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External Shocks and Sustainable Growth in Zambia

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Abstract

Zambia was not significantly affected by the 2008-09 global financial crises, thought real growth could have been higher and employment was adversely affected during the crisis. The country managed to continue with the sustained growth and macroeconomic stability that it had enjoyed over the past decade. Inflation was contained, international reserves were built and the debt levels were still low.

However, the economy has still to grapple with the problem of creating growth that reduces extreme poverty (Ndulo et al, 2009; IMF, 2012a). Moreover, the economy is still vulnerable to future global shocks. These can threaten the growth process and macroeconomic stability if the economy does not build policies that entrench a growth process that reduces poverty and builds macroeconomic stability. Observers have speculated that more recent shocks during 2011 and 2012 might have arisen from the Euro-zone crisis, the slow-down in the economic growth of economies of Brazil, Russia, India, China and South Africa (BRICS), and the increased global food and energy prices. The experience from the past is that such shocks to the economy are likely to express themselves from time to time in various forms. This means that policymakers should not sit idle. They should continuously seek to understand the changing world and endeavour to design both short term and long term policies that can address vulnerabilities so that sustained long term growth can continue.

The rest of this paper is organised as follows. In section 2, we discuss the country's vulnerability to external economic shocks. We first examine the key channels through which shocks can be transmitted into the economy. These are through trade, capital flows, remittances and external aid. We thereafter discuss the relevance of the Euro-zone crisis, BRICS growth slow-down, the energy and food price crises to the economy. Section 3 discusses the likely impact of the economic shocks on the economy. Section 4 discusses the possible growth and development effects. We look at the policy responses in section 5 and conclude the paper in section 6.

Introduction

Zambia was not significantly affected by the 2008-09 global financial crises, thought real growth could have been higher and employment was adversely affected during the crisis. The country managed to continue with the sustained growth and macroeconomic stability that it had enjoyed over the past decade. Inflation was contained, international reserves were built and the debt levels were still low.

However, the economy has still to grapple with the problem of creating growth that reduces extreme poverty (Ndulo et al, 2009; IMF, 2012a). Moreover, the economy is still vulnerable to future global shocks. These can threaten the growth process and macroeconomic stability if the economy does not build policies that entrench a growth process that reduces poverty and builds macroeconomic stability. Observers have speculated that more recent shocks during 2011 and 2012 might have arisen from the Euro-zone crisis, the slow-down in the economic growth of economies of Brazil, Russia, India, China and South Africa (BRICS), and the increased global food and energy prices. The experience from the past is that such shocks to the economy are likely to express themselves from time to time in various forms. This means that policymakers should not sit idle. They should continuously seek to understand the changing world and endeavour to design both short term and long term policies that can address vulnerabilities so that sustained long term growth can continue.

The rest of this paper is organised as follows. In section 2, we discuss the country's vulnerability to external economic shocks. We first examine the key channels through which shocks can be transmitted into the economy. These are through trade, capital flows, remittances and external aid. We thereafter discuss the relevance of the Euro-zone crisis, BRICS growth slow-down, the energy and food price crises to the economy. Section 3 discusses the likely impact of the economic shocks on the economy. Section 4 discusses the possible growth and development effects. We look at the policy responses in section 5 and conclude the paper in section 6.

Defining the Country Vulnerability

This section examines the country's vulnerability from external shocks. These are the Euro-zone crisis, the break on the economic growth of the BRICS countries, and the energy and food price crisis. This is assessed through the various key channels that can transmit the crisis to the economy. These are trade, foreign direct investment (FDI), remittances and external aid (ODA). We first give an overview of the transmission channels and then discuss the relevance of the Euro-zone crisis, BRICS economic growth slowdown, and increased energy and food prices to them. This is discussed within the context of the transmission channels.

