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EUROBONDS

Weighing risks against gains

Used motor vehicle imports: The quest to squash lemons

Private Sector Development: Engine for growth?

High trade costs: What can be done?

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Message from the Executive Director

Welcome to the second edition of the ZIPAR Quarterly. This issue brings to you our reader some of the topical issues that have emerged on the economic land scape which at the same time form part of the studies ZIPAR is currently undertaking. These topics include Zambia's entry onto the Sovereign Bond Market.

Our cover story talks about Eurobonds: weighing the risks against gains. In the last few years, the issue of public debt has taken centre stage. This has come in the wake of Government issuance of the two recent Eurobonds, US$750m and US$1 Billion. Government has assured stakeholders that the current debt levels are well under manageable levels. The Eurobonds have been received with mixed feelings with some sections of society fearing that the external debt stock has soared closer to the pre-HIPC levels. The question has been asked whether we should be worried about the current levels of debt.

Although Zambia is a second-time issuer of the Eurobonds, its experience and therefore information on international sovereign bonds is still limited. Hence ZIPAR is undertaking a study titled: 'Assessing Zambia's Entry onto the Sovereign Bond Market: Opportunities and Challenges'. This study seeks to understand the opportunities and challenges of Zambia's entry into the sovereign bond market by drawing on the experiences of other countries that have borrowed on the capital markets before to finance their infrastructure projects.

With Zambia becoming a lower middle income country, coupled with slow economic recovery from the global economic crisis in advanced economies, access to concessional resources has become more limited. Therefore, non-concessional borrowing from the international capital markets will inevitably be considered for projects with a high rate of return. Though Zambia's debt is currently sustainable, investing in projects that have a higher investment return must prudently be undertaken to avoid risk of default that could otherwise escalate the current debt levels.

To ensure that Zambia's sovereign-bond issues do not turn into a financial disaster, the country should carefully put in place a sound, forward-looking, and comprehensive debt-management structure. Despite the diversification 'song' regarding copper, most of our export earnings are still copper-dominated. Therefore, dependence on copper export earnings renders the country vulnerable to copper price shocks. Furthermore, a deterioration of other macroeconomic fundamentals may lead to the credit rating agencies downgrading the country's rating, as recently done by Fitch and Standard and Poors, thereby increasing the cost of borrowing.

With these remarks, I usher you into the first article of this issue; Eurobond- weighing risks against gains.

Dr. Pamela Nakamba-Kabaso

ZIPAR Zambia Institute for Policy Analysis & Research

By Albert Halwampa

EUROBONDS:
Weighing risks against gains

There has been recent media speculation about the government issuing another Eurobond – the third in two years. Earlier this month the Ministry of Agriculture talked of the possibility of floating a bond to plug the US$400 million financing gap in the agriculture sector. This has resulted in apprehensions in some quarters of the economy regarding the risks associated with this seemingly allure of Eurobonds. I therefore attempt to weigh up some of these risks.

Zambia successfully issued its first $750million Eurobond in 2012. It was oversubscribed by $11billion with an interest rate of just over 5%. In 2014 another $1billion Eurobond was issued with a higher interest rate of over 8.5%, and a lower level of oversubscription - just $4.25billion. While the former shows high level of investor confidence at relatively lower interest rates, the latter shows some degree of waning investor confidence. $128million will be paid in annual interest to service these debts up until 2022 when the first bond will be paid back. Against this backdrop any third Eurobond requires careful consideration.

There are clear benefits to Eurobonds. Zambia has a huge infrastructure deficit in various sectors of the economy that requires substantial amounts of funds. Now that Zambia is a lower middle income country, it has less access to cheaper loans from the bilateral and multilateral lenders making commercial borrowing more necessary. It makes good economic sense for the country to borrow to fill the public spending gap to accelerate economic growth, poverty reduction and employment creation opportunities.

There is another argument for borrowing more now. During the recent financial crisis most of the countries in the developed world embarked on stimulus plans to stabilize their economies. The measures resulted in interest rates falling to almost zero. Bond investors had to look to more attractive interest rates that prevailed in the emerging markets. In the very near future the current low interest rate environment in the global markets is likely to change with rates rising considerably. Zambia will face higher borrowing costs and market access difficulties in competing for funds. Therefore, Zambia has had an opportunity to take advantage of this by issuing Eurobonds before they become expensive. Recently the US treasury began reducing the size of its bond buying program, known as quantitative easing, which was aimed at stimulating the economy and supporting financial markets, an indication that the tide of low interest rates might be already changing.

Borrowing money from international financial markets is a strategy which has significant potential,

but also one with enormous downside risks. As Zambia's own history and more recent experiences in countries like Argentina, who in 2001 defaulted on $81billion worth of bonds, demonstrates the scale of these risks. There are three particular risks for Zambia, each of which needs an adequate response before taking on substantial further debt.

First, there is a risk that increased capital investment projects financed by Eurobonds may be poorly selected or executed and fail to generate more economic growth and therefore increased government revenue. Increased public capital investment, for example in the transport and energy sectors, may also lead to pressures to increase recurrent spending such as maintenance, which may be hard to contain. Zambia therefore needs to invest the proceeds in the right type of high-return projects capable of generating enough revenue to service the debt.

Secondly, there is always market uncertainty in terms of exchange rate and interest rate risks. Bonds may have to be repaid at a time of higher interest rates, or when the kwacha may be weaker making debt servicing expensive. Zambia's two Eurobonds require interest to be paid each year, but then the full principal to be repaid in 2022 and 2024. Therefore there is a possibility that the country will not have the funds to repay the loans when due. This could result in having to borrow more to repay debt. To mitigate against these risks, Zambia should emulate countries such as Gabon and Ghana who have put in place a sinking fund managed by their central banks.

Thirdly, Zambia faces a particular risk because it is so dependent on copper exports for its foreign exchange earnings. This exposes the country to the volatility in international copper prices. In the event that the copper prices plummet, foreign currency will be in short supply and therefore servicing the Eurobonds will be a challenge. This is why diversifying the economy away from dependence on copper exports by increasing non-traditional exports is so important.

