been liberalized. The exchange rate is now market determined. And, Zambia's trade regime has been transformed into one of the most open trade regimes in Africa.

Notwithstanding these achievements, full macroeconomic stability proved elusive (Table 2.1)[6]. While the rate of inflation has been substantially reduced, it remains high (18 percent in 2004). Persistently high fiscal deficit fueled inflation, crowded out the private sector, and led to unsustainable external indebtedness (about 170 percent in 2004). Real interest rates, although declining, are high and volatile reflecting lack of competition in the banking sector, high levels of unremunerated reserve requirement, and the high degree of dollarization of bank deposits. The exchange rate, which is determined in an inter-bank foreign currency market managed by commercial banks, exhibits volatility reflecting the lack of synchronization of foreign exchange inflows (export revenue, donor assistance, capital inflows) and outflows (import payments, debt service), because the foreign exchange market in Zambia remains shallow.

Yet, the reforms were successful in arresting and reversing the chronic economic decline. Indeed, after three decades of decline, real per capita income began to increase as of the late 1990s. Since 1999, per capita income grew at an average rate of about 2 per cent per annum, the first period in Zambia's history of uninterrupted growth in per capita income over six consecutive years. The

---

[6] The macroeconomic situation further improved in 2004 as copper production and exports increased significantly as a reaction to a turnaround in copper prices.

growth was broad based - almost all sectors experienced growth each year. Substantial increase in a wide range of non-traditional exports played an important role in the turnaround. The share of non-traditional exports in total exports increased from 8 percent in 1990 to 38 percent in 2003 (Table 2.1). The share of population below the poverty line has likely declined in this period. However, with an annual per capita income of $380 and over 70 percent of the population living below the poverty line, Zambia remains one of the poorest countries in the world.

Table 2.1: Main Economic Indicators

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
GDP growth (%)	-0.5	0.0	-1.7	6.8	-8.8	-2.5	6.6	3.3	-1.9	2.2	3.6	4.9	3.3	5.1
Composition of GDP (%)														
Agriculture	20.6	17.4	23.8	34.1	15.5	18.4	17.6	18.7	21.1	24.2	22.3	22.1	22.2	22.8
Mining	10.2	9.2	6.3	9.8	19.2	16.4	13.7	11.3	7.1	4.2	4.6	4.4	3.9	3.0
Industry	41.1	41.8	42.7	32.1	20.7	19.5	21.1	22.9	22.1	20.6	20.7	21.3	22.2	24.0
Services	28.1	31.6	27.2	24.0	44.7	45.7	47.7	47.1	49.7	51.0	52.4	52.3	51.7	50.2
Inflation (%)	109	93	191	138	38	46	35	19	31	21	30	19	27	17
Real treasury bill rate (%)	-37.9	-24.8	-48.0	-25.9	11.0	-4.5	24.8	1.7	2.8	15.6	4.0	31.8	5.8	-3.4
Real exchange rate ($/kw)	107	99	96	109	105	100	105	125	115	112	113	101	95	93
Gross Investment/GDP (%)	17.3	11.0	11.9	15.0	8.2	15.9	12.8	14.6	16.4	17.6	18.7	20.0	23.0	26.1
Composition of investment (%)														
Public sector	36.0	71.0	56.5	29.8	48.3	32.2	47.1	37.1	68.8	60.2	53.7	59.1	51.1	43.9
Private sector	41.9	32.1	32.4	46.5	89.1	45.9	40.5	52.6	21.6	30.9	38.7	34.1	42.6	51.0
Domestic savings/GDP (%)	16.6	8.4	0.3	8.2	7.4	12.2	5.3	9.4	3.9	-1.1	-3.2	8.3	17.3	17.7
Fiscal Balance/GDP (%)	-8.3	-7.0	-2.5	-5.6	-6.8	-4.3	-0.5	-1.1	-5.2	-3.7	-5.9	-7.1	-5.6	-6.0
Current acc. balance/GDP (%)	-2.5	0.2	-5.6	-4.0	-1.5	-8.5	-7.2	-7.2	-11.6	-8.8	-11.4	-10.8	-6.5	-7.5
Merchandize Exports/GDP (%)	38.6	34.4	36.9	31.5	33.3	35.6	30.5	29.1	29.1	24.7	24.2	24.8	25.1	25.2
Composition of merchandize exports (%)														
Traditional exports	92.0	89.6	91.3	87.9	86.6	83.9	75.7	71.0	66.8	60.6	66.4	65.4	60.3	61.7
Non-traditional exports	8.0	10.4	8.7	12.1	13.4	16.1	24.3	29.0	33.2	39.4	33.6	34.6	39.7	38.3

Source: Various IMF and World Bank reports

Significant changes have taken place in the structure of production since the early 1990s. The share of mining in GDP fell from 10.2 percent in 1990 to 3.0 percent in 2003 as the production base expanded. The share of services almost doubled reaching 50.2 percent of GDP, while the share of industry fell from 41.1 percent of GDP to 24.0 percent in the same period. The sharp decline in industrial production is explained partly by the disruptive effect (particularly in the textile sector) of import liberalization without adequate precautionary measures.

Zambia could have grown faster since the early 1990s if the political commitment to policy and institutional reforms had continued, implementation had been stronger, the investment climate improved, governance strengthened, and donor coordination more effective. Some estimates suggest that Zambia has a long-term potential to grow at a rate of about five percent, with per capita income growth at about three percent. To be able to realize this potential, Zambia will need to refocus the reforms on alleviating the binding constraints, building on progress to date.

In particular, Zambia will need to improve:

- macroeconomic management (tighten fiscal stance to bring down inflation to a single digit and strengthen competition in the financial markets to reduce the level and volatility of real interest rates);
- coordination of donor funding and foreign exchange reserve management to reduce the volatility of the exchange rate;
- trade policies (allow duty-free imports of capital goods, simplify the export incentive system and fully reimburse import duties and VAT to exporters in a timely manner, improve trade facilitation and export support services, operationalize the export processing zones);
- the business environment (streamline procedures for company registration and licenses, immigration and land acquisition, simplify tax and customs administration, amend the labor laws to make it less costly for employers to manage their labor force, improve partnership with the private sector and governance and accountability);
- delivery of physical and human infrastructure services (enhance the regulatory system and competition, encourage private sector participation in infrastructure, strengthen education services and the fight against HIV/AIDS);
- sector specific policies, particularly in sectors with strong comparative advantage (agriculture, agro-processing, textiles and garments, gemstones, horticulture and floriculture, tourism).

TRADE PERFORMANCE

Since the early 1990s, important changes have taken place in Zambia's trade, in both the commodity composition and the relative importance of trading partners. Exports of non traditional products[7] have increased substantially since 1995. However, the increase in non traditional exports has been offset by the steep decline in copper prices, leading to a fall in total exports from $1,270 million in 1990 to $1,084 million in 2003, with the export/GDP ratio falling from 39 percent to 25 percent in the same period (Table 2.2)[8]. Zambia's share in world exports also declined from 0.038 percent to 0.014 through the period 1990 to 2003 indicating Zambia's failure to take advantage of the trade opportunities created by rapid globalization since the 1980s and its further marginalization in world trade. There have also been significant changes in the direction of trade. South Africa has emerged as the most important trading partner for both imports and exports, as shares of the EU and Japan have declined considerably.

[7] Non traditional products are defined as total exports minus copper and cobalt.
[8] 2004 has seen a major turnaround in copper prices and a rebound of copper production significantly increasing export revenue.

Table 2.2: Main Trends in Trade Performance

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
In Current US Dollars (000)														
Merchandise Imports	1218	810	836	701	455	782	834	697	1087	876	1101	1080	1072	1551
Merchandise Exports	1270	1163	1174	1030	1114	1238	997	1138	943	772	785	902	928	1084
Copper and Cobalt	1168	1041	1072	906	965	1039	754	809	630	468	521	590	560	669
Non-Traditional Exports	102	121	102	124	149	199	243	329	313	304	264	312	368	415
Percent of GDP														
Merchandise Imports	37.0	24.0	26.3	21.4	13.6	22.5	25.5	17.8	33.6	28.0	34.0	29.7	29.0	36.1
Merchandise Exports	38.6	34.4	36.9	31.5	33.3	35.6	30.5	29.1	29.1	24.7	24.2	24.8	25.1	25.2
Copper and Cobalt	35.5	30.8	33.7	27.7	28.8	29.9	23.1	20.7	19.5	14.9	16.1	16.2	15.1	15.6
Non-Traditional Exports	3.1	3.6	3.2	3.8	4.4	5.7	7.4	8.4	9.7	9.7	8.1	8.6	10.0	9.7
Exports/World Exports (%)	0.038	0.033	0.031	0.028	0.026	0.024	0.019	0.021	0.017	0.014	0.013	0.012	0.015	0.014
Copper Price ($/mt)	2661	2339	2281	1913	2307	2936	2295	2277	1654	1573	1813	1578	1559	1779

Source: IMF Direction of Trade

Composition of trade

Zambia has achieved the largest export diversification in the region[9]. Expansion of non-traditional exports is a key bright spot in Zambia's trade performance in the last decade. NTE increased from $102 million in 1990 to $ 329 million in 1997 before slipping back to $ 264 million in 2000 (Table 2.2). NTE recovered in 2001 to reach $ 415 million in 2003. The share of NTE in total exports increased from 8 percent in 1990 to 38 percent in 2003. Substantial increases have been achieved in primary agricultural commodities, floricultural products, horticultural products, and processed food (Table 2.3). The agro-based NTE increased from $30 million in the early 1990's to $210 million in 2003. Floriculture and horticulture accounts for $70 million and employs about 15,000. The turnaround in growth of GDP in the past 6 years is explained partly by the successful export diversification drive. Poverty has likely been reduced in recent years because most of the NTE are labor-intensive sectors. To maintain the growth momentum and improvement in living standards, export diversification needs to accelerate.

In addition to trade and foreign exchange reforms in the first half of 1990s, the NTE sector benefited from specific sector measures. Introduction of an export credit scheme financed by the donors and technical assistance provided by the EU facilitated investment in NTE sectors, in particular, foreign investment in the floriculture and horticulture sectors. The strong reaction from the NTE to improvement in policy environment and progress in creating a dynamic private sector in recent years indicate clearly that the economy is responsive to changes in incentives.

Changes in the composition of imports have been moderate (Table 2.4). The share of manufacturing (largely intermediate and capital goods) in total imports fell from 88.3 to 81.0 percent through the period 1990-93 to 2000-03 while the shares of agriculture (food and feed) and fuel increased from 7.2 to 10.0 percent and 0.5 to 7.1 percent, respectively.

---

[9] The Hirschman-Herfindahl index of concentration of exports declined from 0.70 in 1990-92 to 0.26 in 1999-01. See, Fahrettin Yagci and Enrique Aldaz-Carroll, "Salient Features of Trade Performance in Eastern and Southern Africa", 2004, World Bank.

Table 2.3: Non-Traditional Exports (US $ million)

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
Animal Products	0.4	1.4	1.7	3.4	4.1	4.4	3.4	3.1	5.2	3.6
Floricultural	9.1	13.5	18.3	21.3	32.9	42.7	33.9	34.1	30.3	22.4
Horticultural	2.4	4.0	8.9	15.9	20.6	23.9	27.4	36.4	44.9	46.0
Primary Agriculture	10.0	24.1	37.9	90.9	62.2	75.5	37.1	51.4	76.5	97.9
Processed Agriculture	9.4	25.2	33.8	30.9	49.4	33.0	35.6	43.0	43.7	43.9
Wood Products	-	1.4	1.8	3.4	3.2	3.0	3.9	3.8	3.2	3.0
Building Material	3.0	3.2	7.9	12.0	8.6	10.2	8.7	7.1	8.2	11.1
Chemicals	2.2	2.4	3.1	7.8	6.9	5.9	7.0	6.0	14.4	9.7
Engineering Products	34.5	39.4	36.5	42.4	31.7	23.2	20.6	21.3	22.2	29.1
Garments	0.5	0.1	0.1	0.3	0.4	0.4	0.4	0.2	0.2	0.2
Handicrafts	-	-	0.2	-	0.2	0.2	0.3	0.2	0.4	0.2
Leather	1.2	1.9	2.1	2.2	3.1	2.0	4.3	3.9	4.1	3.4
Non-Metallic	0.8	0.7	0.7	0.5	0.5	1.0	1.1	0.9	1.4	2.6
Textiles	28.5	39.1	40.5	50.6	42.4	37.0	36.0	34.1	25.6	26.0
Other Manufacturing	-	0.5	1.5	3.0	3.1	6.5	4.4	9.2	9.8	15.4
Petroleum Oils	3.9	11.4	5.7	1.8	6.8	6.4	0.4	1.6	1.4	18.4
Gemstones	22.2	7.5	10.9	14.5	11.6	13.8	15.4	30.3	37.1	23.7
SUB-TOTAL	129.3	178.2	211.6	304.7	287.7	286.2	239.8	276.5	326.7	356.3
Re-Exports	-	-	4.1	3.9	3.7	2.7	4.0	4.2	5.7	3.6
Scrap Metal	-	-	10.7	6.0	4.2	6.1	5.1	4.1	3.1	3.7
Mining	-	-	-	3.7	12.2	3.3	7.3	17.6	25.5	44.6
TOTAL VISIBLE NTE	129.3	178.2	226.4	314.7	307.8	298.4	256.2	302.5	361.0	408.2
Electricity	19.5	21.1	16.2	14.8	5.6	6.1	7.4	9.3	7.3	7.0
TOTAL NTE	148.9	199.3	242.6	329.5	313.4	304.5	263.6	311.8	368.3	415.2

Source: Zambia Export Board

Table 2.4: Commodity Composition of Exports and Imports (percent)

	Exports			Imports		
	1990-93	1995-98	2000-03	1990-93	1995-98	2000-03
Agriculture	2.9	8.6	21.1	7.2	9.6	10.0
Food and Feeds	1.9	5.3	11.8	6.2	8.2	9.1
Agricultural Material	1.0	3.3	9.3	1.0	1.4	0.9
Ores and Metals	92.5	82.9	62.3	2.8	2.5	0.9
Manufacturing	4.4	7.7	13.5	88.3	85.6	81.0
Fuels	0.0	0.6	0.1	0.5	1.1	7.1
Misc.	0.2	0.2	3.0	1.2	1.2	1.0

Source: COMTRADE (mirror statistics)

Direction of trade

Changes in the direction of trade are more profound. The combined share of the EU and Japan in total exports fell from 53 percent in 1990-92 to 25 percent in 2000-03, while the share of South Africa and COMESA increased from zero to 26 percent and 4 to 15 percent, respectively, in the same period (Table 2.5). This is only partly explained by the fall in copper prices. Changes in the origin of imports are equally profound with South Africa increasing its share from 24 to 69 percent at the expense of the EU, Japan, and COMESA.

Table 2.5: Direction of Trade (percent)

	Destination of Exports			Origin of Imports		
	1990-92	1995-97	2000-02	1990-92	1995-97	2000-02
Low Income Countries	33.5	48.7	66.7	40.3	62.1	82.7
COMESA	3.8	8.5	15.2	8.1	15.0	4.7
SADC	3.5	12.0	36.8	32.6	50.3	75.1
South Africa	0.3	3.1	25.8	23.8	34.5	69.1
Rest of Africa	0.3	0.2	0.8	0.1	0.1	0.3
East Asia and Pacific	16.5	16.6	14.2	0.7	2.2	3.1
Thailand	8.6	11.5	7.2	0.1	0.2	0.2
China	0.6	1.0	5.5	0.4	1.6	2.6
South Asia	6.2	8.1	2.8	4.1	5.3	2.7
India	5.7	7.1	1.9	3.3	3.7	2.4
Others	5.9	10.7	7.3	2.5	3.8	1.2
High Income Countries	66.5	51.3	33.3	59.7	37.9	17.3
EU15	27.7	19.7	16.6	38.7	22.9	10.5
Netherlands	0.4	0.9	5.6	2.4	1.1	0.5
UK	2.2	3.9	2.0	15.6	9.5	3.4
East Asia and Pacific	34.1	25.9	14.5	10.5	7.0	2.7
Japan	25.2	15.7	8.5	8.2	4.2	1.7
North America	3.8	5.5	1.8	7.3	5.6	2.6
USA	3.6	4.5	1.8	6.5	4.9	2.2
Others	1.0	0.2	0.4	3.3	2.3	1.4

Source: COMTRADE (mirror statistics)

The replacement of the EU and Japan by South Africa as the leading trading partner cannot be explained by trade diversion created by preferential reciprocal trade arrangements under SADC because implementation of the SADC Trade Protocol started only recently. The likely reasons are: South Africa’s geographic advantage, the emergence of trade opportunities after the end of Apartheid, and increasing South African investment in Zambia.

The USA’s share in Zambia’s trade is very small and decreasing. Through the period of 1990-92 and 2000-02, its share in Zambia’s exports and imports fell from 3.6 percent to 1.8 percent and from 6.5 percent to 2.2 percent, respectively (Table 2.5). This is an indication that Zambia failed to take advantage of the opportunities provided by the Africa Growth and Opportunity Act (AGOA) of the US.

Zambia’s border trade with its neighbors, particularly with the Democratic Republic of Congo and Zimbabwe, has significantly increased despite disruptive political and economic events in these countries. The bulk of this trade is in processed and unprocessed food. A large part of this trade remains unrecorded. There is potential for much more trade, realization of which depends on improvements in transportation.

3. What are the External and Internal Barriers to Integration?

MARKET ACCESS

Zambia qualifies for preferential treatment as a least developed country under the Generalized System of Preferences (GSP) that is offered on a bilateral basis by developed economies. In addition, Zambia has duty-free and quota-free non-reciprocal access to the United States under the African Growth and Opportunities Act (AGOA), and to the EU under the Everything but Arms (EBA) Initiative and the Cotonou Agreement for almost all products. Zambia has also entered into a number of regional trade agreements on a reciprocal basis with neighboring countries, namely the Common Market for Eastern and Southern Africa (COMESA) and the Southern African Development Community (SADC), and is negotiating bilateral trade agreements with the Democratic Republic of Congo and Mozambique.

This web of preferences provides Zambia with duty free access for most of its existing exports. For many of Zambia's exports (copper and raw materials) the MFN tariffs are either zero or extremely low so tariff preferences are not relevant. This is not the case with the NTE, including horticulture, floriculture, sugar, coffee, cotton, and light engineering products including copper wiring. For these products, preferential access is relevant and Zambia benefits from the existing pattern of preferences. These benefits will decrease as the trading partners reduce their MFN tariffs, as part of the Doha negotiations and offer similar preferences to other developing countries. Zambia should focus more on improvement in non-tariff aspects of these arrangements (rules of origin, trade facilitation, aid for trade, etc.), strengthening of its trade and behind the border policies (macroeconomic policies, administrative and regulatory environment affecting business), and removal of supply side constraints to increase its competitive strength.

While market access is presently not a binding barrier to expansion and diversification of its exports, Zambia should participate actively in regional and global trade negotiations to ensure that its longer term trade interests are adequately reflected in these agreements. During the course of the next five years, Zambia will make a series of important policy decisions regarding trade agreements. It needs to decide whether to conclude an EPA with the EU, whether to participate in regional customs unions, and how to engage in the ongoing WTO multilateral trade negotiations. Identifying best interests across competing trade negotiations requires a national trade policy that clearly articulates the key objectives of promoting export-oriented and private sector led growth in Zambia.

Maintaining market access does not require Zambia to move towards a customs union with either COMESA or SADC, or to sign an EPA with the EU unless it offers benefits beyond those provided by the EBA Initiative. Prior to embarking on more complex trade arrangements or MFN reductions in tariffs, Zambia should focus on improving trade facilitation and behind the border policies to enhance the supply side response. In addition, preferential tariff reform should mirror MFN tariff reductions to avoid trade diversion and take into account the need to maintain government revenue.

Zambia could use its participation in the Doha Development Round WTO negotiations to negotiate for reduced cotton subsidies, lower MFN tariffs in India and other major developing country markets and also follow the trade facilitation negotiations closely. As a land locked country Zambia stands to benefit from improved trade facilitation.

European Union preferences

Zambia has unilateral preferential access to the EU market under the Cotonou Agreement, which was signed in June 2000 between the EU and 77 countries in Africa, Caribbean, and Pacific (ACP) when the Lome Convention IV expired. The Cotonou Agreement provides for the negotiation of Economic Partnership Agreements (EPA) between the EU and the ACP countries as regional groupings or individually. The negotiations are to be completed by December 2007. The EPAs are to go into effect in January 2008, and the terms of the agreements will be phased in gradually over 12 years. The EPA process has four main objectives: replacement of unilateral preferences with reciprocal free trade arrangements to make the EPAs WTO-compatible; differentiation in the treatment of the least developed countries (LDC) and non-LDCs; strengthening regional integration among the ACP countries; and, provision of aid for trade by the EU for ACP countries.

Zambia is currently negotiating for an EPA as part of the Eastern and Southern Africa (ESA) group of 16 COMESA member countries. Negotiations on the content of the EPAs started at the ACP level in 2002. At the regional level, negotiations on the ESA EPA started in 2003.

As an LDC, Zambia also has unilateral access to the EU market under the EU's Everything-But-Arms (EBA) Initiative, which offers duty free, quota-free access for an unlimited period to all products excepting arms[10]. The EBA Initiative is part of the EU's GSP and is compatible with the WTO's Enabling Clause, as it grants special preferences to a permissible group of countries -- the LDCs. Data show that Zambia's exports to the EU have been largely under the Cotonou Agreement rather than the EBA Initiative. A possible explanation of the low utilization of EBA preferences may be the restrictive rules of origin (RoO) of the EBA Initiative as compared with the RoO of the Cotonou Agreement.

An important decision for Zambia is whether to sign an EPA with the EU. If Zambia decides to not enter into an EPA, it will continue to have duty-free and quota-free access to the EU market for goods under the EBA Initiative without providing any reciprocal concessions to the EU. Therefore, in order for Zambia to obtain something in return for giving EU imports duty-free access to its market, the EPA needs to offer benefits beyond those provided by the EBA Initiative.

If designed and implemented in a development-friendly form, an EPA could have profound positive impact on trade and growth in Zambia. In particular, a development-friendly EPA could be a catalyst for Zambia to accelerate implementation of the border and behind the border policies suggested in this study and remove the barriers to trade expansion and diversification, thereby strengthening its regional and global integration.

[10] Implementation of full market access is immediate except for a transition period allowed for bananas, rice and sugar, for which tariff-quotas restricting LDC exports to the EU market are to be phased out by the end of January 2006, September 2009, and July 2009, respectively.

For a development-friendly EPA that is preferable to the EBA Initiative, in negotiating the EPA, Zambia should press for the following features: (a) improvements in the EBA and the Cotonou RoOs, (b) increased financial assistance to address supply side bottlenecks and to offset revenue loss from lower tariffs on imports from the EU, (c) adequate flexibility in EPA design to accommodate differing conditions in countries within the ESA group, and (d) EU's technical support for reducing intra-regional barriers to trade and deepening regional integration.

To realize the full potential benefits of a development-friendly EPA, Zambia will also need to take measures to offset the possible adverse effects of an EPA. About 10 percent of Zambia's imports originate from the EU. They include goods such as vehicles, paints, tires, second-hand clothing, soybean oil, etc. that carry the maximum tariff rate. Granting duty-free access to the EU would significantly reduce the revenue base of the government (custom duties constitute about 12 percent of Zambia's tax revenue). This loss could be offset through a combination of VAT and excise taxes collected at the border and domestically, and with improvements in tax administration. Because restructuring of indirect tax system and related improvements in tax administration require institutional changes that will take time, it is advisable for Zambia to seek financial assistance from the EU until the adjustments are made.