Overview of the Main Transmission Channels

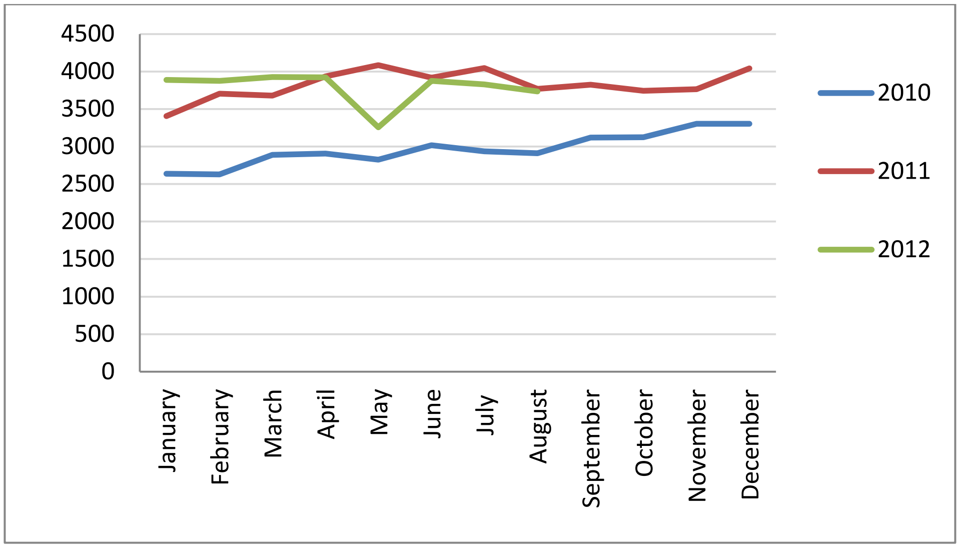
(a) Private Capital Flows

The major activity in private capital flows is the foreign portfolio investment into Zambia. This is captured by looking at the stock and bond markets and international banking.

(i) Stock and Bond Markets

The stock market was adversely affected by the global financial crisis of 2008/9. It however picked up in 2009 (Ndulo et al, 2010). It has performed fairly well in terms of market capitalization and market turnover. The Lusaka Stock Exchange (LuSE) All Share Index has been stable with a gentle upward trend during 2010 and 2011, and a fairly flat trend in the first part of 2012, except for the big trough in May 2012. This could have been caused by negative investor sentiments on the global market, probably because of the Euro-zone crisis. This is shown in Figure 1 below.