In order to adequately assess the opportunities and challenges of borrowing from the international capital market, ZIPAR is conducting a study on Zambia's entry onto the Eurobonds market. This study examines the experience of other countries, such as Argentina, Ghana and South Africa, etc, in order to ensure a more effective debt management system for Zambia.

The Government recognizes the challenge, but we feel that Zambia is still not well placed to take on further large debts. For example, we argue that in order to respond to the risks we need a comprehensive legal and institutional framework. Arising from such a framework is a sound, forward-looking, and comprehensive debt-management structure with well trained and remunerated debt managers. One important point is that the Ministry of Finance will require building expertise in debt and risk analysis – in the finance sector this is referred to as the "middle office". It undertakes portfolio analysis, develops a risk management strategy, and develops borrowing scenarios and compares emerging debt indicators with agreed benchmarks.

Zambia's past debt crisis is still fresh in many memories. As Zambia starts to borrow more we must avoid the risk highlighted by Joseph Stiglitz, a Nobel laureate economics professor, who recently predicted that, "if analysis of risks involved in borrowing from the international markets is not rigorously undertaken, the debt crisis will again return to Sub-Saharan countries".

By Zali Chikuba

Used motor vehicle imports:
The quest to squash lemons

The used car market is a classic problem long studied by economists whereby sellers generally have more information than buyers regarding the quality of a product.

Earlier this year, an overwhelming majority of cars failed the basic roadworthiness test leading to the suspension of the new automated fitness test. Following this, the head of the organisation responsible for road safety - the Road Traffic Safety Authority (RTSA) - has urged Zambia to consider restricting imports of second-hand vehicles. These are comments which echo Government's concerns over the current policy position on second-hand vehicles.

Second-hand motor vehicles are certainly an issue which affects many Zambians. With no car manufacturer in the country, all motor vehicles registered here are imported. Importation of motor vehicles attracts customs duty at 25%, excise duty of 20%-30% depending on engine size and on top of this, value added tax (VAT) at 16% thereby inflating the cost of cars in Zambia by 75% to 90%. Consequently, most consumers cannot afford to buy new motor vehicles and as a result, the overwhelming majority of imported vehicles – approximately 90% - are second-hand.

The used car market is a classic problem long studied by economists whereby sellers generally have more information than buyers regarding the quality of a product. On the buyers' side, it is hard to know for sure the quality and the safety of the car they are buying. As a result of not having full information about the vehicles being bought, while some second-hand vehicles imported in the country may be fine, there may also be some bad cars commonly referred to by economists as "lemons."

The question is whether Zambians have the information to spot a lemon when they are buying a car? The answer is almost certainly not. Importing used cars into Zambia only requires fulfilment of a very minimal roadworthiness inspection test. This entails confirmation that vehicles have such basic things as genuine mileage, no damage to the chassis, working lights, no major rust, safe tyres and good working brakes. Given this lack of full information, it is in order for RTSA to be concerned about the state of motor vehicles that ply our roads.

Economic realities have forced developing countries like Zambia to depend on used motor vehicles. Consumers with less purchasing power attach greater value to used cars, which is largely why the second-hand car trade flourishes. Some of the used cars imported have conferred greater benefits to the users compared to their cost of acquisition. Therefore, the highly liberal used motor vehicle importation policy has given even some low income households an opportunity to own cars. This improves their everyday lives, but

can also enable better transportation of goods around the country which helps trade. The level of car ownership in Zambia, though relatively low, has considerably increased over the past decades from about 9 cars per 1000 people in 2004 to about 32 cars per 1000 people in 2012. From this point of view, it can be argued that the policy has contributed to improving the lives of Zambians.

The above advantages notwithstanding, the conditions under which the market for used motor vehicles has developed are characterised by minimal regulation. In this market, as already noted, information concerning the fitness of the vehicles being sold is usually inadequate. This means that many buyers will unknowingly have bought a 'lemon'.

This has real implications for both individual consumers and the general public. For an individual consumer, older cars are generally less dependable and costly to maintain but when they buy a lemon, they are deprived and have nowhere to turn to for remedy. For the general public, compromising on safety and health is of real concern. These safety issues are clearly apparent when so many newly registered vehicles end up in auto repair shops. Some of the imported second-hand cars are outmoded and replacement parts are scarce and expensive. This has led to the growth of another discomforting market: the used auto parts market. This has further increased the number of vehicles on our roads with doubtful fitness.

All in all, the overall benefit of the very liberal used car market remains largely uncertain. As the developed world has set high emission standards to coerce owners of old cars to replace them with newer, safer, fuel efficient and cleaner models; old cars have found a market here in Zambia. But this has happened without due consideration to our own economy and safety. If any car that passes only a basic roadworthiness test can be imported into Zambia, are we not then turning this country into some dumping ground?

The growing concern about the condition of motor vehicles being imported in the country is appropriate, but any policy intervention must be supported by evidence. In order to leverage the benefits of the used motor vehicle trade for the welfare of most Zambians and the economy as a whole, the Zambia Institute for Policy Analysis and Research (ZIPAR) is currently undertaking a study to evaluate the effects of the policy position on used motor vehicle importation in Zambia focusing on the reliability of the motor vehicles owned by Zambian households, the relationship between motor vehicle age and the incidence of accidents and motor vehicle price drivers. This study will contribute to informing any policy decisions made in response to some of the concerns raised by Government and RTSA. It is in all our interests that Zambians can avoid lemons when they buy their family car.

For an individual consumer, older cars are generally less dependable and costly to maintain but when they buy a lemon, they are deprived and have nowhere to turn to for remedy

High trade costs: what can be done?

