

AFRICA RISK CONSULTING**Country briefing – Zambia****25 November 2013****Summary**

President Michael Sata threatens to revoke Konkola Copper Mines' mining licence after it announces plans to lay off 1,529 workers. KCM proceeds to lay off 76 employees resulting in the revocation of chief executive Kishore Kumar's working visa. Fitch downgrades Zambia's credit rating due to expectation of a continually high deficit in 2014. Zambia Electricity Supply Corporation receives approval for proposed plans to increase electricity tariffs. The 2014 budget introduces higher operational costs for the mining sector, most significantly an export duty on semi-processed copper products.

1.1 President Michael Sata threatens to revoke Konkola Copper Mines' licence
Konkola Copper Mines (KCM), owned by **Vedanta Resources**, announced plans on 1 November to lay off 1,529 workers by March, due to increased mechanisation at its Konkola shaft in **Chililabombwe**.¹ President **Michael Sata** (2011 – present) responded by threatening to revoke KCM's licence, a move which would cloud the investment outlook for foreign direct investors.² The mining sector accounts for 11 percent of gross domestic product (GDP) and 80 percent of export earnings. The favourable climate for foreign direct investment and competitive metal prices have resulted in continued growth in the mining sector for the past number of years; as of 2012 the sector employs 74,000 workers compared to 27,000 in 2000.³

However, more recently the industry has faced increased costs of production and decreased copper prices. Konkola in particular has struggled with an annual output per employee at 8 tonnes per employee, nearly a thirteenth of the average global efficiency.⁴

¹ Reuters, 4 November 2013

² ibid

³ Times of Zambia, 12 November 2013

⁴ Reuters, 4 November 2013

KCM went on to lay off 76 employees from its shaft in Chiliabombwe (**Copperbelt**) on 6 November. In retaliation Sata revoked the working visa of CEO **Kishore Kumar** on 11 November while he was away on a scheduled trip to **South Africa**.⁵ Interior ministry spokesman **Suwali** reportedly defended the government's actions saying that Kumar had left the country when he was supposed to meet government officials to discuss the planned retrenchments.⁶ However, KCM held that the contractors who were let go were those whose employment period had lapsed.⁷

While Sata portrays his actions as defending the interests of Zambian workers⁸ his actions could stifle FDI and corresponding job creation due to a perceived increase in risk. In addition job losses are inevitable in the increasingly capital intensive mining industry:

*“It shows [the] **Government of the Republic of Zambia (GRZ)** still does not understand the significance of mining. Despite the fact that only a tiny (and relatively privileged) proportion of the labour force (50,000 or so) work in mining, GRZ is still obsessed with jobs. They do not recognise that mining is an increasingly capital intensive enclave industry and that many jobs in the old mines will inevitably go. The priority should be on both attracting investment and making sure the tax take is maximised (over time) so that the benefits of mining can be shared with all Zambians, not just a few thousand miners.”⁹*

Sata’s actions appear to be “completely political”:

“It is a real shame because it sets bad precedent, you have those old mines which really do need to get rid of some workers. It’s still almost like a remnant of the old nationalisation days where the workforce is still really bloated [...] A lot of his cabinet are scared to change any of his decisions. Even if he’s got something wrong they won’t say anything about it.”¹⁰

⁵ Times of Zambia, 6 November 2013

⁶ Reuters, 11 November 2013

⁷ *ibid*

⁸ *ibid*

⁹ Reuters, 11 November 2013

¹⁰ *ibid*

In September an internal government report entitled "Restructuring" recommended that 6,066 workers be pruned from government provincial and district administration offices. The report advocates retrenching these government workers to improve operations and save money.¹¹

In a public report regarding Zambia's economic progress **KPMG** wrote in November that *"analysts have agreed that [Zambia's] growth will remain redundant unless there is a corresponding increase in job creation."*¹²

1.2 Fitch downgrades credit rating

Due to the expectation of a high deficit continuing into 2014 **Fitch** has downgraded the country's credit rating from B+ to B. According to the **International Monetary Fund (IMF)** Zambia's fiscal deficit is projected to reach 8.5% of GDP this year due to higher pay for government workers and delays in scrapping a fuel subsidy. This is double the government's target of 4.3%.¹³ Fitch expects further spending over-runs and revenue shortfalls and predicts a deficit of 9% of GDP for 2013. Although the rating agency considers the economic outlook stable, it expects the deficit to remain high in 2014. However, **Standard & Poor's** rated the country with a negative outlook and a rating of B+.¹⁴

Former finance minister **Situmbeko Musokotwane** criticised the government saying that the downgrading by international credit rating agencies is a serious indication of the poor management of the country's resources and that Zambia could not hide its inadequacies in this matter with heavy borrowing and the huge deficit taking its toll on the treasury.[15]¹⁵