Granting tariff concessions to the EU while maintaining high MFN tariffs would impose inefficiencies through trade diversion. These risks could be reduced if the maximum MFN rate is gradually lowered at the same time as tariffs on imports from the EU are reduced and supply side bottlenecks are removed.

United States preferences

The United States provides Zambia with benefits under the GSP and the AGOA, with the latter providing for duty free access to a wider range of products with liberal rules of origin for qualifying countries. AGOA was enacted in May 2000 and expanded the list of products that eligible African countries could export duty free to the US, including textiles and many labor-intensive products such as footwear and apparel. AGOA contains a special apparel provision that provides for duty free and quota-free access to the US market for apparel made in eligible SSA countries from US fabric, yarn and thread[11]. A special rule of origin for LDCs, which includes Zambia, allows for cloth to be sourced from third countries[12].

Zambia ratified AGOA's apparel provision in December 2001 and provided for the AGOA textile certificate of origin in February 2002. Through 2004, Zambia had not requested preferences on apparel under AGOA, however, it has benefited indirectly from the Act increasing exports of cotton yarn to South Africa as inputs into apparel for exports to the US under AGOA. Direct beneficiaries under AGOA are wooden panels and leather.

As a beneficiary of AGOA, Zambia has requested several Pest Risk Assessments to satisfy US SPS requirements, as a prerequisite to exporting to the US; these are now in progress and are expected to be completed within the next 12 months. High transportation costs raise serious questions about the commercial viability of exporting time-sensitive fresh products to the US. Increasing the benefits of

[11] If the apparel is made with fabric and yarn produced in beneficiary countries within SSA, imports are subject to a cap of three percent of overall US apparel imports, increasing to seven percent by 2008.
[12] AGOA was amended in 2004 to extend this RoO until August 2007.

AGOA requires that Zambia address the many supply side constraints that influence competitiveness.

Eastern and Southern African regional trade agreements and preferences

Zambia participates in two major regional trade groupings (SADC and COMESA) with overlapping membership. The Membership of the two groupings is shown in Table 3.1. Nineteen and thirteen Member States belong to COMESA and SADC, respectively, with seven countries belonging to both regional organizations. Zambia is one of four countries[13] that participate in both the COMESA FTA and the SADC Trade Protocol.

Table 3.1 : SADC and COMESA Member States

Member States	SADC	COMESA	Member States	SADC	COMESA
Angola	X		Mauritius	XX	XX
Botswana	XX		Mozambique	XX	
Brundi		XX	Namibia	XX	
Comoros		X	Rwanda		XX
Congo, DR	X	X	Seychelles		X
Djibouti		XX	South Africa	XX	
Egypt		XX	Sudan		XX
Eritrea		X	Swaziland	XX	X
Ethiopia		X	Tanzania	XX	
Kenya		XX	Uganda		X
Lesotho	XX		Zambia	XX	XX
Libya		X	Zimbabwe	XX	XX
Madagascar	X	XX			
Malawi	XX	XX	Total	14	19

X = Member State,   XX= Participating in Trade Agreement

COMESA

The COMESA implemented its FTA on October 31, 2000 when nine Member States removed all tariffs on products originating from their countries. The non FTA COMESA members continued to offer preferential access at between 10-90 percent of the MFN rate. One of the objectives of COMESA was to move to a customs union in 2005. This objective has been postponed to a future date.

It is not clear what additional benefits Zambia would gain by moving to a customs union. The main benefit of a customs union over an FTA is a substantial reduction in the transaction costs of trade arising from elimination of the need for RoO, and simplification of clearance procedures at internal borders. The proposed COMESA customs union will not provide such benefits because each country will retain responsibility for collecting their own tariff revenue. This means that the

[13] Although seven countries belong to both organizations, DRC has not signed the SADC Trade Protocol, Angola has not submitted an implementation schedule for the SADC Trade Protocol, and Swaziland, as a member of the Southern African Customs Union (SACU), is not participating in the COMESA Free Trade Area. The four countries implementing both agreements include Malawi, Mauritius, Zambia and Zimbabwe.

COMESA customs union will continue to require RoO and customs clearance for intra-COMESA trade.

One should also take into account the revenue and trade effects of a customs union on Zambia. Recent work reviewing the impact on Zambia from implementation of the proposed COMESA Common External Tariff (CET) finds that the three proposed options (maximum rate being 30, 25, and 20 percent) would have different implications for the structure of incentives facing importers and exporters[14]. If the maximum CET were either 30 or 25 percent, trade would be restricted relative to the current schedule. The third option, with a maximum tariff of 20 percent, would result in a marginal (1 percent) increase in trade flows. All three options divert trade away from Europe and Asia and retain the bias against exports of manufactured goods through tariff escalation. The least restrictive option (maximum rate being 20 percent) would result in reduced tariff revenues.

At this time, the priority for Zambia is to deepen the COMESA FTA through improving trade facilitation and harmonizing policies in the FTA area, rather than preparing for a customs union.

Regional markets remain important for Zambia. COMESA's share in Zambia's merchandise exports is about 15 percent. Increasing small scale cross border trade appears to have immediate and direct benefits to the poorest groups in society. Expanding regional trade to the DRC and Zimbabwe is exacerbated by their civil conflict and lack of macroeconomic stability, and high transaction costs and restrictive trade regimes within COMESA continue to have a dampening effect on Zambia's exports.

Zambia has a clear interest in encouraging increasing openness within the COMESA FTA. The RoO, which are relatively liberal, need to be improved. The COMESA RoO requires that imported inputs be valued at CIF prices, although transport costs incurred in transit through member states can be deducted. However, when these transport costs cannot be ascertained, the CIF value in the country in which they are processed must be used. For most products, the invoice that customs uses for valuation purposes does not contain information on transit transport costs. Therefore, in practice the RoO discriminates against land-locked members, such as Zambia, resulting in higher transport costs as compared with those for other members. Another issue is that Uganda requires 45 percent of value-added, while most members apply the agreed value-added requirement of 35 percent, which constrains the access of Zambian exporters to Uganda under the COMESA FTA. Thus, to improve market access within COMESA, Zambia should request that imported inputs should be valued FOB and that the agreed RoO, which also allows for a change of tariff heading rule as an alternative to the value added requirement, should be consistently implemented by all members.

SADC

Implementation of the SADC Trade Protocol commenced in September 2000 with the introduction of tariff preferences leading to an Article XXIV compatible FTA by 2008[15]. All tariff lines are classified into three categories: immediate duty free access (category A), duty free access within eight years (B), and sensitive products, on which tariffs are to be removed between 2008–12 (C).

---

[14] See "Zambia and the COMESA Common External Tariff" by Philip Schuler and Takako Ikezuki, January 2005.

[15] Under the tariff phase down schedules, members offer to remove tariffs on at least 85 percent of their trade by 2008. In 2004, in accordance with Article XXIV, SADC member states notified the WTO Committee on Regional Trade Agreements of the SADC Trade Protocol.

Zambia reduced tariffs to zero for category A goods in April 2001, and began implementing reductions on category B goods in July 2004.

SADC has recently prepared a Regional Indicative Strategy and Development Plan 2004-2015 (RISDP) to provide strategic direction to all components of its integration agenda. The RISDP presents an ambitious program including: establishing a FTA (2007) that will evolve into a customs union (2010) and culminate in a common market (2012); achieving macroeconomic convergence, financial integration, a common regulatory framework, and food security; putting in place a system for regional management of common goods such as river basins; etc.

The poor track record of implementation of the FTA, the weak implementation capacity of the SADC Secretariat and most of the member states, and large diversity among members in terms levels of economic, political and institutional development, raise concerns about the feasibility of the RISDP program.

Zambia is advised to use its limited negotiation capacity to strengthen SADC's FTA arrangements through improving its very restrictive RoO, removing other barriers to intra-SADC trade, and pushing for harmonization of SADC and COMESA objectives so that it can continue membership in both.

Because it sources almost 70 percent of its imports from South Africa, Zambia should pay particular attention to two aspects of implementation of the SADC FTA program. First, in the absence of further MFN tariff liberalization, Zambia will be vulnerable to trade diversion on imports from South Africa. South Africa is the largest source of imports with existing tariffs: removing the tariffs does not guarantee that importers will reduce prices by the height of the tariff. Indeed, Zambia may find that foregone tariff revenue is captured by producers/importers and not passed on to consumers. The restrictive RoO within SADC serves to preserve the level of protection within the more industrially developed countries, and will inhibit lesser developed members, such as Zambia, from being able to increase trade within the SADC FTA.

Second, implementing the SADC FTA would result in a substantial loss of revenue as tariffs on imports from South Africa are phased out. The Ministry of Finance estimates that, by 2008, approximately 35 percent of customs duty will be foregone under the SADC FTA. Imports from South Africa will account for 83 percent of the reduction.

It is, therefore, advisable for Zambia to reduce the MNF tariff in parallel with implementing the SADC tariff phase down to obviate the risk of trade diversion, and implement compensatory revenue measures to offset the expected revenue shortfall.

TRADE POLICIES

Zambia has one of the most open trade regimes in Africa with a rating of 2 on the IMF's restrictiveness scale ranging from zero to 10, 10 being the most restrictive. The comprehensive trade reform program in the early 1990's significantly reduced import duties, repealed import and export licenses and export bans and taxes, moved to a market determined exchange rate, and introduced a package of export incentives. The priority in further reforming the trade regime in the near term will need to be placed on ensuring that export incentives operate effectively, trade facilitation is strengthened, and tariffs on capital goods are eliminated after compensatory revenue raising measures are taken.

Policies directly affecting imports

The simple average MNF tariff in Zambia is 13.4 percent with a coefficient of variation of 0.7, indicating modest dispersion of tariff rates. Weighting tariffs by imports reduces the average to 10.2 percent. Taking the COMESA and SADC preferential tariff rates into account, the trade-weighted average applied rate falls to 8.0 percent[16]. Ad valorem tariffs comprise four bands: 0, 5, 15, and 25 percent. Specific rates apply to a few items. Table 3.2 shows the distribution of the 6,106 tariff lines, imports and customs revenue in each of the four tariff bands. Most of the tariff lines in the schedule lie in the upper two brackets, while most of the trade consists of imports in the lower tariff bands. The imports in the top bracket generate almost half of the customs revenue.

Table 3.2: Main Indicators of Tariffs, 2003 (percent)

	Tariff bands	Share of tariff lines	Share of imports	Share of customs revenue
Raw Materials	0-5	21	30	0
Capital Goods	0-5	14	24	15
Intermediate Goods	15	33	26	36
Finished Goods	25	32	21	48

Source: CSO, tariff data submitted to UNCTAD

The industries facing the highest duties are fishing and light manufactures such as wood products, manufactured food, beverages and tobacco, and textiles, apparel and leather (Table 3.3). These average tariffs of 19–23 percent on light manufactures are especially worrisome because they tend to create an anti-export bias on the export of these products, both in a static sense (a producer can earn the world price plus the tariff if it sells to the domestic market but only the world price if it exports) and in a dynamic sense (by shielding the producer from world competition, high tariffs dampen incentives to innovate). High tariffs on agriculture and processed foods shield commercial farming operations from incentives to innovate, raise the price of food, with adverse consequences for poverty alleviation, and make Zambian food processors less competitive in world markets.

[16] Under the free trade agreements, Zambia provides on a reciprocal basis duty free access to some COMESA members for all goods, and to SADC members for certain products.

Table 3.3. Pattern of Protection by Industry

ISIC	Industry	Tariff Lines	Simple Average	Dispersion
11	Agriculture	310	17.7	49
12	Forestry and Logging	31	15.5	61
13	Fishing	91	23.6	15
21	Coal Mining	6	15.0	0
22	Crude Petroleum and Natural Gas Production	8	13.8	26
23	Metal Ore Mining	23	5.0	0
29	Other Mining	82	7.0	81
31	Manufactured Food, Beverages and Tobacco	457	20.1	38
32	Textile, Apparel, and Leather	982	19.1	33
33	Manufactured Wood Products	83	23.1	17
34	Paper, Printing and Publishing	167	12.9	74
35	Manufactured Chemicals, Petroleum, Coal, Rubber, Plastics	1,642	8.4	116
36	Manufactured Non-metallic minerals (except petroleum)	160	14.6	43
37	Basic Metal Industries	387	7.4	105
38	Manufactured Metal Products, Machinery and Equipment	1,474	12.6	68
39	Other Manufacturing	178	21.5	23
41	Electricity, Gas, and Steam	1	15.0	0
99	Other Industries (excludes HS99)	24	9.4	117
	All Industries	6,106	13.5	71

Source: Mission team's calculations using 2003 tariff schedule submitted to UNCTAD.

The tariff system shows strong escalation – higher tariff rates on goods as the degree of processing increases. This tends to increase the effective rate of protection on final goods well above their nominal tariff rate, which in turn introduces strong bias against exports in these activities. A medium term priority for Zambia would be to introduce greater uniformity in tariff rates across industries. One should start by reducing the highest tariff rates first—those in the light manufacturing industries, fishing, and agriculture.

All quantitative restrictions (QR) are eliminated. Zambia does not exercise licensing requirements on imports, save for a short negative list. Import controls are maintained only for environmental, health, and security reasons.

Zambia also collects a 17.5 percent VAT on goods and services, and excise duties on selected products whether imported or domestically produced. Exports of goods and services are zero-rated. The Ministry of Finance is responsible for tariff setting policy. The tariffs are administered by the Zambian Revenue Authority (ZRA). Customs duties constitute about 12 percent of Zambia's tax revenue. Duty exemptions apply to a limited number of selected goods and beneficiaries.

Zambia's current tariff schedule lumps together capital goods with raw materials and then taxes imports at five percent while others in the combined category enter duty free. Duties on capital goods raise the prices of such goods, discouraging investment and exports, and, thereby adversely affecting growth in production and employment. Government can remove this barrier to investment and trade by export incentives and special exemption schemes, but these measures will only partially eradicate this constraint at a high cost. The reasons are as follows: the administration of a duty drawback system in the case of capital goods is more difficult, particularly for small companies; special exemptions encourage lobbying and corruption; and companies producing for the domestic market and not benefiting from special exemptions continue to pay import duties. It is, therefore, advisable to set the import tariff rate on capital goods at zero, and allow the companies to access capital goods at world prices.

To compensate for a fall in tariff revenue, alternative sources of revenue need to be identified. However, it is very difficult to estimate the revenue impact of reducing the import duty to zero for all capital goods for several reasons.[17] First, capital goods and raw materials are lumped together and taxed at five percent and zero percent. Second, capital goods imported from FTA and PTA partners enter duty free. Finally, revenue loss critically depends on the definition of a capital good. The definition of Zambia's tariff schedule is very narrow. If broader COMESA or UN definitions are used, some capital goods fall into the 15-25 percent tariff bands. Considering that between 38 and 67 percent of imported capital goods, depending on how one classifies capital goods, are imported from FTA and PTA partners, the revenue impact of eliminating the five percent band would not be significant.

In November 2004, the Customs and Excise Act and the Import Control Acts were amended to allow for safeguard measures to be applied. The MCTI arranged for a training program to facilitate their capacity to effectively apply safeguards, however, additional training is required. The amendments were drafted with the objective of ensuring compatibility with the WTO, COMESA and SADC Agreements, and to address the concerns of the private sector. The private sector has been particularly concerned about unfair competition and cases of predatory pricing. In the past twelve months, the Zambian Association of Manufacturers expressed its concerns about the export incentives available to South African exporters and called for a level playing field. The PRSP also refers to the need to ensure against-intra regional unfair competition.

Policies directly affecting exports

Zambia does not have general licensing requirements for exports, but certain goods such as fertilizers, live animals, gemstones, and fire arms require export permits. Export prohibition exists only for certain logs under international agreements, and occasionally for grains during the drought years.

Zambia has three incentive programs to overcome anti-export bias inherent in its import regime: the duty drawback system, manufacturing under bond, and export processing zones (EPZs).

Duty drawback system

A duty drawback system reimburses exporters for the customs duties and other taxes paid on imported inputs, thus giving the producer access to inputs at world prices. Under this incentive program, an exporter first registers with ZRA and calculates input-output coefficients showing the

[17] For a detailed discussion see "Notes on Tariff Revenue from Capital Goods Imports for Zambia DTIS" by Philip Schuler and Takako Ikezuki.

total duties (both customs and excise) it pays to produce a unit of final output, whether it pays these directly or indirectly, and in cases where it buys inputs imported by third parties. The firm pays customs duties as usual when it imports its inputs. Each time it exports a finished product, the company submits a claim to ZRA for reimbursement of the total duties it estimates it has paid on all inputs used to produce that shipment. ZRA reviews the claim and issues a reimbursement.

Exporters can also claim refunds for a portion of their spending on domestically produced inputs. Since import tariffs affect the domestic price of all tradable goods, not just those articles that are imported from abroad, Zambia's duty drawback provision attempts to compensate exporters for the higher domestic prices they pay for locally sourced goods as a consequence of the import tariff[18].

Exporters routinely complain about the delays in receiving reimbursements of import duties and VAT. Some exporters suggest that reimbursements take 3 months at a minimum. Some report that delays of 6–9 months are common.

There are two types of weaknesses in implementation of the duty drawback system. The first has to do with the exporters' computation of input-output coefficients. Computing this requires detailed and comprehensive cost accounting information, which may be difficult to obtain if the firm is a new producer or so small that it cannot afford accounting services. Some companies also report that they spend a considerable amount of time bargaining with ZRA over the coefficients that they arrive at. A senior accounting official at a large exporter reported spending several months of staff time to work out input-output coefficients with ZRA. An accounting official at another large exporter acknowledged that the investment of staff time needed to establish input-output coefficients would be prohibitive for small firms. Finally, as prices fluctuate, these coefficients must be recomputed.

The second weakness in Zambia's duty drawback system, as in many other countries, is in the government's ability to manage its cash flow so that it has money on hand to pay duty drawback claims as goods leave the country. Government officials report that a new system was developed in 2003 to address this funding problem. Customs receipts are sequestered until ZRA meets its revenue collection targets, after which time duties are refunded and money can be transferred to the general revenue pool. This system is supposed to ensure that new duties collected do not go into the general treasury until duty drawbacks have been paid. Data on reimbursements from 2001 through 2004 suggest that the 2003 reforms may have helped: the ZRA's average monthly disbursement doubled from 2001–2002 to 2003–2004.[19] In the absence of data on monthly allocations from the Ministry of Finance to ZRA and data on duty drawback requests, these data are only suggestive and not conclusive.

Government officials attribute the delays in part to problems they uncover when verifying duty drawback applications. Many applications are based on incorrect coefficients or contain outdated supporting documents. These problems appear primarily in applications submitted by smaller

[18] Some exporters complain that the usefulness of the duty drawback program has declined with implementation of the COMESA free trade area, since the government uses the preferential tariff rate to determine the size of the deemed duty drawback.

[19] Based on ZRA data, around 900 million kwachas were paid on average in 2001 and 2002; this jumped to 2.4 billion in 2003 and 1.95 billion in 2004. All figures are based on averages of payments made between January–July.

exporters. In the past year, ZRA has stepped up its extension work to educate exporters about procedures.

The problem of delays in refunding VAT payments on inputs, whether imported or domestically supplied, is well-known. There is no evidence to suggest that delays are systematically biased according to firms' participation in the international economy—delays are apparently neither longer nor shorter if a firm imports its inputs or exports its output, than firms buying or selling solely in the domestic economy. Slow refunds therefore do not act as a hidden import tax. Nevertheless, they do act as a barrier to international integration by reducing the competitiveness of Zambian firms relative to firms in other countries, increasing the costs of investing in Zambia, and discouraging firms from operating in the official economy.

Manufacturing under bond

This facility is not widely used in Zambia, though not uncommon in other countries. Imported inputs are kept under bond until used in the production of the good to be exported, and the producer only pays customs duties on the inputs if the final product is sold on the domestic market instead of being exported. The advantage of this scheme over a duty drawback system is that exporters do not first pay duties and then wait for reimbursement. Furthermore they do not need to devote staff time to computing input-output coefficients. On the other hand, the producer does incur the cost of paying a bond. But this cost is very small in practice. A manufacturing under bond system decentralizes the clearance process: instead of clearing goods at the border, customs officials or clearing agents clear goods at each bonded warehouse. The government should encourage the use of this system, especially by established companies.

Zambia operates another bond system, known as Removal in Bond. This is not designed specifically to mitigate the anti-export bias. Under this program, a company places newly imported products into a bonded warehouse and pays customs duties only when removed from bond. This delays payment of customs duties until the imported product is used.

The ZRA proposes to discontinue the bonded warehouse facility, because it appears to have been abused, with bonded goods leaking into the domestic market. The management of bonded warehouses needs to be improved. Effective enforcement of the existing rules and regulations governing transit trade and bonded warehouses is more appropriate than removing the RIB facility.

Export processing zone program

The EPZ Act which was passed in November 2001, established the Zambia Export Processing Zone Authority (ZEPRA). ZEPRA became operational in January 2003, but the Cabinet suspended the EPZ program in order to review its revenue impact. Over the past twelve months a Technical Committee has undertaken a study to re-evaluate the program in terms of: the eligibility criteria and list of sectors that may be awarded EPZ status; the tax incentives granted to exporters under the general tax regime compared to those available in the EPZ framework; the types of EPZ organization structures to follow; and a comparison of the incentive packages proposed under EPZ programs within Eastern and Southern Africa.

In November 2004, a revised EPZ Act was tabled to the Cabinet. Once the amendments have been enacted the EPZ Program is expected to resume.

The existing program allows for stand-alone EPZs and industrial parks. The facilities will be open to both foreign and domestic companies, as long as they meet a minimum export threshold of 80 percent. Three main types of activities are eligible: agriculture, agro-processing and manufacturing. The EPZA offers a range of specific tax exemptions including: corporate tax for 15 years from the date of first sale; withholding tax on dividends and tax on interest or royalties; capital gains tax; duty on imported raw materials, plant and machinery, intermediate and capital goods and services; value added tax on imports and on inputs purchased from Zambia; and excise duty.

In addition, Zambia offers a range of procedural incentives to all investors. These include an absence of minimum investment requirements, no restrictions on investments by foreigners, no exchange controls, on site customs documentation and inspections, and facilitation and after care support by the ZEPTA.

The EPZ is a tool to help stimulate, increase, and encourage non-traditional exports and investment in the country. Critical factors for success will be strong political will and private sector support. A block of almost two years on implementation of the EPZA has taken its toll on private sector confidence in the government's ability to design and implement strategic trade and investment policies. Effective implementation of the EPZA in parallel with the reform of Zambia's Investment Laws will send a positive signal that Zambia is open for business.

In order to build confidence, the new ZEPRA policies, regulations and guidelines should ensure that approvals and monitoring processes are transparent and effectively eliminate the role of discretionary decision-making. This requires:

- Defining within the regulations the types of industries and sub-sectors permitted in the EPZ (the proposal extends the list to include services, however, moving to a short negative list would be preferable);
- Setting down precise and transparent criteria for evaluating new investments;
- Establishing the parameters and qualifying criteria for existing investment;
- Developing criteria for determining and evaluating export ratios;
- Defining minimum standards for EPZ development; and
- Preparing a regulatory framework for private sector industrial parks.

Based on interviews with ZEPRA (November 2004), the regulations and guidelines for evaluating projects has not been developed. The revised Act is intended to attract investment while minimizing foregone revenue. While the intent is clear, the specific changes proposed to the Act use rather vague language and lend themselves to discretionary interpretations. This needs to be rectified, as a matter of priority, and a comprehensive, detailed set of regulations must be prepared and adopted (an assessment of the Act is contained in the separate report on the EPZ). Statutory instructions are important since they are effectively an implementation tool. To date ZEPZA has not produced instructions to supplement the EPZ Act and this leaves too many opportunities for discretionary implementation.