By Mwanda Phiri

A scrutiny of the World Bank's Ease of Doing Business report 2014 reveals that Zambia has been performing poorly on 'Trading across borders' ranking 163 out of 189 countries for the years 2013 and 2014. Zambia's lack of progress on this ranking is symptomatic of high trade costs and bottlenecks to trade. The ranking records the time and cost necessary to complete every official procedure for exporting and importing a standardised cargo of goods. These procedures include documents preparation, customs clearance, ports handling and inland transportation.

76 percent of the time in export and import procedures in Zambia is attributable to administrative procedures – documentation, customs and ports handling.

According to the report, it takes 44 and 49 days respectively to complete all export and import procedures in Zambia whereas it takes 31 and 38 days respectively for Sub-Saharan Africa on average. It takes even less time for developed countries to export and import at 11 and 10 days respectively. On average, 76 percent of the time in export and import procedures in Zambia is attributable to administrative procedures – documentation, customs and ports handling. Such lengthy export and import procedures present high trade costs for businesses and add to their cost of doing business. In particular, the expense of covering per day rates for truck hire and per diem transit allowances paid to drivers. Exporters also incur losses for time-sensitive goods such as perishable agricultural products.

Moreover, businesses risk losing customers due to late and unpredictable delivery of goods. On the other hand, consumers bear the cost of lengthy import procedures by paying higher prices charged for imported goods. But most importantly, lengthy export procedures can negatively impact trade volumes. Caroline Freund and Nadia Rocha in their paper "What Constrains Africa's Exports?' estimate that a one day increase in inland transit time reduces exports by 7 percent on average in Sub-Saharan Africa.

Equally of concern is that bureaucratic and inefficient border procedures encourage smuggling and corruption resulting in lost revenue for governments. The Organisation for Economic Co-operation and Development (OECD) estimate that revenue loss from inefficient border procedures exceeds 5% of GDP in some African countries. For a country like Zambia with a pressing need to improve revenue collection, it is imperative that our border procedures operate more smoothly and efficiently to ensure the optimal collection of revenue.

Granted, Zambia has made some important strides in facilitating trade through the implementation of various initiatives such as the Chirundu one-

stop border post; improved web-based customs handling; and the introduction of scanning machines at border posts among other measures. These measures largely implemented between the years 2011 and 2013 have started to show benefits as evidenced by the sharp growth in Non-Traditional Exports (NTEs). The value of NTEs doubled between the years 2011 and 2013 which to some extent, can be attributed to the implementation of these initiatives. Notwithstanding this achievement, trade costs remain high therefore necessitating continued efforts that will further reduce trade costs, boost trade flows and revenue collection.

Findings from the OECD trade facilitation analysis illustrate short-term measures that can reduce trade costs for lower middle income countries, namely: harmonising and simplifying trade documents reduce trade costs by 2.7% - the top 10 countries that make importing and exporting easy according to the Doing Business report require between 2 to 4 documents whereas Zambia currently requires 7 to 8 documents. Reducing the number of documents necessary for importing and exporting in Zambia should expedite the movement, release and clearance of goods;

Streamlining border procedures further reduce trade costs by 2.2%; ensuring the availability of trade-related information create cost savings of 1.4%; and advance rulings on customs matters bring cost reductions of 1.5%. Beyond this, Zambia stands to benefit from trade facilitation measures that will address factors affecting inland transit time given that increases in inland transit times negatively affect trade volumes. These factors that may affect the ability of firms to meet the specified delivery timelines of goods include the quality of roads and vehicles, efficiency of checkpoints, road blocks, accidents, and border waiting times among others.

In addition, Zambia can easily reduce trade costs by merely strengthening and broadening existing reforms. For instance, the roll out of the one stop border posts will greatly reduce the time spent on customs clearance and port handling at other border posts such as Nakonde and Kasumbalesa. Further, the Zambia Revenue Authority (ZRA) has recently announced that all major customs stations have been connected to a robust Optic fibre network and pooled bandwidth. This measure should address the slow customs procedures that were experienced following the upgrade of the Automated System for Customs Data (ASYCUDA) world.

Of course, improving Zambia's trade will depend on more than these proposed measures. Nonetheless, evidence shows that improving efficiency in border procedures expands trade and in turn, contributes to economic growth. Other benefits include efficiency in revenue collection. Equally important for Zambia is that if inputs to production and finished goods can be imported and exported quickly and in a reliable time-frame, the country will become a more attractive destination for foreign investment.

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By Tamara Billima

Does Zambia need to change the way it allocates the CDF?

As the Ministry of Finance commences the preparation of the 2015 National budget, it is worth asking how the government allocates spending across the different programmes it funds. These decisions are often based on existing historic allocations and developmental plans. It is, however, rare for the government to base spending decisions on some measure of 'need': that is targeting funding at those areas that experience higher levels of poverty, or where the cost of delivering services is higher.

While there is evidence in Zambia of spending decisions based on some measure of need, for example funding to districts under the Ministry of Health uses a resource allocation formula, this is still rare. Governments tend to be weary of using measures of need because of the complexities it introduces to the budgetary process. ZIPAR believes that there is scope for a needs based funding approach. The aim should be to start small and innovate with an appropriate fund. One of the strongest candidates is the Constituency Development Fund (CDF), which accounts for 0.5% of the national budget but which is not distributed equitably.

CDF is intended to help constituencies in Zambia meet their development challenges and is disbursed annually to all constituencies. The CDF has evolved to become an important developmental tool for constituencies and has grown from K60, 000 in 1996 to K210 million in 2014. Constituencies use the fund to deliver certain services including construction of roads, bridges and health posts.