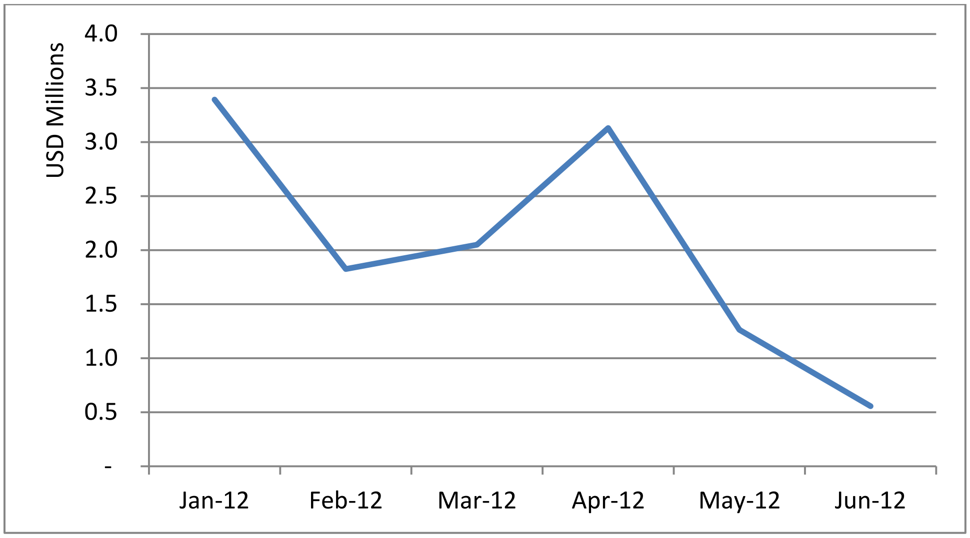
Figure 1: LuSE All Share Index



Source: Calculated from LUSE database

However, there seems to be restless activity among the foreign investors on the market. This is clear if we look at the total foreign turnover, foreign inflows and outflows on the market. We see that total foreign turnover, total inflows and outflows by foreign participants on the stock market, increased to US$323 million in 2010 after the global financial crisis. This could be partly attributed to the mandatory offer by Bharti Airtel Limited to Zain PLC minority shareholders when it took over Zain It collapsed to US$ 52 million in 2011. This could be mainly attributed to the political uncertainty arising from the general elections in 2011 and the post-election policy changes. During 2012, total foreign turnover has had a downward trend as is exhibited by Figure 2 below.

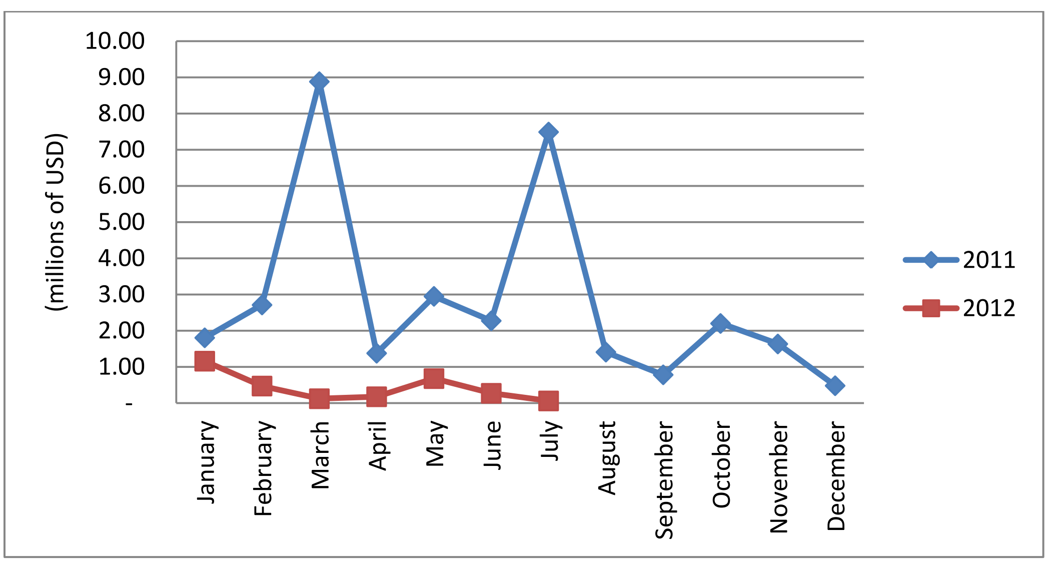
Figure 2: Total Foreign Turnover by Month, 2012 ($ millions)



Source: Calculated from LuSE database

If we look at both inflows and outflows during 2011 and 2012, there was a downward trend translating in the reduction of foreign participation on the market. This is shown in Figures 3 and 4. This downward trend seems to be building up during 2012 (Figure 2).

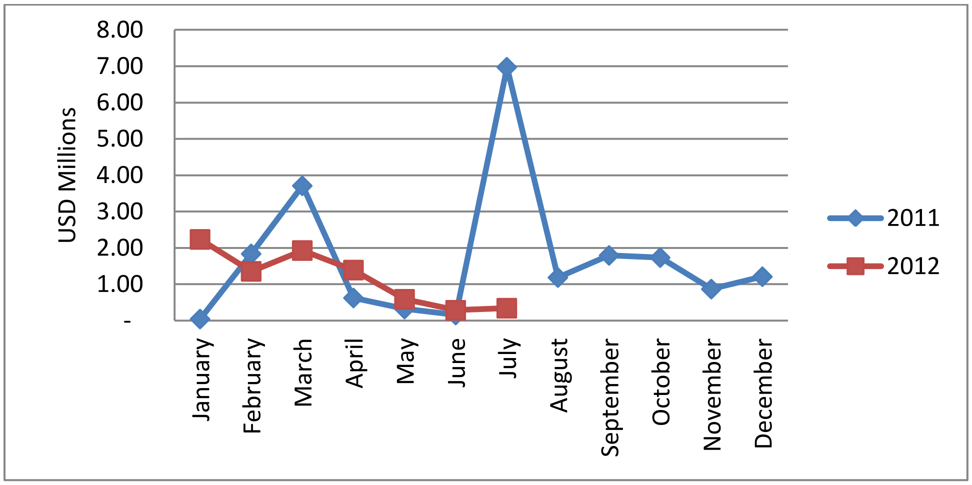
Figure 3: Foreign Portfolio Inflows on the LuSE



