

## AFRICA RISK CONSULTING

### Zambia Monthly Briefing October 2018

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#### Zambia Summary 18 October 2018

**Finance minister Margaret Mwanakatwe says the government will introduce new mining duties and increase royalties on mining companies in an effort to reduce its increasing debt. Mining companies claim the increased tax will hurt output and employment in the sector. Government spokesperson Dora Siliya announces that the government will return to the United Kingdom (UK)'s Department for International Development (DFID) \$3.5m in funding that was reportedly misappropriated. United States-based ratings agency, Fitch Ratings, downgrades Zambia's long-term foreign-currency default rating from 'B' to 'B-' and gives the country a negative outlook.**

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#### Miners warn of economic collapse if Zambia increases mining tax

Finance minister **Margaret Mwanakatwe** stated on 28 September that the **Zambian** government will introduce new mining duties and increase royalties on mining companies in an effort to reduce government debt.<sup>1</sup> Mwanakatwe made the remarks during the 2019 budget speech, in which she outlined the \$7.1 billion budget and pledged to decrease the fiscal deficit to 6.5% of gross domestic product in 2019 from 7.4% in 2018.<sup>2</sup> The proposed changes to the mining fiscal regime, expected to come into effect 1 January 2019, include a new 10% export duty on precious metals such as gold and gemstones and a 5% import duty on copper and cobalt concentrates; a new 10% tax on copper when the price exceeds \$7,500 per tonne; and a 1.5% increase to the sliding royalty scale, which is currently between 4% and 6%.<sup>3</sup> The scale increases as commodity prices rise, and reduces when prices fall. According to the budget estimates, the new mining royalty will bring in 4.8 billion Zambian kwacha (\$391m) to the treasury.<sup>4</sup>

Most Zambians agreed with the increase in mining taxes. The **Association of Mine Suppliers and Contractors** approved of the changes and argued that some areas, such as the increase in royalty on cobalt, should have been increased to 10% or 15% rather than from 5% to 8%.<sup>5</sup> The opposition **United Party for National Development (UPND)** also welcomed the increases:

*"The changes come at a time when Zambians are feeling they were not benefitting from the mineral resources."*<sup>6</sup>

However, mining companies and advisory companies have criticised the proposed tax increases and claim they will damage Zambia's copper industry. **PricewaterhouseCoopers** tax expert **Jyoti Mistry** stated that the higher mining tax increases risk as it makes the government highly vulnerable to commodity price shocks.<sup>7</sup> **Zambia Chamber of Mines** president **Nathan Chishimba** said that

*"...more tax regime instability, massive increases, and novel taxes not seen anywhere else in the world will hurt the mining industry and all those who rely on its success. As industry production*

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<sup>1</sup> Reuters, 28 Sep 2018

<sup>2</sup> Reuters, 28 Sep 2018

<sup>3</sup> Reuters, 28 Sep 2018

<sup>4</sup> Lusaka Times, 28 Sep 2018

<sup>5</sup> The Independent Observer, 1 Oct 2018

<sup>6</sup> Lusaka Times, 29 Sep 2018

<sup>7</sup> The Mast Online, 3 Oct 2018

*shrinks through the impact, there will be fewer jobs, fewer taxes and as a result, there will be less in the government's bank for many years to come.”<sup>8</sup>*

Chishimba stated that some companies have already paused expansion plans in Zambia due to the taxes, though it is unclear to which mining companies he is referring.<sup>9</sup> The finance ministry responded on 7 October that it is open to dialogue with mining companies over the proposed tax increases and has appointed a tax policy review committee to deal with the technical issues relating to the tax increases.<sup>10</sup>

For the government, the tax increase will have two major benefits. First, it will help the government show Zambians that it is holding foreign companies to account. Civil society has applauded the tax increase, which will help to increase support for the government. Second, the government wants to increase transparency within the mining sector. The government has claimed that mining companies use creative accounting to short-change the government on revenue,<sup>11</sup> such as deducting any royalties from operating income, therefore reducing profits (if any) and potential income tax paid to the government. In the new tax regime, mineral royalty payments are no longer deductible against corporate revenue.<sup>12</sup> Mining companies will also have to pay royalties in dollars directly to the **Bank of Zambia** (central bank) in an effort to increase foreign currency reserves and stabilise the kwacha.<sup>13</sup>

For mining companies, there is a feeling that the government's tax increase will hamper a sector that needs long-term investment and stability to turn a profit, which is needed for Zambia's future growth. The increased royalty and tax rates will mean less revenue for mining companies, increasing the possibility that mining companies will restructure their operations to decrease costs – which could mean employment cuts and suspended expansion projects. This will reduce output, which will in turn diminish government revenue. As this is the tenth mining tax change in 16 years, the government may be banking on mining companies to continue as they have in the past. However, much will depend on whether the **Zambia Revenue Authority** and the treasury meet their forecasted targets and, if not, the government is likely to be more willing to meet with companies to discuss the new tax regime.