It is necessary to prepare detailed regulations that will guide the investor step by step through the process and remove uncertainty. The regulation should include detailed evaluation criteria explaining how the application will be assessed. Over time, the ZEPZA should also develop additional instructions for:

- Streamlined and transparent customs procedures specific to the EPZs as per section 6(2) in the EPZ Act;
- The minimum development/construction standards when designing a larger scale EPZ project;
- Health, environmental, and safety guidelines within the EPZ, and
- Employment responsibilities of EPZ developers and operators.

In order to develop an appropriate, transparent regulatory framework including the standard operating procedures in support of the EPZ Act the Zambia EPZ program will require short term technical assistance.

CUSTOMS ADMINISTRATION

The customs and excise department of the Zambia Revenue Authority (ZRA) is responsible for all customs-related issues. The ZRA is an autonomous body established by an Act of Parliament in 1993. It has 645 employees of which 200 are support staff. The customs & excise department is responsible under the Customs and Excise Act for: collecting customs and excise duties, licensing and management of registered excise manufacturers, licensing and control of bonded warehouses, regulation and control of imports and exports, facilitation of trade, travel and movement of goods, carrying out controls on behalf of other government ministries, provision of trade statistics and the protection of society.

The Customs and Excise Department (C&ED) maintains 31 border posts, 7 inland ports and the Head Office through which goods must be cleared. Chirundu, 140 km south-east of Lusaka, is the most important border crossing, accounting for approximately 80 of total road haulage to and from Zambia.

Over the past decade Zambia has pursued a policy of modernizing its customs procedures through introducing risk assessment, adopting the WTO customs valuation agreement, and active participation in regional programs of customs cooperation and harmonization. Notwithstanding significant improvements, customs procedures remain a constraint to increasing exports. There are problems with long clearance times, inadequate information sharing between all the border control agencies, unnecessarily complicated procedures requiring redundant information, and inadequate use of risk assessment to reduce the proportion of goods being inspected. The private sector complains of excessive checking, physical inspection and redundant control procedures. These explain the long border clearance delays that result in higher costs and increased uncertainty. They also create incentives for corruption.

The C&ED at ZRA adopted AYSCUDA++, which provides for streamlined customs clearance procedures. AYSCUDA ++ also has a risk module that suggests a particular risk profile for each shipment: green-no inspection, yellow-inspection of documents, blue-post audit, red-physical and document inspections. However, this risk module does not appear to work properly. The mission was unable to ascertain whether Zambia has made full use of all ASYCUDA's functionalities, including manifest management, transit, warehousing, and manufacturing under bond.

While ZRA began to implement the WTO/GATT method of valuation in 2000, interviews with Customs Officials indicate that all the transaction values are checked using a central database of identical/similar goods. When values are disputed, which one respondent said could happen as many as 10 percent of total import transactions, customs release the goods but request that the disputed amount be paid, pending finalization of the dispute. There are particular problems with the valuation of secondhand clothing and the veracity of invoices of small traders.

Import clearance

All imported goods must be cleared at the point of entry through approved customs-clearing agents unless the importer is authorized by ZRA to self-clear. To clear merchandise through customs, an importer must provide the Customs Declaration Form, along with the usual commercial documents such as the bill of lading, airway bill, and commercial invoice. Most goods are cleared at the border using the CE 20, which is the standard form for entry and exit and is designed to classify the goods according to the HS code and to compute the customs charges. After payment of a processing fee of K32,760 ($7) the CE 20 is prepared for electronic submission on behalf of the importer by Necor, a private agency. Customs then assigns the tariff classification, values the goods, computes the duties, and based on a risk assessment, assigns the cargo to the green, yellow, or red line. Only the red line is supposed to undergo systematic physical inspection. At the end of this process, Customs issues an invoice. Upon payment of the invoice, Customs issues a release order. ZRA reported that there had been a major improvement in clearance times over the past five years. Subject to documents being in order, the ZRA states that clearance can be achieved within 8 hours for major clients who use credit account facilities to pay their taxes, although a random check at the Chirundu border (during the fieldwork for the DTIS) revealed waiting times of 2-4 days.

Certain agricultural goods require an import permit and a sanitary and phytosanitary (SPS) certificate prior to the order being confirmed with the exporter. For imports requiring an SPS certificate, the certificate must be obtained in advance and included in the shipment documentation. When the consignment arrives at the port of entry, the SPS certificate is examined by the plant inspector stationed at the border. The inspector may test samples before allowing the products to be released for entry into Zambia. The SPS certificates are valid for one month, frequently this is insufficient and importers need to obtain an extension, which can only be obtained in Lusaka.

Export procedures

Export documentation has been streamlined and requires an exporter to obtain the Export Document Form (CE 20 in six copies) from a commercial bank, which endorses it to confirm the availability of funds (through either a letter of credit or actual payment). The endorsed document is then taken to ZRA with the commercial invoice and shipping documents attached. These documents need to be endorsed by ZRA prior to the goods leaving a border post. The border post requires one copy of the documents prior to the goods being processed through the border. Since the introduction of ASYCUDA++ this is implemented electronically through the Wide Area Network between Lusaka and Chirundu. The ZRA carries out inspections on exports as a check against the smuggling of proscribed goods, and to obtain the information for VAT refunds and duty drawbacks.

Customs clearance times

Notwithstanding the improvements in customs clearance times over the past five years, there is substantial evidence from the private sector that customs procedures continue to represent a serious administrative hurdle. Interviews with the C&ED and private firms, including a consultant who liaises with ZRA on behalf of private clients, have indicated that delays and clearance times remain slow. Traders requiring permits indicated that they spend between 3 to 10 hours in the customs offices. This appears to reflect personnel and capacity constraints rather than the intent of policy. When the process was computerized, the effect was to add another layer rather than to reduce the number of steps required. The time taken for inspection is generally one day. If the goods are not selected for inspection, and the paperwork is in order, ZRA claims the goods can be exported within a few hours. Unfortunately, border delays are still common at Chirundu where traders report delays of between 2-4 days for trucks. At Lusaka airport, shipment clearance may take up to 4 days.

Bonded warehouse and removal of goods in bond

Zambia authorizes the use of bonded warehouses and permits the Removal of Goods in Bond (RIB). RIB allows goods to enter Zambia without the payment of duties. The goods may remain in the country for 30 days without the payment of taxes, after which time, taxes are paid, or goods are assigned to a bonded warehouse. Goods may remain in the bonded warehouse for up to two years without tax payment. The bonded warehouse facility appears to have been abused, with bonded goods leaking into the domestic market. The management of bonded warehouses needs to be improved. Effective enforcement of the existing rules and regulations governing transit trade and bonded warehouses is more appropriate than removing the RIB facility.

Licensing of customs agents

The ZRA has licensed 208 clearing agents and 154 bonded warehouses. Most of these warehouses are very small and lack proper facilities. Zambia should apply stricter entry requirements for licensing clearing agents. Establishing stricter entry requirements would assist with monitoring and reduce the risk of widespread abuse.

Transit trade

The time limit for transit trade of five days is not always sufficient for goods to transit through the country using the rail system. For examples, raw copper from DRC to South Africa has experienced some difficulties in meeting the five day transit requirement.

Special import regimes

The administration of the duty drawback scheme is addressed in the chapter on Trade Policy. The mission was unable to obtain detailed information from the ZRA on time taken to reimburse exporters, however, discussions with the private sector revealed dissatisfaction with the delays and with the onerous administrative requirements.

Recommendations

It is recommended that Zambia implement the following:

- Identify reasons for clearance delays and define a plan for reducing clearance times. ZRA should undertake a cargo release-time study that clearly documents the time required for processing documentation and releasing goods to the importer. This can be undertaken for all the major entry points with the results being published and updated annually. This would serve as a useful indicator for monitoring progress in trade facilitation. Shared with the private sector, this would allow a beneficial dialogue and a joint search for a solution;
- Request AYSCUDA (UNCTAD) staff to review the extent to which all the modules (transit, risk, statistics, MIS, special regimes) are used;
- Examine the reasons why bonded goods appear to 'leak' into the domestic market and take appropriate actions;
- Introduce and further develop electronic data interchange between Customs and Excise and other border agencies;
- Encourage ZRA and other agencies involved in border crossing to co-ordinate between themselves and with the respective authorities of neighboring countries to facilitate border clearance procedures;
- Assess the progress and commitment to one-stop shop procedures, the progress towards joint border posts;
- Strengthen the training unit within ZRA. Currently, training is provided under donor projects including the DFID Revenue Institutions in Zambia Enhanced Support project (RIZES). Upgrading the quality of personnel is an ongoing task and needs to be integrated into the ZRA structure;
- Increase the availability of Customs staff to facilitate export inland clearance procedures;
- Review transit policies and procedures;
- Revisit the procedures for duty drawback, including the calculation of the refund rate, control mechanisms and the availability of funds to finance refunds. Consider allowing ZRA to be liable for penalty interest payments to traders after a clear cut off date;
- Strengthen public-private dialogue through establishing a trade facilitation sub- committee as part of the National Working Group on Trade. Ensure that changes in customs rules and procedures are discussed and introduced in a transparent manner;
- Establish clear and publicly available effectiveness and efficiency performance indicators for trade facilitation. While data relating to tax collection is readily available, information on payment delays, contested claims, identified violations, imports receiving exemptions, trade volume per number of staff, and measurements related to the cost of applying customs procedures, are not readily available.

TRANSPORT

Zambia is surrounded by eight countries and faces long routes to international ports in South Africa, Tanzania and Mozambique. Transport costs and the quality of infrastructure are important determinants of international competitiveness with transport costs representing a greater barrier to export markets than import tariffs. Breaking a journey into an overland and a sea component raises transport costs considerably. Improving efficiency throughout the logistics chain is central to augmenting exports and sourcing more competitively priced imports. As a landlocked country, improvements in port efficiency in neighboring countries (Durban, Dar es Salaam and Beira) would directly benefit Zambia. Zambia stands to gain from regional initiatives in transport infrastructure and regulation and efficiently managed border crossings. Some of the new non-traditional exports are air freighted to Europe.

Physical infrastructure, traffic flows and transport costs

Historically, the physical transport infrastructure – roads, railways – was developed to link Lusaka and the Copper belt with the main north-south routes. Non-traditional agricultural exports are primarily concentrated within a 100 mile radius of Lusaka. The recent expansion of tobacco production is located close to Lusaka and along the transit route to Malawi. The dearth of good access roads throughout Zambia continues to constrain smallholder participation in the production of high value cash crops such as baby vegetables and cut flowers. ZEGA cites the inadequacy, unreliability and the high cost of transport as the major impediment to sustained high growth. Most of the horticulture exports are air freighted from Lusaka, with road transport being used mainly for vegetable exports to South Africa and the DRC.

Zambia's road network of approximately 37,000 km includes 6,476 km of bitumen road surfaced to Class 1 standard, 8,478 km of gravel roads and 21,967 km of dirt (i.e. earth) roads. There are a further 30,000 km of tracks and trails that, while they are used by large numbers of the population, are not officially registered and are, therefore, not eligible for public funds, The bulk of the formal road network was constructed during the first decade after Independence, and owing to the lack of adequate maintenance through to the mid 1990's, gradually deteriorated. The main problems with the road network include the existence of potholes, and the condition of the dirt roads. Apart from the paved roads that await rehabilitation, road quality is adversely affected by the failure to prevent systematic overloading of trucks. The dirt roads are vulnerable to the weather and frequently become impassable during part of the rainy season, which holds back the further development of commercial agriculture.

The Road Sector Investment Program (ROADSIP), partly funded under IDA credits, is a 10-year initiative (1997-2007) to rehabilitate and maintain half of the formal road network. Routine road maintenance is funded by the Road Fund, which is financed by a levy of $0.03 per liter of fuel and is allocated on a fixed percentage basis to urban roads (20 percent), feeder roads (40 percent) and trunk and main roads (40 percent).

The Zambian railway network consists of Zambia Railways Limited (ZRL) and the Tanzania-Zambia Railway system (TAZARA). It is important to integrate the two separate rail systems in order to increase speed and reliability. ZRL has a total single track of 1,266 km and runs from the border with Zimbabwe at Livingstone to the border with DRC, with branch lines to the Copper belt, which has granted a concession to the Railways Systems of Zambia (RSZ) for 20 years at $1.5 million per annum. ZRL is committed to rehabilitating the existing network and rolling stock: once completed the average speed will increase by 67 percent to 70-80 km/hour. TAZARA owned jointly by both Governments, is 1,700 km and runs from Dar-es-Salaam to Kapiri-Mposhi where it connects to the ZRL system.

Zambia has one inland port at Mpulungu on Lake Tanganyika, which serves the three neighboring countries- Tanzania, DRC and Burundi. Mpulungu Harbor Management Limited (MHML) was granted a concession to operate the harbor in September 2000 and is currently operating at a capacity of 70,000 tons per year. The air transport sector is not well developed although there are some local private airlines. There are 144 airports/aerodromes in Zambia, but only four major airports –Lusaka, Ndola, Livingstone, and Mfuwe –all operated by the National Airports Corporation.

The total volume of foreign trade and transit traffic was 3.5 million tons in 2002, with road and railways accounting for 60 and 40 percent respectively. In South Africa, 75 percent of long haul freight is transported by road. The volume of trade by corridors and mode of transport is shown in Table 3.4. With improved transport links Zambia has the potential to serve as a regional distribution center with the North-South transport corridor linking DRC with South Africa and Tanzania, and in the future integrating with Angola. The link to Beira in northern Mozambique is still not being used because of the quality of the access roads in Mozambique and inefficient operations in the Port of Beira. The two major corridors are the Copper belt Lusaka-Johannesburg-Durban via Chirundu and Livingstone, and the Lusaka-Copper belt Kapiri-Mposhi-Dar-es-Salaam.

Table 3.4. Transport volume in tons (2002)

	Road	Railway	Total
Copper belt/Lusaka – Chirundu	1,000,000	0	1,000,000
Copper belt/Lusaka – Livingstone	500,000	1,000,000	1,500,000
Copperbelt/Lusaka – Kazungula	200,000	0	200,000
Copperbelt/Lusaka – Dar-es-Salam	300,000	400,000	700,000
Other	100,000	0	100,000
Total	2,100,000	1,400,000	3,500,000

Source: Rene Meeuws, Zambia: Trade and Transportation Facilitation Audit, 2004.

South African and Zimbabwean truckers dominate international road transport to, from and through Zambia. The long trip times, eight to ten days to travel from Durban to Lusaka, the absence of standardized documents, and the difficulty of entering an established market, all serve as barriers to entry for Zambian truckers to the cross border transport market.

Rail transport from the Copper belt to South Africa costs $75 per ton. The imbalance in freight flows between South Africa and Zambia result in south bound haulage costing 60 percent of the rate of north bound transport. Depending on the size of the south bound transport, the cost varies from $112 per ton to $100 per ton for 13 tons and 36 tons, respectively. Mixed loads cost more, in some cases they can be significantly more because of the delays for checking at the border post. The lengthy trip times require firms to maintain relatively large inventories in order to guarantee production continuity.

Virtually all of the fresh vegetables and cut flowers are air freighted to international markets. There is a lack of guaranteed and reliable air cargo capacity. The volume of air cargo handled through Lusaka airport has been stagnant at around 15,000 tons per annum since 1997. ZEGA charters air cargo planes for the shipments to Europe: the major farms such as York and Borassus reserve space on these planes. There is a concern that the existing service providers occasionally divert capacity at short notice to transport more lucrative cargo. Air freight exports at 250 metric tons a week are five times the size of imports. This imbalance results in exports incurring a higher charge in order to cover the unutilized space. Air freight rates are extremely high at $1.55 -1.60 kg for vegetables and $1.70 for flower exports during the high season (October-April) and $1.45-1.55 and $1.60 during the low reason respectively. For Borassus, the freight rate for vegetables represents 43 percent of the FOB value landed in the UK.

The further development of the horticulture industry requires more reliable, higher frequency and reduced air freight rates. However, obtaining the services of a dedicated air carrier requires much larger volumes of cargo.

Transport policy

The recently published national Transport Policy (2002) seeks to clarify the role of government and the private sector in the provision of transport services. After a decade of liberalization the private sector is responsible for delivering road and air transport services, with the government establishing the enabling environment. The Transport Policy recognizes the need for further regulatory reform for air transport, specifically liberalizing the procedures for permitting foreign owned air carriers to have landing rights. The ZBF has requested the government to improve the procedures for obtaining an Air Service Permit. The rail sector continues to lack a clear policy on the role of private sector participation in railway infrastructure, signaling and communications systems and operations. The liberalized road transport sector continues to conflate passenger and freight transport. It is good practice to separate passenger and freight since different criteria are required. The Road Traffic Act, which is administered by the Road Transport and Safety Agency, includes requirements on wages and pricing policy – these should be left to the operators. The Transport Policy argues that measures should be introduced to ensure a balanced distribution of transport services. This could lend itself to some form of restrictive licensing and be used to limit competition.

Reliable and cost effective transport requires Zambia to engage in international transport agreements. Zambia is an active participant in international agreements in the transport sector. The most important are the SADC Protocol on Transport, Communications and Meteorology, and Chapter 11 of the COMESA Treaty on Cooperation in the Development of Transport and Communications. Zambia is also a signatory to bilateral Road Transport Agreements with South Africa, Zimbabwe, Malawi, Tanzania and Namibia, which deal with market access.

Zambia is implementing the road transport facilitation programs under SADC and COMESA[20]. These include the harmonized road transit charges (10 USD per 100 km); the maximum axle load limits; the maximum length of the commercial vehicle (22.0 m.); the COMESA carrier license; the COMESA Transit Plates; and the use of the High Frequency X-border Land Mobile Radio Communications System[21].

The SADC Protocol [22] encourages Member States to conclude appropriate bilateral agreements based on non-discrimination, reciprocity and extra-territorial jurisdiction, on the path to realizing

[20] Except for overload control.

[21] Report of the Seventh Meeting of the Transport and Communications Committee; COMESA, February, 2003.

[22] The SADC Protocol on Transport, Communications and Trade states that this liberalization may go through three stages: "Member States shall introduce the following liberalization phases: Phase 1 Abolition of restrictions on carriers of two Member States to carry goods on a defined route between – (1) Member State: Provided that such transit traffic may only be undertaken if the carrier's vehicle traverses the territory of its home state. Phase 2: Abolition of restrictions on carriers of one Member State to carry goods on a defined route between another Member State and a third Member State or non-Member State, irrespective of whether the carrier's

fully liberalized access to the regional road transport market. The agreements between Zambia and Zimbabwe and South Africa include the use of the Single Permit System[23]. The Protocol remains to be fully implemented and further harmonization is required to reduce the impediments to cross border transport services[24].

The creation of an international level playing field for international road transport operations is important. The SADC Protocol on Transport is an important guideline, yet serious regulatory constraints remain. These include:

- South Africa does not permit Zambian transporters to uplift cargo from third countries that is destined for Zambia.
- South Africa/Zimbabwe/Botswana require Zambian transporters to pay Commercial Vehicle Guarantee fees.
- The DRC requires Zambian transporters to pay visa and tourism fees.

Recommendations

The recommendations include the upgrading of transport infrastructure, strengthening the public-private dialogue and improving transport policy. Upgrading transport infrastructure would benefit from:

- Introducing new public-private partnerships for financing investments;
- Promoting and facilitating the building and operation of (dry) ports and intermodal terminals;
- Encouraging additional investment in border crossing infrastructure to include banking and financing services and improved telecommunications;
- Providing training to transport operators, providers of logistics services, forwarders and terminal operators;

Strengthening the quality of public-private dialogue requires:

- Enhancing technical capacity at the Ministry of Transport to enable it to more effectively monitor transport performance, transit and border crossings;
- Establishing and appointing an Independent Ombudsman (appeal) to address complaints and infringement of the rules and regulations;
- Continuing regular independent audits.

The reform of transport policy should address the following:

- Transpose international transport and trade agreements (COMESA/SADC) to national legislation;

---

vehicle traverses the territory of its home state; and Phase 3: Abolition of restrictions on carriers of one Member State to carry goods between another Member State and a third Member State or a non-Member State."

[23] The Single Permit System standardizes the permit required by the road transport operator needs to carry load through and to other countries.

[24]These include the acceptance of a credit card type of standardized travel document for professional drivers and trailers. General Agreement on Trade in Services; Transport Sector; Report for Zambia Business Forum; George Lewis; May 2004.

- Ensuring mechanism and resources (staffing) are in place to implement and enforce the rules and regulations;
- Establish a transport information system to monitor developments in the transport sector;
- Develop a transit strategy.

QUALITY AND SAFETY STANDARDS

As an emerging exporter of cut flowers, fresh vegetables and other agricultural related products Zambia is required to meet the food safety and agricultural health standards in the major markets. Meeting quality standards presents challenges to the whole supply chain from the sourcing of inputs through to the delivery of the finished product. The supplier must be able to prove conformity with the requirements of the market and technical regulations. The standards infrastructure in Zambia is dominated by the public sector and offers a poor service to traders. Ensuring compliance and increasing awareness of the importance of standards is a trade issue and needs to be incorporated into the trade agenda. The WTO SPS and Technical Barriers to Trade (TBT) Agreements provide the framework for minimizing the trade distorting effects of mandatory technical regulations through establishing clear and transparent principles. Effective implementation of these Agreements remains a challenge.

The continued diversification of horticulture and other high value agricultural exports requires a regulatory structure that recognizes the role of commercial testing facilities and encourages accreditation by foreign accrediting bodies. This will obviate the need for duplicate testing, reduce the risk of rejection in foreign markets and provide a spur to increased quality. Public sector institutions should focus on setting and enforcing standards, and ensuring the dissemination of information. Technical assistance is required to assist Zambia to reform it regulatory framework and to effectively implement the WTO TBT and SPS Agreements.

WTO compliance

The WTO Agreements on SPS and TBT seek to establish a framework for minimizing the trade distorting aspects of compulsory standards, through requiring members to apply the principles of transparency, most favored nation and national treatment. In 1997, Zambia notified the Zambia Bureau of Standards (ZBS) as the WTO Enquiry Point, but has not formally notified the technical regulations in place in accordance with Article 15.2 of the TBT Agreement.

Little or no consultation takes place at the national level before WTO TBT meetings. There is also no effective mechanism to provide feedback to the various stakeholders, including the MCTI and the industry itself. Given capacity considerations, Zambia may consider supporting a regional mechanism for effective SADC-wide participation in the WTO/TBT committee meetings.

The Enquiry Point is required to notify the WTO whenever Zambia contemplates the introduction of new or revised technical regulations. No personnel have been dedicated exclusively to the Enquiry Point. The ZBS has no specific budget line item to ensure that the Enquiry Point activities are appropriately funded on a sustainable basis. An effective enquiry point requires the following:

adequate financing, communication equipment and trained personnel;[25] a mechanism to facilitate technical regulation notifications from all the relevant Ministries and/or Regulators to the WTO Secretariat; a process to evaluate notifications from other WTO Member States to identify issues relevant to its own industry, disseminate the information to the relevant stakeholders, and facilitate the preparation of a national response to the WTO/TBT Technical Committee.

Standards infrastructure

The standards infrastructure in Zambia continues to be driven largely by state intervention and public sector control. While the ZBS is the main government body responsible for setting, reviewing, monitoring and implementing technical standards for all industries including agriculture, the Food and Drug Agency (FDA) and the Ministry of Agriculture also set standards and are not required to notify the ZBS. Regulatory fragmentation, in conjunction with a dearth of clearly defined boundaries between the three standard setting bodies, needs to be addressed. The ZBS does not have a comprehensive database of existing standards scattered across a wide range of legal instruments. The MCTI is also involved through chairing the National Food Safety Committee which brings together the FDA and the ZBS.

