

AFRICA RISK CONSULTING**Zambia Monthly Briefing February 2016**

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Cabinet approves changes to the mining tax regime on 17 February. Zambia now returns to a royalty system that adjusts for the international copper price. The Zambia Chamber of Mines welcomes the change in taxation system but the price of copper remains low. The Zambia Electricity Supply Company (Zesco) reverses its December 2015 decision to increase electricity tariffs for industrial and commercial consumers. Analysts disagree on whether the decision is to help the ruling Patriotic Front (PF) win the November 2016 general election. The Bank of Zambia (BoZ) central bank monetary policy committee (MPC) keeps the interbank lending rate of 15.5% as inflation remained steady at 21%. The BoZ's preliminary growth statistics for 2015 indicate the Zambian economy grew 3.6%, down from 3.9% in 2014.

Government and mining companies approve of new tax regime

The cabinet approved changes to the mining tax regime on 17 February, moving it back to a price-based system.¹ The move comes with the approval of the **Zambia Chamber of Mines (ZCM)** and mining houses operating in the country, ending a period of dissatisfaction with taxation since 2012.² The cabinet took the action in order to

"...sustain continuous operation of existing mining companies and avert the continuation of suspension of mining operations and job losses".³

Under the new regime, taxation will be tied to the price of minerals, rather than a flat rate of royalties. It will include:

- a varied mineral royalty rate for copper, based on the prevailing copper price;
- a mineral royalty rate of 5% for other base metals, industrial minerals and energy minerals;
- a mineral royalty rate of 6% for precious metals and gemstones;
- the removal of variable profit tax but the maintenance of 30% income tax; and
- the complete suspension of 10% export duty on unprocessed ores/concentrates where there are no processing facilities in Zambia.

Presidential spokesperson **Amos Chanda** clarified that the variable rate of taxation for copper will be:

- 4% when the price is below \$4,500 per tonne;
- 5% when the price is between \$4,500 and \$6,000; and
- 6% when the price is above \$6,000.⁴

According to the ZCM the new tax regime is a sign the government takes the issues within the industry seriously:

"This shows that the government is striving to collect revenue from the industry in the way that does not discourage mines from investing in new mining projects and new employment."⁵

¹ Zambia Daily Mail, 17 Feb 2016.

² Reuters, 19 Feb 2016.

³ Zambia Daily Mail, 17 Feb 2016.

⁴ Lusaka Times, 19 Feb 2016.

⁵ ZCM spokesperson in Lusaka Times, 19 Feb 2016.

The regime shifts from a compromise agreement that the government brokered in April 2015 of a royalty rate of 9%, corporate income tax of 30% for mines and 35% for processors, variable profit tax of 15% on profits higher than 8% of copper sales, and a limited deduction of tax losses carried forward to 50% of taxable profits.⁶ According to a source of a copper mining house in Zambia:

*"The new regime gives us something that we have asked for since 2012, a flexible tax regime that adapts to the situation...we are happy to pay the higher rates when we can afford to."*⁷

Copper is Zambia's largest export commodity; the value of the kwacha and the level of government receipts tend to rise and fall with the price of the commodity. Copper was at \$4,577/tonne at time of writing – putting the royalty rate just into the 5% bracket.⁸ The commodity dipped to a seven-year low of \$4,318/tonne in January as low demand from **China** keeps the price down.⁹ Major copper miners in Zambia, **Switzerland**-based **Glencore**, **Canada**-based **First Quantum** and **Barrick Gold** and **United Kingdom**-based **Vedanta Resources**, have cut thousands of jobs and scaled back operations to cope with low prices (see *ARC Briefing Zambia 2015* coverage). The copper mining source put the tax development in perspective:

*"Our operations in Zambia are not out of the woods, we don't have the capital to cover our investment programmes and the medium term prospects for copper are uncertain."*¹⁰

Zesco reversal on tariff increase decision raises fears of political interference