The CDF is disbursed equally to all constituencies when they differ significantly in terms of geographical size, population and levels of poverty. Constituencies in rural areas lack basic necessities such as adequate access to social amenities. Urban constituencies, in contrast, are better placed, in terms of developmental opportunities and levels of economic activity. Yet under the CDF because there is no attempt to take account of different levels of deprivation and poverty, each constituency receives the

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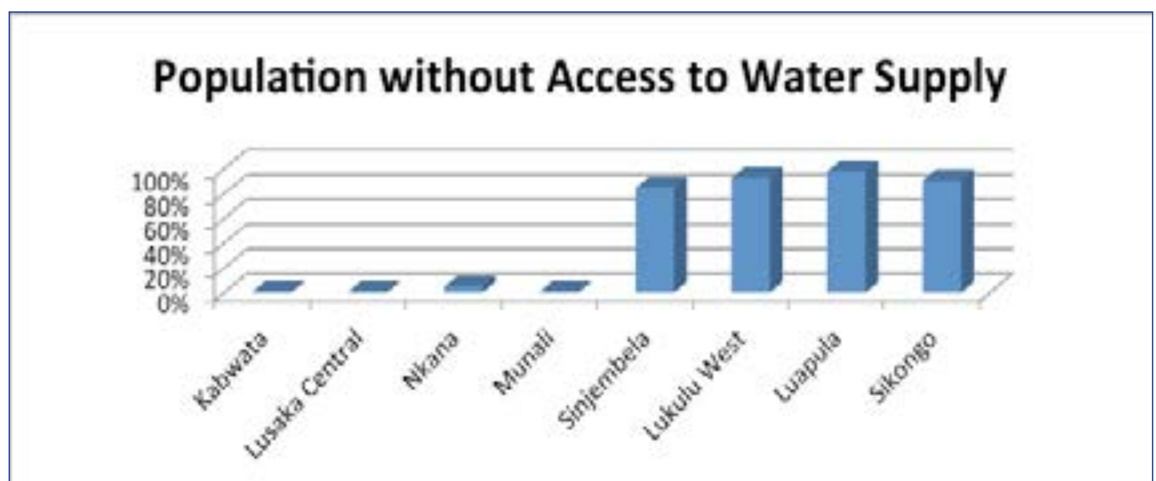


same amount of funding. The current allocation means that a constituency such as Kabwata in Lusaka where only 1% of its population is without access to proper water supply gets the same level of funding as Sikongo in Western Province the most deprived constituency, where 91% of its population lack access to water supply as shown below.

Under the current allocation, Sikongo given its high developmental needs has the same amount of funds to address these challenges as Kabwata which needs less funding to provide water to the 1% without water. To appreciate these varying challenges, ZIPAR has developed a formula that allocates resources based on the deprivation of the constituencies. The formula takes into account the population size of the constituency, access to education, health, water and sanitation, living conditions vis-à-vis the type of housing and employment in the area. The formula thus uses a needs-based approach.

The use of the formula entails that constituencies that are more deprived get more funding than those that are less deprived. ZIPAR proposes two ways of applying the formula. One way of using the formula is through a pure needs approach that requires allocating funds based on the deprivation of the constituency. Using this approach and the 2013 CDF allocation, we find that Kabwata constituency would get K2, 779 while Sikongo would get K947, 629. This realignment of the CDF means reducing the current K1.4 million per constituency significantly and may not be very desirable.

The second way of using the formula however does not significantly distort the current allocation but prescribes a minimum amount to all constituencies and then applies the formula on the excess amount. This alternative can be applied by allocating a minimum of K1 million to all constituencies and then the application of the formula on the excess funding. This way shows that while better-off constituencies do not lose out, worse-off places would be given a fairer slice of the pie. This model avoids creating winners and losers, but rather a win-win situation and should be given consideration.

There is sufficient international evidence to demonstrate the effectiveness of needs-based funding. Uganda for instance has successfully implemented the use of a resource allocation formula in health resources. Zambia as well through the Ministry of Health which has been using the allocation formula since 2004 has found the use of the formula to be relevant and useful.

Countries world over show that it is good practice to allocate resources on a needs based approach as it brings about equity in the nation. The use of a needs based formula will be a good move for Zambia to start allocating government funding based on the needs in the area to address equity concerns in the country.

There is sufficient international evidence to demonstrate the effectiveness of needs-based funding. Uganda for instance has successfully implemented the use of a resource allocation formula in health resources.

Comprehensive Debt Management Structures needed in Management of Eurobonds

Shebo Nalishebo

Full transcript of the interview by Idriss Linge, a Journalist and Communication Consultant for Agency Ecofin with Shebo Nalishebo, Research Fellow, ZIPAR

Agency Ecofin: Your organization, the Zambia Institute for Policy Analysis and Research, is conducting a study to assess and compare the risks and benefits of using Eurobonds as a funding mechanism in Zambia, what justifies this study?

Shebo Nalishebo: *Sovereign bonds carry significantly higher borrowing costs than concessional debt, which we have traditionally been exposed to. Zambia is a second-time issuer of sovereign bonds, having issued its first ever Eurobond in 2012 worth US$750 million and the second in 2014 worth US$1 billion. So the country still has limited experience in terms of how to manage Eurobond debt. The country, and government in particular, needs to make sure that Zambia's sovereign bond issues do not turn into a financial disaster. ZIPAR is therefore undertaking a study titled "Assessing Zambia's entry onto the sovereign bond market: opportunities and challenges" to understand the experience and draw lessons of other developing countries which have taken a similar path in recent years.*

In pursuing this key objective, the following underlying objectives were pursued:

i. Assessment of Zambia's current debt policies and strategies;

ii. *opportunities and risks of private sector borrowing and the inadequacy of private lenders' credit assessments;*

iii. *Understanding the role of credit rating agencies and mitigation of vulnerabilities;*

iv. *the experience of other developing countries with international sovereign bond issues;*

v. *the experience of other countries with municipal bonds;*

AE: If we make with you a partial assessment of the first Eurobond, Zambia will have to repay $ 128 million through 2022, how the money was used, and do the investments that have been made with, allow to generate growth and tax revenues to support debt repayment?