Source: Calculated from LuSE database

However, since the major foreign participants on the stock exchange are not from EU and the BRICS countries, it is not likely that the downward trend was affected by the Euro-Zone crisis and the BRICS slow-down. There seems to be other domestic reasons that lead market actors to be cautious. This might result from the policy uncertainty from the new government.

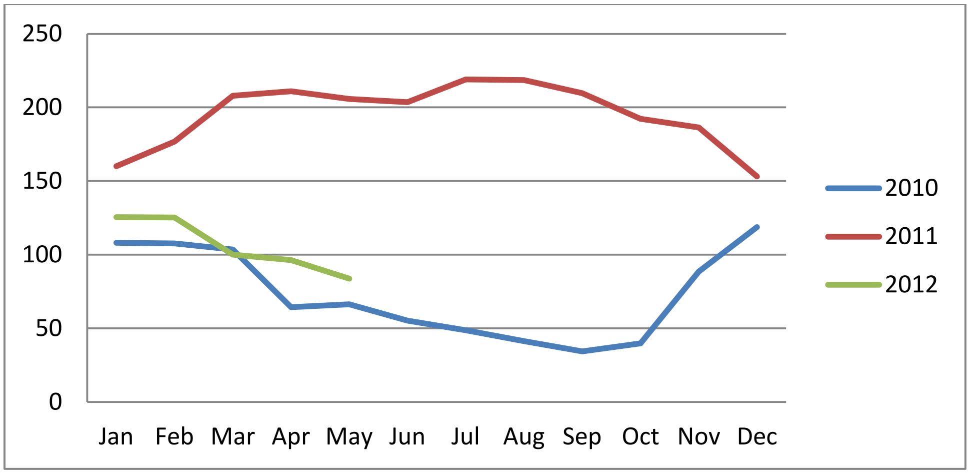
Figure 4: Foreign Portfolio Outflows on the LuSE



Source: Calculated from the LUSE database

The participation of foreign investors in the bond and treasury bill market has been declining since July 2011. This can be attributed to the political uncertainty pending the outcome of the 2011 general elections which adversely affected investors' sentiments. After the elections, there has continued to be political uncertainty which could have adversely affected the participation for foreign investors on the market. Thus investors' total holdings of government securities peaked in July 2011 at US$219 million. This has since then continuously dropped and was estimated at US$84 million in May 2012. This is shown in Figure 5 below.

Figure 5: Foreign Investment in Government Securities (Total Treasury Bills and Bond, US$ million)

