The Impact of Privatisation on the Zambian economy

From 1975 Zambia's economy underwent a world record breaking decline. Between the periods 1970-1975, 1976-1990 and 1991-1999, per capita GDP fell by -0.8, -3.1 and -7.2% respectively. A large share of the blame for this disaster can be put at the feet of the collapse of the world price of copper. Mining's contribution to national GDP fell from 16.5% in 1994 to 11.8% in 1997, the year privatisation started. In the next five years it fell further, to just 7.9% in 2002 (133). This figure was at least rebounding a little, and though more up to date figures are not available, we can assume that the rebound has continued, on the basis that production and profits have done.

Mines privatisation was claimed to hold the key to turning the economy around in the medium term. Firstly, it was said, taking responsibility for what had become a loss-making industry out of Government hands would reduce the burden on the Zambian state. Secondly, if reinvestment could make the industry profitable again, it was hoped that new taxes would flow into state coffers, that the companies would train the Zambian workforce up to international standards, and new linkages would be made to local firms.

However, it was always possible that new companies would 'revive' the profitability of the copper industry without reviving the national economy. If the companies made themselves profitable principally by cutting back the workforce, reducing wages and stripping the assets of the mines, before leaving the country with their profits, without re-investing, Zambia would benefit not at all. Something similar had already occurred in the Zambian steel and textile industries, in which most privatisations had involved asset stripping and then companies quickly selling up and leaving. The Development Agreements for the copper mines were therefore designed in part to counter this risk. They committed the companies to making investments in the first few years of their ownership.

However, one of the first problems with Zambian privatisation to show up was the absence of constraints on companies to encourage them to adopt a longer-term perspective rather than making a quick buck and getting out. Anglo-American and Binani pulled out completely, early in the process, without suffering any significant regulatory penalties. Nonetheless, as we have already seen, overall the privatisation did bring in new investments

Foreign ownership

The clearest impact of privatisation is that it places ownership of the copper mines in private hands, rather than being in the control of Government, and in Zambia's case, because there are few if any Zambian companies with enough wealth to buy a copper mine, it places ownership in the hands of foreign firms rather than Zambian nationals. This makes it likely that profits from mining leave the country without having any positive impact on the Zambian economy, and, rather than being re-invested in building up the national economy, will be placed in banks or re-invested in companies outside the country. As the Permanent Secretary notes, "Today the public is saying that these large-scale mines are now with foreigners. Mining is the backbone of the Zambian economy, so the backbone is in foreign hands. What about us nationals - can't we participate in ownership? Government should have put in place measures to allow Zambian private individuals to participate in the ownership of these mines." (134).

There is one obvious problem. There are not very many individual Zambian nationals or nationally-based companies with sufficient capital to make a go of taking over and investing in the rehabilitation of a major mining company. The original privatisation model did attempt to provide some wider 'participation' of Zambians in the process. The idea was that ZCCM-Investment Holdings (ZCCM-IH), would be set up as a state-equity company, holding minority interests in each company. The company would therefore make some money for the state as the mines became profitable. At a later date, the aim was somehow to widen the share-owning base of ZCCM-IH. This has not yet happened, and asked how to increase local participation in the mining sector, the Permanent Secretary recognised that ideas about how to proceed are thin on the ground. "It's a challenge. How can one do it? Provide loan facilities or do what? Well the feelings of the population at large is that they would wish they had participated and that Government should have come up with measures to make that possible. Of course they don't explain how Government would have done it. They just want the Government to have thought of something. I think it's possible to use ZCCM-IH as a vehicle for individual Zambians to own shares in those mines. So something creative could have been worked out. There are opportunities. It's not impossible to come up with measures to let nationals participate in large scale mines. It just takes some exercise of the mind." (135).

The tax take from Zambian mining

Placing the mines in private hands means that any income to the state is not directly from sales and profits from the mines, but rather from any taxes that can be levied on the companies – in the form of income tax for employees, VAT paid on services purchased by the mines, border taxes paid on imports and exports, corporate taxes on profits, and mineral royalties on sales of copper. However, as we have seen, in their Development Agreements, the mining companies managed to negotiate exemptions from paying most of these taxes.