The ZBS does not provide testing and certification services, these are provided by the publicly controlled Food and Drug Laboratory and Mount Makulu Research Station, and by a limited number of private laboratories. All the publicly funded testing agencies are located around Lusaka, are short staffed and face severe cash flow constraints. ZEGA facilitates commercial inspection services by training and financially supporting agricultural inspection officers from Mount Makulu to be based at Lusaka airport to undertake insect and disease inspections on plant exports. A second inspection is carried out on Zambian exports by the national phytosanitary services of the importing country at the point of entry. This duplicate testing imposes an additional cost on exporters.

Technical and resource constraints prevent ZBS from offering internationally recognized accreditation services. ZBS continues to request funding from the government and donors to construct new laboratory testing facilities. In 2001 a study[26] cautioned against assisting ZBS to develop certification and testing services, recommending increasing the role of private laboratories for testing and certification. This conclusion remains valid. ZBS continues to try and engage in all aspects of the standards rather than focusing on the core areas of setting standards and acting as the official Enquiry Point.

Improvements in the standards infrastructure would reduce the costs of testing and accreditation, shorten delivery time and assist with quality improvements. Removing the need for a second inspection at the point of entry requires the inspection services in Zambia to be accredited by the appropriate authorities in the importing country. Currently, no laboratory in Zambia is accredited by an internationally recognized body for horticulture testing[27]. The typical accreditation body provides a range of services including accreditation, annual auditing, advice and training. The market for accreditation services in Zambia is unlikely to support a stand-alone accreditation

[25] Some training has been offered and computer equipment supplied within the context of UNCTAD/ITC/WTO program of assistance.
[26] James W. Fox & Donald E. Greenberg (2001), How Zambia Can Achieve Export-Led Economic Growth.
[27] South Africa has about 150 accredited testing laboratories.

agency[28]. In many countries the national standards body is the accrediting organization, however, in Zambia this would require a large annual government subsidy. Zambia has looked to SADC to develop a regional accreditation body as part of the SADC Committee for Accreditation under the SADC Standards, Quality Assurance, Accreditation and Metrology (SQAM) Memorandum of Understanding. Unfortunately, progress on establishing a regional accreditation body is unlikely in the short term.

Zambia should aim to get its laboratories recognized by an accrediting authority in another country: this could include South Africa or an EU country. The main international accreditation bodies[29] have established procedures for cross-frontier accreditation. Zambia's demands are currently in testing laboratories where the recognition procedures are relatively straightforward. The South African National Accreditation Service (SANAS) recognizes that accrediting laboratories outside South Africa supports their vision of collaborating within the SADC framework.

The testing industry for horticulture in Zambia is poorly developed and based on public sector institutions that are unable to provide efficient and internationally accredited services. Increasing public investment in ZBS will not be sustainable and will continue to impose costs on the private sector by crowding out the emergence of private sector providers. Encouraging private sector investment requires the government to streamline the standards infrastructure. Currently the government is responsible for setting standards, testing conformity and enforcing compliance. Creating incentives for private sector testing services requires the government to withdraw from the activity. Zambia should establish a medium term goal of clarifying the roles of the public and private sectors through regulating a private market for testing and related services such as certification and training. Encouraging the development of competitive private testing and certification services would serve the private sector more than increasing the testing capabilities of the ZBS. This will require the government to commercialize the testing facilities in Mount Makulu, the Food and Drug Laboratory and other public laboratories. This is consistent with redefining the role of the public service to create the enabling environment for a market based and private sector led economy.

Recommended policy options

Reforms aimed at supporting the continued growth of horticulture exports should aim to boost access to testing services in Zambia; upgrade the quality and range of testing and related quality services such as training and advice; and make internationally recognized testing services available in Zambia at competitive prices. The reform options should be guided by the principal of *commercial sustainability*. This should caution against increasing financing to the public sector testing laboratories since it would not be sustainable. Reliance on regional services, given the slow progress within SADC, does not appear to be a realistic short-term option. Promoting private sector provision of such services should be the preferred option. While there are only a few private labs today, and little competition for price and quality, there seems to be a potential for rapid market

[28] UNIDO (2003) estimates that a financially and technically viable accreditation program requires more than one hundred laboratories and ten certification bodies.

[29] Two organizations, the International Laboratory Accreditation Cooperation (ILAC), and the International Accreditation Forum (IAF), are empowered to recognize accreditation authorities. They have established a world-wide network of national accreditation bodies to ensure that similar standard principles are used to assess the competence of certification and inspections bodies and laboratories.

response to demand. Both public and private laboratories have trained technicians and testing equipment that could be much more productively used under market incentives. Market incentives will increase the responsiveness of Zambian services to changes in international standards, such as the rapid move to EUREPGAP. Two possible approaches to promoting the private sector are discussed:

Increased financing by the private sector under a new regulatory framework that recognizes domestic laboratories along with the privatization of public laboratories. This option has the advantage of explicitly relying on market forces, but is risky because privatization of the laboratories under their existing financial situations and technical capacities will be difficult. Failure could disrupt existing services.

Commercialization of commercial activities of public laboratories, encouragement of third country certification and accreditation of domestic facilities, and step-by-step establishment of a commercial market for testing and assessment services for international and domestic needs. This is the preferred option. Zambia has several facilities in the public and private sectors with some skills and the fundamentals of equipment from which to grow a commercial testing industry. This option can be launched in the short-term with low risk, is consistent with budget constraints and Government policies of commercialization, maximizes the value of existing skills and facilities, and creates the foundation for the emergence of a private testing and certification industry that can mobilize resources for continuing investment and improvement as markets develop.

Implementation and donor support

To implement the recommended commercialization option, the government needs to:

- Develop a multi-year transition plan for commercial laboratory testing, with the end goal of a sustainable, private testing industry.
- Clearly separate the roles of the public and private sectors in setting standards and providing quality control, conformity assessment, and certification services for a growing range of exports. This will require that the government:
    - commercialize the commercial activities of the public laboratories that provide horticulture testing services. Commercialization would permit recruitment and retaining of skilled staff, market-based fees, and expansion of services to meet market needs.
    - Reorganize ZBS to strengthen its capacities to set and enforce standards for domestic markets that converge with regional and international standards, including strengthening the point of enquiry functions of ZBS. Despite the efforts of ZBS and the other standards bodies, grades and standards in the domestic market are poorly developed.
    - Adopt a neutral regulatory regime for the private testing sector that:
        - recognizes commercial testing facilities under the investment code,
        - encourages foreign investment in testing,
        - creates markets for testing services such as through competitive government procurement opportunities,
        - ensures that commercialized public labs operate on commercial principles,

- recognizes domestic private labs for purposes of domestic testing requirements in food safety, and other needs, and
- provides for the national recognition of accreditation by foreign bodies. Already, accredited bodies from other countries are certifying in Zambia. Horticulture produce is now collected in packing sheds that were certified as EUREPGAP compliant by South African authorities, although the costs are high since the certifiers travel from South Africa.

For their part, donors may assist in:

- Financing diagnostic reviews to assess the capacities of existing facilities, and determine the public laboratories skills and equipment investments required for commercial viability;
- Building managerial and technical capacities in public sector testing facilities slated for commercialization so that they move toward commercial viability and respond to market needs within a clearly defined time frame;
- Providing technical assistance for national accreditation bodies to upgrade the skills of the testing laboratories so that they move toward accreditation status;
- Upgrading ZBS capacities to set and enforce standards through training, information and IT resources, and financial assistance for staffing.

BUSINESS ENABLING ENVIRONMENT[30]

Private sector growth requires an enabling environment that encourages investment, risk taking, and innovation. To create such an environment, the government should ensure macroeconomic stability, freedom to enter and exit a business, openness to foreign trade, good quality infrastructure and financial services at a reasonable cost, law and order, and enforcement of contracts. Capital is sensitive to regulatory burdens, and money moves to markets that are relatively investor-friendly.

Despite significant progress made in improving the business environment since the early 1990s, perceptions of the business community of the investment climate in Zambia remain poor. FDI inflows have been declining in recent years, particularly FDI flows towards sectors that have been identified as having high potential for export diversification. FDI inflows as a percentage of GDP increased constantly in the second half of the 1980s, fell drastically in the early 1990s, increased until 1998, but have fallen annually since 1998.

UNCTAD’s Inward FDI Potential Index has placed Zambia near the bottom of its list of countries, and Zambia’s ranking has fallen in recent years unlike other countries in the region.[31] Zambia has

[30] This section draws upon World Bank reports, including the FIAS Administrative Barriers to Investment (March 2004), Zambia CEM (June 2004), Zambia Assessment of the Investment Climate (May 2004); as well as the Progress Report on the Zambia PSD Reform Program (December 2004).

[31] The UNCTAD Inward FDI Potential Index ranks countries according to their potential to attract FDI. Countries are scored on a scale of 0-1; a higher score indicates greater FDI potential. The index is reported on the basis of three-year periods to offset annual fluctuations in the data. Zambia’s rank and score for the following periods among the surveyed countries are: 2000-2002: rank 134, score 0.081; 1999-2001: rank 134, score 0.091; 1998-2000: rank 131, score 0.100; 1997-1999: rank 127, score 0.114. The index for all surveyed countries and information on methodology and survey sources are available at *www.unctad.org*.

fared similarly in the Heritage Foundation's Index of Economic Freedom[32] and Transparency International's Corruption Perception Index.[33]

The government has recently launched a Private Sector Development (PSD) Reform Program, prepared by the MCTI with support from the donor community. The program aims to strengthen the momentum already created for production and export diversification led by the private sector by implementing an Action Plan for enhancing Zambia's business environment and restoring investor confidence. The salient features of this program are outlined below in Table 3.5.

Constraints to productivity and growth in Zambia

A recent Regional Program on Enterprise Development (RPED) survey of approximately 330 manufacturing and services companies identified the following barriers to business: (i) cost of and access to finance; (ii) macroeconomic instability, (iii) tax rates and administration, (iv) regulatory policy uncertainty, (v) crime and corruption, and (vi) infrastructure services. The survey results also showed that these constraints affect both domestic and foreign investors.

*Cost of and access to finance***.** This is by far the most significant constraint on business for all firms in Zambia (small and large, exporter and non-exporter, foreign and domestic): over 80 percent of firms rated the cost of financing as a major or severe constraint in the RPED survey.

According to the RPED survey, the average firm with a loan pays an annual interest rate of 28 percent, which represents a high real rate of over 10 percent. The cost of capital varies with the size of the firm, as medium-sized firms paid, on average, 37 percent interest rate on their loans, while large firms paid just over 20 percent. Small firms have the lowest access to bank loans and pay the highest rate: less than 20 percent of small firms have a loan, and of those, 93 percent must provide collateral averaging four times the loan amount. Required collateral for all firms averaged three times the loan value.

The high cost of capital in Zambia can largely be attributed to crowding out by government spending. Government borrowing dries up credit and provides financial institutions a low-risk alternative to investing in private business.

*Macroeconomic instability***.** Through the past decade Zambia experienced serious macroeconomic imbalances that have created uncertainty and risk for businesses and adversely affected investment. Underlying macroeconomic imbalances is large fiscal deficit (before grants) that exceeded 10 percent of GDP in recent years. Financed by the Bank of Zambia, large fiscal deficits led to high inflation, high interest rates, and crowding out of the private sector. The real exchange rate has also

---

[32] The Heritage Foundation's Index of Economic Freedom score countries on a scale of 1-5; a higher score indicates greater levels of government interference in the economy and the less economic freedom. Zambia's scores over the past six years are: 2005: 3.40; 2004: 3.50; 2003: 3.50; 2002: 3.30; 2001: 3.25; 2000: 2.94. The index for all surveyed countries and information on methodology and survey sources are available at *www.heritage.org/research/features/index*.

[33] Transparency International's Corruption Perception Index scores countries on a scale of 1-10; a higher score indicates more transparency and less corruption. Zambia's rank and score over the past five years among the surveyed countries are: 2004: rank 102, score 2.6, 2003: rank 92, score 2.5; 2002: rank 77, score 2.6; 2001: rank 75, score 2.6; 2000: rank 57, score: 3.4. The index for all surveyed countries and information on methodology and survey sources are available at *www.transparency.org.*

been volatile, adversely affecting export diversification efforts. The past two years have witnessed a significant reduction in the budget deficit and both interest rates and inflation have declined, and the exchange rate has been more stable.

*Tax rates and administration***.** The marginal tax rate in Zambia is five points higher than those of its neighbors. In 2002 and 2003, the marginal corporate tax rate was 35 percent in Zambia, while it was 30 percent in South Africa, Uganda, and Tanzania and 18 percent in Botswana.[34] In the RPED survey, firms also reported dissatisfaction with tax administration in addition to high tax rates. The sources of dissatisfaction include:

- The high frequency of changes in tax policy, which are either unjustified or unexplained to the business community;
- The value added tax, which has been plagued by implementation problems;
- The Zambia Revenue Authority's (ZRA) behavior toward firms, which is perceived as arbitrary and punitive. Some staff lack required skills, are not armed with clear guidelines, and are given wide discretionary power that, ultimately, can allow for corrupt practices.

*Regulatory policy uncertainty***.** Seventy percent of firms consider government officials interpret and apply regulations in inconsistent and unpredictable ways. Regulatory uncertainty is also reflected in the amount of senior management time spent on routine matters, such as completing forms dealing with taxes, customs, labor regulations, licensing, and registration. In Zambia, the amount of time spent on these routine matters is 13 percent of the total senior management time: high compared to Uganda, where the amount is four percent, but comparable to and lower than Kenya (14 percent) and Tanzania (16 percent). Finally, mandatory termination benefits in Zambia are high and uncertain. Hence, the high cost of firing employees has a deterrent effect on hiring.

*Crime and corruption***.** An outstanding 77 percent of firms claimed losses due to theft, robbery or arson in the year previous to the RPED survey. Only half of these incidents were reported to authorities (suggesting low confidence in the outcome of reporting), and of those reported, only a quarter were solved (suggesting low confidence may be justified). Overall, this indicates that the public services related to law enforcement (policy and judiciary) need to be substantially improved.

Corruption is a pervasive constraint to investment. Firms reported spending an average of 1.7 percent of their total revenues on bribes in order to "get things done." Additionally, business reported that a government contract would typically require an average bribe of 3.7 percent of the value of the contract.

*Infrastructure services***.** Poor quality, unreliability, and limited availability of infrastructure services in Zambia inhibit firms from doing business. Electricity is the leading complaint, cited by 40 percent of all firms and 55 percent of exporters as a major or severe constraint. Zambian firms recorded an average of 37.2 power outages the year previous to the RPED survey. The percentage of production lost due to power outages was 4.5 percent, with small firms reporting having lost 5.6 percent of their output.

[34] World Development Indicators (WDI), 2004.

Zambian firms also reported difficulties with telecommunications, roads and water services. Fifty-one percent of exporters found telecommunications to be a major or severe constraint. Although the road system has improved in recent years, these improvements have been concentrated in a few areas. Finally, with respect to water, many industrial districts in major towns lack a reliable water supply, leading businesses to incur the extra expense of building and maintaining wells.

*Small businesses***.** Zambia's informal sector, as a percent of GDP, is one of the largest in sub-Saharan Africa. Businesses choose the informal sector largely because of entry barriers within the formal sector and to avoid taxes, fees, and other administrative and regulatory costs that are often prohibitively high and comparatively more burdensome for small investors. However, residing in the informal sector has its costs, as overall business growth potential, access to credit, and ability to have formal land titles are limited or non-existent. Easing regulatory burdens will encourage business to move out from the informal sector, allowing businesses to grow.

Concentration of public services: Resource constraints are more keenly felt outside of Lusaka, as there are few government ministries or agencies that have offices outside of Lusaka. Foreign Investment Advisory Service (FIAS) survey respondents who were located farther from Lusaka reported greater dissatisfaction with the performance of government agencies and administrative procedures than those closer to Lusaka. In particular, businesses complained about the absence of local staff able to handle licenses and permits, especially those related to exports and imports. These findings have a bearing on exports diversification strategy since many of the economic sectors where growth is sought are centered outside of Lusaka.

Delays in business start up: There are differences of opinion between government officials and industry representatives as to the length time it takes to complete procedures for business start-ups. Businesses report that the actual amount of time is significantly greater than expressed by government officials.[35] There were no material changes in the lengths of time reported by officials between 1998 and 2003, and, in spite of inflation, there have been few changes in the kwacha-denominated fees. This leads to the conclusion that little progress has been made in removing barriers to starting new businesses.

Institutional weaknesses: Organizational weaknesses and shortages of financial and human resources within the regulatory system are factors that impede sound regulatory policy implementation. Some agencies, such as those responsible for land allocation and development, are under particular stress and probably would be unable to accommodate even a small increase in applications from businesses. Before adopting or revising administrative procedures, it is necessary for the government to take stock of current resource constraints and determine if agencies are equipped to deal with an increase in the number of businesses and amount of investment that changes are expected to produce.

Moving forward

The draft PSD Reform Action Plan was endorsed by the Cabinet after discussions at two workshops held in 2004. The workshops were attended by the Permanent Secretaries and private sector representatives. The program was finalized in Livingstone at a three-day PSD Forum held between June 20-23, 2004. The purpose of the Forum was to provide a platform for public-private dialogue

[35] See the FIAS Administrative Barriers to Investment report for detailed results.

and consensus building among key stakeholders in the government and the private sector on reform priorities. Participants reviewed and finalized the PSD Reform Action Plan and agreed on an implementation framework. The PSD Reform Program is supported by the World Bank through the SEED project and other donors.

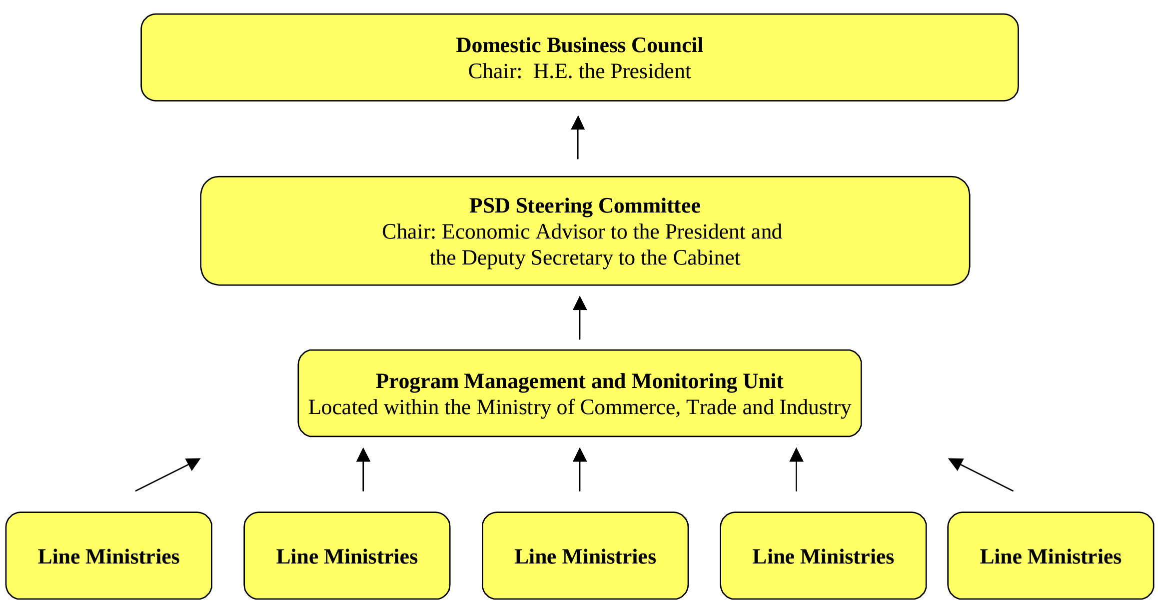
Implementation structure: Implementation was recognized as being a weakness in past efforts, and was thus emphasized at the Livingstone PSD Forum with a commitment to ensuring that broad regulatory reform is realized and parties involved are given the necessary capabilities. To that end, the government has developed an implementation structure that stresses accountability and ownership.

Oversight and implementation will be the responsibility of the Zambia Business Council (ZBC), which is chaired by the President of Zambia. The ZBC will meet quarterly. The Steering Committee, co-chaired by the Economic Advisor to the President and the Deputy Secretary to the Cabinet, will meet monthly to review and guide implementation of the reform program by ministries and the PSD Reform Program Management and Monitoring Unit (PMMU). The PMMU will be housed in the Ministry of Commerce, Trade and Industry. The PMMU will initiate and facilitate PSD reform projects and disburse pooled funds to line ministries who will perform specific PSD reform deliverables. The line ministries will report on PSD reform progress to the PMMU (Figure 1.)

Currently, the MCTI is recruiting candidates for ten positions at the PMMU, including a program manager and four program officers.

The importance of carrying out reforms in the context of public-private cooperation is irrefutable. One of the strong points of the PSD program has been the regular and productive consultations between the private and public sector. This partnership must continue in order for success to be realized.

Figure 1: Implementation Framework for PSD Program



However, the program is still in its nascent stage. The Steering Committee was launched at a meeting on February 10, 2005 and the ZBC had its inaugural meeting on February 24, 2005. The PSD Reform Program's objectives require prioritization. The government should concentrate on a short list of priority reforms that will maximize impact, are viable and cost effective. This will require tradeoffs and endorsement by the private sector on prioritized actions.