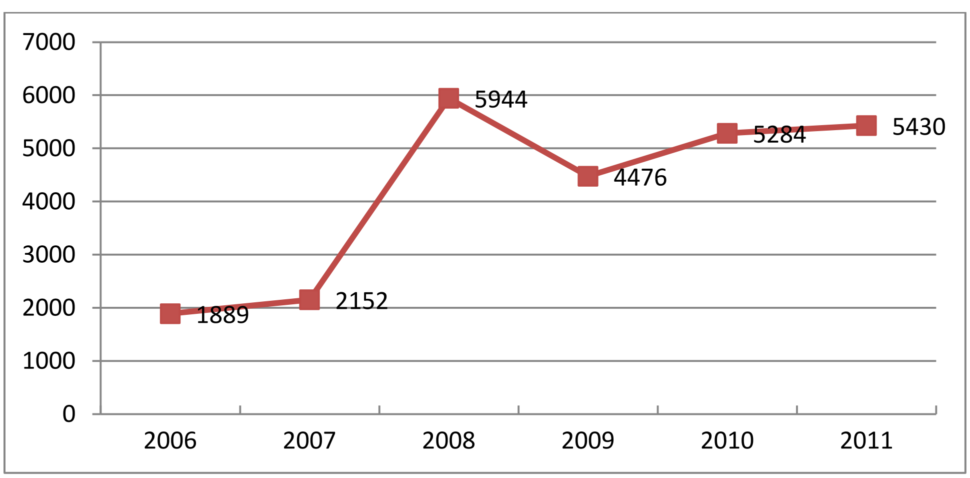


Source: Bank of Zambia Database

(ii) Cross –border Bank Lending

The banking sector in the country is dominated by subsidiaries of foreign banks. These are mainly from the United Kingdom, South Africa, China and the Netherlands. These will have a large role to play in cross-border banking. Figure 6 shows the total international claims on the country for the period 2006 to 2011. International claims on Zambia reached their peak in 2008 at US$2,944 million. They thereafter fell in 2009 to US$4,476 million.

Figure 6: Total International Claims (US$ million)



Source: International Bank of Settlements

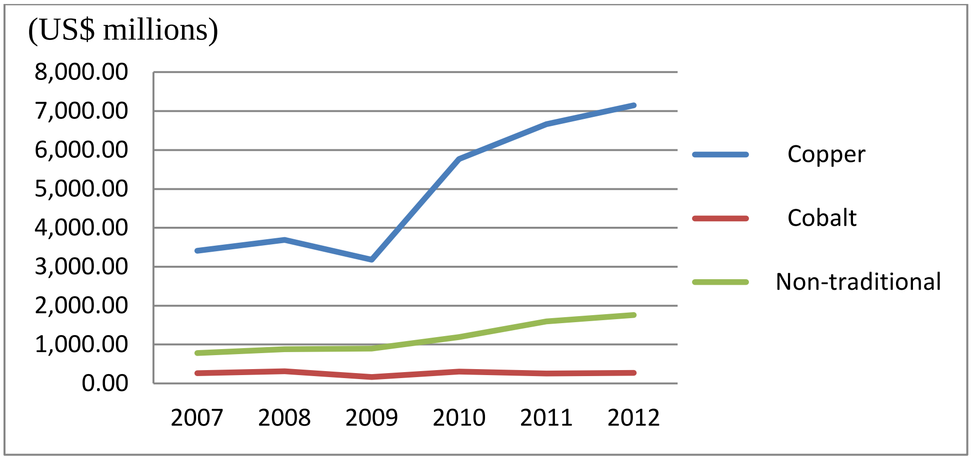
They have, however, been increasing since then. They were estimated at US$5,430 million in 2011. In terms of importance, international claims were 28 per cent of GDP in 2011. They averaged 30.8 per cent of GDP over the 2007-2011 period. The Euro-zone crisis did not seem to affect the performance of cross –border bank lending.

(b) Trade

Trade is expected to be one of the major transmission channels for any major global economic shock. The external sector in Zambia has performed very well during the past decade. It weathered the 2008/09 global economic crisis. Total trade has increased by about 88 per cent between 2007 and 2011 from about US$8624 million to uS$16,209 million respectively, most of the time enjoying a positive balance. Total exports have increased significantly. These are estimated at US$ 9,018 in 2011. Most of this increase has been boosted by increased copper prices and increased production and exports from the mining companies. A large proportion of the copper exports are destined to China through Switzerland.

Figure 7 shows the distribution of metal and non-traditional exports between 2007 and 2011. Copper exports have continuously increased over the period and are expected to be US$7 billion by the end of 2012. On other hand, non-traditional exports have increased more slowly. They are however expected to reach US$ 1.8 billion by the end of 2012. The major non-traditional exports are copper wires and electric cables, cotton lint, cane sugar and burley tobacco.