The World Bank argues that "The main feature of the mining sector is that most of the incentives are negotiated on a case-by-case basis by companies which have purchased privatized entities from ZCCM. This feature makes it difficult to analyse the sector as a whole. However, in general, mining contributions to total tax revenues are extremely small." (136). Nonetheless, the Bank calculates an aggregate figure, called the 'Marginal Effective Tax Rate' (METR) to describe how much each industrial sector is taxed and concludes that, "Because of the relatively low tax rates and significant incentives, the mining sector enjoys an METR of around 0%. In particular, the expensing of many equipment purchases and moderately accelerated depreciation deductions for the rest, the METR on machinery reflects the largest subsidy (-18.3 percent) received in any sector for any asset." (137) Mining is the most favoured sector in the Zambian economy, a source of significant resentment as the Government is thus favouring international investors over local business owners.

Fig. 2: Comparative Marginal Effective Tax Rates for different industrial sectors in Zambia

Mining	0%
Tourism	0-10%
Manufacturing	0-10%
Small Businesses	20-25%
Financial	25-35%

Source: World Bank

As shown in Appendix 8, even the Chamber of Mines own statistics, presented to make the case that tax on the mines should not be increased, demonstrate that, while the revenue generated for Government from mining has increased since ZCCM's nadir in the second half of the 1990s, the 2005 contribution, of around $75 million, is less than one third of the contribution made to the national treasury by ZCCM in 1991.

The mining industry does contribute to government revenue through the taxes paid by its employees in form of income tax. However, in their Development Agreements, companies negotiated to pay lower corporate tax rates than apply to other industries. Because they are also able to roll losses from previous years forward and to write off profits that would have been taxable, the mining sector barely contributes at all. As shown in Appendix 8, mining contributes less corporation tax than smaller sectors such as the financial services and telecoms sector. The mining sector also claims back from the Zambian Government all of the VAT that it pays on goods that it buys locally. Since the company from which these good were initially bought will have paid the VAT aspect of the price charged to the Government, and the Government then pays that back to the purchaser, VAT contributions show up as a minus figure – a subsidy from Government to the mines.

In 2006, one company, First Quantum, which is still well within the period of the tax holiday provided by its development agreement, decided that the situation was embarrassing and decided to start paying tax, contributing $19million to the Zambia Revenue Authority. The companies also argue that, although the tax income so far has been very low, their ability to write off investments against profits will soon come to an end, and the Zambian state will benefit more. They also point out that there are a number of other ways in which the Zambian state benefits. Written into the Development Agreements are 'price participation' clauses, under which, as the world price increases beyond a certain point, a larger share of income is paid to the state. Finally, through their minority interest in the companies, held by ZCCM-IH, the Zambian state has a stake in the companies. As and when the companies start to reap major profits, dividends will also be paid to ZCCM-IH. The Chief Financial Officer at Mopani argues, "GRZ are going to benefit substantially from the various investments that the mining houses have made, and particularly Mopani. They are not going to benefit from it now in 2006, but 2008 onwards they are going to see significant benefit. That's when the capital allowances have been used for tax purposes, so then the tax is 25% and that is a significant amount of money to any regime…You're going to see a dramatic jump in 2-3 years time.

Bwana Mkubwa is already paying tax. I think they are forcecasting about US$150million next year and Mopani will join suit 2007 - 2008 so we've got to be very careful that GRZ aren't rushing to strangle the goose again before it lays its golden egg… The GRZ through the ZCCM-IH have had a free carry for the last five year. They've invested no capital but their 10% holding in the various companies has gone up. So when the dividends do get paid, which will be happening in the next year to two years, and they'll be reaping benefits far outweighing any attempt at a 2.5% royalty they're looking at. Now that doesn't happen anywhere else in the world." (138)

Training of the local workforce
Mining companies can contribute to the Zambian economy by providing experience and training for their own management and workforce. However these benefits will only occur if the companies develop good human resources and training programmes and commit to building up the skills of Zambians, rather than employing expatriate workers in all of the senior and technical roles. As the CEO at Luanshya Mining argues, for many companies it may seem easier to bring in expatriate workers. He suggests however," There has got to be a conscience that says, those skills we accept - those ones no. And that I don't think is happening very effectively at the moment. There definitely is an inclination to employ expats where you actually have the skills in Zambia." (139)

