#DebtConcernsMe

Understanding the Impact of Zambia’s Growing Debt on Different Stakeholders
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Executive Summary

Over the past few years, Zambia’s debt situation has been a major topic of discussion in both local and international news. This has largely been due to Zambia’s growing debt: in 2011, Zambia’s total debt was recorded at US$3.5 billion and as of September 2018, this had risen to US$14.4 billion (US$9.4 billion external debt and K3.19 billion domestic debt). Concerns expressed by various stakeholders have been that Zambia’s debt contraction has not increased growth but has instead become a burden on the economy.

During the first six months of 2018, wages and salaries accounted for 42 per cent of domestic revenues and 29 per cent accounted for interest payments. Only 30 per cent of government revenues was spent on all the remaining government programmes, which drive the country’s development, such as health, education, social protection, agriculture and so on. With debt servicing costs amounting to 30 per cent of the national budget, Zambia’s debt weakens the economy by forcing the government to spend money on interest payments when it should be spending on national development. Ultimately a lack of investment in public services has a long-term impact on the social well-being of Zambians. In 2017 this scenario led the International Monetary Fund (IMF) to declare Zambia at high risk of debt distress raising concern among investors, international cooperating partners and the general public.

High debt levels have also left Zambia in a precarious financial position. Much of the country’s debt is contracted in foreign currency, therefore, when the kwacha weakens the amount that Zambia owes in real terms will increase significantly. This fear was actualised in September 2018 when the Kwacha depreciated by 20 per cent. The growing cost of servicing the increasing levels of debt are beginning to squeeze out domestic spending and indications are government are beginning to be a drag on the economy.

Zambia’s debt situation has negative implications on business owners and consumers making the cost of doing business and the cost of living very high. In this environment the need to influence the public and policy makers to understand the consequences of debt and promote value for money policies through well evidenced research is critical.

Against this background the Consumer Unity and Trust Society (CUTS) sought to raise awareness about the gaps within Zambia’s public financial management system as it relates to debt and provide recommendations on how to address them. In an effort to do so CUTS worked with the Daily Mail and News Diggers to produce a weekly column in each outlet. The series of columns focused on debt and the consequences of growing debt in Zambia. Timed to begin alongside the budget they provided a platform to raise awareness of the impact of Government policy amongst the public and support influencing of the Government to tackle the growing debt problem. This brief contains the six articles that were published from September 25 to November 16, 2018.

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Explaining Zambia’s Debt

There is no doubt that Zambia’s debt has been rising dramatically. In 2011, total debt was recorded at US$3.5 billion and as of March 2018, this has risen to US$14.4 billion. These debt levels are alarming; it has been almost one year since the IMF declared Zambia at high risk of debt distress, and during this time, debt has risen significantly. Zambia’s debt risk has also made international news, with the Economist running two articles on Zambia’s debt in a recent edition.

However, more often than not, the people that talk about debt are economists. Talk of bond yields, debt to GDP ratio, foreign exchange reserves and exchange rate risk are important but can be confusing. But we all need to discuss debt as it affects individuals, businesses and public services. Over the next six weeks, CUTS will explore why Zambia’s debt should concern us all – what it is and why it matters. We believe Zambia could be on its way to a debt crisis, but we also believe that as a country we have time to act to prevent this. So we want to take this opportunity to explain the public debt, what it means and set out why together Zambians - individuals, CSOs and Government - need to work collectively to solve it.

UNDERSTANDING ZAMBIAN DEBT

Zambia’s situation is similar to a household that borrows money beyond its means to repay. Let us give you the example of Mr. Chomba, head of a household, who is married with three children. He earns a monthly salary of K7,000 and on average spends K5,000 for basic needs such as transport, food, utility bills and so on. The family also has a car – it’s not fancy but it works. However, Mr. Chomba has decided they need a new one and gets a loan from the bank to pay for it. But Mr. Chomba not only owes the bank the money he borrowed, but also has to pay interest. The problem is that over a period of time, the loan repayments exceeded his monthly earnings. His family now has less money and cannot afford basic needs because of the burden of paying back the loan. His children have to drop out of school as he cannot afford to pay school fees because he can no longer provide as much as he could for his family. If Mr. Chomba had planned carefully and obtained the loan to invest in a business that would generate more income for his family then getting the loan would have been justified. He would have borrowed to increase his income and eventually pay back his loan. However, he borrowed beyond his means to repay, leaving him and his family in a worse off position than before he got the loan.