### Government returns misappropriated funds to DFID

Government spokesperson **Dora Siliya** announced on 3 October that the government would return \$3.5m in funding, which was reportedly misappropriated, to the **United Kingdom's (UK) Department for International Development (DFID)**.<sup>14</sup> The UK and other **European** countries froze their funding to Zambia due to allegations of fraud and corruption around the payments (see *ARC Briefing Zambia September 2018*). These particular funds were intended for poor families through Zambia's social cash transfer programme.<sup>15</sup> The national post office, **Zampost**, was tasked with distributing the funds, but it was found that officials misappropriated the funds instead of disbursing them to the families.<sup>16</sup> In response to this and other corruption allegations, the UK froze its aid funding and requested the return of that funding, while President **Edgar Lungu** (2015-present) fired social welfare minister **Emerine Kabanshi** as a scapegoat for the incident.<sup>17</sup>

The government also suspended more than 80 general education ministry officials on 11 October for financial irregularities not associated with the social cash transfer misappropriation.<sup>18</sup> DFID also

<sup>8</sup> IOL, 5 Oct 2018

<sup>9</sup> IOL, 5 Oct 2018

<sup>10</sup> IOL, 8 Oct 2018

<sup>11</sup> NewsDiggers, 8 Oct 2018

<sup>12</sup> NewsDiggers, 8 Oct 2018

<sup>13</sup> Mining Weekly, 3 Oct 2018

<sup>14</sup> Tio Zambia, 4 Oct 2018

<sup>15</sup> Business Ghana, 8 Oct 2018

<sup>16</sup> Business Ghana, 8 Oct 2018

<sup>17</sup> Business Ghana, 8 Oct 2018

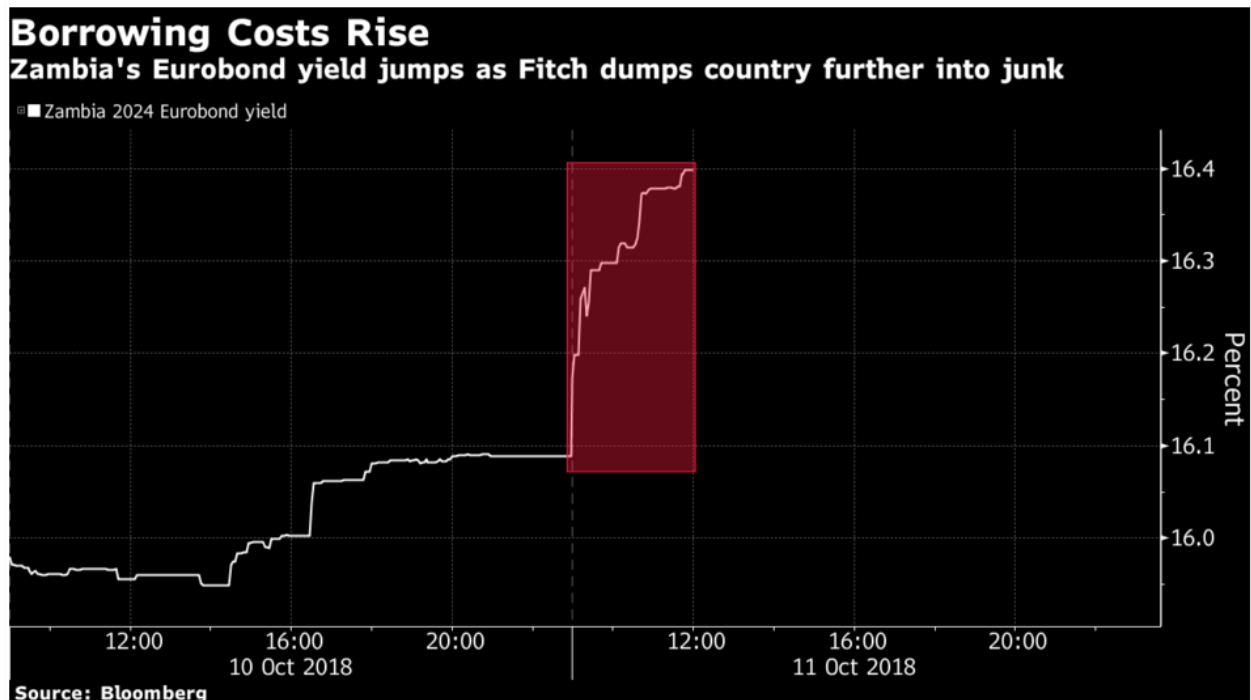
<sup>18</sup> Zambia Daily Mail, 11 Oct 2018

suspended funding to this ministry until investigations are completed into the irregularities.<sup>19</sup> According to Siliya, the funds were in a bank account of Zambia-based bank **Zanaco**, and were returned, as per DFID's request.<sup>20</sup> The UK confirmed receipt of the funds on 12 October.<sup>21</sup> The government is reportedly still disbursing the social cash transfer without the UK's funding.<sup>22</sup>

The scandal will embolden the opposition, which now has international confirmation of its accusations that Lungu and his government are corrupt. Lungu has acted fast to fire and suspend those implicated in the scandal, but the loss of funding and aid will further hurt the government as it will have to fund those programmes out of its own budget, or cancel them completely.