SN: *Government outlined how the money for the debut Eurobond was going to be used in the 2013 national budget as outlined in the table below.*

report is still not ready yet.
US$69 million has been allocated for power distribution projects. Half of the projects have been signed.
Zambia Railways got US$120 million which has been used on rehabilitating rail infrastructure. This has somewhat improved the capacity and speed of cargo haulage for the railway company. But they need more money to revamp this sector. In fact they have been asking for at least US$345 million from the US$1 billion Eurobond issue so that they can revamp the haulage of copper and copper products. Additionally, 4, 000 jobs have been created. It is unclear if these are permanent or temporary jobs or if the workers are eligible to pay personal income tax whose monthly exempt threshold is about US$500.

With regard to the road projects which were allocated US$310 million, US$145 million was actually used to pay back funds borrowed by Government under the Lusaka Urban Roads Project

	PROJECT	ALLOCATION
1	Energy (Generation and Transmission)	US $255 million
2	Transport (Road and Rail)	US $430 million
3	Human Capital and Access to Finance Of which	US $49 million
	Rehabilitation of Central Hospitals	US $29 million
	Access to finance SMEs (DBZ)	US $20 million
4	Fees and Transaction Costs	US$1.4 million
5	Discount Premium	US$14.6 million
Total		US$750 million

Source: 2013 Budget Speech, Ministry of Finance, 2012

prior to the 2011 General Elections. The remaining will be used for road maintenance and upgrading works.

Looking at the projects that the funds have been invested in, we do not anticipate these projects to generate enough returns within the next ten years to pay back the debt due to delays in project implementation, among other reasons. The Ministry of Finance issued a statement on the use of the proceeds of the debut Eurobond.

With regard to energy, US$186 million was allocated for the construction of Kafue Gorge Lower Project. As at April 2014, almost two years after the securing of the money, only about half of the required 11, 500 hectares of land has been secured. While infrastructure for the resettlement of the soon-to-be displaced persons has been completed, this is still awaiting handover. The feasibility study

From the foregoing, it is clear that Government is using funds from elsewhere to pay interest on the debt and it is unlikely that these projects alone will be used to pay back the debt.

AE: The government of Zambia wishes to return to the capital market to raise up to $ 400 million to support investments in the agricultural sector. To what kinds of expenses the government will channel funds, which will be obtained in case of success of this operation. Farming to consumption that focuses on the domestic market, or industrial agriculture that allows entry into segments impacting on the stock of foreign exchange

reserves?

SN: *The details on the agriculture Eurobond are scanty. We are aware that the Ministry of Agriculture recently launched the National Agriculture Investment Plan for the period 2014-2018. We imagine the intended Eurobond is to bridge the financing gaps for this plan. The key areas of focus in this plan include:*

i. *Sustainable use of the natural resource base [land-use planning, administration and management; efficient water use and irrigation; forestry management, energy efficiency promotion and capture fisheries management.*

ii. *Infrastructure and market access* [institutional market arrangements and performance; increasing access to rural and market infrastructure; increasing access to rural finance; and promote value chain integration]

iii. *Food security and disaster risk management and mitigation; and*

iv. *Research and technology to improve crops, livestock and aquaculture production and productivity*

AE: Your organization cites a number of risks that are mentioned when talking about Eurobonds in Africa. What are the risks and how do they manifest themselves already in Zambia?

SN: *First, there is the risk that increased capital investment projects financed by Eurobonds may be poorly selected or executed and fail to generate more economic growth and therefore increased government revenue. Increased public capital investment, for example in the transport and energy sectors, may also lead to pressure to increase recurrent spending such as maintenance, which may be hard to contain. Zambia, therefore, needs to invest the proceeds in the right type of high-return projects capable of generating enough revenue to service the debt. One of our recent studies "Optimisation Study for Core Road Network Planning to Link Zambia" points to the fact that road projects need to be prioritized based on transportation efficiency, accessibility and socioeconomic characteristics. In this study, we provide a simplified Travel Demand Model to prioritise the road projects. We are not aware of any such study done prior to the launch of the Link Zambia 8000 programme which is a huge road infrastructure project for the construction and rehabilitation of 8, 000 km of road infrastructure in Zambia.*

Secondly, there is always market uncertainty in terms of exchange rate and interest rate risks. And the country may be forced to borrow at higher interest rates to services the debts. Bonds may have to be repaid at a time of higher interest rates, or when the kwacha may be weaker making debt servicing expensive. To mitigate against these risks, Zambia should emulate countries such as Gabon and Ghana which have put in place a sinking fund managed by their central banks.

Thirdly, Zambia depends on copper exports for its foreign exchange earnings. This exposes the country to the volatility in international copper prices.

In order to respond to the above risks we need a comprehensive legal and institutional framework. Arising from such a framework is a sound, forward-looking and comprehensive debt-management structure with well-trained and remunerated debt managers.

One important point is that the Ministry of Finance will require building expertise in debt and risk analysis - referred to as the "middle office" – to undertake portfolio analysis, develop a risk management strategy and develop borrowing scenarios and compare emerging debt indicators with agreed benchmarks. We are not convinced that we have such comprehensive mechanisms in place at the moment.

AE: Another consequence of the use by African governments to Eurobonds is that reducing government borrowing authority with domestic commercial banks, which in some countries has led to open up more opportunities for credit businesses. What has been the impact of two Eurobonds on the financial system in Zambia. Are commercial banks operating in Zambia lend themselves to benefit private companies?

As a percent of GDP, domestic debt in 2012 when the first Eurobond was issued was 0.9 percent. In 2013, Government borrowed extensively from the domestic market thereby increasing the domestic debt to 5 percent of GDP. With the issuing of the second Eurobond in 2014, domestic debt is expected to reduce to 1.7 percent of GDP. Lending to the private sector remains way above the lending to government by commercial banks. However, lending to government remains significantly high and is partly responsible for the high interest rates currently being experienced.

AE: As a solution, you offer one of several tracks of reflection, the government of Zambia to do a risk assessment in the management of the debt policy. But at the same time one wonders what he would eventually do. The ODA is complex, recourse

to the capital market is more risky, so where to go?

