

AFRICA RISK CONSULTING**Zambia Monthly Briefing April 2015**

Zambia Summary 24 April 2015

The Edgar Lungu (2015-present) government revises its mineral royalties tax increase from 20% to 9%. Following the announcement, Barrick Gold says it will not go ahead with the closure of its Lumwana mine while First Quantum's operations will continue as normal. Opposition figures and civil society groups criticise the administration for its handling of the taxation reform. Zambia's budget deficit will exceed the projected 4.6% of GDP due to the change in taxation regime and the ongoing slump in global copper prices. The kwacha improves slightly against the dollar across April but remains above K7 to \$1. The Zambia Electricity Supply Corporation (Zesco) commissions the 15MW Lunzua Hydro Power Station in Northern Province but says that poor rainfall has decreased electricity generation by 200MW, leading to load shedding.

Government revises mining royalties tax to 9%....

The government revised the mineral royalties tax from 20% to 9% following a four-month process of consultation with copper miners.¹ This is an important change of course from resource nationalism and runs counter to public opinion that mining companies should pay more tax. Mining minister **Christopher Yaluma** increased the tax to 20% from 6% in January 2015 to extract greater value for the country from its largest extractive industry. However, outcry from copper miners and the **Zambian Chamber of Mines** led to President **Edgar Lungu** (2015-present) ordering a revision of the new tax regime. Yaluma put the tax rate revisions to parliament on 20 April. Local sources say it will pass through the legislative process without obstacles.² The vital role of copper mining in the economy increased pressure on the government to resolve the mining royalties issue:

*"The mining industry represents more than 86% of Zambia's foreign direct investment. This investment is critical for increased capacity and production levels in the mining industry, and is fundamental to the development of growing economies such as Zambia."*³

The old taxation rate of 6% will apply until the new rates come into force on 1 July. The president emphasised that the change in legislation recognises the poor global state of the copper market, implying that the government did not give in to the demands of miners when adjusting the tax:

*"Obviously the mining industry has been affected by copper prices on the international market. It is clear that this unfavourable economic trend globally has been mainly on account of weak global demand for copper."*⁴

Following the proposed rate changes **Canada**-based **Barrick Gold** announced that it no longer intended to close its **Lumwana** copper mine in **Northwestern Province** on 23 April. The company had planned to pull out of operations if the new tax regime remained in force.⁵ However, **London**-listed **Vedanta Resources** subsidiary **Konkola Copper Mines**, which operates three mining operations in **Central Province**, will continue to make a loss even under the new tax regime due to

¹ Zambia Daily Mail, 20 Apr 2015

² Source: think tank director, Lusaka

³ Source: mining negotiations participant

⁴ Press release: 15 Apr 2015

⁵ Zambia Reports, 23 Apr 2015

the low global price of copper.⁶ London-listed **First Quantum Minerals** will go ahead with 343 redundancies at its **Kansanshi Mine** in Northwestern Province. The government has been pressuring First Quantum not to make any workers redundant. Labour minister **Fackson Shamenda** asked mining companies not to shed any labour while royalty tax negotiations were ongoing. However Kansanshi spokesperson **Godfrey Msiska** explained that the workers had been contracted to build a smelter on site and were let go after the work was completed.⁷ Operations at Kansanshi will continue as normal under the new taxation regime.⁸

Lungu's administration has averted a serious fall-out with the mining industry. However, opposition figures have criticised Lungu for causing the tensions in the first place. Opposition **United Party for National Development (UPND)** leader **Hakainde Hichilema** said:

*"The solution is not to increase the tax but rather to ensure that all taxes owed are properly recorded and collected, and that further investment is also facilitated so that revenues and jobs can both increase, and not one at the expense of the other."*⁹

Transparency International Zambia (TIZ) director **Goodwell Lungu** said the government might have created more problems than existed before the regime change. He said the government had created an opportunity for mining firms to avoid tax as income tax was easier to evade than a royalties tax.¹⁰ However, the government has said that the **Zambia Revenue Authority (ZRA)** would introduce new enforcement mechanisms to ensure greater effectiveness in collecting revenue from mining companies.¹¹

...but the loss of revenue and low copper prices increase budget deficit.

Zambia's budget deficit is likely to increase beyond the projected 4.6% of GDP in 2015. The increase is tied to the low global price of copper and loss of projected income from copper miners due to the amended mineral royalties tax rate.¹² **Mike Masiye**, director of the budget at the treasury, said that the combined factors added up to an increase in the deficit of \$310m.¹³

The price of copper has been in steady decline since 2011. It has fallen from over \$10,000 per tonne in February 2011 to \$5,940 per tonne at time of writing.¹⁴ The 2015 budget was predicated on a copper price of \$6,700 per tonne. International observers tie the decline in the price of copper to decreasing demand due to a slowdown in major construction projects worldwide. **China's** slowing growth has also had a major effect on the copper price.¹⁵ According to sources with knowledge of the commodities market, the outlook is not likely to improve before 2018:

*"The current demand is from a series of major construction projects in **Asia** that are coming to an end and there is nothing in the pipeline...this means that supply will outstrip demand for at least three years."*¹⁶

The kwacha is also tied to the copper market. Despite a steady improvement in rates, the currency has remained at over K7 to the dollar throughout April. It shifted from K7.59 on 1 April to 7.42 on 24 April

⁶ Reuters, 21 Apr 2015

⁷ Lusaka Times, 4 Apr 2015.