Table 3.5: Reform priorities in Zambia (from PSD Reform Program)

Issue	Action
1. Create the enabling macroeconomic environment, strengthen the public agencies	
Macroeconomic policy uncertainty	Reaffirm commitment by government to market-based policies
	Ensure operational independence of BOZ by implementation of the BOZ Act amended to incorporate best practices
	Ensure delineation of responsibilities between BOZ and MoFNP: exchange rates, interest rates, and monetary policy should be left to BOZ, while fiscal performance is left to MoFNP as per draft FSDP submitted to Cabinet
	Review the Committee of Estimates Report of 2001 with a view to implementing the recommendations
High cost of capital / private sector crowded out of debt market by Government	Continue to reduce Government borrowing as provided for in the medium-term expenditure framework
Difficulty for SMEs to access finance	Ensure implementation of the FSDP by appointing a committee to oversee its implementation
Lack of credit culture	Establish the Credit Reference Bureau as called for in the FSDP
Long delays in dispute settlements	Enforce Small Claims Court Act
Corruption	Ensure that the "Ministerial Code of Conduct" is observed
Weak corporate governance	Ensure the development and implementation of good corporate governance as per FSDP
Weakness of public agencies serving the private sector	Create single Zambia Development Agency (e.g., rationalize and enhance effectiveness of ZIC, EBZ, ZPA, ZEPZA)
Bureaucratic procedures of public agencies	Implement recommendations of the FIAS report (Admin Barriers) and define time limits for delivery of services
Need to further enhance public/private dialogue	Formalise quarterly meetings of the Zambia Business Council as the vehicle for public/private dialogue on PSD
Lack of HIV/AIDS workplace policy guidelines for the public/private sector	Involve and encourage employees/ employers/ trade unions/ work-related institutions to initiate/implement HIV/AIDS prevention, treatment and care programs
2. Improve regulatory frameworks and revise investment code to foster PSD	
Lack of incentives to support economic diversification	Provide incentives for accelerating investment in priority economic sectors
Contradictions between Investment Act and related legislation	Form review committee (including private sector) and review and amend all investment-related legislation to ensure alignment with revised Investment Act
Complex and bureaucratic tax administration system	Form review committee (include private sector) - same committee as for issue 2
	Implement comprehensive business process redesign project
Cumbersome customs administration	Analyse and simplify clearance procedures and set time-based targets
Bureaucratic immigration procedures	Streamline procedures, and set clear approval criteria and time-based targets
	Accelerate review of Immigration Act
Restrictive labour laws related to retirement and retrenchment	Accelerate current initiatives to review Statutory Instruments 2 and 3 of 2002 (retirement and terminal clauses)

Limited availability of land for commercial/industrial use	Review policy and procedures relating to acquisition/lease of traditional land
Lack of serviced stands	Facilitate private sector development of serviced stands and industrial parks
	Amend Local Government Act
Slow land development approvals	Streamline and decentralise approval process and set time-based targets
3. Enhance the infrastructural platform for PSD by encouraging private investment in infrastructure (PPI)	
Poor quality of telecommunication services	Accelerate revision of the Telecom Act and the licensing framework
High cost of telecommunication	Liberalize the international telecommunications gateway
Lack of reliable and cost effective power supply	Monitor the commercialisation of ZESCO
	Review energy policy and create more competition
	Complete the power rehabilitation project
Lack of investment and growth in provision of water supply and sanitation services; and solid waste management	Promote PPI arrangements for public-private and/or private sector management of water supply and sanitation services, and solid waste management
	Review water and sanitation act/NWASCO
	Monitor the process of strengthening the autonomy of the regulator
High transport costs due to limited development of road infrastructure	Implement recommendations of the 2002 Transport Policy and subsequent enabling legislation for the trunk, main and district roads, and improve construction of urban and feeder roads
Inadequate regulatory environment to support Government's decision to encourage PPI	Develop a PPI road map that identifies priority infrastructure sectors which lend themselves to a PPI approach, and develop an appropriate regulatory and incentives framework
Inadequate accommodation due to lack of investments in housing	Introduce Municipal Housing Bonds
	Provide incentives to financial institutions involved in housing development
4. Remove administrative barriers to business entry and operation, and facilitate development of high-growth sectors	
(a) Complex and time-consuming company registration and licensing procedures (b) Complex tourism licensing procedure	Implement procedures needed to ensure that licenses or permits will be deemed to have been granted if there is lack of response within a specified period of time
	Review for rationalization relevant legislation to support the rationalized licenses
	Establish First Stop Shop (Zambia Development Agency, encompassing ZIC, EBZ, ZPA, ZEPZA, ZNTB) as opposed to One-Stop Shop to facilitate investment
	Rationalize and consolidate licenses required to operationalize tourism enterprises
	Rationalize with other laws as necessary and streamline environmental assessment procedures and fees while preserving essential protections (ECZ should be supportive to business)
Cumbersome and costly environmental impact assessment process	Publicize the Tourism Policy, advance development of the Tourism Master Plan
Growth potential of the tourism sector	Enact the Tourism Hospitality Bill and ZNTB Bill
	Set up Inter-Ministerial Committee on tourism
	Promote domestic tourism
	Allow airline operators to lift fuel directly from Indeni / source
	Improve infrastructure
	Reclassify tourism as a non-traditional export so as to be taxed at 15%
Underdeveloped traditional and non-traditional mining sector (gemstones)	Develop strategy for expanding the industry, formalize the gemstone sector including provision of funds to small scale miners
	Operationalize the gemstone exchange
	Update the fiscal/regulatory regime
	Implement the Diversification Task Force recommendations on the mining sector
	Resolve issues relating to development agreements
Lack of market linkages between small-scale agricultural producers and processors	Begin implementation of the agribusiness component of the SEED program and involve the private sector
	Develop the livestock sector through a dedicated project which will include components dealing with quantity, quality and disease control in order to meet export standards

Narrow local manufacturing base and limited technology transfer	Proactively promote strategic investments with potential to stimulate development of local satellite manufacturing industries
	Devise a development agreement that will ensure no duty is paid on capital equipment and raw materials for manufacturers and agro-processors
	Revive tertiary / artisan skills training
Weak negotiating capacity on various trade and industry issues/protocols	Provide trade negotiating skills training
	Include private sector in negotiations
5. Create greater opportunities for access to regional and international markets by Zambian businesses	
Limited access by Zambian businesses to regional/ international markets	Develop a national export trade strategy, mainstreaming trade policy and placing export strategy/promotion/diversification at the center of national development policy
	Continue trade negotiation capacity building within Government Ministries, Missions, Business Associations and other non State actors
	Ensure completion of bi-lateral agreements with target neighbor markets: Congo DR, Mozambique, Angola, Tanzania
	Export financing support – develop an export credit guarantee scheme, pre & post shipment finance facilities
	Expedite trade facilitation mechanisms including removal of NTB with neighboring countries
	Enhance capacity of trade & investment promotion officers in missions abroad
	Establishment of liaison offices to facilitate trade activities at priority border points
Stop/start approach to EPZ legislation	Review and update EPZ strategy and business plan and revise/finalize EPZ legislation and incentives accordingly
Lack of industrial infrastructure for export-oriented production	Mobilize funding for development of EPZ industrial parks
Lack of credible and internationally recognised certification standards	Enhance capacity of Zambia Bureau of Standards in quality testing to international best practice
	Strengthen capacity in MACO to provide SPS services for export of fresh horticultural / floriculture products, livestock and aquaculture products and enhance capacity for disease eradication/control
Limited knowledge of new export-market opportunities	Launch awareness creation campaign on market access initiatives and of the quality standards required, e.g., COMESA, SADC, AGOA, EBA, Cotonou
6. Unlock the growth potential of the SME sector through business development support and local empowerment initiatives	
Lack of preferred procurement policy for local SMEs	Negotiate with cooperating partners for mechanisms that will favor the participation and build capacity of local firms through tendering for donor funded projects
	Develop preferred procurement policy for local businesses in tendering for government contracts
Limited business development capacity of local SMEs	Review existing support to and develop strategy for SMEs development
Limited migration from informal to formal sector	Develop incentives for voluntary migration from informal to formal e.g., South African Close Corporation Model program
	Organize business clinics to create awareness of the benefits of formal sector migration such as increased recognition and acceptance by formal sector customers, and easier access to credit

EXPORT CREDIT

Although Zambia does not have officially dedicated credit facilities for exports, the financing needs of exporters are adequately served. Established exporters have long been preferred borrowers from the financial institutions because they: (a) are considered less risky as their revenue base is largely immune to fluctuations in domestic demand, (b) are among the few classes of borrowers to whom banks can confidently make foreign exchange denominated loans, (c) offer financial institutions direct access to foreign exchange, and (d) are potential clients for fee-earning banking products such as letters of credit, performance bonds, etc.

Zambia's economic and financial policies are also conducive to meeting exporters' financial needs. Liberal current and capital account policies and the presence of reputable international banks provide fast and direct access to main trading partners and international money centers. Fund flows into and out of the country are also relatively well established

Credit availability

Exporters' credit needs can be separated in two categories; short-term working capital needs, and medium-to-long term needs for investment. It appears that the Zambian banking sector is currently meeting the working capital needs of exporters. Given the current level of NTE of about $450 million, exporters' working capital needs would be expected to be about $360 million over a year (assuming working capital levels of 80 percent of total NTE). This would require the presence of about $90 million in traditional 3-month export pre-shipment facility. Total lending to the private sector by commercial banks in Zambia was about $430 million as of the end of 2004. Of this amount, about $100 million was for long-term lending. The remaining $330 million was for short-term -- more than three times the total working capital needs of exporters. Given the fact that Zambian exporters are among the most likely borrowers from the banking sector, it can be assumed that the working capital needs of Zambian exporters are already included in this total.

The banking sector provides three main instruments for investment finance in Zambia: (i) intermediation of facilities offered by multilateral and bilateral sources, (ii) rolling over overdraft facilities, and (iii) intermediation of offshore facilities offered mainly by the headquarters of international banks, and suppliers and export credit agencies. Among these facilities, lines of credit offered by bilateral and multilateral sources are by far the largest and most important. The EIB and IDA facilities for investment purposes that are presently intermediated by the banking sector total about $100 million. The term of these facilities can go up to seven years. While the magnitude of investment finance through rolling over overdraft facilities is not known exactly, interviews with commercial bankers suggest that about one-third of total private sector credit is being used for this purpose. The figures for offshore financing facilities are also not known. These facilities fluctuate year-to-year, and are generally tied to bigger projects. Interviews with Zambian bankers suggest that a yearly average of $100 million would be a conservative estimate for these facilities. Hence, it is probably safe to assume an annual availability of about $350 million for investment finance in Zambia. Virtually all of this financing goes to exporters. This amount corresponds to about $525 million in investment, assuming a debt-to-equity ratio of 3:1. The examination of the IDA facility supplemented by interviews with bankers suggest that the average rollover period of investment finance is about three years. This indicates a yearly new investment of $175 million in exporting activities within the NTE sector, which is compatible with an output increase of $35-40 million in this sector. This amount corresponds to about ten percent of total NTE.

The above analysis indicates that exporters do not seem to be constrained by lack of access to working capital. But, their growth is restrained by the small size of the Zambian financial sector, which is small even by African standards. Indeed, the depth of the financial sector in Zambia (measured by the ration of broad money supply to GDP) is about half of the sub-Saharan African average (Table 3.6) and has been quite stagnant over the past decade.

Table 3.6: Financial Debt (M2/GDP)

	1991	2003
Zambia	0.21	0.21
Sub-Saharan Africa	0.25	0.40

Source: WB staff estimate

In addition to broad monetary measures, banking sector indicators also show the relatively small size of the Zambian financial sector. Total banking assets in Zambia are about 27 percent of GDP (about the same level as in 1992) as compared to about 40 percent in sub-Saharan Africa in 2003.

Terms of credit

Interest rates in Zambia for kwacha denominated facilities have been quite high both in real and nominal terms (Table 3.7). The levels of interest rates on Kwacha have essentially made Kwacha lending for the long-term impossible. However, the situation in foreign exchange lending has been much better - most of the multilateral funds are lent out at LIBOR plus two to four percent. These rates are better than the rates firms have to pay in most emerging economies.

Table 3.7: Domestic Interest Rates

	2002	2003	2004
Call	6.9	8.3	5.3
30-day deposit	19.5	18	8.2
Base lending	42.5	38.0	29.8
Inter-bank	37.4	5.3	14.4
T-bill	32	18.2	16.3

Source: Bank of Zambia

Credit dispersion by sector and firm size

Zambia's agriculture based exporters have been the largest recipients of finance (Table 3.8). There is no data on distribution of export credit, but one can safely assume that the dispersion of the IDA credit facility of $45 million, about half of the formal investment finance, gives a good indication of the beneficiary sectors.

Table 3.8: Sectoral Distribution of IDA Credit

	Total Disbursed US$ '000	Share (%)
Agriculture	7 522	12.6
Agro processing	18 530	31.0
Construction	2 290	3.8
Mining	4 845	8.1
Mine servicing	2 593	4.3
Manufacturing	9 233	15.4
Services	5 695	9.5
Transport	5 862	9.8
Tourism	3 263	5.5
Total	59 833	100.0

Note: This is a revolving facility. Figures as of June 2003

It should also be noted that Zambian firms of all sizes have access to export finance from the formal financial sector. About one-third of the loans from the IDA credit are less than $100,000 (Table 3.9).

Table 3.9: Loan Size

Size of loans/leases	Number of Beneficiaries		Amount Disbursed	
	Enterprises	%	US$ '000	%
Up to US$ 100,000	60	31	3,550	6
US$ 100,000 – 1,000,000	126	66	48,780	81
US$ 1,000,000 and above	6	3	7,500	13
Total	192	100	59,830	100

4. What is the Potential for Export Diversification and Greater Integration?

Zambia has established a convincing track record of diversifying its exports away from copper. As discussed in Chapter 2, the share of NTE in total exports increased from 8 percent in 1990 to 38 percent in 2003. Given its rich natural resources (land, ground and surface water, gemstones, minerals, forests and national parks), location on a high plateau and consequent temperate climate, stable political environment, access to major regional and global markets under preferential trade arrangements, and competitive wages, there is potential for much more export diversification. Zambia's competitive strength is in natural resource- and labor-intensive activities such as agriculture, agro-processing, tourism, textiles and garments, and light manufacturing.

Economy-wide, cross-cutting constraints to export diversification (trade and behind the border policies, particularly poor infrastructure and administrative barriers) were reviewed in the earlier chapters. This chapter focuses on specific issues in selective sectors where Zambia has comparative advantage.

AGRICULTURE

Zambia has substantial untapped agricultural potential. Only 14 percent of the cultivable land and 10 percent of the country's water resources are currently utilized. Unlocking this potential is essential to diversify exports, stimulate growth and reduce poverty.

Agriculture was viewed traditionally as a sector of secondary importance for the Zambian economy. Today agriculture and agro-processing industries are Zambia's fastest growing economic sectors and they offer the greatest potential for export diversification. Agriculture provides employment for about 67 percent of Zambia's labor force, and it provides raw materials for agro-processing industries that account for about 84 percent of manufacturing value added. Because most of Zambia's poor live in rural areas and earn their living through agriculture, agricultural growth and, specifically, agriculture based export growth is a key to redressing Zambia's poverty problem.

Priority agricultural products which promise both rapid income and employment generation and longer term market sustainability include floriculture and fresh vegetables within the horticultural sector, and cotton, tobacco, coffee and paprika within the agricultural sector. These commodities together accounted for nearly 55 percent of Zambia's total agricultural export earnings (USD 60 million) in 2000, which is approximately 23 percent of total Zambian NTEs for that year.

A national development program that aims to tackle the closely intertwined issues of agricultural growth and poverty reduction should focus on policies to accelerate the production of the most promising export-oriented products, and strengthen vertical integration with agro-processing industries (textiles, food processing, etc.) Priority emphasis should also be placed on drawing subsistence farmers' participation into the production of cash crops (see chapter 6 for a detailed discussion).

Since the early 1990s, agricultural policies have been significantly improved, but much remains to be done. Zambia's trade arrangements (Cotonou, EBA, AGOA, COMESA, SADC) provide ample export opportunities for many agricultural and agro-processing products in regional and international markets. Therefore, demand is not a constraint on the rapid expansion of agricultural production. The main impediments are on the supply side. They include, in broad terms, (a) lack of access to water, fertilizer, HYV seeds, extension services, financial services, and marketing; (b) customary land tenure system that does not allow secure land rights and long-term investment in land development; and (c) inadequate infrastructure (rural roads, storage facilities, marketing infrastructure, power and telecommunications services) [36].

As noted below, each agricultural product has its own product-specific set of constraints. However, it will be difficult to overcome the product-specific constraints before the broader cross-cutting problems noted above are addressed.

Cotton

Cotton is Zambia's largest cash crops for smallholders. About one of five smallholders in Zambia grows cotton, and 98 percent of Zambia's total annual cotton crop is produced by these small farmers. Cotton production is dominated by the out-grower scheme.

Smallholders are willing to produce cotton not because it is more profitable than other crops but, rather, to diversify their production in a risk-free manner. By planting cotton, they gain access to credit through the distributor system for purchasing inputs for other crops and also benefit from a guaranteed market for cotton.

In 2001, cotton's contribution to Zambia's total agricultural exports was 19 percent, or USD 29.6 million; the corresponding figures for 1997 were 34 percent and USD 49.1 million, respectively. This notable decline in cotton export earnings between 1997-2001 was largely due to a decline in cotton lint prices worldwide. Rather than supporting the downstream processing industries, Zambia exports its cotton to South Africa and the EU.

The rules of origin of the major trade arrangements (e.g., AGOA) require Africa-wide cumulation to be eligible for preferences. This provides substantial opportunity for Zambia to expand its cotton production. The government's crop-specific policy should focus on increasing yields in cotton production through improving input use and extension services, and encouraging vertical integration to produce higher value textile and garment products.

Tobacco

Zambia's climate is very favorable for tobacco cultivation. Two types of tobacco are grown: flue-cured Virginia and burley. Despite ongoing international anti-smoking campaigns and some related setbacks since 1998, demand on world markets for tobacco remains strong (especially for the flue-

[36] For a detailed discussion see "Zambia Country Economic Memorandum: Policies for Growth and Diversification", World Bank, October 20, 2004, volume 1.

cured variety). Flue-cured tobacco is the more skill-and capital-intensive variety and grown by larger farmers in Southern Province. Burley tobacco is grown principally in Eastern Province, mostly by smallholders. Tobacco farming requires a greater quantity of costly inputs and fetches more export earnings per hectare than most other types of farm enterprises. The Tobacco Board of Zambia, a statutory organization, is responsible for overseeing and monitoring tobacco production and providing extension services.

Between 1995-2001, the value of Zambia's tobacco exports averaged about 10 percent of total agricultural exports. Much of Zambia's tobacco is sold through Zimbabwe and Malawi where there are established auction and processing facilities. Zambia is a small producer in the region (10,000 tons/year) as contrasted with Malawi (140,000 tons/year, mostly burley) and Zimbabwe (175,000 tons/year, mostly flue-cured). Instability in Zimbabwe has, however, now led international tobacco companies to look for alternative supply sources elsewhere, including in Zambia, Mozambique and Tanzania.

Currently there is an opportunity to increase Zambia's share in the tobacco trade. To realize this opportunity, tobacco yields need to be increased through improved extension services and the use of modern inputs, and marketing networks need to be strengthened.

Coffee

Zambia is a low cost producer of high quality arabica coffees. Even with the collapse in coffee prices in the latter 1990s, coffee farming has remained largely profitable in Zambia. Coffee production is predominantly the domain of large commercial growers. Modernization of coffee production was supported by financial assistance from the World Bank's Coffee II funds and the EU's Export Development Program.

A substantial advantage that coffee production has is that, unlike flowers and vegetables, the transport of coffee does not depend on expensive airfreight to reach destination markets. Exports are normally routed through Lusaka-Durban by road or rail. Planned improvements in rail services are expected to result in increased use of Tanzania's Dar-es-Salaam port.

Between 1995-2001, the value of coffee exports averaged about six percent (USD 6.9 million) of total agricultural exports. Markets for Zambian coffee include the EU (Germany, the UK, Switzerland, Holland), South Africa and the United States. Zambian coffee is almost exclusively marketed through the Zambia Coffee Grower's Association (ZCGA), which contacts with international buyers and promotes the product at international trade fairs. Regulatory functions within the sector are performed both by the ZCGA and the Coffee Board of Zambia, a statutory organization.

With Zambia's abundant land resources and suitable climatic conditions, the potential for expanding coffee production is very high and would increase with improved rural roads. Based on recent plantings, Zambian coffee production is projected to at least double by 2010. Part of this increase will be achieved by expanded out-grower schemes. One Lusaka-based commercial farm is now promoting a small-scale out-grower coffee production scheme. It will assist the small farmers in marketing their coffee crops and also guide them in specialty fresh vegetables cultivation while awaiting coffee harvests. Similar schemes can be promoted on a broader basis through government and donor support.

Paprika

Paprika production in Zambia started in the early 1990's. Production accelerated very quickly, increasing five fold during 1997-2001. Three quarters of Zambia's paprika is produced by commercial farms with irrigation facilities; the remaining quarter comes from smallholder rain-fed crops. Returns on paprika production are very high. Although cut flowers, fresh vegetables and coffee offer more profit on a per hectare basis, paprika costs less to produce.

In 2001, paprika contributed 1.3 percent, or USD 3.6 million, to Zambia's total export earnings. Total world consumption of paprika is around 100-120 thousand metric tons annually. Zambia has been supplying about two percent of this demand.

Paprika is used both as a spice and natural colorant. The major markets for bulk and processed paprika, and paprika derivatives such as oleoresin, include Spain and other members of the EU, the US, Japan and South Africa. Spain is the main destination of Zambia's paprika products. Major producers of paprika in southern Africa include Zimbabwe, South Africa and Malawi. Zimbabwe alone accounts for more than 10 percent of world production.

Many of the processing plants are located in South Africa. There are initiatives in Zambia to establish paprika processing: this should be encouraged to add value to paprika exports and create additional employment.

A key problem in this sub-sector is the widespread side-selling practice that undermines the out-grower system. The Agribusiness Forum is in the process of creating a database of paprika farmers who have received inputs and have pledged crops to out-grower associations. The purpose of this database, financed by NORAD and to be widely published, is to record crop pledges and thereby prevent side-selling. The Zambian Agribusiness Technical Assistance Center (ZATAC) and the Smallholder Enterprise Marketing Program (SHEMP) also provide assistance to paprika producers.

For smallholders, credit recovery problems are paramount. Implementing a variant of the distributor system, introduced by Dunavant in the cotton sub-sector, promises to improve the credit recovery rate and efficiency and transparency in input supply and marketing arrangements. A well-established out-grower system will also deliver critically needed extension services and information to smallholders raising awareness about important paprika crop characteristics such as moisture content and color that determine crop sale prices.

FLORICULTURE AND FRESH VEGETABLES

Sector background and potential. Air freighted exports of cut flowers and vegetables to Europe began as a venture in the 1980s by some commercial farmers who were trying to raise foreign exchange with which to finance other agricultural needs. This has now become an area of dynamic agricultural export growth for Zambia. Principal products include cut roses (60 varieties) and pre-packaged specialty vegetables (some organically grown) including sugar peas, green beans, baby corn and carrots. Over an irrigated area of about 5000 hectares located within proximity to

Lusaka's international airport, there are about three dozen farms dedicated to this business. About one dozen are large corporate farms which have varying degrees of foreign ownership.[1] Two of the largest growers handle most of the exports and buy the produce of the others. The big businesses employ skilled managers and farmers to run their field and packaging operations. Small out-growers are now also entering these arrangements, a key for the sector's expansion in the future. The physical size of the sector is small, yet the concentration of skilled labor and labor intensity are unparalleled in other sectors.

Between 1990-2002, the value of floriculture and horticulture exports increased over thirteen-fold (USD 5.6 million to USD 75.2 million, respectively). By 2002, this value represented 38 percent of Zambia's total agricultural exports. The floriculture and fresh vegetables (a sub-sector of horticulture) sector is Zambia's most modern NTE area. Its ratio of financial and labor investment to yield per hectare is the highest among any agricultural sector; the value per kilogram of product is the highest; operational and product quality standards are the highest in international terms; and its supply chain mechanics are the most fluid and efficient. This is dictated in part by the quickly perishable nature of the products, and also in part by the nature of the demand for the products in European markets.

Despite the impressive growth experienced by floriculture and fresh vegetable enterprises over the 1990-2000 decade, it must be noted that floriculture experienced significant revenue losses between 2000-2003. For the sector as a whole, these losses were somewhat offset by the continued momentum in vegetable sales. Reasons for the downturn in floriculture sales include oversupplied markets (specifically by competitor country roses) and hence depressed prices, and the Guilder's loss of value relative to the US dollar. This regression halved the number of growers, particularly the smaller businesses. Presently, the larger businesses are absorbing the smaller bankrupt or non-viable ones. There is also new FDI directed at these mergers in response to concerns about the flower industry in Zimbabwe (traditionally Europe's second largest supplier). Persisting high airfreight charges continue to plague business in the sector and this has also factored into the recent revenue declines in floriculture.

Markets. Europe is currently the largest market for Zambia's cut flowers and fresh vegetables. Eighty percent of exports are shipped to the UK and Holland, and much of the remainder goes to South Africa. These two industries in Zambia command a small share of world markets and there is plenty of room for expansion.

Although markets in the USA (through AGOA provisions) and in Australia offer expansion potentials, the higher costs of freight, and competition from Central, South American and other sub-tropical producers in that region offer constraints. Market opportunities in southern Africa are also limited by the lower incomes of consumers and lower costs for similar items there. Wealthier Middle Eastern markets (United Arab Emirates, Saudi Arabia, Israel) may be viable and worthy of investigation.