Foreign investors tended to bring in entirely new management teams at the moment of their purchase of the mines. They seem to have been able to do so because Zambian labour laws are antiquated. While the IMF suggests that Zambia simply doesn't have a labour market law, one ex-miner noted, "The labour laws date from the 1960s. We have had two new Republican Constitutions since then. How can we not have changed the labour law?" (140). The IMF goes on, "The current labour laws are also weak on the engagement of expatriate staff by new investors and the differences between their incomes and those of local staff. Many new investors take advantage of the situation by recruiting their managers in management positions and paying them heftily, compared to local experts of similar qualifications and experience."(141).

This situation has created significant resentment, as much of the most educated and skilled workforce from ZCCM was laid off. Many of those Zambians have left the country and taken their skills and knowledge with them. As already noted, this is still the situation at firms such as NFCA that employ just one Zambian manager and even bring in shift bosses from China. However, other companies clearly are making an effort to redress the situation. Vedanta brought in Indian management wholesale after they bought KCM. However, they are now altering the balance, and have identified 40-50 Zambian 'young business leaders' who they are fast-tracking on a management training scheme. KCM claims to be the only company that has taken Zambian staff out of the country to work on its other international programmes, to gain international experience. KCM has also re-established something similar to the old ZCCM training scheme for the main workforce, recruiting 1,200 school-leavers from all around the country to be trained and to work at KCM. Many of the company executives interviewed expressed similar views on the issue – arguing that total numbers of expats were low and dropping, blaming a lack of trained Zambian workers on the country's educational and training systems, and arguing that they have no desire to hire from outside Zambia. As the resident Director at KCM put it, "I have absolutely no interest in bringing in Chinese labour if it's not necessary. The contractor has absolutely no interest in bringing in expensive expat labour if a local could do it." (142)

Linkages from the mines to other industries

There are a range of wider expected impacts of privatisation to the Zambian economy other than the tax paid to Government. Firstly, if new investment revitalises the mining industry, the mines should need to buy more goods and services from local firms. This should multiply the effects on employment and wages. Secondly, by lowering costs of production and introducing new technologies, the new companies might be able to make new linkages to manufacturing industries, set up around the mines to process the copper into basic electrical goods.

One of the reasons that the collapse of employment in ZCCM had such a devastating impact on the Copperbelt region, with many of the main urban centres becoming ghost towns, is that the mines sit at the centre of trading networks with a huge number of other local businesses. The mines themselves buy in food, cleaning, security, building materials, petrol etc. from outside suppliers.

There is a widespread belief amongst local firms on the Copperbelt that the management of the new companies distribute contracts on a less-than transparent basis to companies in which they themselves already have an interest. It was not possible to confirm this theory, and a range of alternative explanations also present themselves:
- Problems of supply and stock-holding for local companies make it difficult to meet the short notice demand of multinational companies. The situation is cyclical. Once local companies lose confidence that they might be approached for a particular good, they will stop stocking it. As a result, as the Chairman of the local Chamber of Business notes, "they will come to you, and say we want this, like yesterday, and when you fail to supply, they will say you are not efficient." (144)

- Finally, once a machine has been purchased from a foreign company, servicing and repairs will also typically come from the same source, at least for the first five years where a guarantee is in place.

There have been some efforts to resolve these problems. For example, there is now a mining liaison committee in the Chamber of Commerce and the group is running an exercise with KCM to try and match KCM's needs to local manufacturers of goods such as foundry, fabrication and machinery products which have been produced locally for many years. However, there is a huge lack of trust between even the Chamber of Business and the mine owners. This results on the part of the owners in part from corrupt practices that emerged in the chaos of deregulation and the rush by a huge number of 'briefcase businessman' that competed in the early years of privatisation for contracts from the mines.

As the Chairman of the Chamber of Mines notes, "In the past we had a system where every year, all the registered companies were given a questionnaire and were registered here and that questionnaire would ask you what you supplied and many other things. They would ask you for your address and bankers and they could counter-check that information. But now they have destroyed that system and lots of crooks have come on board." (145).