### Fitch downgrades Zambia with negative future outlook

**United States**-based ratings agency **Fitch Ratings** downgraded Zambia's long-term foreign-currency default rating from 'B' to 'B-' and gave the country a negative outlook on 11 October.<sup>23</sup> Fitch downgraded Zambia's debt deeper into junk status due to MkwanaKatwe's budget speech on 28 August. In its budget the government failed to decrease the budget gap and presented a budget that had less ambitious targets for fiscal consolidation than previous targets.<sup>24</sup> The 'B-' rating is the same level as that of **Moody's** and **Standard & Poor's**, which downgraded Zambia in July and August, respectively, though Standard & Poor's has a positive outlook on Zambia's debt.<sup>25</sup> Fitch's announcement caused the **2024 Eurobond** yield to jump 30 basis points, reflecting investor's bearishness towards Zambia's current situation.



Fitch's main issue with Zambia's long-term plans is the desire to continue to finance the 2019 deficit with \$2.1 billion in new loans, despite a depressed kwacha that makes repayments more costly.<sup>26</sup> This continual accumulation of debt will also not sit well with the **International Monetary Fund (IMF)**,

<sup>19</sup> Zambia Daily Mail, 11 Oct 2018

<sup>20</sup> Tio Zambia, 4 Oct 2018

<sup>21</sup> Lusaka Times, 12 Oct 2018

<sup>22</sup> Tio Zambia, 4 Oct 2018

<sup>23</sup> Fitch, 11 Oct 2018

<sup>24</sup> Business Day, 11 Oct 2018

<sup>25</sup> Bloomberg, 11 Oct 2018

<sup>26</sup> Bloomberg, 11 Oct 2018

which has refused to offer the government a \$1.3 billion bailout until Zambia can rein in its spending.<sup>27</sup> According to an analyst at the **Zambia Institute for Policy Analysis and Research**,

*“The loosening of the targets means that the government is actually not applying austerity – it’s an expansionary fiscal policy stance. Many people are wondering, to what extent is this sustainable? How does this actually get corrected?”<sup>28</sup>*

The funding that Mwanakatwe mentioned will not come from the IMF but is likely to come from **China**. Despite growing anger over China’s reported neo-colonial presence in Zambia,<sup>29</sup> the government will need the Chinese government to grant it the necessary loans to continue spending as it has without major restructuring, as required by international financial institutions. Lungu and the ruling **Patriotic Front** do not appear to have a long-term strategy for how to get out of this debt crisis. Other countries in the same boat, such as **Mozambique**, at least expect large payments from natural resources in five years, but Zambia’s economy still depends on copper, despite attempts at diversification. In the future, investors should expect more tax increases, as well as claims of unpaid back tax (as **Canada**-based **First Quantum Minerals** experienced with its \$8 billion tax bill from the Zambian government) to allow the government to continue some service delivery and not default.

### Planner

19-20 Nov 2018 **Bank of Zambia Monetary Policy Committee** meeting  
2021 (**Zambia**) Scheduled presidential elections;

### Chronology

17 Oct 2018 **Lusaka (Zambia)** *Reuters*. Finance minister **Margaret Mwanakatwe** states that mining companies can meet their operational costs, even with higher taxes;

16 Oct 2018 **Lusaka (Zambia)** *Reuters*. The **Association of Zambian Mineral Exploration Companies** states that the new mining taxes will decrease mineral exploration;

11 Oct 2018 **Lusaka (Zambia)** *BBC*. The government suspends more than 80 general education ministry officials for embezzling more than \$1.6m from the **United Kingdom’s** aid funding;

7 Oct 2018 **Lusaka (Zambia)** *Reuters*. The finance ministry states it is open to dialogue with mining companies over the plans to increase mining taxes;

30 Sep 2018 **Lusaka (Zambia)** *Sowetan*. Authorities refuse entry to **Kenyan** law professor and former anti-corruption commission director **Patrick Loch Otieno Lumumba** for security reasons, though critics argue it is because Lumumba was to deliver an anti-**China** lecture;

28 Sep 2018 **Lusaka (Zambia)** *Reuters*. Finance minister **Margaret Mwanakatwe** plans to introduce a new mining duty of 10% when copper exceeds \$7,500 per tonne and increase royalties by 1.5% to counter growing debt;

27 Sep 2018 **Lusaka (Zambia)** *Zambia Daily Mail*. The government states it will return \$3.5m of diverted funds to the **United Kingdom’s Department for International Development (DFID)**;

21 Sep 2018 **Lusaka (Zambia)** *Lusaka Times*. **World Bank** country economist **Ziv Chinzara** says that **Zambia** is not in a debt crisis despite media reports.

<sup>27</sup> Bloomberg, 11 Oct 2018

<sup>28</sup> Bloomberg, 11 Oct 2018

<sup>29</sup> Lusaka Times, 4 Sep 2018