Zambia’s debt has not been spent in a way that has increased growth but has become a burden on the economy. Interest payments alone consume a huge proportion of the national budget. Total domestic Government revenue – the money the government makes from taxes, fees and levies – was K39.2 billion in 2017. Meanwhile, Zambia’s interest payments to service its debt in 2017 was K9.8 billion2. This means that interest payments – often called ‘debt servicing’ costs - amounted to 25 per cent of the Government’s revenue. This is equivalent to the total health, social protection and Farmer Input Support Program (FISP) budget allocations for the 2017 national budget. And as debt rises, these payments will increase.

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1. Zambia Revenue Authority 2017 Annual Report
2. Outturn data provided by Ministry of Finance
Why Does Debt Matter?

High debt levels leave Zambia in a very difficult position. A lot of the country’s debt is contracted in foreign currency, which means if the kwacha weakens due to external factors, such as the copper price falling unexpectedly, the amount that Zambia owes in real terms will increase significantly. High debt servicing costs weaken the economy by forcing the government to spend money on interest payments when it should be spending on national development. Health, education, social protection are just three areas, which are significantly impacted, as money spent on interest cannot be spent on these sectors. Lack of investment in these services has a long-term impact on the social well-being of Zambians. High debt levels also leave the Government unable to pay its obligations to companies and contractors who have been engaged for various development projects: this is called payment arrears and at the moment Government owes K13.9 billion. We will discuss the impact of arrears and public debt in general on businesses in more details later in the series.

The impact of high debt levels should concern everyone, as everyone will be affected — be it closing down of businesses or hospitals lacking medicines. Amidst all the debate, there is no doubt that debt in Zambia is increasing at an alarming rate. Zambians will be the first to pay the real price for the country’s debt, as our social services are underinvested and economy is weak. On Friday September 18, the Government will be announcing the 2019 budget, and we will see the direct impact of debt servicing on social services.
Why Debt Concerns You

High impact on social spending

In our last column we outlined Zambia’s alarming debt position and explained how it came about. As we continue our series one particular cause for concern that we want to highlight is that increased debt has seen higher interest payments, which has consumed a large component of our national budget in 2018. As a result, less funds are available to spend on initiatives that help reduce poverty or support job creation in the country.

The amount spent on debt servicing, which includes interest payments as well as payments towards reducing the actual amount borrowed has increased significantly since last year. According to the Zambia Institute for Policy Analysis and Research (ZIPAR), the Government spent K9.1 billion on debt servicing for the first half of 2018, which was more than planned the budgeted amount of K6.2 billion. This K9.1 billion on debt servicing for the first half of 2018, which was more than planned the budgeted amount of K6.2 billion. This K9.1 billion on debt servicing for the first half of 2018 is almost equivalent to the entire amount spent on debt servicing payments for the year 2017, which amounted to K9.8 billion. During the first six months of 2018 personal emoluments, that is, wages and salaries, accounted for 42 per cent of domestic revenues, while 29 per cent accounted for interest payments. As such, only 30 per cent of government revenues was spent on all the remaining government programmes, which drive the country’s development, such as health, education, social protection, agriculture and so on.

The amount spent on debt servicing is only expected to increase in the coming years. As we have seen in last week’s budget speech, the amount Zambia is paying for debt servicing is still increasing even as the available budget for social services is decreasing. In this year’s budget external debt servicing costs doubled from K7.2 billion in 2018 to K14.9 billion in 2019.

A look at the current situation on the ground on the status of public services and poverty reduction initiatives in Zambia shows that there is urgent need to ring-fence social spending.