*"The economy is incredibly dependant on copper, 80% of export earning, so if the copper price dips more than what it is it may cause a lot of problems for existing Eurobond never mind if they [were to] raise 1 billion [...] I spoke to the former deputy finance minister earlier this year, he said the price is coming down now but we but we think it's temporary because china is going to keep growing."*¹⁶

¹¹ Source, Senior Economist, Zambia

¹² KPMG Africa, 14 November 2013 Source, Zambia

¹³ Reuters, 28 October 2013

¹⁴ Reuters, 28 October 2013

¹⁵ Zambia Reports, 3 November 2013

¹⁶ Source, Zambia

To combat the elevated deficit the government is contemplating the sale of a \$1 billion Eurobond. Treasury secretary **Fredson Yamba** said the sale of a second Eurobond is “*one of the avenues available. We are looking at various options. We have to go out there and see which the cheapest source is.*”¹⁷ Although the government may be able to sell a \$1 billion Eurobond, it will be more expensive to finance than its debut securities:¹⁸

*“Fiscal stimulus from the **Federal Reserve** will probably continue until next year, providing a window for new bond sales from **African** countries. Zambia’s Eurobonds may underperform others from the continent because of its aggressive issuance, while the Fitch downgrade will also push yields higher.”*¹⁹

1.3 Increased electricity tariffs and 2014 budget increase strain on mining companies

Zambia Electricity Supply Corporation (ZESCO), which provides 80 percent of the country’s electricity, proposed in July this year to increase its electricity tariffs for domestic and commercial customers by an average 26%.²⁰ Prior to the proposal ZESCOs tariff increases have been constantly below inflation rates; over the last 10 years tariff increases cumulatively reached 109% while the cumulative inflation over the same period reached 134%. Additionally, the 69% depreciation of the kwacha against the **United States** dollar over this period has increased the import cost of parts resulting in ZESCO’s operational costs being consistently higher than revenue generated.²¹

Energy minister **Christopher Yaluma** confirmed in early November that the tariff increase proposal had been approved by the government, although by “much less” than the proposed 26%.²² While he could not disclose the approved increase amount, he did confirm that it would be a “double digit” increase.²³ **Zambia Consumer Association** executive director **Muyunda Ililonga** said in an interview with **Qfm** that the approved increase in tariffs will be a burden on consumers. Instead of increasing tariffs for domestic consumers he proposed that the tariff increase should be directed at the mining sector.²⁴ However, earlier this year the government declared that it intends to raise electricity tariffs for mining companies to reflect the cost of producing power. Yaluma announced that companies such as the Zambian units of **Glencore Xstrata** and Vedanta Resources have agreed to start talks about

¹⁷ Bloomberg, 29 October 2013

¹⁸ Bloomberg, 29 October 2013

¹⁹ Bloomberg, 29 October 2013

²⁰ Zambia Reports, 1 November 2013

²¹ ZESCO Press Statement, June 2013

²² Zambia Reports, 1 November 2013

²³ Bloomberg, 6 November 2013

²⁴ Zambia Reports, 6 November 2013

paying more for power. According to **Copperbelt Energy Corporation**, mines currently pay about half the cost of generating power for new projects."²⁵ The government would like to see mines paying cost-reflective tariffs by 2015."²⁶

The 2014 budget includes policies which the **Chamber of Mines** (CMZ), representative for all major mining operations in Zambia, says would render the sector "extremely vulnerable" to collapse during the current volatile commodity cycle. CMZ objects in particular to the introduction of an export duty on semi-processed copper products on the grounds that it will have a "huge and substantial" effect on those companies that do not produce finished copper cathode, which currently stands at six of the eight major mining operations.²⁷

*"These operations rely on smelting facilities owned by other mining companies to treat their products. Introducing a duty that increases the cost of operation of these smelting facilities will inevitably result in these additional costs being passed on to the affected operations. This will have a major impact on the viability of these mines."*²⁸

2 Implications

Sata's reaction to KCM's planned layoffs implies that he is looking ahead to the 2016 election and acting in a way that shows his interests lie firmly with Zambian workers. This makes it unlikely that he will follow the government's internal report's recommendation to streamline the provincial and district administration offices for fear of hypocrisy. However, Sata's hasty actions, if continued, could increase foreign direct investors' perception of investment risk, potentially stifling the job creation that further investment would bring. In addition, Fitch's downgrading of Zambia's credit rating will raise the cost of the \$1 billion Eurobond if it goes through, increasing the dependence of the economy on the mining sector. In turn, the mining industry is becoming more susceptible to changes in copper prices due to increasingly high operational costs. The 2014 budget and ZESCO tariff hikes add pressure by increasing operational costs further. While it is important to maximise tax takes, the introduction of an export duty on semi-processed copper products when there is little infrastructure to process these products domestically will further weaken the sector. ZESCO tariff hikes are inevitable without total reform of the organisation due to their currently unsustainable financial position.

²⁵ Bloomberg, 6 November 2013

²⁶ *Zambian Economist*, 7 November 2013

²⁷ *Times of Zambia*, 12 November 2013

²⁸ *ibid*