While much of the focus in national debates has been on suppliers to the mines, it is also useful to think about the 'forward linkages that the copper mining industry could be developing in order to build up the Zambian economy. The most basic tasks of processing copper ore do mostly take place in the country. The rock is crushed and concentrated next to the mines. It is also usually smelted into flat sheets of copper, called cathodes, which are convenient for transporting and exporting copper. As new ore bodies are discovered and mined, both in Zambia and in the DRC, Zambia is trying to position itself as the place to smelt these ores and to manufacture them. However, this is not true of all the mines. For example, Chambishi Mines do not have a smelter, and having encountered difficulty getting other local smelters to process their concentrates, are exporting the concentrates to Namibia. As NFCA management recognise, they are literally exporting jobs. As an MUZ representative noted, "despite our proximity to the ore body, our tax structure and the treatment charges appear not to have been very competitive." (146)

An industrial strategy might chose to shift the incentives currently offered to copper mines towards processing industries. For example, placing higher export duties on copper concentrate would create a clear economic incentive to do the smelting in Zambia. It could also be possible to offer incentives to companies that could further process the copper, manufacturing wires, electrical plugs, pipes and other light-industrial goods. Suppliers could similarly be encouraged to manufacture their products in Zambia. For example, for the past fifty years, a Swedish company, Alvinius, has provided all of the piping required by Zambian copper mines, shipping in pipes manufactured in Sweden. Since privatisation their product has been imported by the mining companies under no/low tariff arrangements established under the Development Agreements. However, with the opening up of sourcing systems, the company has been considering its response to lower-quality, lower-price competition from South African firms. One strategy that would lower costs for Alvinius and secure its position as the most competitive manufacturer would be to finish semi-manufactured pipes at a new facility that it is considering building on the Copperbelt. However, the current system provides very limited incentives for the building of such facilities – because mining companies can import equipment from overseas without paying duty, there is little incentive to attempt to source locally. If supplying companies did set up locally, it is not clear what incentives they might be given. (147)

Could renegotiating the Development Agreements provide funds for development and to overcome aid dependence?

The relationship between copper revenues and aid dependence

From independence until the first oil crisis, Zambia received relatively little aid. From 1978 there was a steady increase until 1990. The arrival of the new MMD Government in 1991 saw huge increases, reaching a high point in 1995, before dipping in the period to 2001. Aid has again recently picked up, with 2004 seeing the second highest flows in the country's history. Aid as a share of Zambia's GNI has been as high as 63% in 1995, but by 2004 was back to 21% (148).

While Zambia's aid statistics are high, they are not unique amongst low-income countries. What marks the country out, rather, has been its spectacular debt burden. By 2004, debt service was US $ 424 million a year, 8.1% of GNI. Around 60% of this debt was owed to the IFIs (150). This debt emerged in the late 1970s when the Government (encouraged by the World Bank) believed that the collapse of copper prices would be temporary and borrowed to soften the blow to health and education services and food and industrial subsidies. However, as government spending continued to grow, and copper prices did not recover, the debt ballooned. As early as 1984, Zambia was the most indebted country in the world relative to its GDP (151). Since 1996, a number of debt relief initiatives slowed growth of the debt, making faltering inroads into its overall size and the size of annual debt service until the point in 2006 when a massive new deal was struck. When Zambia finally attained HIPC 'Completion Point' in April 2005, debt stock reduced significantly from US$7.1 billion to $4.5 billion. The best news was still to come. Under the Multilateral Debt Relief Initiative (MDRI) arrangement, announced by the Bank and Fund in 2006, those countries that had already reached HIPC Completion Point won a massive additional write off with debt stock reduced to $500 million, less than 1/10th of its previous level.

Because foreign donors attach policy conditions to new loans and debt relief, Zambia's massive debt weakened the government's ability to set its own policies over the past twenty years. The country has been described as a 'disciplined democracy' (152), in which aid conditions have been used by the International Financial Institutions (IFIs) to such an extent that, no matter who gets elected, liberalisation and privatisation will inevitably follow.