Education provision is suffering from a lack of funding. The teacher to pupil ratio has remained high with an average ratio of 1 teacher to 60 pupils and there is limited access to teaching aids and support infrastructure such as desks. The health sector is under-resourced, with most rural health centres and clinics not having medical doctors and support staff such as pharmacy technologists, lab technicians and midwives. Also, support for farmers has fallen due to a lack of extension officers: the ratio of these officers to farmers is as high as 1 to 1,200 in some areas, three times the ideal of 1 to 400. This lack of investment is hindering Zambia’s development as the country needs a well-educated, healthy and productive workforce that can help develop the country and lift people out of poverty. Good quality education and proper healthcare are necessary to build a productive workforce that can help develop the country and lift people out of poverty. The impact of the cost of servicing the country’s debt is reducing social spending, which will negatively impact us all, especially the poorest in the society.

High levels of government spending going towards debt servicing, less money is left to improve the quality of public services. Further to this, the government is already struggling to fund key budgeted activities due to the need to redirect resources to debt repayment. For instance, it was reported by ZIPAR that only 27 per cent of the funding for the Social Cash Transfer Scheme Pension Fund was released in the first half of 2018. Additionally, no funding has been released for the Food Security Pack initiative and other empowerment programmes this year.

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High debt levels should concern all of us as no one is immune to its impacts. There is need to recognise the importance of social spending for all of us as citizens and for the country as a whole. Good quality education and proper healthcare are necessary to build a productive workforce that can help develop the country and lift people out of poverty. The impact of the cost of servicing the country’s debt is reducing social spending, which will negatively impact us all, especially the poorest in the society.

In an effort to gain a perspective on the ground, CUTS conducted an interview with Mr Alick Muleya, Council Chairman of Sinazongwe District, Southern Province. He expressed how the lack of quality public services has left his district under-developed. The district has 13 health posts of which only six are functioning; the remaining seven are not operational due to lack of funds to pay health workers and staff houses to accommodate them.

He also noted that 32 schools in the district did not have electricity and other essential infrastructure resulting in students having to sit on bricks because there are no desks or chairs.

Why Does Debt Matter?

1. ZIPAR, Debt servicing and delivery of social services, 2018

2018 Half Year Expenditure

- Wages and Salaries: 42%
- Interest Payments: 29%
- Other Development Programmes: 30%

Total exceeds 100% because recurrent expenditure has been more than domestic revenue
The Impact Of High Debt Levels On The 2019 National Budget

Over the past two weeks we have discussed the high debt levels the country has accumulated and the implications this has for Zambians. On the September 28, 2018, the Minister of Finance announced the 2019 national budget, which showed the impact of debt on the national purse. Debt payments have consumed the largest allocation of the national budget amounting to K23.6 billion or 27 per cent of the entire budget. The amount allocated to debt servicing in 2019 is equivalent to the total allocation for education, health and social protection combined, showing that debt obligations alone are now consuming the majority of national revenues at the expense of the much-needed social spending.

As debt levels are increasing the Government needs to increase its revenue in order to provide public services and also pay back its debt. The Government does this through taxation and charging fees to raise revenues domestically and reduce its reliance on borrowing. However, taxes need to be raised fairly as there is a risk of stagnating private sector-led growth and squeezing ordinary Zambians into poverty by leaving them with little money to meet their basic needs.

This year a number of taxes and fees have been imposed, such as the borehole tax, increased toll gates and the government is set to introduce internet calling tax. The 2019 budget has come with the introduction of new taxes as well as increases in different taxes and fees to finance the different plans set out for next year. Some of these taxes will hit low income consumers the hardest. The government will introduce a 30 ngwee excise duty on non-alcoholic drinks, increase the rate of carbon emission surtax on vehicles and increase the charge on fees and fines. Additionally, the National health insurance scheme will be implemented, which will involve deducting a percentage of citizens’ income. This all adds to the pressure that ordinary Zambians are feeling.

One of the key policy changes is the plan to abolish VAT and replace with sales tax. VAT is a consumption tax placed on a product whenever value is added at each stage of the supply chain from production to the final point of sale. On the other hand, sales tax is a consumption tax imposed by the government on the final sale of goods and services. The rate and mechanism at which sales tax will be charged has not yet been announced but the introduction of the tax is likely to result in consumers paying more for goods and services. The sales tax has not been developed yet so its impact is hard to predict, but as government makes its plans, it needs to consider the risk that the tax will further squeeze consumers.