The current debt strategy is to maximize the use of available concessional resources. However, concessional resources have been dwindling and the amounts offered are not high enough for the kind of projects that Government intends to use the resources on. So Government has had to consider non-concessional borrowing, hence the two Eurobonds. We clearly have to consider both options. But we need to be aware of the risks and put in place a comprehensive debt management structures to manage the debt. We still remain a copper-dependent country. If the price of copper in the coming years is not good, or indeed if we have some uncertainties in the global financial markets, what happens? While Government has issued several statements through the Minister of Finance and the Secretary to the Treasury about the sustainability of the current debt levels, the question is "What is Government doing to avert the liquidity challenges when the two bonds mature in 2022 and 2014 in the event that Government fails to refinance the maturing bonds?" With regard to the first bond, we have lost out two years already without any measures put in place. For example, the Loans and Guarantees Act empowers the Minister of Finance to set up a Sinking Fund. We have not heard anything in that regard.

There are still other options: for example, we could think of buying back a tenth of the bonds every year. What about public-private partnerships in infrastructure projects? What about the private sector, touted to be the engine of growth? Except for the US$20 million SME financing that was spelled out in the first Eurobond, shouldn't we be using this money to lend to the private sector who we are sure will pay back since they are going to no doubt invest in high return projects?

We also need to consider quality issues, particularly the quality of the expenditure. This is because the potential return on any borrowing is a function of the overall quality of economic management and particularly the overall quality of public expenditure, not the particular investment financed by the bond (or donor finance). The issue to focus on is the marginal expenditure permitted by the additional finance raised. Money is fungible. You can do a beautiful rate of return analysis and finance a very worthwhile, high return project, but if the marginal expenditure by the government is a white elephant, or a huge increase in the salary bill, or a poorly targeted subsidy, the overall impact of the borrowing on the capacity to repay will be negative.

The essence of this study by ZIPAR is to provide answers to these questions. We have an opportunity as a country to bridge the infrastructure gap through the issuing of these Eurobonds. All we are saying is, we need to prudently manage our debt.

AE: In the presentation of your research project, you quote Joseph Stiglitz, the renowned Nobel Prize in economics. We want to give you another name, Dambisa Moyo. Is it not time for Zambia to resort to such people who are still famous for having some pretty original ideas?

SN: *Dambisa Moyo is an internationally renowned economist and a Zambian. As a Zambian think tank, we are proud of her. Personally I have read two of her books: "Dead Aid" and "Winner Takes All". Dambisa advocates that countries like Zambia need to overhaul their development strategy away from the aid-based model which has achieved little in terms of poverty alleviation and delivering growth. She instead wants African countries to move towards the market-driven interventions that have fundamentally transformed the fortunes of many emerging economies such as South Africa and Botswana. I personally agree with what Dambisa is saying. One of the things we as ZIPAR are advocating is a comprehensive review of our debt (and aid) strategy. The timing is right for Zambia to embrace capital markets. But all we are saying is, let us learn from the experiences of other countries and put in measures (legal, institutional) that will ensure that we reap the benefits of this new form of financing and mitigate the risks of default come 2022 and 2024, which, as has been the case with Argentina, can have undesired consequences.*

Disclaimer: The study on sovereign bonds is still on-going. The views expressed in this interview are those of the interviewee and can in no way be taken to reflect the views of ZIPAR.

Dr. Pamela Nakamba-Kabaso, (left) Executive Director, ZIPAR and Mr. Emmanuel Q. Chileshe, Board Member, Zambia International Trade Fair (ZITF) during proceedings at the ZITF Business Seminar on 4th July 2014 in Ndola.

Private Sector Development: Engine for growth?

Is the private sector an engine for growth and a platform for development? ZIPAR posed the question in a presentation on the development of the private sector in Zambia over the last 50 years during the 50th Zambia International Trade Fair Business Seminar in Ndola on 4th July 2014.

The ZIPAR Executive Director, Dr. Pamela Nakamba-Kabaso gave the Business Seminar participants an account of the share of the private sector that was inherited at independence; the economic structure that soon ensued following the Mulungushi and Matero reforms, nationalization of many private enterprises and the rationale behind this reform. In her presentation, the private sector was taken in a broader context to indicate businesses both formal and informal that are not under government control. Enterprises that are not state owned but exist for charity or are non-governmental organizations were excluded. Dr. Kabaso indicated that the private sector is widely recognized as a critical sector in economic development because it is a key source of productivity, growth and innovation. The sector creates jobs, generates income, provides goods and services and promotes competitiveness in the economy. It signals how enabling the business environment is in the country and it anchors Foreign Direct Investment (FDI).

Historical Context of Private Sector in Zambia

She stated that various accounts indicate that between 1964 and 1968, Zambia inherited a private sector driven economy with state participation restricted to public infrastructure such as railways, electricity and water. But commercial business was heavily concentrated among multinational corporations, companies owned by expatriates and foreign owned farms e.g. mining while contributing about 50% to GDP at that time was under the control of two multinationals - Anglo American Corporation and Roan Selection Trust. The private sector expanded further when suppliers from Zimbabwe started to produce locally following trade sanctions imposed by the UN in the wake of Unilateral Declaration of Independence (UDI).

The fairly liberal economic policy continued until it was first eroded by the Mulungushi Reforms in 1968 and Matero Reforms a year later. The Mulungushi reforms nationalized non-mining commercial sectors while the Matero reforms extended nationalization to the copper mines

She pointed out that the number of parastatals is recorded to have risen from 14 to 147 after the reforms while the share of the public sector in GDP rose to more than 80% from the previous 15% average in the 1960s. The private sector became 'extinct' except for the banking and agriculture sectors. By the late seventies, evidence suggests that the public sector accounted for approximately 72% of formal sector employment and almost 80% of investment. Thus, the state became the engine of growth and a platform for Development

> ...the private sector is widely recognized as a critical sector in economic development because it is a key source of productivity, growth and innovation

ZIPAR Zambia Institute for Policy Analysis & Research

Motives for Nationalization

Dr. Kabaso indicated that nationalization of many private enterprises was motivated by the failure by foreign investors to re-invest sufficiently in the economy. There was excess repatriation of profits at the expense of development in Zambia and the rural-urban gap was accentuated by private investors' preference to concentrate activities in urban areas. The gap between indigenous Zambians and foreigners widened and there was an apparent inability of government to direct the pace and direction of economic development.