Floriculture: Auctions in Holland are the way most Zambian flowers are now sold, but fees and commissions with this system constitute the second largest cost component (15 percent), after

[1] Agriflora, one of the largest growers, is currently in receivership. Formerly owned in part by the regional conglomerate, TZI, some of Agriflora's assets are being sold to the British firm Plantation and General Investments PLC.

airfreight (35 percent). Direct sales to international buyers (supermarkets and florists) is an option that promises more profit than sales made through an intermediary.

Vegetables: Europe is Zambia's main market for vegetables and nearly all sold there are pre-packed and shelf-ready. The specialty vegetables are too expensive for the average southern African consumer, and difficult to get into US and Australian markets due to somewhat different sanitary controls. US spot market opportunities have sometimes been available and have been filled (e.g. sugar snap peas) but the opportunities are not regularly recurrent. Opportunities do exist in affluent Middle Eastern markets with linkages here also yet to be developed. Middle Eastern markets would be particularly attractive for smaller producers, so as to hedge the strict codes that European, US and Australian buyers must operate under. European markets could also be broadened for small producers specializing in organic and exotic vegetables, however this avenue would be skill and documentation intensive (third party certifications are required). Aiming for sales in European wholesale markets is another alternative that would require bulk produce and airfreight price negotiations, different packing methodologies, but most importantly, a broader producer base in Zambia.

Institutional and policy framework. Institutional arrangements and linkages within this sector are, perhaps, the most expansive, coordinated and effective of any NTE sector. Sector activities were expanded in the 1990s through the financial assistance and long-term production vision of the European Investment Bank and the European Union's Export Development Project. Low interest financing has also been available at times from Dutch and other European, Japanese and World Bank sources.

Activities in floriculture/fresh vegetables are overseen and monitored by a network of public and private, domestic and foreign agencies. The Export Bank of Zambia, a government statuary organization tasked with promotion of NTEs in foreign markets, publishes and disseminates brochures about Zambia's fresh produce to Zambian foreign missions and provides promotional services at international trade fairs (some of these activities are financed by the EU-EDP). Government/private sector partnership assistance is provided by:

- the Zambia Export Growers Association (ZEGA) which promotes sector interests (e.g., attracting foreign investment) through publicity and seminars; by lobbying the government; securing air freight services, inputs and technical assistance; providing information about financing and markets;
- the National ZEGA Training Trust (NZTT) established at Zambia's Natural Resources Development College which provides special skills training for greenhouse and packing facility managers;
- the Zambia Investment Centre (ZIC) which promotes, facilitates and monitors domestic and foreign investment targeting economic growth projects.

Specific interest groups also active in sector activities include the Organic Producer's and Processor's Association (OPPA), Zambia Agribusiness Technical Assistance Centre (ZATAC), and the Smallholder Enterprise and Marketing Programme (SHEMP).

Public and private international organizations involved in the sector principally promote implementation of codes of sanitation and other standards. Such groups include the World Trade

Organization (WTO), the Europe/Africa-Caribbean-Pacific Liaison Committee (COLEACP), and the European Retailers Protocol for Good Agricultural Practice (EUREP-GAP). The latter represents the specific codes of 17 European supermarkets. Beyond sanitation and quality control, most of these codes also address issues of worker welfare and environment.

Additionally, the UK's Department for International Development (DFID) is working through its Crop Post Harvest Programme at the Natural Resources Institute (NRI) of the University of Greenwich to address the issue of farm audits in Zambia. EUREP-GAP, for example, requires certified farm audits of their growers. The costs of such audits are particularly prohibitive and, in most cases, compliance with expected standards (e.g., ISO 9000) is infeasible in the case of small growers working off one half to two hectares of land. NRI's work in Africa is focused on developing an auditing system that is both appropriate to the needs of small-scale growers and acceptable to buyers. Export companies in Zambia are working closely with NRI on the project, as is the government through its community health workers.

Policy recommendations. The supply-chain regulating the production and sales of Zambia's floriculture and fresh vegetables is functional and impressive. It has been built up through experimentation and sound strategic thinking. The chain extends from buyers in Europe to producers in Zambia, and it is supported at critical junctures by international donor agencies as well as the Zambian government. The government has provided: incentives of 15 percent (versus 35 percent normal) corporate tax; a five-year tax exemption on dividends from farming activities; customs duty exemptions on most capital equipment; duty free imports of agro-chemicals; and depreciation allowances on farm machinery. The sector gives Zambia a positive image. There remains work to be done, however, to overcome the recent downturn in revenue from floriculture and to achieve more of the sector's potential. Improvements and needs to consider are:

- establishment of a grower's cooperative, or consortium, that unifies smaller producers to be able to better leverage terms of sale/profits in exports;
- solving the critical problem of high cost air freight by negotiating with carriers not as individual businesses but as a block[2];
- securing long-term financing at competitive rates that could assist at all levels of production (capital goods, skilled labor and competent managers/supervisors); because operations in this sector are very capital intensive, the availability of external financing is critical to boosting sector capacity;
- public assistance in improving and expanding road networks (to allow smaller growers to participate regularly in sector production and marketing); sector capacity cannot be augmented without growth in exporter critical mass;
- public assistance in providing increased water supply (to enable expanded irrigation facilities);
- technical assistance in the following specific areas: identifying and targeting comparative advantage for Zambia's flowers (and vegetables) in international markets; seed trials to promote diversification and improved strain; soil improvement methodologies; fertilization methods; pest control; produce grading; post harvest handling; cold storage; processing/in-plant training; packing and specialty packaging.

[2] In September 2004, ZEGA concluded an airfreight contract with Cargo Lux for use of a Boeing 747-400 to transport flowers and vegetables to Europe once a week. More frequent flights available to all producers are necessary to sustain the viability and growth of sector businesses in the future.

TEXTILES AND GARMENTS

Sector background and potential. Textile and garment production is a light manufacturing sector that holds dual promise for the Zambian economy. It is an important economic sector for export diversification. Being labor-intensive, it can also create employment opportunities for a broad band of skilled and unskilled labor. Thus, developments in this sector can lift large segments of population out of urban and rural poverty.

Sector activities consist of ginning, spinning cotton yarn and manufacturing cloth and clothing. Cotton and poly-cotton yarn alone account for over 90 percent of Zambia's textile exports.

Zambia's textile industry has had a bumpy ride since 1990. The entire manufacturing sector declined during the early years of the decade as tariff rates were reduced. By 1997 the textiles and garments sector had an explicit focus on exports and ranked second among NTE, with earnings of about USD 50 million. Between 1997-2003, the value of exports from this sector declined to USD 26 million. The causes for this were mostly external, such as a decline in world prices for yarns (as well as for cotton lint); the Asian financial crisis; and the entry of eastern European countries into Zambia's traditional textile markets. In 2003, the sector ranked fifth among NTE.

Markets. Markets for Zambia's textiles have changed significantly since the second half of the 1990s. Focus has shifted from European markets towards regional markets, particularly South Africa. Factors responsible for this reorientation include the weakness of the Euro against the USD (peaked around turn of century), and the increasing flow of textile products into Europe from eastern European locations and Pakistan (lower transport costs). Driving the greater concentration on regional markets has been the opportunities created by AGOA together with the SADC Trade Protocol. Between 2001-2002, sales to Europe declined by 28 percent, while sales to AGOA eligible countries (mainly South Africa) increased by 70 percent.

Zambia has not been able to benefit directly from AGOA through increasing apparel exports in contrast to some other countries in the region. This is partly explained by Zambia's slow ratification of AGOA. However, Zambia has benefited indirectly through increasing exports of cotton yarn to South Africa as inputs into apparel for exports to the US under AGOA.

Institutional and policy framework. Zambia's exports to the EU enjoy duty-free and quota-free entry under the Cotonou Agreement and the EU's EBA Initiative. The Cotonou Agreement is the more generous of the two because its rules of origin (ROO) permit Zambia to export duty-free to the EU apparel produced from regional fabrics and yarn. The EBA program does not permit such regional cumulation. The Cotonou Agreement will be replaced by an EPA at the end of 2007 that Zambia is negotiating with the EU together with 15 COMESA members. If Zambia does not conclude an EPA by the end of 2007, its preferential access to the EU will be governed by the EBA Initiative which has more restrictive ROO. Pressing for more liberal ROO under EBA is therefore a priority medium-term objective for Zambia.

Zambia also has duty-free access to the US market under the US AGOA until September 2015 (It ratified AGOA's apparel provision in December 2001). Under AGOA's standard ROO, apparel assembled in sub-Saharan Africa (SSA) from fabric wholly formed in SSA from US or SSA yarns is eligible for duty-free treatment. AGOA's special ROO for LDCs permit such beneficiaries to use fabric and yarns sourced from third countries. The special ROO will be in force until September 2007.

Zambia exports textiles and apparel to South Africa duty free under the SADC Trade Protocol using the MMTZ special rule, which permits single stage transformation.

The textiles and garments sector does not have an effective trade association that can voice and lobby for sector interests. This is probably due to the still relatively small size of the sector in the national economy and the dispersion of different types of interests throughout the sector (ginners vs. spinners, etc.).

Policy recommendations. To arrest the decline of the textiles and garments sector and to maximize its export revenue, Zambia should take full advantage of the preferential access opportunities and its comparative advantage in this sector. It is advisable to set up a task force to identify and prioritize requirements and prepare a comprehensive reform package to revitalize the sector. The program would include the following sector-specific objectives:

- Support development of a strong apparel sector association as an important bridge between the industry and government to ensure that government policies are responsive to the sector's requirements;
- Conduct a value-chain analysis to identify weaknesses at each stage of production and develop policies to address these weaknesses;
- Analyze the possible impact of the end of the MFN on Zambia and make recommendations on how to react to increasing global competition in the sector.
- Build links and partnerships with regional and global suppliers to improve access to regional and international markets.

PROCESSED FOODS

Sector background. With its strong backward and forward linkages, the processed foods sector is very important for Zambia for employment creation and export diversification. The principal export products of this sector are sugar, wheat flour and stockfeeds. Sugar constitutes Zambia's largest processed foods exports. There are a variety of other sector products, but the most amply produced are staple commodities that meet domestic consumption needs, such as maize meal[1].

In 2003, this sector earned Zambia the third highest revenue among NTE; these earnings were nearly USD 44 million and comprised 10 percent of total NTE. Sugar accounts for about 90 percent of Zambia's processed food exports. Despite general expansion over the years, the sector's export performance has been variable, subject to the same external and domestic factors that have affected all NTEs. The sector is also highly dependent on developments in primary agriculture (weather conditions) and trading partners' policies (non-trade barriers).

[1] Other products include honey, beeswax, fruit juices, peanut butter, jams, tomato paste and sauce, dried fruits and vegetables, soft drinks, molasses, cooking oil and marigold meal.

The Zambian Sugar Company (ZSC) accounts for 97 percent of sugar production in Zambia. A former parastatal company that was part-owned by the British foods manufacturing firm Tate and Lyle, ZSC has been 90 percent owned by the South African firm Illovo since April 2001. Illovo is Africa's leading sugar producer and a significant manufacturer of downstream products. In addition to Zambia, Illovo also has agricultural and manufacturing operations in Malawi, Swaziland, Mauritius, Tanzania and Mozambique.

Zambia is the fourth lowest-cost sugar producer in the world.[2] Sugar cane is produced by ZSC farms and smallholder out-growers. In 2004, Zambia produced 230,000 MT of sugar, about half of which were sold domestically.[3]

Markets and potential. The DRC accounts for over half of Zambia's processed foods exports. The DRC market has been problematic for Zambia (delays at the border, problems getting payments for shipments); but, at the same time, sales to the DRC yield higher revenues because of lower transportation costs relative to shipping to distant international markets. Sugar accounts for over 68 percent of exports to DRC. Other high earning products include molasses, stockfeeds, maize meal and honey. Beyond DRC, the top destinations of Zambian processed foods exports in 2004 (in rank order of importance) were: Kenya, Portugal, Rwanda, Burundi, Uganda, Tanzania, Zimbabwe, Angola, South Africa and Namibia. Zambia's non-sugar industry processed foods are mostly absorbed by the domestic market.

The prospects for expanded Zambian sugar exports are brighter than those for other commodities produced within the sector. Sugar production, processing and marketing in Zambia are coordinated by one large, private firm (ZSC/Illovo) that is highly efficient and experienced in international trade. Given that Zambia is one of the world's low-cost producers, Zambia will have attractive opportunities to increase its sugar production and exports once the highly controlled and distorted world sugar market is liberalized.

Institutional and policy framework. The regional exports of processed foods are carried out under the COMESA and SADC FTAs. The EU's quota for Zambian sugar under the Sugar Protocol is 20,000 MT. The US provides much narrower market opportunities.

South Africa, the EU, and the US have very strict sanitary/phytosanitary standards that restrict market access for many Zambian (as well as other developing country) products. Currently, almost all Zambian food-processing enterprises lack international quality standards certifications (i.e., ISO 9000).

Policy recommendations. With local markets being the principle destination, expansion of exports will depend primarily on a deepening of regional integration under COMESA and SADC. This would involve strengthening transport, transit arrangements, and customs administration; harmonization of policies and standards; acceleration of implementation of the FTAs; and elimination of the remaining non-trade and technical barriers to trade.

---

[2] The world's top ten lowest-cost sugar producers are, respectively: Brazil, Zimbabwe, Malawi, Zambia, Australia, South Africa, Swaziland, India, Thailand, and Chile (2002-2003 Sugar Statistics, Illovo Sugar Company).

[3] In the same year, the combined sugar production of SADC countries was about 5 million MT. The principal SADC sugar producing countries are: Malawi, Mauritius, Mozambique, Swaziland, South Africa, Tanzania, Zambia and Zimbabwe.

A key objective of sector policies should be improving the standards and competitiveness of the products both in domestic and international markets. To this end, a "quality vendor" program can provide technical assistance, even working capital, to food processors to upgrade their products and packaging to meet the standards of supermarket chains and other retailers. The possibility of improving domestic manufacturing of packaging materials should be explored.

It is also advisable to establish strong producer associations to interact with the government to ensure that government policies are responsive to the sector's needs, to build contacts and partnership with regional and global suppliers, and to provide technical assistance and information to companies in the sector.

TOURISM

Sector background and potential. Tourism holds significant export earning potential for Zambia. Zambia's location on a high plateau and consequent temperate climate within the southern Africa region poise the country favorably for year-round tourism. Zambia is a politically stable country that is home to over 70 different ethnic groups. It is a safe travel destination that is endowed with many kinds of tourist attractions including Victoria Falls; the Lower Zambezi (with numerous water sporting options); cultural tourism (local ethnic customs, song, dance, art and handicrafts, museums); and eco-tourism (experiencing game and lodging in a natural setting).

Over the past 15 years, tourist arrivals and associated foreign exchange revenue, investment and employment in the tourism sector have increased. Between 1997-2002 the volume of both tourist arrivals in Zambia and revenue from tourism expenditures grew at an average annual rate of about 13 percent. Revenue nearly doubled during this 5-year period to about USD145 million in 2002. Despite these increases, tourism continues to represent a small fraction of the Zambian economy, accounting for less than three percent of GDP.

Zambia's tourism market primarily caters to European, regional and domestic travelers. Visitors from the UK, Germany, Sweden and France comprise 25 percent of arrivals in Zambia; Australians and New Zealanders comprise another 20 percent, and North Americans an additional 14 percent. The total number of visitors to Zambia during the past year was approximately half a million. Among these arrivals, 55 percent were business travelers and 32 percent were vacationers. According to the Zambia National Tourist Board (ZNTB), the most popular attractions for vacationers in Zambia, in rank order, are game safaris, hunting/fishing, adventure trips (e.g. rafting, canoeing, bungee jumping), birding, backpacking and over-landing.

Markets. Zambian tourism faces serious competition in the region. Active participation in regional tourism circuits such as RETOSA (SADC country joint initiatives to market the touristic attractions of southern Africa) promises an avenue by which to share in the growing popularity of the region. The World Tourism Organization projects average annual growth of tourism arrivals in southern Africa at 5.4 percent through 2020.

The Americas comprise a virtually untapped market for Zambia, accounting for only 7 percent of tourist arrivals; Asia is another relatively untapped market. Both regions offer substantial potential for Zambia's tourism sector. Recent upgrades made to the ZNTB's Website advertising Zambia's tourist destinations and resources is a positive step to tapping these broader markets.[1] However, much infrastructural work remains to be done in the sector. Negotiations must also be conducted with airlines serving southern African destinations and international travel package operators in order to achieve reductions in airfares into Zambia and extensions in the amount of time that package deals allow for tourists to stay in Zambia. Special events, such as the past solar eclipse and the upcoming World Cup Soccer competition to be held in South Africa in 2010, present valuable opportunities to draw tourists to showcase Zambia for travelers who may not otherwise visit the area.

Institutional and policy framework. The Ministry of Tourism, Environment and Natural Resources oversees and formulates policy for the sector. The ZNTB is an autonomous statutory body that implements government tourism policies. The ZNTB advises on sector development and marketing; conducts market research; collects statistics relating to the sector (arrivals, revenue, accommodation capacity, employment and investment); performs investment appraisals; and licenses tourism enterprises. The ZNTB also performs regulatory tasks including review and enforcement of operating standards.

Another statutory organization, the National Heritage Conservation Commission (NHCC), inventories potential sites for tourism development. Zambia has 19 national parks and 34 game management areas covering 33 percent of the country, however, only five percent of these resources have been developed for tourism. The NHCC has catalogued 1700 unexploited sites for development.

In the private domain, The Tourism Council of Zambia (TCZ) functions as a cooperative marketing and lobbying organization for the various productive components of the tourism industry (airlines, hotels and caterers, tour operators, travel agents, associations for specific touristic attractions and sports, conservation groups, hunters, wildlife producers). The TCZ maintains a database of Zambia's tourism services.

In 1997 the Zambian government adopted a tourism sector strategic action plan for 2000-2005. This plan comprises strategies focused on management and marketing, product planning and infrastructure development. Since adoption of this plan, there has been much talk about promotion of the tourism sector. Alliances have been forged with international tourism marketers and operators worldwide; conferences have been held in Lusaka and attended elsewhere; journalists and VIP's have been invited to Zambia and shown around the country. Yet, the nuts and bolts of policy implementation remain an elusive goal because of a lack of coordination among the government agencies responsible for execution of strategic plan objectives. As a result, gain from well-intended policy measures has been modest, and precious time has been lost in safeguarding environmental resources and benefiting from the increasing general tourist flow to the southern Africa region.

Policy recommendations. Tourism, by its nature, is a trade based on appeal and trust. Potential customers must have confidence that the services they will receive will be predictable and a fair

---

[1] The ZNTB's Web homepage can be accessed at www.zambiatourism.com/zntb. An additional ZNTB site, www.zamnet.zm/zamnet/zntb/zntb.html, offers travelers useful information about means of travel, resorts, excursions, health matters, currency exchange, commercial offices and embassies.

value. Enticing leisure travelers to Zambia will necessitate merging transportation, housing and attraction into convenient, relatively seamless and replicable packages.

Immediate objectives for the Zambian government and private sector in the tourism sector are:

- Providing infrastructure (roads, electrification, telecommunications, solid waste management, public transportation);
- Improving the private investment climate (providing financial credit at lower cost, making land acquisition process more flexible and fluid);
- Attracting foreign investment into the tourism sector (foreign companies have marketing links, experience, technology, etc.) by simultaneously promoting the unique attractions of the country and reassuring foreign developers of the stable and rewarding features of doing business in Zambia;
- Encouraging more private investment in constructing tourist accommodations, including mid-range priced hotels to cater to a broader range of touristic clientele;
- Complementing accommodations with shopping complexes, restaurants, recreation centers; making medical care available proximate to major tourist attractions;
- Conducting inspections ensuring that best practices are used and international standards are adhered to (ISO 9000);
- Assisting the ZNTB with increased funding so that it can use more sophisticated technologies in expanding its promotion programs.

Zambia has tremendous tourism resources, and more promotion attention focused on these resources will also bring ancillary economic and social benefits. Promotion should aim at countering negative perceptions of Zambia as a travel destination due to health and security reasons. Promotion should also focus on the potential for attracting tourists from the Americas and Asia. Increasing the number of travelers to Zambia will augment the number of flights going in and out of the country – a definite plus for other NTE sectors such as horticulture that often depends on excess airline cargo space to ship perishable products to international markets.

GEMSTONES

Sector background and potential. Zambia is one of the world's three largest producers of emeralds, along with Colombia and Brazil. Zambia is believed to have the second largest deposits of high quality emeralds in the world, although there is some uncertainty as to deposit size rank order among these three countries. Zambia currently produces about 20 percent of the world's emerald supply. Zambia also has large quality reserves of tourmalines, aquamarines, amethysts, citrines and garnets. The government statistics show that exports from the gemstone sector between 1990-2003 have more than tripled to a value over USD 23 million. Unofficial estimates generally put this value much higher, at somewhere between USD 50-100 million due to the presence of illegal mining and trading activity.[1] In comparison, in 2003 Colombian exports of emeralds alone were valued at USD 79.7 million. The World Bank projects that Zambia's gemstone exporting potential

[1] Unauthorized mining trenches, theft, and unrecorded trading of Zambian gemstone resources has been a by-product of years of government inattentiveness, or lack of comprehensive vigilance in monitoring activities within the sector. There is little consensus on the extent of "informal" cross-border exports from the sector. One source estimates that unrecorded exports of Zambian emeralds could be as high as USD 200 million annually (PricewaterhouseCoopers, "How Zambia Can Achieve Export-Led Growth," Report Prepared for USAID, March 2001, Annex C, p.6).

may be as high as USD 600 million;[2] other estimates project actual annual exports at between USD 165-200 million.

Thus far, more than 90 percent of the gemstones mined and exported by Zambia have been raw, uncut stones. Zambian authorities have issued about 450 ten-year gemstone mining licenses and 430 two-year "artisan" licenses. The sector includes at least four large mining enterprises. The largest of these is Kagem Mining, Ltd., launched in 1984 as a joint government/private operation. Kagem employs about 350 persons, has annual sales in the USD 10 million range, and is currently owned 55 percent by the government and 45 percent by Hagura, an Israeli-Indian consortium (although further privatization of the enterprise is underway). Major U.S. companies and other foreigners have also bought assets in Zambia's mining industry.

Country "reputation" in the gemstone trade is one important factor that will impinge upon Zambia's ability to expand its participation in the international gemstone marketplace. Fine emeralds from Colombia, Brazil and Zambia differ in many characteristics specific to the trade (color, clarity, etc.), combinations of which appeal differently to buyers. On balance, however, a Zambian stone equivalent in quality to a Colombian stone will be valued 50 percent lower because of prevalent perceptions that Colombian stones are superior. Colombia's status as exporter of the finest emeralds is now in jeopardy due to its practice of synthetically enhancing stones with inclusions through oiling and heat treatments. This practice itself has contributed over the past decade to diminished demand for emeralds worldwide and a concomitant depression of prices. Zambian emeralds, it is said, generally do not need enhancing if they have not been fractured as a result of mining techniques such as blasting. Because of their lower cost, Zambian emeralds currently pose attractive prospects for gemstone speculators who will buy now and hold onto inventories until international prices recover.

Private initiatives are now underway to introduce more gemstone processing facilities in Zambia. By domestically washing, polishing and cutting selected stones of quality, Zambia can impart new skills to local workers, acquire more export revenue by adding value to its gemstone products, and also elevate its stature in the international gemstone trade.

Markets. The current principal market for Zambia's raw gemstones is India, accounting for about half of the officially recorded export value. South Africa is the second largest market, followed in importance by Hong Kong, Thailand, Israel, Korea, the UK, Switzerland, the U.S. and France. Also, there are some intermittent purchasers of Zambia's gemstones, such as Japan. Potential markets are, of course, larger segments of the broadest and most lucrative markets, such as in the United States and European countries.