It is commendable that in an attempt to broaden the tax base, compliance initiatives and new taxes were introduced targeting corporate sectors particularly the mining sector. This should be applauded because taxes are collected from industry players more capable of paying tax. The government should avoid reliance on fees, fines and taxes on consumer goods because these are ‘regressive,’ meaning that all individuals are hit by them regardless of income. Taxes on ordinary Zambians come at a time when families are feeling the pinch: the depreciation of the Kwacha (itself linked to Zambia’s debt position) is likely to increase inflation, with September food prices 8.6 per cent higher than the year before. We can see evidence of this squeeze in how fees and fines are set to increase next year in line with inflation, but the Pay as You Earn (PA.YE) thresholds are unmoved. All this creates a worrying picture for the wellbeing of ordinary Zambians.

Higher taxes threaten to increase the cost of living on individuals, push low-income earners into poverty, and also slow down economic growth if individuals have less money for consumption of goods and services. While government needs to improve revenue to pay off its debt, poorly executed taxation policies threaten to derail the government’s ability to raise money, as well as leave ordinary Zambians suffering. We are calling for the objective of the tax system to be progressive and for taxes to be designed in a way that ordinary people are not made worse off but wealth is redistributed from those more capable of paying taxes to the poor and most vulnerable in society.
The adverse effects that high government debt has on everyday life are widespread; however, much of it goes unnoticed. In the immediate term, the impact of government debt on consumption is not very noticeable, but in the long run, the effects of it can be just as hard hitting as the increased tax burden we discussed last week. In continuing the series on how debt concerns you, this article explains the linkage between high government debt and inflation and what that means for consumers in their everyday lives.

Over the course of a month, you buy lots of different things, the price of which is impacted by a number of different factors, such as the cost of labour, the exchange rate, and costs of doing business in the country, such as taxes.

At 7.9 per cent, September overall inflation, the rate at which prices increased in September, was stable — just below the target of 8 per cent. However, this year we have seen food prices rise 8.6 per cent from the year before; and last week Monday we saw fuel prices rise from K13 to K16. The country's debt levels are not the only cause of price increases, but debt is at the heart of many of the reasons and provides the explanation why we can expect further inflation.

Debt has a strong link to the stability of the kwacha, which, in turn, impacts the everyday lives of consumers through inflation. Over the past few years, the Zambian government has been issuing bonds. When a government issues a bond, it is accepting a loan to finance certain activities. Foreign investors buy government bonds in order to make money through interest repayments. These investors assess whether to invest in a country by assessing how likely the country is to default, that is, not pay back its debt. This assessment is done by analysing the economy's immediate and long-term performance. Foreign investors assess the country’s financial position, plans for managing debt and prospects for growth through documents such as the medium-term expenditure framework and budget.

Lately, investors are becoming concerned about Zambia's debt levels being unsustainable. We see this in the high interest rates on Zambian debt. We also saw evidence of this in September when investors drastically reduced investment in government bonds. As buying bonds requires converting foreign currency to kwacha, demand for the kwacha fell, contributing to the depreciation of the kwacha by 20 per cent from K9 to K12 to the dollar that month.

When a currency is weakened, importing goods become more expensive. Zambia being a country that is heavily reliant on imports will be adversely affected by the depreciation of the currency. This means that anything imported becomes much more expensive. The increase in petrol prices, driven by a combination of rising oil prices and Zambia’s weak currency, is the most dramatic example of debt-fuelled inflation. However, food prices are increasing steadily, and as businesses adjust to higher import prices, more prices will increase in the near future, leaving Zambians increasingly squeezed.

The picture does not look very positive for the value of the kwacha. Firstly, the government has not offered investors reassurance that it is managing the debt position, as the kwacha has continued falling in value after the budget announcement on September 28. Secondly, the country's foreign exchange reserves, which the Bank of Zambia uses to buy kwacha and stabilise the currency, are under pressure. The Minister of Finance announced that the reserves had fallen from $2.1 billion in December to $1.8 billion at the time of the budget and are below target. As the reserves are needed to pay increasing debt servicing and petrol costs, the Bank's scope to manage the value of the currency is limited.

While inflation has been triggered by the depreciation of the kwacha in September, debt has created long-term and emerging pressure on prices. Businesses pass on borrowing costs caused by high interest rates to consumers, as well as the risk of reduced cash flow due to government arrears. Furthermore, tax increases will also create inflation as businesses pass on any additional costs of doing business.