Lessons from history

The Executive Director continued that the state inspired by "socialism/humanism" relegated indigenous citizenry participation mainly to being employees of parastatals rather than entrepreneurs. Domestic production failed to efficiently (in terms of technology, management, input sourcing and competition) displace imports. The "missing" private sector perpetuated inflexibility in the economy.

Privatisation

Massive privatization occurred in the 1990s as part of the Structural Adjustment Programme. Modes of privatization centered on direct sale of company units, liquidation of assets and management buyouts. Less prominent modes included joint ventures and concessions. Dilution of government holding and public offering of shares was almost nonexistent. Privatization stirred sentiments among stakeholders with some feeling that many locals were not adequately empowered to effectively participate in the program. Some stakeholders felt there was too much offering of assets in the midst of weak demand that contributed to dampened market prices (undervaluation). Regulation of the market environment deemed weak entailed replacing state monopolies with privately owned ones. There were further concerns that sequencing of privatization within SAPs was poor and was coupled with weak institutional arrangements. Some stakeholders also claimed that the privatization agency had inadequate capacity to execute its mandate effectively.

Private Sector Post 2000

Dr. Kabaso observed that an impressive expansion of the private sector is widely acknowledged by many stakeholders today. Although heterogeneous with varying degrees of success across sectors, private sector dominance cuts across many commercial sectors. The growth decade that has placed the country among the ten fastest growing economies in Africa has seen significant private sector growth. Investor confidence remains at all-time high with private investments, both local and foreign continuing to surge despite modest downside risks.

Informal Enterprises

Dr. Kabaso continued that the dominance of microenterprises is linked to the issue of Informality. The universe of informal enterprises

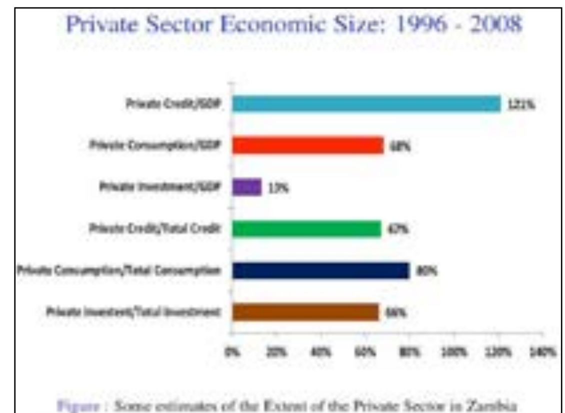


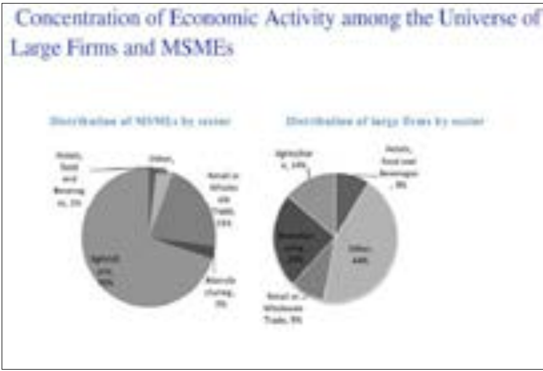
Figure : Some estimates of the Extent of the Private Sector in Zambia

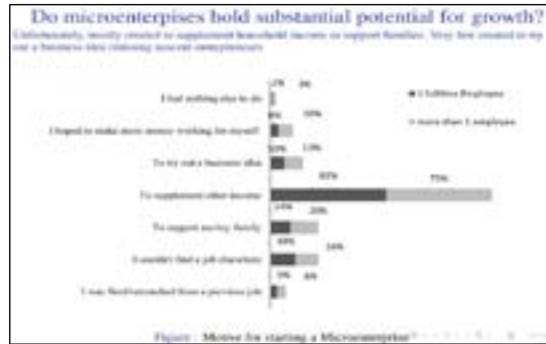
(all of which are private sector) is still not well established due to incomplete data, false reporting and the definition problem. Some available estimates Phiri-Kabaso_(2010) estimate informality at 40% of GDP; and CSO rebased GDP estimates it at 33%. Kedia-Shah_(2012) indicates that 5% among MSMEs classified based on monthly sales have municipal licenses; 3% registered at PACRA; and 2% have a TPIN. According to the Labour Force Survey, 85% of employment located in the informal sector is dominated by agricultural activities.

Private Sector Concerns Today

Dr. Kabaso highlighted key concerns in the private sector such as the failure to significantly re-invest profits with notable repatriation of profits especially among large investors in mining. The other concern was the concentration of private investment in urban areas adversely unbalancing development and increasing the rural-urban polarity gap between indigenous Zambians and foreigners.

Nevertheless, the private sector has grown into a dual structure (large and MSMEs) with a sizable informal sector. This has posed new challenges towards economic development. Reports of discrimination against indigenous private sector especially in mine supply contracts have emerged. Innovative financing remains a challenge with lack of access to finance reported as a major obstacle faced by many enterprises particularly MSMEs. Coordination or market failure has been often highlighted. At this point Dr. Kabaso posed a question to the participants that; 'Could this be an economic justification for the establishment of the Industrial Development Corporation?' She continued that the private sector continues to





lobby for rationalization of policies e.g. concerns expressed that many inputs are taxed at similar rates as final imports and this has been blamed for failure of manufacturing to grow rapidly in the country.