Institutional and policy framework. A problematic regulatory environment surrounding gemstone mining practices in Zambia is another, and perhaps the most critical, factor hampering sector growth and the international image of Zambia as a reputable trader in gemstones. The policy framework for the gemstone sector is largely defined by the Mines and Minerals Act of 1995; the Ministry of Mines and Minerals is responsible for implementing the provisions of this Act. These provisions include encouragement of foreign investment in exploration; establishment of large and

---

[2] World Bank, "Zambia Country Economic Memorandum: Policies for Growth and Diversification," Volume 1, Washington, D.C., 2004, pp. xiii, 49.

small private mining enterprises; and assurances regarding property rights, sector economic stability and environmental management.

The provisions of the Mines and Minerals Act have not been systematically implemented in Zambia. As a consequence, there exists weak monitoring of investors and investor interest in the sector; inadequate dissemination of information about available plots for mining; and irregular recording of commercial mining activities. Lax government oversight and administration of the sector (e.g., staffing shortages at regional mine bureaus) and ineffectual coordination between offices of the Ministry of Mines and other government agencies (e.g., labor and immigration, the police) has left mining areas short on infrastructural improvements as well as security. Without the existence of any unified trade association that can lobby for miner grievances, private mining enterprises have resorted to using their own resources to compensate for government gaps and lapses in order to protect their investments. This unfortunate situation has exposed the sector to routine pilfering of valuable assets, some through unauthorized mining; it has damaged the well-being and integrity of villages located in the heart of mining areas; and it has served to erode the dependability and sustainability of reputable markets abroad for Zambia's gemstones.

In December 2004, the Government announced establishment of the Zambia Gemstone Exchange, Ltd., a formal clearinghouse for Zambia's gemstone products. The Exchange has been designed, through consultations with the Lusaka Stock Exchange and the Zambian Securities and Exchange Commission, to provide a fair value marketing system for Zambia's gemstones. The Gemstone Exchange is a positive step toward stabilizing the gemstone sector and it realizes one of the principal recommendations of the poverty Reduction Strategy for Zambia.

Policy recommendations. In order to realize more mining potential and maximize value, Zambia needs to improve the investment climate and reputation of its gemstone sector. The Government needs to adhere to a coherent strategy from mining-to-export using the terms of reference and guidelines provided by the Mines and Minerals Act and PRSP. Implementing policy specifics will necessitate close-knit teamwork on a continuing basis between private and public sectors. For their part, government authorities should:

- professionalize record keeping for the mining sector to promote accuracy in tracking plots available for mining; commercial mining activity; potential investors in the sector;
- review all stages of bureaucratic procedure within the sector to simplify and streamline paperwork and eliminate other barriers impeding legal activity (e.g., privatization cases that are pending);
- provide duty and value added tax exemptions to mining firms in a timely manner, lower corporation tax rates as is done for other non-traditional exporters; oversee rates of local council taxes for the sector;
- establish and enforce a system of monitoring compliance with mining licensing rules;
- support establishment of smaller-scale mining businesses by making affordable financing credits available (e.g., a mining community revolving fund);
- provide new infrastructure (e.g., roads linking remote mining areas with trade and export centers, electrification, housing) and security;
- finance increased formal promotion of Zambian gemstone products.

With successful implementation of measures as cited above, it can reasonably be expected that the private firms operating within the sector will undertake initiatives to heighten Zambian gemstone competitiveness in international markets, and specifically in broader markets such as the U.S. These initiatives will likely include:

- introducing alternate technologies and equipment for gemstone extraction (underground mining versus destructive blasting);
- backing away from commodifying output through informal channels such as the Internet and steering toward formal, reputable marketplaces by working through the Gemstone Exchange; the examples set by larger firms will encourage more small suppliers to enter and thus enlarge domestic auction markets—a means that can secure year-round supplies of products that can consistently meet worldwide demand;
- investing in additional gemstone added value activities (importing skilled foreign craftsmen, training and management courses for domestic workers, capital outlays for modern machinery and tools).

ENGINEERING PRODUCTS

Sector background and potential. The range of products produced in this sector includes semi-finished and finished non-ferrous metal products such as copper rods and cables, metal sheets, strips and coils; finished metal by-products and consumer goods, such as bicycles, metal railway sleepers, radiator ingots; and other engineered products such as cans and drums, and carbon brushes. The Export Board of Zambia currently lists eight companies as conducting business in this sector.

Zamefa, the largest manufacturer of engineered metal products in southern Africa, dominates Zambian exports of engineering products with over 90 percent of business. The firm was privatized in 1996 and is currently part of the Phelps Dodge Cable and Wire Company of the U.S. Most of the other firms in the sector are of medium size and supply only the domestic market. The sector is going through a slump. Many of the smaller enterprises have recently ceased production (e.g., Galco, Zamula) because of competition from cheaper imports from China, Russia and South Africa. Declines in product purchases by the copper mines and by the government for its infrastructure projects; and delays in the implementation of infrastructure projects, such as rural electrification, have also contributed to the slump.

During 2003, engineered metal product exports accounted for 7 percent, or USD 29 million, of all Zambian NTE substantially lower than the peak export of USD 42 million in 1997.

Markets. Zamefa is one among a few firms in Zambia that operates within internationally recognized quality standards; it has ISO 9000 certification. Most of Zamefa's engineered metal products are sold to South Africa, Kenya and Tanzania. The DRC is a potential market to which, according to some estimates, Zambia could triple its sales during the course of DRC's rehabilitation of infrastructure and mines. France and Sweden are among Zamefa's new customers, and the company is now also targeting the Indian market.

Institutional and policy framework. The sector uses locally produced copper as the main raw material. Therefore, its competitiveness depends largely on efficiency in local copper mining. The high cost production of copper in the past seriously affected particularly small producers of engineering products. They have not been able to cope with competition from cheaper imports; some have ceased production altogether, let alone expand capacity to enter export markets. Successful privatization of copper mining in Zambia (recently completed) is expected to improve efficiency in mining and strengthen the competitiveness of the engineering sectors.

Regional markets are the main destination of Zambia's exports of engineering products. Improvements in trade facilitation (transportation, customs administration, standards, etc) collaboratively with the trading partners in the context of SADC and COMESA should be a policy priority for Zambia.

Policy recommendations. A key policy issue is the foreign exchange risk for exporting companies. Zamefa, the exporter, pays for its primary input in USD; it pays VAT to local copper mines also in USD; the mines remit the VAT to the government in kwacha; the VAT is ultimately returned to Zamefa in kwacha. Similarly, Zamefa experiences currency risks in its operations due to its paying for its inputs in USD, but receiving payments from South Africa in Rand. Zamefa's chief competitor, a manufacturer in South Africa, does not have this risk, as it both pays for its inputs and receives payment for products in Rand. Not all of these problems can be eased through government actions. However, the tax system could be modified to permit VAT payments and reimbursements to be made in the same currency.

5. How Can Enhanced Trade Capacity and Coordination Help Increase Integration?

Zambia faces a daunting array of trade negotiations and on-going agreements in addition to the usual national trade policy concerns. The Government is trying to participate effectively in the Doha Development Round, while preparing for the negotiation of an Economic Partnership Agreement with the EU. It is a beneficiary of both the US-sponsored AGOA and the EU-sponsored EBA preferences, and a member of COMESA and SADC. Landlocked, with eight immediate neighbors, bilateral trade and transit issues loom large in the day-to-day work of Government trade officials. And, Zambia needs to promote exports, notably non-traditional exports in order to reduce the country's dependence on copper.

To handle this workload, the Ministry of Commerce, Trade and Industry (MCTI) appointed, in June 2004, a Director of International Trade – who also serves as the Chief Trade Negotiator - assisted by five trade officers in Lusaka, and two trade and investment promotion officers in Geneva and Pretoria.[37] A few members of the MCTI Planning and Information Division also have some familiarity with trade policy, but their attention has tended to focus on privatization. Until recently, there was an Export Board in charge of export promotion, which has now been merged with the Zambia Investment Center and the Export Processing Zones Authority. Staff turnover has been high due to the low level of government salaries as well as the low priority attached to trade issues. The Government also has trouble filling positions that are approved because funding is not made available or because good candidates can not be found.

One of the big challenges for trade policy is the need to coordinate with other concerned ministries. MCTI does not have direct authority over many of the key stakeholders even within government, and it must compete with other priorities in those ministries and agencies. Some key elements of trade policy are outside its authority altogether. Tariff policy is set by the Ministry of Finance and National Planning (MFNP), where revenue concerns can take precedence, while tariff collection and implementation of the duty-drawback system are the responsibility of the Zambia Revenue Authority (ZRA). While this situation is fairly common across countries, the coordination issues involved place a particular burden on understaffed administrations in least developed countries. Furthermore neither the MFNP nor ZRA have significant capacity to do analysis of trade policy options.

Outside of government, the situation is similar. Some business associations, such as the Zambia National Farmers Union (ZNFU) and the Zambia Export Growers Association (ZEGA) have proven to be effective lobbyists, but they have little capacity to evaluate trade policy. The traditional apex

---

[37] Two other officers are returning from educational leave with Masters degrees, and three BA graduates have since joined. Two more trade and promotion officers have been posted to Brussels and Washington, D.C. but at least one of them will be drawn from existing staff. An ODI fellow is currently working in this Department for a period of two years, and the EU is sending a resident advisor.

organizations for business, such as the Zambia Association of Chambers of Commerce and Industry (ZACCI), have not been able to fill this gap due to their very limited resources. There is only one economist at the University of Zambia who has specialized in trade issues, and there is no think tank or research center covering such issues. The Zambia Trade Network has started to build understanding of trade issues in civil society but they have little in-house capacity and their task is enormous. Zambia does benefit from the presence of the COMESA secretariat, which has a core group of trade economists and an active program of analysis and capacity-building, but its focus is regional rather than national, and its region is vast.

Some recent developments hold the promise that this situation may be improving, and increased donor funding is now available. However, many challenges will continue to confront the government, as well as donors concerned to have a sustainable impact. Technical assistance and training has not been in short supply; indeed it may have exceeded Zambian absorptive capacity.[38] Yet one has the sense that the situation today is probably not much different than it was ten years ago. Virtually all of the findings contained in the Trade Related Needs Assessment report of 2001 remain valid.[39] Somehow, one needs to break the cycle of short-term projects dependent largely on foreign consultants who do good work but leave no mark on the institutional capacity of the country once the funding ends.

Improved trade policy formulation and implementation will depend on a variety of factors:

a) political commitment and vision,
b) more regular and informed dialogue between government and key stakeholders,
c) better coordination between Ministries and agencies,
d) greater analytical capacity inside and outside government, and
e) co-operation among donors to address the short, medium and long-term priorities of government and stakeholders.

Political commitment and vision

Because of their cross-cutting nature, trade policy and export development require a clear vision and strong support from the highest level if they are to succeed. The ultimate structure of the trade policy process is secondary.[40] An Export Council chaired by the Prime Minister of Zambia used to exist but it was closed down in 1992. There is no national export strategy. The Poverty Reduction Strategy acknowledges the importance of export-led growth, but it becomes just one more theme, which is marginalized by the time the budget is allocated. There is need for a well-defined strategy on trade and private sector development which is mainstreamed into the Poverty Reduction Strategy and other key national policy statements.

The Private Sector Development (PSD) Forum held in Livingstone, in June 2004, was a welcome contribution which goes part way to address this concern. It was the culmination of a consultative process involving the key stakeholders to develop a well-focused Action Plan which ultimately attracted high level support from eleven Ministers and the President, who endorsed the Forum's recommendations on its final day. While the focus of the forum was considerably broader than export development, many of the key issues and sectors necessary for export success were

[38] USAID, "How Zambia Can Achieve Export-Led Economic Growth", March 2001, p. 32.
[39] Ibid.
[40] This point was made eloquently in Ibid. p. 33.

highlighted. A narrower export strategy, as called for in the Action Plan, would have the advantage of clear performance indicators to monitor progress and maintain political attention. It will be important to follow through on this and the other recommendations to send a clear message of the priority that the government attaches to this issue.

Dialogue between government and stakeholders

With the demise of the Export Council, there has been no high-level mechanism for consultation between government and the private sector, and individual members of the business community have tended to use their personal connections with senior government officials to make their concerns heard. However, the pendulum is moving back. The PSD Forum was organized under the auspices of the Zambia Business Forum (ZBF). The Agricultural Consultative Forum has been meeting for a few years. A National Working Group on Trade has been established, as has a Zambia Business Council.

The ZBF is an interesting initiative designed as an umbrella mechanism that can bring together the various private sector associations so that they speak with a common voice in their dialogue with government. It has recently been established as an independent entity with a very small secretariat, and it performed well in preparing and executing the PSD Forum. Nevertheless, its relationship with other umbrella business associations, notably ZACCI, needs to be clarified in order to avoid unnecessary competition. ZBF also needs to convince associations to start contributing to its financial costs, if it is to become sustainable.

In order for the ZBF to live up to expectations, it must have the capacity to monitor a wide range of issues, assess proposals put forward by government, and develop its own initiatives. This will require some technical staff as well as financial resources, and continued support from a group of donors will be necessary for the medium term. But, it should not be seen as competing with or replacing viable business associations. Consequently, ZBF should also play a role in building the capacity of its constituent members and delegate work and funding to them wherever possible.

The ZBF is more of a lobby group than a consultative mechanism, since it is composed strictly of business representatives. The proposed Zambia Business Advisory Council could complement the ZBF, providing the two are directly linked. The President has been having regular annual meetings with foreign business representatives through the Zambia International Business Advisory Council, and this has prompted domestic businessmen to request similar treatment. The creation of the Zambia Business Council, chaired by the President of Zambia, is an important step to keep private sector issues at the top of the agenda.

A similar, though lower profile, mechanism has just been created to deal specifically with trade negotiations. The National Working Group on Trade (NWGT) consists of 13 members of the private sector and government, chaired by the Director, Foreign Trade, MCTI. In fact, it is intended to provide oversight for a whole series of working groups which have sprung up for Zambia's various trade agreements – one each for WTO, COMESA, SADC and Cotonou – as well as for agriculture and services, and for donor programs (JITAP and the IF).

The proliferation of committees is cause for concern. One option would be to organize uniquely along sectoral lines, limiting the total number of sub-committees to three: agriculture, services and manufacturing. This would have several advantages. First, it would encourage participants to consider liberalization and negotiation options across the various agreements rather than in isolation.[41] Second, it would reduce the time spent by participants listening to discussions of sectors that are of no immediate interest to them, and thereby increase the likelihood of their continued participation. Third, it will provide a venue to discuss national trade policy issues, which may end up being the most important ones.[42] Fourth, this proposal would permit some specialization within the Ministry. The complexities of the services trade are very different from those of agriculture, but similar across negotiations, and trade officials will be more effective if they are specialized in certain sectors. Given the cross cutting nature of trade facilitation we would proposed that as the fourth sub-committee.

The existing trade in services group is apparently working fairly well already. The agricultural trade forum has met only infrequently, but it should be able to build on the successful Agricultural Consultative Forum which has developed into an effective mechanism for coordination and dialogue between the farmers' union, private sector, government and donors on the full range of agricultural issues. Only one new sub-committee would need to be formed – on manufacturing.

At the level of the NWGT itself other questions arise. There will need to be some link with the ZBF and the PSD Forum to ensure consistency and avoid duplication. It would be a good idea to include a few researchers and representatives of civil society to promote transparency and reduce the risk of capture by protectionist interests. And, once again, the agenda should not be driven by the demands of the next trade negotiation, but rather by country priorities.

Coordination within government

There is also a need for improved mechanisms to coordinate across the various ministries and government agencies. Currently, meetings to prepare for trade negotiations have tended to meet on an ad hoc basis prior to important events, and to suffer from lack of ownership on the part of key departments outside of MCTI. These meetings have been viewed as MCTI meetings, and hence they receive low priority from others. After an initial meeting, there is a tendency to send junior officers who are often inadequately prepared to participate effectively. Meanwhile, the Ministry of Finance has the ultimate authority to recommend tariff changes and it does not always wait to reach a consensus with MCTI or other concerned ministries.

An inter-ministerial committee (including the Bank of Zambia and the ZRA) established by the Cabinet is needed to develop positions for the various trade negotiations, assess requests from the private sector for trade policy changes, and coordinate government positions before stakeholder consultations. The MCTI should remain the secretariat for such a committee, but it would be a government-wide committee with Ministers sharing joint responsibility for its performance. The creation of a Steering Committee for the PSD Reform Program, chaired by the Economic Advisor to the President and the Deputy Secretary to the Cabinet, offers such a mechanism, although at present that Program does not explicitly refer to trade negotiation preparations, and the Committee includes donor representatives. A sub-committee should be formed for this purpose, without donor

[41] E.g. Decisions on whether to liberalize the telecommunications sector in the EPA negotiations should be based on an assessment of the alternatives available through the WTO, SADC and COMESA.
[42] E.g. The shortage of export finance or the difficulties in meeting standards in the horticulture sector.

participation, which would feed into both the PSD Steering Committee/Zambia Business Council and the NWGT.

The aftermath of the PSD forum has underlined the need for a new structure to push forward that agenda at the working level. In spite of the momentum created by that Forum and its preparations, follow-up has been disappointing. Consequently, it has been proposed that a special Program Management and Monitoring Unit (PMMU) be established in MCTI, reporting to a PSD Steering Committee of the Zambia Business Council, which would be responsible for driving forward the implementation of the PSD Reform Program. Two of its officers would be responsible for promoting reforms necessary in key growth sectors, and for trade expansion. This structure should also be used to support the Chief Trade Negotiator in her efforts to coordinate preparations for negotiations across ministries.[43]

Capacity-building for policy analysis

Perhaps the greatest challenge is to increase the capacity of the government and other stakeholders to cope with the growing set of trade policy issues and negotiations. This will require institutional knowledge of the WTO, EPA and regional arrangements, analytical capacity to conduct the necessary economic work, and the experience which can only be gained over time. The MCTI has obtained considerable training on trade institutions and theory, but its economists have had little chance to apply and improve their economic tools on the job. This reflects the heavy burden of day-to-day responsibilities and frequent international meetings, as well as a high rate of staff turnover. Yet the first problem is typical of most governments, while the second is partly dependent on broader public sector reform and pay scales. The short- to medium-term answer lies in continued efforts to invest in the analytical capacity of MCTI trade staff, and the creation of an independent unit outside of government which has the necessary expertise to conduct in-depth studies and serve in an advisory role to both government and business/civil society.

Many other African countries now have local think tanks or policy research centers with one or more highly trained economists focusing on trade policy for a significant share of their time. These local experts often accompany government delegations to trade meetings, as well as conduct studies for donors and the business community, participate in local workshops, and contribute to the debate through the media. Zambia does not at present have a trade policy unit to fulfill these functions. Past donor support has focused heavily on studies conducted largely by external consultants. Greater effort needs to be made to transfer knowledge to local economists so that the work is grounded in the Zambian reality, local champions are in place to follow up when the consultants go home, and dependence on external expertise is gradually reduced.

Recently, a proposal for a new semi-autonomous policy institute has been developed by the Ministry of Finance and approved by the African Capacity-Building Foundation (ACBF). The proposed name is the Zambian Institute for Policy Analysis and Research (ZIPAR). It would be devoted to policy-oriented analysis directly relevant to the government, but it would also have a

---

[43] While this PMMU raises the usual concerns about project management units outside the normal civil service rules, the alternative of working within the existing structures has proven ineffective. The PMMU will need to work hard to build a culture of coordination across ministries that is mainstreamed within the administration by the time its 3-year mandate has expired.

mandate to reach out to other stakeholders in order to inform public debate. Representatives from the private sector and civil society will sit on its Board. Located outside the public service, it would be free to offer the competitive salaries necessary to attract and hold senior researchers.

We strongly recommend that MCTI take an active interest in the establishment of ZIPAR and argue for the recruitment of a trade economist as one of its core staff. It should ensure that some of the donor funding now being offered for trade capacity-building be channeled to ZIPAR to help launch its trade program, perhaps by funding a second trade position or providing a technical assistant to be based at ZIPAR. In this way there will be some enduring institutional capacity when this round of donor funding comes to an end. Other ACBF-sponsored think tanks have managed to attract and retain PhD and MA economists, who are contributing to trade policy formulation in their respective countries.[44]

Donor coordination

There is an urgent need to improve donor coordination in the area of trade capacity-building. Happily, trade has become a popular field after years of neglect, but there is a risk that the lessons learned only slowly in other sectors will have to be reinvented in the trade field.[45] Sector-wide approaches have gained acceptance in more clearly defined areas such as health and education, and while it may be difficult to adopt this approach for trade, the underlying principles are valid. The donors need to assist the government in establishing a sense of priorities from the perspective of its development goals, to channel their financial and technical support accordingly, and to promote sustainability by building long-term capacity. This is now being done for Private Sector Development and a similar exercise is needed for trade policy capacity-building. With a new wave of donor projects now starting or under development, the government needs to ensure that they address its priorities in a coordinated way.[46]

Donors involved in private sector development have not traditionally met as a group with the public or private sector, and are not yet promoting a sector wide approach."[47] However, this seems set to change with the establishment of the PSD Steering Committee and its PMMU. Two donors will represent all of their colleagues on the Committee, on a rotating basis, and donors will be encouraged to channel their assistance through the PMMU. If it works, this will be a big improvement. Trade policy should be incorporated into this process more explicitly than indicated by the PSD Reform Program. The JITAP project does call for creation of its own National Steering Committee to manage JITAP activities, and suggests that this committee could also coordinate and monitor all trade-related technical assistance.[48] In the interest of streamlining, and in the spirit of

[44] E.g. KIPPRA (Kenya), EPRC (Uganda), CEPA (Ghana), ESRF (Tanzania), and BIDPA (Botswana).
[45] The government has put considerable emphasis on the need for better governance of the aid relationship and key partners have committed themselves to the Harmonization in Practice (HIP) initiative.
[46] New trade funding is coming from the JITAP project, phase two of the USAID-funded ZAMTIE project, DFID's Enabling Environment project, and EU support for private sector development under EDF 9.
[47] MCTI, "Institutional Strengthening and Capacity Building for Private Sector Development", Proposal for EDF 9 funding, January 2004, p.26.
[48] As planned, the JITAP steering committee should be a sub-committee of the NWGT. The JITAP project calls for the creation of an Inter-Institutional Committee to guide trade negotiations, which is now satisfied by the establishment of the NWGT. This project faces a challenge in coordinating with other donors as none of its three lead agencies (WTO, UNCTAD, ITC) has a representative in Lusaka.

the new Harmonization and Coordination MOU between the government and the donors, it should rely on the PSD PMMU for project coordination.

The absorptive capacity of MCTI to handle all this support is an issue. Two on-going projects are providing long-term technical assistants for the Foreign Trade Department and the JITAP project also allows for the recruitment of a local professional.[49] However, donors will have to do more if they wish to be effective. This will include adapting their interests and priorities to those of Zambia, avoiding competition between donors, and devoting some of their resources to long-term institutional capacity-building.

Recommendations:

1) Mainstream trade and export development in the PRSP;
2) Develop a national export strategy as agreed in the PSD Forum Action Plan;
3) Streamline the National Working Group on Trade, focusing on sectoral sub-committees;
4) Create a sub-committee of the PSD Steering Committee to deal with preparations for trade negotiations and use the PMMU to assist with inter-ministerial coordination;
5) Develop trade policy analysis capacity within ZIPAR;
6) Improve donor coordination through the JITAP or IF steering committees.