The last few weeks have shown just how the country's debt position is hitting ordinary Zambians' pockets. Not only do citizens have to pay off the debt through increased taxes, incomes are being squeezed by inflation. And the country is in danger of entering a spiral as economic growth slows and investor confidence drops further, driving inflation higher. The budget offered an opportunity for the government to provide investors with assurance that the country was stabilising its finances. Instead it borrowed nearly K30 billion. The government needs more transparency in the scale of the problem and more credible plans to address it if it has to stop inflation hitting ordinary Zambians. Otherwise, we will all pay.
A Tough Climate And Weakened Economy: How Debt Concerns Businesses And Employees

With 90 per cent of employment created by the private sector, how does debt impact businesses and employees like you?

Businesses of all sizes are at the heart of the country’s development as they create employment for many Zambians and are a major provider of tax revenues for the Government. It is, therefore, important for the Government to create an environment in which the private sector can thrive and contribute to the development of the country. However, Zambia’s debt position is making it difficult for businesses to sustain themselves.

We are already seeing the impact of high debt levels on business, which could lead them to effect redundancies or even close down. The 2019 national budget speech confirmed non-performing loans (loans where scheduled payments have not been made) are at 11.7 per cent higher than the standard 10 per cent threshold. This is a sign that businesses are struggling with finance and could be linked to the high level of payment arrears in the economy. With more and more money being channelled to paying off its debt, the Government is short of cash, making it difficult to pay companies and contractors. This results in a build-up of payment arrears to the private sector, which stood at K13.9 billion in March 2019. Payment arrears have negative implications throughout the economy as contractors cannot pay suppliers, hitting many businesses’ cash flows, leaving them struggling to make more investments and even pay their workers.

High levels of domestic borrowing by the Government have also made it harder for businesses to access finance to make investments or simply keep going in times of poor cash flow. This situation has occurred through what is called a ‘crowding-out’ effect whereby banks would rather give credit to the Government than businesses. This is because these investments with the Government are seen as safer, which increases the cost of lending to the private sector, thereby reducing their borrowing. Government is increasingly looking for overseas investment to reduce this effect, but interest rates remain high and access to credit difficult for companies of all sizes.

Finally, in order to raise revenues to pay back public debt the private sector becomes a target. Small businesses in particular may find it harder to operate when taxes are increased as this affects their profits. In the proposed 2019 budget small and medium enterprises (SMEs) are expected to be paying more in taxes and fees next year. Turnover tax, which is a tax charged on small business with an annual turnover of K800,000 or less is expected to increase next year to 4 per cent from 3 per cent. All fees and fines will be adjusted upwards in line with inflation and thereby the cost of operating businesses will further increase next year.

We spoke to the Zambia Association of Manufacturers (ZAM) Chief Executive Officer Chipego Zulu to find out what debt means for businesses. She pointed out that reinvesting in the sector was difficult for manufacturers because of heavy Government borrowing on the domestic market. “The current high debt levels are increasing the cost of production for local manufacturers making our products less competitive than products outside Zambia. Small scale industries need to scale up operations, but heavy domestic borrowing has resulted in lack of affordable finance as interest rates have remained stubbornly high above 20 per cent despite interventions form the Bank of Zambia to reduce the cost of borrowing.” This shows that key economic sectors such as manufacturing are struggling to grow because of the country’s debt position.

Not only have high debt levels created a difficult environment for businesses to prosper, they are weakening the wider economy. As we know from our previous articles, debt levels have contributed to depreciation of the Kwacha, which has direct and indirect effects on businesses. Firstly, businesses will directly suffer from higher costs of inputs such as fuel and other imported goods, thus increasing running costs. Secondly, inflation threatens to reduce demand for goods and services in the economy as Zambians’ incomes are squeezed by higher prices. A weakened economy can lead to reduced profits and job losses.

