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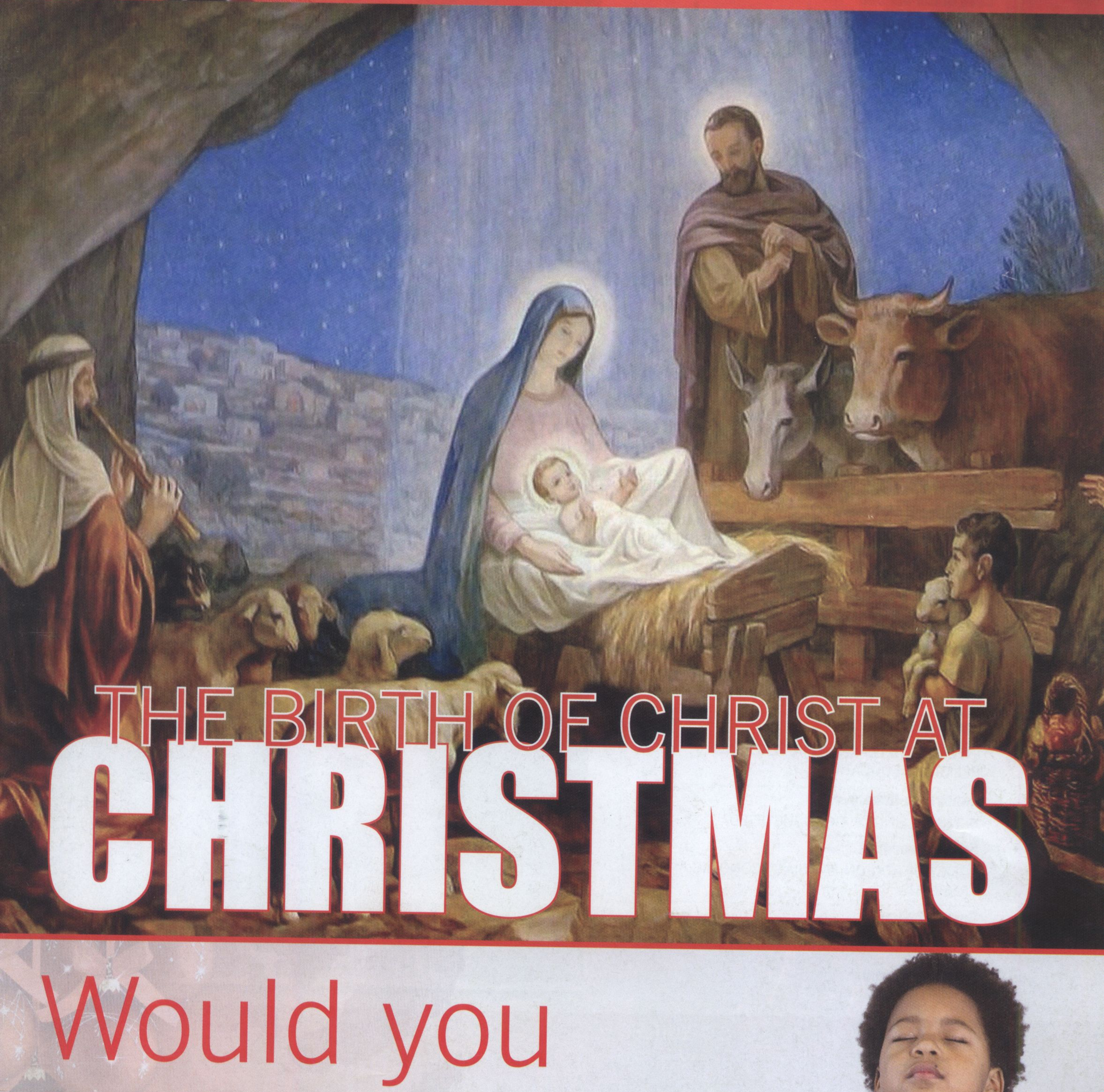

THE BIRTH OF CHRIST AT CHRISTMAS

Would you like to pray?

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POLICY OPTIONS ON ZAMBIA'S ECONOMIC PROBLEMS

Zambia's currency, the Kwacha, has been dubbed as the worst performing currency in the world this year. This is following de-investment in the copper mine fields (copper itself accounting for about three quarters of Zambia's foreign exchange earnings). Today, the mines are owned by foreign conglomerates, and they have suspended part of their production owing to a drop in copper prices (largely a consequence of reduced Chinese demand; China consumes 48% of global copper). It is hard to know for sure how much of Zambia's copper is imported by China because of issues of tax evasion and transfer pricing. If indeed accusations of tax evasion and transfer pricing are true, justice must prevail, and Zambia must get a fair share of its resources – it's a poor country that desperately needs these funds! Yet the consequences of the Chinese slow-down have been devastating for Zambia. Some estimates forecast Zambia's growth to be just over 3% in 2015, the lowest since 2000. Against the dollar, the Kwacha has declined by well over 60% this year alone. With reduced production, and some mines opting to run on care and maintenance, job losses only serve to compound the problem. Inflation increased to 14.3% from 7.7%, hurting Zambians even more. Furthermore, Zambia is experiencing chronic electricity deficits, with consumers being starved of electricity for up to 14 hours per day. The effects on production and productivity of this scourge should not be underestimated: businesses have been forced to adjust their terms of operation, revise their cost structures, and ultimately, the consumers are bearing the burden.

Current Interventions: Practical or Divine?