Private Sector Driven Initiative to Resolve Market failure

In conclusion, Dr. Kabaso illustrated private sector driven initiatives in addressing market failure. She pointed out to a partnership of thirteen commercial farmers in Mkushi, the largest commercial farming block in Zambia, which formed a holding company that specializes in a wide range of activities including commercial grain storage and crop processing. It is located on the rail line with state of the art silos and wheat meal facilities. The facility is expected to improve competition in flour pricing, soya cake and other feed stocks for livestock.

It was primarily created as a response by commercial farmers to develop an organized and coordinated market. Previously the absence of an organized market posed severe difficulties for farmers especially when it concerned unscrupulous market dealers and the weak bargaining power of individual farmers. The company has a strong corporate governance system based on its fairly large number of shareholders. However, it still faces challenges with the ICT infrastructure owing to the absence of a fiber-optic connection in the farm block and unreliable train haulage.

A case of Agri Options Limited in Mkushi

Media cardinal in adoption of 'good policies'

"To ensure that Zambia's sovereign-bond issues do not turn into a financial disaster, Government should among other things put in place a sound, forwarding-looking and comprehensive debt-management structure. It is our belief that this is already being taken care of",

ZIPAR holds the media in highest regard because they play a key role in adoption of 'good policies'.

Addressing Journalists during a media breakfast on Eurobonds at Radisson Blu Hotel in Lusaka on 13th August 2014, the ZIPAR Executive Director, Dr. Pamela Nakamba-Kabaso observed that the policy process and specifically the adoption of "good policies' is at times characterized by a situation of conflict between stakeholders. Hence ZIPAR considered the media as a key networking partner in promoting evidence based policy dialogue between Government and a wide range of stakeholders.

Dr. Kabaso added that the issue of public debt had taken centre stage in the wake of Government issuance of the two recent Eurobonds, US$750m and US$1 Billion, a move that sparked mixed reactions with some sections of society fearing that the external debt stock has soared closer to the pre-HIPC levels.

She stated that ZIPAR was glad to share preliminary findings of its on-going study titled; "Assessing Zambia's Entry onto the Sovereign Bond Market: Opportunities and Challenges" to the media because the question whether Zambians should be worried about the current levels of debt was prominent.

The Executive Director observed that although Zambia's debt was currently sustainable, investing in projects with high rate of return must be prudently undertaken to avoid risk of default that could otherwise escalate into a crisis.

"To ensure that Zambia's sovereign-bond issues do not turn into a financial disaster, Government should among other things put in place a sound, forwarding-looking and comprehensive debt-management structure. It is our belief that this is already being taken care of", she stated.
Dr. Kabaso added that while the issuance of sovereign bonds should be one of several avenues of broadening government financing instruments, efforts should also be made towards broadening options for Government financing.

A total of 20 media houses that included the CNBC -Africa Business News, Zambia National Broadcasting Corporation (ZNBC), Zambia Daily Mail, Times of Zambia, Hot FM Radio attended the breakfast. At the same event findings of two other studies namely; Trip Modelling and Cost Analysis for Public Road Transport System and Comparison of Welfare Status of Districts in Zambia were disseminated.

National Assembly grateful to ZIPAR for recommendations on Fiscal Decentralisation and Performance-Based Management

The National Assembly has adopted recommendations submitted by ZIPAR on the implementation of fiscal decentralization and performance-based management in Zambia and have included them in the committee's report.
In December 2013, the National Assembly through its Committee on Estimates requested ZIPAR to submit memoranda on the status, challenges and make recommendations on the implementation of fiscal decentralisation and performance-based management in Zambia. This was followed by a presentation by ZIPAR to National Assembly in February 2014. The National Assembly expressed gratitude to ZIPAR for the submissions in a letter dated 2nd July 2014.

The following recommendations have been included in the report:
Fiscal decentralisation

Increase revenue base

Councils should be proactive in coming up with strategies to increase revenue base. Amend the Ratings Act to facilitate regular property valuation.

Enhance Capacity building

Government should facilitate robust training programmes for council workers.

Develop Indicators for fiscal decentralisation

Government should develop monitoring indicators for tracking of decentralisation policy.
Performance based management

Review legal framework

Legislation on performance-based management should be presented to parliament for enactment.

Invest in building capacity

Develop robust training programmes for the public officers to bring them to speed with performance-based management.

Need for organisational buy-in and leadership

Government should sensitise all the stakeholders including political leadership on the benefits of performance –based management.

Photo Focus

ZIPAR exhibited at the 88th Agriculture and Commercial Show in Lusaka from 30th July -4th August 2014. Researchers disseminated various reports on research and studies conducted by ZIPAR. On the left, Thulani Banda explaining a point to a visitor and on the right; Tamara Billima-Mulenga and Shebo Nalishebo (far right) sensitizing show goers on various policy issues.

ZIPAR signed a K1,028 million grant agreement with Zambia Economic Advocacy Programme (ZEAP), a project supported by UK DFID. The grant which runs till 31st December 2014 will support two of ZIPAR's eight core studies this year and communication and advocacy programmes. Here Dr. Pamela Nakamba –Kabaso, Executive Director, and ZEAP Programme Manager Dr. Simon Foot during the signing of the agreement at the ZIPAR offices on 2nd July 2014

ZIPAR collaborated with Researchers from a UK lead think tank, the Institute for Public Policy Research (IPPR). Will Paxton and Guy Lodge held training and mentoring sessions for ZIPAR researchers and Knowledge Manager on topics such as Policy Development, Writing for Different Audiences, Presenting to Policy Audiences and drafting Executive Summaries. The trainings took place on 20th -21st May 2014 and 25th-27th June 2014. Here Will (in grey shirt) and Guy (in white shirt) pose for a group photo with some of the ZIPAR staff.

ZIPAR places value and appreciates staff dedication to duty. Mr. Shebo Nalishebo on behalf of the ZIPAR Executive Director presenting a Labour Day Award to Mrs. Beenzu Puta for Most Outstanding and Consistent Employee of the Year on 2nd May 2014.

“Working towards the formulation of sound economic policies”.

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