Furthermore, the outlook for the economy is worrying because high debt levels leave it vulnerable to shocks such as a fall in the copper price, failing rains or currency depreciation. High debt servicing costs also limit the Government’s ability to inject cash into the economy to stimulate growth and have (among other factors) reduced foreign currency reserves, which the Government uses to protect the kwacha against depreciation. The Government would, therefore, be unable to cushion the impact of an economic shock, threatening economic collapse, which would see businesses close down and unemployment increase.

The private sector is very important for the growth of the economy as it creates jobs and provides income for Zambians. Increased debt accumulation is negatively affecting the operations of businesses, slowing down growth and ultimately leaving the economy vulnerable to collapse. Businesses are already underperforming, holding back growth, and will suffer if the Government does not address the debt problem, resulting in increased unemployment, coupled with higher cost of living and increasing poverty in the country.
Tackling Zambia’s Debt Situation – What Are The Solutions?

Over the past five weeks we have discussed the implications of high public debt in the country. The alarming rate, at which debt has been rising has impacted the economy negatively, contributing to the Kwacha depreciating and increasing inflation, which impacts consumers and contributes to slow economic growth. The implications trickle down to ordinary Zambians who end up being taxed more while public service provision declines. Businesses and employees also feel the burden as the cost of doing business increases and could potentially lead to job losses or businesses closing down. The situation needs to be addressed as it could lead to hard economic times for all Zambians now and also in the future. This article will explore some of the ways the Government can tackle the debt situation, which will in turn start to build investor confidence in the economy.

IN THE SHORT TERM

The first step on the road to recovery is to be more transparent on the exact amount of Zambia’s debt, its broad structure, creditors and interest terms. This can be achieved through delivering the promised quarterly debt status reports, as well as publishing the recently conducted Debt Sustainability Analysis (DSA). The publication of these reports would help avoid speculation and open avenues for discussions on the way forward for the country, which will in turn start to build investor confidence in the economy.

IN THE MEDIUM TERM

Demonstrating improved governance, management and controls over the economy and a willingness to re-engage with the IMF will further bolster market confidence in Zambia’s ability to manage its debt stock. This includes enacting the pending legislation needed to improve financial management in the country. For example, the revision of the Loans and Guarantees Act to allow for parliament to approve loans will help to improve oversight of debt acquisition in the country; while enactment of the Planning and Budgeting Bill and Public Procurement Act will lead to prudent management of public funds. Government also needs to acquire an IMF program to help build up its foreign reserves. This would relieve the burden of interest payments and free up space for spending on pro-poor policies and public service delivery that Zambia needs to continue with economic growth trajectory.

IN THE LONG TERM

Actions taken in the short and medium-term will help strengthen the Kwacha, build up foreign reserves, encourage more foreign investment and, ultimately, help make the longer-term refinancing of existing debt less painful.

Refinancing means that new loans will be raised in order to pay out an existing loan – namely the pending Eurobonds due in 2022, 2024 and 2025. Without taking actions in the immediate future to improve market confidence in Zambia’s economy, however, this option could be extremely expensive as market confidence impacts the rates, at which Zambia can borrow money, and could swell the debt stock even further.

#DEBTCONCERNSUSALL

Tackling the country’s high debt levels requires bold steps by the Government from the short to long term. Yet building a stronger future for Zambia is not just the job of the Ministry of Finance, but should involve representatives from all sectors of our society. Government should engage business, civil society, economists, researchers, the church and other stakeholders in a constructive dialogue to explore practical ways forward for the economy. After all, debt concerns all of us.

The manufacturing sector in the economy has somewhat declined over the last 15 years. In the year 2000, the sector contributed about 10.2 per cent of Zambia’s GDP, but this has since declined to only 7.9 per cent of GDP in 2015. In spite of this, the key stakeholders have described the general investment and business climate as favourable. Specifically, the ongoing road development projects over the years have had a positive development for the manufacturing sector as they have allowed local manufacturers easier access to export markets in the region.

In addition, local producers consider the 5 per cent surtax on imported goods that are already produced in Zambia as a positive move that has protected Zambian manufacturing. However, the stakeholders are concerned about the business impact of the delays in processing VAT and duty drawback refunds at the ZRA. In addition, some industry players view the proposed scrapping of the five-year tax holidays, which were offered by the ZDA as a negative development. Furthermore, the industry noted a lack of sufficient tax incentives for medium scale firms in the sector.