[49] The Commonwealth Secretariat Hub-and-Spoke Project has an ODI fellow in place, and the EU EDP2 (Export Development Project) is sending an advisor.

6. How Can Increased Integration Help Reduce Poverty

Poverty profile in Zambia

Zambia faces two poverty ordeals: it is one of the poorest countries in the world, and it suffered from increasing poverty rates during the 1990s[50]. Table 6.1 describes the poverty dynamics. In 1991, the poverty rate at the national level was 69.6 percent. Poverty increased in 1996, when the head count reached 80 percent, and then declined towards 1998, with a head count of 71.5 percent. Poverty further declined in 2002, reaching a head count of 67 per cent. The 1990s was a lost decade for Zambia: the percentage of the population in poverty only fell slightly in 11 years.

Table 6.1: Poverty in Zambia (1991 – 2002) Per Cent

	1991	1996	1998	2002
National	69.6	80.0	71.5	67.0
Rural	88.3	90.5	82.1	74.0
Urban	47.2	62.1	53.4	52.0

Note: Based on the Priority Survey (1991) and the Living Conditions Monitoring Survey (1996), (1998) and (2002).

In rural areas, poverty is widespread; the head count was 88.3 percent in 1991, 90.5 percent in 1996 and 74 percent in 2002. Urban areas fared better, with a poverty rate of 47.2 percent in 1991, 62.1 percent in 1996, and 52 percent in 2002.

The poverty head counts in 2002 reported in Table 6.1 were taken from estimates of the Zambia Central Statistical Office (CSO); CSO followed the methodology used in 1991, 1996 and 1998. Using different methods, the estimates of the 2002 Zambia Poverty Assessment differ slightly. Tables 6.2 compare regional poverty counts in 2002 using the CSO (column 1) and PVA (column 2) methods. All provinces showed aggregate poverty counts higher than 50 percent, except for Lusaka, the Southern Province. Poverty in the Copperbelt was 52 percent. The highest head count was observed in the Northern Province, where 75 percent of the total population lived in poverty. The other provinces showed head counts in the range of 50 to 67 percent. Poverty was much higher in rural areas than in urban areas.

Links between trade and poverty in Zambia

International trade brings about benefits and losses that affect households both as consumers and as producers or income earners. As income earners, households are affected when trade changes wages

[50] The analysis uses data from the 1998 and the 2002-2003 Living Conditions Monitoring Survey.

and agricultural income. As consumers, households are affected when trade changes the prices of goods consumed by the family.

Table 6.2: Poverty Profile in 2002

	CSO	PVS
National	67	56
Central	69	54
Copperbelt	58	52
Eastern	71	56
Luapula	70	67
Lusaka	57	47
Northern	81	75
North-Western	72	61
Southern	63	47
Western	65	52

The effects of trade on the income side can be characterized by studying income shares for different sources of income. In Table 6.3, we report the average income shares for different sources of income. At the national level, the main sources of income are income from own production (28.3 percent), income from non-farm businesses (22.3 percent) and wages (20.8 percent). Regarding agricultural income, the sale of food crops accounts for 6.3 percent of total income, while the sale of cash crops, for only 2.5 percent. Livestock & poultry and remittances account for 5.5 and 4.9 percent of household income, respectively.

Table 6.3: Sources of Income, 1998 (in percent)

	National			Rural			Urban		
	Total	Poor	Non-poor	Total	Poor	Non-poor	Total	Poor	Non-poor
Own production	28.3	33.3	19.1	42.5	42.9	42.0	3.3	4.4	2.4
Sales of food crops	6.3	7.6	3.8	9.1	9.5	7.6	1.4	1.7	1.1
Sales of cash crops	2.5	3.0	1.3	3.8	4.0	2.9	0.1	0.1	0.1
Livestock and poultry	5.5	6.8	2.9	8.1	8.7	5.9	0.8	1.0	0.7
Wages	20.8	14.4	32.9	6.9	5.9	10.3	45.3	40.3	49.4
Non-farm income	22.3	20.9	24.9	16.8	16.3	18.3	32.0	34.7	29.7
Remittances	4.9	5.0	4.8	5.3	5.0	6.1	4.3	4.9	3.9
Other sources	9.5	9.0	10.3	7.5	7.7	6.9	12.8	13.0	12.7
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Own calculations based on the Living Conditions Monitoring Survey 1998

There are important differences in income sources between poor and non-poor households. While the share of own-production is 33.3 percent in the average poor household, it is 19.1 percent in non-poor families. In contrast, while wages account for 32.9 percent of the total income of the non-poor, they account for only 14.1 percent of the income of the poor. The shares of income generated in non-farm businesses are 20.8 and 25 percent in poor and non-poor households respectively. The poor earn a larger share of income from the sales of both food and cash crop, and lower shares from livestock and poultry.

There are also significant differences in income shares across rural and urban households. In rural areas, for instance, 42.5 percent of total income is accounted for by own-production; the share in urban areas is only 3.3 percent. The share of non-farm income in rural areas is 16.7 percent, as compared with a 32.1 percent in urban areas. In rural areas, the shares from food crops, livestock, wages and cash crops are 9.1, 8.1, 6.9 and 3.8 respectively. In urban areas, in contrast, wages account for 45.3 percent of household income, and the contribution of agricultural activities is much smaller.

Reducing poverty in rural areas

In rural areas, there are two main channels through which new trade opportunities can affect household income: (a) households can switch from subsistence farming to cash crop farming, (b) household members may earn a wage in other farms. To provide some quantification of the gains that can be expected from these two new opportunities generated by international trade, we work with two models: the unconstrained household model (where the household can plant an additional hectares of cash crops without giving up subsistence farming) and the constrained household model (where the household switches to a cash crop by giving up subsistence farming). In the case of the unconstrained household model there would be no foregone income by expanding household activities to a cash crop.

In the constrained model, growing cotton (instead of subsistence farming) leads to increases in income of around 20 to 24 percent in the case of (a) and (b) above[51]. In the unconstrained model, instead, the gains are equivalent to around 56 and 68 percent. If the household switches to tobacco, the gains would be 88 and 100-130 percent in the constrained and unconstrained models respectively. Therefore, growing tobacco seems to be an important vehicle for poverty alleviation. In the cases of vegetables and groundnuts, two activities often mentioned as good prospects for non-traditional exports, there are no gains in income in the constrained model, but gains of 37 and 20 percent, respectively, in the unconstrained model.

One key crop in Zambia is maize, which is grown by the vast majority of households. Farmers grow local varieties and hybrid maize. While local maize is devoted to own-consumption, hybrid maize can potentially be produced for the market. We find gains ranging from 55.7 percent in the constrained model to roughly 100 percent in the unconstrained model. These are important results because they support the claim that income gains can be achieved through the production and sale of hybrid maize. In addition, since most Zambian farmers across the whole country grow (or grew) maize, there is a presumption that they are able to produce it efficiently and that some of the constraints faced in other crops may not be present. Know-how and fertilizer use are examples. In those regions in which cotton and tobacco, major exportable crops, are not suitable agricultural activities (due to weather or soil conditions), the production of hybrid maize appears as a valid alternative. Switching from local to hybrid maize requires significant increase in government extension services and other support to maize producers.

If larger market access is achieved, rural labor markets may expand and workers may become employed and earn a wage. By comparing the average income in subsistence and in rural wage employment in agriculture, we estimate gains associated with rural employment ranging from 104.2

[51] For detailed results see, “Zambia: Trade and Poverty” by Ihsan Ajwad, Jorge Balat, and Guido Porto, Dec 2004.

to 128.3 percent of the total expenditure of the average poor household in rural areas. Rural employment in commercial farms could be good instruments for poverty alleviation.

Reducing poverty in urban areas

In urban areas, key vehicles for poverty alleviation through trade involve employment opportunities and higher wages. Zambia's main opportunities for export diversification and employment creation are in the areas of light manufacturing. These include textiles (cotton yarn, loom state fabric, acrylic yarn, and toweling), processed foods (sugar, molasses, honey and bees wax) and engineering products (copper rods, cables, wire, billets and brass ingots). The light-manufacturing sector is the key to poverty reduction because it is low and unskilled labor intensive. Households benefit from the wage incomes, which are generally higher than incomes coming from their next best alternative such as farming their own plots. In addition, incomes from employment in factories are generally less variable than farm incomes, which are very dependent on rain and other exogenous factors.

A healthy and growing manufacturing sector can decrease poverty partly because of its ability to create jobs through direct employment generation and equally importantly, because of the backward linkages it fosters through the sourcing of raw materials (agricultural goods) and intermediate goods (button and thread producers, packers, etc.), capital goods, and through forward linkages (advertising, marketing, distribution, etc.). In Zambia, a healthy manufacturing sector also contributes to a more profitable agricultural and primary commodity sector. The employment opportunities generated decreases the households' dependence on farm incomes, and increases formal sector employment. Employment and hence, wages are not the only benefits that accrue to these workers and to the economy as a whole. In addition, workers in these factories are also likely to be exposed to good production practices, management techniques, quality control practices, etc. In other words, there is significant potential for total factor productivity (TFP) growth, which in turn tends to have a lasting impact on productivity and hence, economic growth.

Between the early 1990s and 2002, Zambian export values of textiles increased three fold from US$9.6 million to US$26.9 million. As a share of manufacturing exports, textile exports doubled in importance between 1990 and 2002. As such, textiles, with about 95 percent of it being cotton yarn (HS 6513), represented around 41 percent of all manufacturing exports in 2002. Approximately 24,000 people were directly engaged in the manufacture of textiles in Zambia (LCMS 98) and the wages earned in the sector contributed to the welfare of around 156,000 people[52]. The current profile of textile sector workers is that 36 percent are extremely poor, 19 percent are moderately poor, and the remaining 45 percent are non-poor. In other words, a majority of textile workers are poor and thus, the poor stand to benefit from an expansion in this sector through higher employment levels.[53]

---

[52] The typical textile worker belongs to a household with 6.5 members.

[53] Several trade related measures can be taken to expand the textile and garment sector to improve the welfare of families. The most obvious of these is increasing use of trading preferences under the Everything but Arms (EBA) and Africa Growth Opportunities Act (AGOA). For instance, the textiles and garments sector can benefit significantly from these preferential trading agreements and, thereby, create significant employment opportunities for the large unemployed population. To date, no textiles or garments have been exported directly from Zambia to the US under AGOA preferences. However, it is thought that some textiles are exported through Botswana, Mauritius, and South Africa into the US under AGOA (World Bank, 2004).

The processed foods sector is a good candidate to promote export diversification (World Bank, 2004). Between 1990 and 2001, the sector's contribution increased from 6 (US$ 6.2 million) to 13.8 (US$ 43 million) percent of all non-traditional exports. Sugar accounts for about 85-90 percent of all agricultural processed goods. The South African firm Illovo Sugar is the sole operator in Zambia. Unlike cotton production, which is produced by smallholders, sugar is produced in large commercial farms. As a result, the impact on households is through wage incomes earned for labor supplied.

The agriculture processing industry is emerging as very important to Zambia, both as a domestic supplier and as an exporter. The agriculture-processing sector employs 41,415 workers. Their incomes contribute to the household incomes of around a quarter of a million people[54]. Workers have on average 8 years of education, 49 percent of the workers are females, and the average age of all workers is about 32 years. The poverty profile of the workers suggests that the biggest beneficiaries in the industry are the extreme poor and the non-poor. Of those employed in the sector, around 43 percent are extremely poor, 13 percent are moderately poor, and 44 percent belong to non-poor households.

Impact of trade on the consumption side

The impacts of trade on the consumption side can be seen by looking at budget shares. In Zambia, as in many least developed countries, most of the budget is spent on food. In 1998, the national average share spent on food was 67.5 percent (Table 6.4). The average was higher in rural areas (reaching 73.6 percent) and lower in urban areas (56.6 percent). Further, the poor spent a larger share of total expenditure on food than the non-poor. At the national level, for instance, 71.8 percent of the total expenditure of an average poor family was devoted to food, while for non-poor households the average was 59.3 percent.[55] This means that the largest impacts of trade policies and economic reforms on the consumption side will be caused by changes in the prices of food items.

There is an important additional role for trade as an instrument to reduce the cost of living. Among several foodstuffs, maize is the main food item consumed in Zambia. There are four main types of maize consumption: home produced maize, mugaiwa, roller maize and breakfast meal. Maize consumption was heavily subsidized until liberalization in the early 1990s. After the elimination of these subsidies, consumers substituted away from industrial maize and towards cheaper mugaiwa maize. This substitution cushioned some of the negative effects on the elimination of the subsidies. However, this substitution was only possible after the liberalization of the small milling industry. Importantly, liberalized access to imported maize -to be grinded by small local mills- is essential if poor farmers are to benefit from cheaper mugaiwa.

---

[54] The typical agriculture processing worker belongs to a household with 5.4 members.

[55] Other goods accounting for a significant share of total expenditure were Personal Items, Housing, Transport, Alcohol & Tobacco and Education. However, these average shares were always below 10 percent. The usual differences between urban and rural households, and between the poor and the non-poor were observed. For instance, non-poor households tended to spend a larger fraction of expenditure on Clothing, Personal Items, Housing and Transportation. Budget shares on Education and Health were not different across poor and non-poor households. Comparing rural and urban households, we find that rural households consumed more food, and urban households more Personal Items, Housing, Transportation and Education. Shares spent on Clothing, Health, and Alcohol & Tobacco were not very different.

Table 6.4: Average Budget Shares, 1998 (in percent)

	National			Rural			Urban		
	Total	Poor	Non-poor	Total	Poor	Non-poor	Total	Poor	Non-poor
Food	67.5	71.8	59.3	73.6	74.6	70.3	56.6	63.1	51.2
Clothing	5.6	4.8	7.1	5.6	5.2	7.0	5.5	3.6	7.1
Alcohol and tobacco	3.6	2.9	4.9	3.7	3.0	6.0	3.3	2.3	4.1
Personal goods	7.1	6.8	7.6	5.7	6.1	4.5	9.6	9.1	9.9
Housing	4.5	4.2	5.0	2.9	3.0	2.4	7.3	7.7	6.9
Education	2.5	2.6	2.3	1.9	2.1	1.0	3.6	3.9	3.3
Health	1.4	1.3	1.6	1.3	1.3	1.5	1.7	1.5	1.7
Transport	4.2	3.2	5.9	3.4	3.1	4.3	5.5	3.6	7.1
Remittances	1.3	0.7	2.4	1.0	0.7	1.9	1.9	0.8	2.8
Other	2.4	1.7	3.9	0.9	0.8	1.2	5.1	4.2	5.9
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Own calculations based on the Living Conditions Monitoring Survey 1998

List of References

Castro L.,Kraus C., & Rocha M., *Regional Trade Integration in East Africa: Trade and Revenue Impacts of the Planned East African Community Customs Union*, Africa Region, Working Paper Series, No. 72, World Bank

Chikosi C. et al. 2004. *Zambia: An Assessment of the Investment Climate, Africa Private Sector Group*, Washington, D.C.

Department for International Development.2004. Project Memorandum: Zambia Enabling Environment Project: Improving the Enabling Environment for Business in Zambia with a Particular Emphasis on Agriculture, Lusaka, Zambia.

Devarajan Shantayanan & Go Delfin S. 2002. *A Macroeconomic Framework for Poverty Reduction Strategy Papers with an Application to Zambia*, Africa Region Working Paper Series No. 38

Export Board of Zambia. 2002.*'Exporter Audit Report,' Various Issues (1999-2002*), Lusaka

FIAS. 2003. *Republic of Zambia: Administrative Barriers to Investment*, Washington, D.C.

FIAS.2003.*The Zambia Investment Act: A review of proposed amendments*.

FIAS, 2004, *Zambia: Study of the Effective Tax Burden in Five Priority Sectors: Aide Memoire*.

Imani Development. 2002. *Zambia: Policies for Export Diversification*.

Imani Development.2004. An Inventory of SADC Region Non Tariff Barriers (NTBs): Zambia

IMF, Zambia. 2004: Request for Three-Year Arrangement Under the Poverty Reduction and Growth Facility-Staff Report, IMF Country Report No.04/222.

Jacobs & Associates.2004.*Market Access for Zambian Horticulture Exports: Developing and Institutional and Regulatory Framework for Testing and Certification Services*, Background Study prepared for the DTIS.

JITAP National Steering Committee.2004.*JITAP II Project Document*, UNCTAD, WTO, ITC, Lusaka, Zambia.

Keyser J.,Heslop T., & Abel J.2002. *Trade and Investment Opportunities in Agriculture*, ZAMTIE project.

Lewis George.2004. *General Agreement on Trade in Services: Transport Sector: Report for the Zambia Business Forum*.

Ministry of Commerce, Trade and Industry. 2004. *Draft Private Sector Development Policy*, Government of the Republic of Zambia, Lusaka, Zambia

Ministry of Commerce, Trade and Industry.2004. *Project Proposals for 9th EDF Funding: Institutional Strengthening and Capacity Building for Private Sector Development*, Government of the Republic of Zambia, Lusaka, Zambia

Ministry of Finance and National Planning.2002. *Zambia: Poverty Reduction Strategy Paper 2002-2004*, Government of the Republic of Zambia, Lusaka, Zambia.

Page Sheila, Options for Zambia in the Negotiations for Economic Partnership Agreements with the EU, ODI, 2004

Porte Deborah, 2004. *An Assessment of the Export Processing Zone Program in Zambia*, background report prepared for the DTIS.

Schuler Philip and Ikezuki Takako.2004. *Notes on Tariff Revenue from Capital Good Imports* for Zambia DTIS, Mimeo, World Bank.

Schuler Philip and Ikezuki Takako.2004.*Zambia and the COMESA Common External Tariff*, Background Study prepared for the DTIS.

Tokeshi H. 1997. *Trade Reform in Zambia: Measurement of its implementation and its impact on import flows*, Informal Discussion Paper 1, Washington, D.C.

Fox James & Greenberg Donald, "*How Zambia Can Achieve Export-Led Economic Growth*", USAID, March 2001,

Voest, Joop de.2002. Trade and Investment Opportunities in Zambia's Cotton through Apparel Industries, USAID, Zambia Trade and Investment Project.

Wichern R., Hausner U. & Chiwele D. 1999. *Impediments to Agricultural Growth in Zambia*, International Food Policy Research Institute.

World Bank. 2001. *Zambia Public Expenditure Review*, Report No. 22543-ZA. Washington, D.C.

World Bank. 2002. *Zambia Poverty Reduction Strategy Paper and Joint Staff Assessment*, Report No. 24035-ZA. Washington, D.C.

World Bank. 2002. *Zambia: The Challenge of Competitiveness and Diversification*, Washington, D.C.

World Bank. 2004. *Zambia: Country Economic Memorandum: Policies for Growth and Diversification*, Draft, Washington, D.C.

World Trade Organization. 2002. *Zambia: Trade Policy Review Mechanism*. Geneva, Switzerland.

Yagci F., Aldaz-Carroll E..2004. *Salient Features of Trade Performance in Eastern and Southern Africa*, Africa Region, Working Paper Series, No. 76, World Bank

ANNEX

Donor Projects Supporting Trade Related Activities

European Union

The EU has provided over 40 million Euros for two export development support programs, namely, the Export Development Program II, 2003-2007 (EDP II) and the Mining Sector Diversification Program. The Export Board of Zambia is coordinating both programs. The first Export Development Program (1993-1999) provided lines of credit to producer organizations involved in non traditional exports: over €18 million was disbursed. The successor project Enhanced Export Support for Marketing (EESM) provided € 5 million to ZEGA, and to the tobacco and coffee sectors. During this period, coffee production trebled and tobacco production doubled.

The EU also provides support to Zambia through the Common Market for Eastern and Southern Africa (COMESA) Secretariat under the Regional Integration Program. This support will continue into the near future under the 9th European Development Fund (EDF) as part of the Cotonou Agreement.

The 9th EDF identified three priority areas in the country strategy paper for Zambia:

- Economic planning and budgeting (including statistics);
- Financial management and accountability; and
- Provision of an enabling policy and institutional environment for private sector- led growth.

The first two of these areas focus on the Ministry of Finance while the third one focuses on MCTI. There are substantial resources available under the 9th EDF. MCTI has prepared a project document for submission to the EU.

USAID

The ZAMTIE (2001 –May 2005) project provides for a trade advisor on an ongoing basis to the MCTI, and supports the ZBF and other private sector associations in capacity building. The project seeks to improve the trade and investment environment, advise the government and the private sector on negotiations under WTO, EU-ACP, SADC and COMESA, assist with legislative instruments to effect appropriate trade remedies (safeguards), assist with identifying trade and investment opportunities and barriers to Zambian exports, and strengthen the technical capacity within MCTI through the provision of training and short courses. The project provided technical support for the implementation of the new Safeguards legislation, including drafting and training courses, a review of the agricultural sector, opportunities for exporting under AGOA, and a study on the textile and clothing sector.

The new USAID Country Strategic Plan 2004-2010 includes Strategic Objective 5 (SO5) "Increased private sector competitiveness in agriculture and natural resources". The specific aim of the Objective is to support interventions to augment the level of Zambian exports through expanded market access and improvement in the business enabling environment. The USAID financed Market Access, Trade and Enabling Policies Project (MATEP) is expected to commence in May 2005 and continue through May 2010. The project cost will total $8 million with $6 million dedicated to for program implementation and $2 million set aside as a loan facility.

Department for International Development (DFID)

DFID has two Private Sector Development interventions planned to commence in 2005. These include facilitating policy dialogue amongst stakeholders within defined agricultural sub-sectors or thematic areas (The Enabling Environment Project), enhancing financial sector market intelligence, and supporting the implementation of the Financial Sector Development Plan (Financial Services Enabling Environment Project). DFID is currently the Lead Donor Advisor for the Integrated Framework (IF) and has signaled its intention to support priority activities. The EEP aims to improve the policy frameworks for pro-private sector growth by identifying and delivering specific strategic policy interventions aimed at strengthening demand- and supply-side capabilities.

DFID previously financed technical assistance for the trade in services negotiations sponsored by the ZAMTIE project.

World Bank

The World Bank presently has two active projects supporting diversification and exports: Enterprise Development Project (EDP) of $ 45 million, and Support for Economic Expansion and Diversification (SEED) of US$ 24 million. The Bank also provides technical and advisory support as needed.

Joint Integrated Technical Assistance Project (JITAP)

The JITAP is a coordinated program of assistance financed by the ITC, UNCTAD and WTO. The program was prepared during 2003 with implementation commencing during the course of last year. It is organized in four components:

- Capacity building on Multilateral Trading System (MTS) issues including understanding and implementation of the WTO agreements, trade negotiations and the formulation of related trade policies;

- Establishment of a national database and knowledge of the MTS and related networks to ensure availability and flow of information;

- Development of sector strategies to assist entrepreneurs and policy makers to convert trading opportunities that becomes available into new export opportunities; and

- Enhanced Linkages and coordination among various stakeholders including trade related technical assistance initiatives.

Commonwealth Secretariat (September 2003-December 2007)

The Commonwealth Secretariat provides technical assistance on trade negotiation and regional trade issues to Zambia through its 'Hub-and-Spoke' Project. Participating countries are required to appoint a counterpart trade fellow, who is provided with technical and research assistance from the Commonwealth Secretariat. A trade fellow ('spoke') has currently been assigned to MCTI (2003-2005), with a regional advisor ('hub') also in place at the COMESA Secretariat in Lusaka (2003-2005). In addition to technical assistance, the initiative also provides modest financial resources to support research projects undertaken by the national trade fellow and the regional advisor.

Other Donors

Sweden, the Netherlands, Norway, UNDP, UNCTAD and ITC all provide advisory services or funding for training and capacity building of Zambians in trade-related areas.