The **Zambia Electricity Supply Company (Zesco)** has reversed its December 2015 decision to increase electricity tariffs for industrial and commercial consumers.¹¹ The company withdrew its application to the **Energy Regulation Board (ERB)** on 9 February.¹² Zesco told the media that it took the decision based on pressure from business customers:

*"We have withdrawn the application we made to the ERB for higher electricity tariffs. We had a lot of complaints and want to consult further."*¹³

Zesco increased its tariffs in December for all consumers except the mines, from an average of 5.64 ¢/kWh to 10.35 ¢/kWh, translating into increases in kwacha terms of between 170% and 250%. The tariff for mines was also increased to 10.35 ¢/kWh, but with effect from 1 January 2016.¹⁴ The Zesco tariff reversal follows a decision that President **Edgar Lungu** (2015- present) took in January to reverse tariffs for domestic consumers as they *"have been hard hit by the economic challenges"*¹⁵ (see *ARC Briefing Zambia January 2016*). Tariffs are now back to pre-December levels of 3.1 ¢/kWh for commercial consumers, with large consumers at an average of 1.57 ¢/kWh.¹⁶

Zambian farmers were a key group that lobbied for the return of tariffs to pre-December rates. The **Zambia National Farmers Union (ZNFU)** reportedly lobbied the government to put pressure on Zesco to reduce the tariffs.¹⁷ The drought across **Southern Africa** has reduced Zambia's harvest and farmers were unable to pay to irrigate their fields.¹⁸ The ZNFU welcomed the decision not to increase the tariffs:

⁶ Zambia Weekly, 19 Feb 2016.

⁷ Source, copper miner, Zambia

⁸ Infomine.com

⁹ FT, 17 Feb 2016.

¹⁰ Source, copper miner, Zambia

¹¹ Times of Zambia, 9 Feb 2016.

¹² Times of Zambia, 9 Feb 2016.

¹³ Zesco in Times of Zambia, 9 Feb 2016.

¹⁴ Zambia Weekly, 12 Feb 2016.

¹⁵ Zambia Weekly, 12 Feb 2016.

¹⁶ Zambia Weekly, 12 Feb 2016.

¹⁷ Zambia Reports, 27 Jan 2016.

¹⁸ Zambia Reports, 27 Jan 2016.

"[After the December increases] it was indeed difficult and costly for farmers to undertake meaningful irrigation."¹⁹

However, the decision to reverse tariffs leaves Zesco in a difficult financial situation. Zesco argued in December that it needed the higher tariffs to attract a \$4.3 billion portfolio of diversified generation projects to solve the ongoing power crisis.²⁰ Zesco now has to continue to subsidise electricity purchased from independent power producers.²¹ International observers including the **International Monetary Fund (IMF)** and the **World Bank** approved of the tariff increases.²² Both observed that Zambia's tariffs are some of the lowest in the region, and have not increased in line with inflation since Zesco last adjusted them in 2012.²³ A source at a power producer confirmed that the new tariffs made Zambia a less attractive investment destination:

"Every other country is designing attractive feed-in tariff schemes to get us to develop projects there. Zambia has just done the opposite and we are now very unlikely to develop there."²⁴

Despite this, mining minister **Christopher Yaluma** told potential investors in **Cape Town (South Africa)** that Zambia will add 1,500 megawatts to its power grid by 2020.²⁵ However, he did not specify how it might be able to do so. A local political source argues that the ruling **Patriotic Front (PF)** will have to put tariffs up eventually and have kept them low to win the upcoming general election:

"This is typical PF politics, give everyone what they want and get them to vote for you...they will reduce the price of fuel and [maize] meal before the vote in November, just you wait."²⁶

However, others believe the government reduced the tariffs in order to help businesses grow:

"The PF have, on one hand, a devalued currency and a power crisis that are putting pressure on businesses. On the other, they have reduced receipts from copper mines and increased unemployment putting pressure on the public purse...if they let Zesco put up the tariffs then the situation could get worse as the harvest fails and more businesses go under."²⁷