For the Central Bank, arresting inflation is the overriding goal, and this takes precedence over policies aimed at growing the economy. The justification is that "in a time of crisis emanating from a mix of external shocks and domestic policy failures, it is better to prioritise stabilisation, even though it might come with a price in terms of constricting growth further". To this end, the Bank of Zambia recently increased its benchmark interest rate to 15.5% from 12.5%, a record 3% increase. Arresting the falling of the Kwacha is an important ingredient in the fight against inflation and "The Bank of Zambia has sold $510 million of its foreign-exchange reserves since January to support the Kwacha… Gross international reserves were $3.87 billion at the end of July, according to the most recent data from the Central Bank." Although the Kwacha did gain about 10% at one point, its performance again began going back to pre-intervention levels. This suggests that the Central Bank's policy response so far has being mostly ineffective.

Some observers have accused the government of doing little. The Zambian President, Edgar Chagwa Lungu, recently called for divine intervention to rescue the ailing economy. While appearing to make a mockery out of the President's decision to seek the supernatural, some have suggested that the government was simply deflecting responsibility from itself. The government should own up to the situation and do something about it. One such way of taking the responsibility would be for the government to simply reduce its external and domestic borrowing. Continuing to borrow will only increase the costs of repaying loans and crowd out the private sector.

There are also talks of inviting the IMF to the discussion table. But from experience we know that what the IMF has in store for Zambia – a set of devastating conditionalities – will only make things worse, especially for the poorer sections of society, despite their usual rhetoric about inclusive policies and growth.

Recommended Solutions

But the question is: what should the government do? The answer is complex. The policy options that exist for Zambia depend upon how the problem is characterised. Broadly, the current economic crisis being experienced in Zambia is underpinned by the distorted economic structure of the country, dependence upon copper being an outcome of it. All the problems considered have structural roots. To deal with these problems, there is both need for long-term and short-term solutions.

Long-term solution

There is need for structural transformation focussing at policies aimed at promoting import-substitution and export-diversification. Lack of diversification and excessive reliance on exporting a single commodity is not necessarily tantamount to excessive reliance upon exports in general. The Zambian economy is going through a crisis, perhaps one that will lead to a contraction. Therefore, addressing structural inflation through ratcheting up interest rates and austerity is flawed. Clearly, the problem is not that the economy is over-heating! High interest rates and austerity are going to suffocate the little economic activity that is still taking place, thereby accelerating the downward spiral. Increasing interest rates is a terrible idea. It is not going to attract any investors at this stage, and it's only going to make debt servicing harder.

Can the current government be truly blamed for lack of structural transformation for over half a century of Zambia's existence as a Republic? The economic structure underpinning the Zambian economy is a function of policy processes and interactions throughout its existence as a Republic. The long-term solution, easier to point out, but difficult to implement, is to seek meaningful structural change. The deeper question, then, is why structural transformation has not taken place? Answering this requires delving into constellations of politics, institutions, ideas, and opportunities that hamper more rigorous efforts. Changing the structure of production by setting up domestic production - cannot be achieved within a short period of time. It will take several years for businesses to be established at sufficient scale and sufficient productivity. Further, all policy measures that can support this (tax incentives, tariff incentives, subsidies, vocational training, etc.) require substantial funds which have been difficult to raise so far.

Short-term solutions

But there is a bit more the government can do in the short-term.

First, it can strengthen the Zambia Revenue Authority (ZRA) and other government agencies to monitor and clamp down illicit financial flows out of Zambia. There is scope for the government to restrain illicit financial flows, and this can explain partly why the Zambian currency is in shambles. So much money leaves the financial system unchecked. The issue here could be, perhaps, that no in-depth studies have been done to determine the extent of this scourge, and thus insufficient data exists to help with planning. Rather, we should ask: Why are there illicit financial flows? And why isn't something being done? How can we strengthen what is being done? In this way, appropriate supervision mechanisms and institutions would be set up while eliminating potential bottlenecks.

Second, addressing worsening terms of trade, and this may require imposing import tariffs. However, there will be need to assess how this policy would come into conflict with tenets of regional agreements (SADC, COMESA). Again, whether this is truly a short-term measure has to do with how complicated it is to go around such binding principles. Meanwhile, a range of selected imports might be targeted for selective, transparent, conditional, temporary subsidies, possibly via tax credits, to keep their demand up if this is deemed important for economic or social reasons. Additional government support may be required for some export sectors, as these will help to bring in foreign exchange, something badly needed.

Third, in dealing with the electricity crisis, as we wait for rains to come, we should ask: what opportunities exist in terms of investment in solar energy? This requires gauging different options. Zambia does indeed have an abundance of 'solar energy' but she is unfortunately incapable of harnessing this resource.

Fourth, the best way in the short-term for Zambia to avoid a balance of payments (BOP) crisis is to attract Foreign Direct Investment (FDI) of some sort. This can ease the BOP pressure and let the government carry on with its plans to reform the economy. Good FDI, if part of an industrial policy plan, can actually help diversify the economy.

Lastly, in seeking outside help, an option would be to negotiate the foreign aid budget in a way that it specifically supports manufacturing production. Some advanced governments such as the Japanese and some other aid agencies could be open to talks along these lines. The trick would be to design clever industrial policies and make them part of aid projects. Cutting deals with the Chinese might also be an option. The Chinese had bought the Chambishi mine, one of the least performing ones, and it stands to reason that their long-term interest lies in securing copper resources rather than making quick profits on the London Metal Exchange. This fact could be used to negotiate deals such as selling them another mine in exchange for the construction of an industrial park and their expertise on industrial policy.

A Zambian problem

This is not just a government problem; it is a Zambian problem. All sections of society must support the government while the government must allow space for debates and dialogue. It is only from such platforms that answers will emerge. The people at the Central Bank and technocrats in government do not hold a monopoly on knowledge. Sound and informed ideas, not just any ideas, should be shared across all sections of society. We need to also tease out under what conditions the state would function more developmentally, a course of inquiry that transcends narrow views on what constitutes an appropriate state.

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