⁸ Source: Kansanshi mine, Northwestern Province

⁹ Hakainde Hichilema, Lusaka

¹⁰ Q FM Radio, 1 Apr 2015

¹¹ Reuters, 20 Apr 2015

¹² Lusaka Times, 24 Apr 2015

¹³ Reuters, 24 Apr 2015

¹⁴ Mining-info data.

¹⁵ FT, 22 Apr 2015

¹⁶ Source: commodities trader, London

despite the resolution of the mineral royalties tax.¹⁷ Prior to the revision of the taxation rate, financial analysts had expected the kwacha to gain against the dollar in the wake of the announcement:

“The kwacha is set to gain strength in the next few weeks because the price of copper on the international market has started rising and because government has started addressing the long standing issue of the Mineral Royalty Tax.”¹⁸

However the kwacha slipped against the dollar from 20-24 April due to the weakness of the global markets:

“Until the global market forecast picks up the markets will mistrust a currency so reliant on a single commodity.”¹⁹

The **Bank of Zambia (BoZ)** has taken steps to improve the kwacha’s standing. It has tightened liquidity conditions and increased the supply of foreign currency available to trade on the interbank market (see *ARC Zambia March 2015 Briefing*). This has led to Zambian companies offloading dollars in exchange for kwacha propping up the currency.²⁰ However it may not be enough to strengthen the currency on the international markets.

Zesco commissions new hydro power plant

Zambia Electricity Supply Corporation (Zesco) has commissioned the **Lunzua Hydro Power Station** project in **Mbala District** of Northern Province. The project upgraded the capacity of the existing installation from 0.75 megawatts (MW) to 14.8MW. It will add much needed power capacity to the Northern Province.²¹ The project cost \$52m and the **China National Electric Engineering Corporation (CNEEC)** upgraded the plant. It is part of a government programme to upgrade existing small-scale electricity installations to improve Zambia’s power generation capacity.²²

Civil society activists believe that the commissioning of Lunzua was politically motivated due to the **Senga Hill** parliamentary bye-election that took place on 15 April. The **Chishimba Falls** plant, which is also being upgraded, could have been fast-tracked instead, adding 40MW to the grid instead of 15MW.²³ The ruling **Patriotic Front (PF)** denied that the commissioning was politically motivated. The PF won the bye-election.²⁴

The commissioning of the new hydro plant comes at an opportune moment for Zesco. The utility said that it had lost 200MW of generation capacity from the grid due to low rainfall in 2014/2015. It will be implementing load shedding across the country to compensate for this. Zesco said that it would continue to shed 200MW of electricity per day until water levels rise.²⁵ Zambian businesses are concerned about the effect that indefinite load shedding could have on the economy:

“The kwacha is already weak, hitting businesses badly... if companies have to contend with ongoing electricity cuts they will lose further revenue... the government needs to keep the lights on.”²⁶

Zambia is highly reliant on hydro generation, which accounts for over 95% of its installed capacity. This makes the country vulnerable to fluctuations in the weather. Zesco is working to add more hydro generation capacity to the grid. The **Kafue Gorge Lower Hydro Project** is a 750MW power

¹⁷ XE.com

¹⁸ Source: financial analyst, Lusaka

¹⁹ Source: currency journalist, London

²⁰ ZANACO money market bulletin Q1 2015, Apr 2015

²¹ Lusaka Times, 10 Apr 2015

²² Zambia Daily Mail, 10 Apr 2015

²³ Source: civil society activist, Lusaka

²⁴ Zambia Reports, 15 Apr 2015

²⁵ Zambia Reports, 24 Apr 2015

²⁶ Source: business association, Lusaka

plant but will not be finished until 2017, two years behind schedule.²⁷ Sector sources point to the potential of hydro generation to provide consistent supply:

“Hydro power makes the most of Zambia’s natural resources and if the country can spread installations geographically it could make itself immune to everything but a serious drought.”²⁸

But others warn that overreliance on a single source of energy increases the risks of load shedding:

“Zambia needs to generate power in multiple ways or else load shedding will always be a risk.”²⁹

Implications

The mineral royalties tax was the Lungu administration’s first major test. Lungu could have avoided the entire situation by either not going ahead with the taxation change or presenting a less radical change in January. However, following his election on 20 January he stood to lose politically by pulling back from a campaign promise. The PF is a populist party and Lungu won on a mandate of carrying on **Michael Sata’s** (2011-2014) work, which included extracting more value from the copper industry. The copper miners are struggling for survival in the global commodities downturn. For them it was not an issue of large profits so much as basic operational viability. Lungu’s willingness to come to the debating table and revise the bill in less than a month shows him to be a more flexible leader than Sata – an encouraging sign for business.

The greater test for Lungu will be Zambia’s economy. The kwacha remains low and the deficit is increasing. Zambia is unable to effect any change in the international price of copper so economic policy will have to focus on diversifying the economy to try and lessen its dependency on a single natural resource. So far the government has announced no policies to this effect. The longer the government waits before acting on this, the more it risks running into more serious financial problems.

Zambia’s reliance on hydro-electric power is a perennial risk for investors. The country has a hydro generation potential of 6,000MW, three times its current generation peak, which it is wise to exploit. However investing in backup generators or thermal generation plants could help keep supply stable. Countries with this infrastructure already in place are able to capitalise on the low oil price to avoid power cuts.

²⁷ Zesco website, 2015

²⁸ Source: renewable energy developer, London

²⁹ Source: power sector analyst, Johannesburg

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