Bank of Zambia holds firm on interest rates as inflation remains at 21%

The **Bank of Zambia (BoZ)** (central bank) monetary policy committee (MPC) kept the interbank lending rate at 15.5% at its meeting on 12 February.²⁸ The BoZ is taking a more cautious approach to the economy following its decision to increase the rate 300 basis points at the last MPC meeting in November 2015.²⁹ This is due to the rate of inflation holding steady across December and January at 21%.³⁰ BoZ governor **Denny Kalyalya** says that the bank forecasts inflation returning to between 10-15% by the end of 2016.³¹ According to Kalyalya,

"We are mindful of the adverse effects so we try to maintain inflation at reasonable levels. We are also aware that if we put too much effort to bring inflation down, other things can be disrupted."³²

¹⁹ ZNFU spokesperson in Reuters, 9 Feb 2016.

²⁰ Zambia Weekly, 12 Feb 2016.

²¹ Zambia Weekly, 12 Feb 2016.

²² Zambia Weekly, 12 Feb 2016.

²³ Zambia Weekly, 12 Feb 2016.

²⁴ Source, power development company, London

²⁵ Reuters, 10 Feb 2016.

²⁶ Source, director of a think-tank, Lusaka

²⁷ Source, developmental economist, Durban

²⁸ BoZ press release, 12 Feb 2016.

²⁹ Reuters, 12 Feb 2016.

³⁰ Zambia Daily Mail, 14 Feb 2016.

³¹ Zambia Daily Mail, 14 Feb 2016.

³² Zambia Daily Mail, 14 Feb 2016.

The BoZ also released its preliminary data for 2015. It shows that gross domestic product (GDP) growth across 2015 was 3.6%, down from 3.9% in 2014.³³ This is considerably lower than the finance ministry's target of 7% growth in 2015.³⁴ According to Kalyalya the low growth was largely due to the poor weather conditions that have led to a shortage of maize and power. The increase in fuel prices and the depreciation of the kwacha also kept growth low and raised the cost of imports, transport and overall production.³⁵

The BoZ released figures showing that Zambia's foreign currency reserves remained within an acceptable limit of three months import cover. They stood at \$2.98 billion at December 2015, equivalent to 3.7 months of import cover.³⁶ Kalyalya remains positive that Zambia can achieve economic growth in the medium term:

"The outlook is still positive; the period we are in is a cycle that is bound to pass, so we should not focus much on challenges because we may miss the opportunity to do something. It is true that growth is elusive, but we have to find drivers to push the economy forward."³⁷

Implications

The new mining tax regime should put to rest four years of disagreement between the government and copper miners. It gives a level of flexibility in the current low commodity price environment, something mining houses have argued for, but keeps key government points such as the 30% income tax, and a tax on exporting commodities where they could be refined in Zambia.

Zesco's decision to reverse the electricity tariffs increase is welcome relief for farmers and small businesses. However, it leaves Zesco with limited funds to make much needed capital investment in power production. If the government does not find some other way to support Zesco and attract private sector investment, the power crisis will return in the dry season, which runs from May to November. Power is a key commodity across **Africa** and Zambia will need to prove itself competitive in order to attract private sector interest. Power shortages will have the same negative impact on growth in 2016 as it did in 2015.

The BoZ's monetary policy helped Zambia to navigate 2015 – one of the most difficult years the economy has faced since independence, due to the decline in copper prices. Maintaining the interest rate means that lending to businesses will not decline further. However, the interest rate remains high, as does inflation at 21%. The BoZ is banking on a currency recovery, and therefore a recovery in the price of copper to reduce inflation. Where the BoZ's policies have paid off are in foreign currency reserves. The decision not to spend them to support the kwacha in 2015 has kept them at internationally acceptable levels. This provides a comfortable financial cushion to soften the impact of slow recovery in international copper prices.

³³ BoZ press release, 12 Feb 2016.

³⁴ BoZ press release, 12 Feb 2016.

³⁵ BoZ press release, 12 Feb 2016.

³⁶ BoZ press release, 12 Feb 2016.

³⁷ Zambia Daily Mail, 14 Feb 2016.

About Africa Risk Consulting:

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