Figure 7: The Distribution of Metal and Non-traditional Exports, 2007-2012*

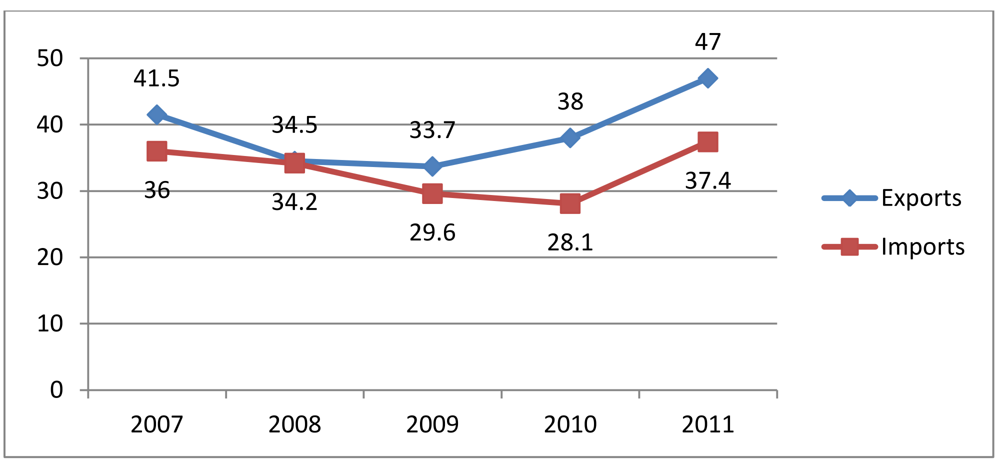


*estimated

Source: Calculated from the BoZ and CSO databases

Figure 8 below shows the distribution of exports as a percentage of GDP. The significance of exports has increased since the global financial crisis which adversely affected Zambia's export sector. This has increased from a period low of 33.7 percent of GDP in 2009 to a period peak of 47 per cent of GDP in 2011.

Figure 8: Zambia's total exports to the World (% of GDP)



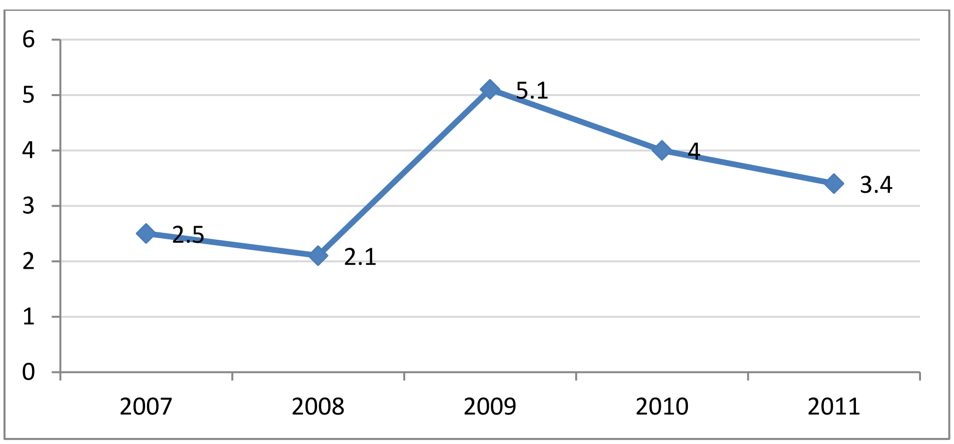
Source: Authors' Construction based on UNCTAD data base

Imports have also increased significantly reflecting the implementation of major investment decisions in the economy. Figure 8 above also shows the significance of imports in the economy. The contribution of imports has also increased continuously from about 29.6 per cent of GDP in 2009 to 37.4 per cent of GDP in 2011.

(c) Balance of Payments

The country's Balance of Payments position has generally been negative. However, starting from 2009, it has been positive. The balances on the current account are estimated at US$538.4, US$1,143, and US$236.1 for 2009, 2010 and 2011 respectively. The comfortable current account position has been attributed to the high export earnings because of the high copper prices. One cannot discern any impact of the current economic shocks on the current account. The healthy balance of payments position has allowed the country to build up reserves. This would be a good buffer to address any future economic shock. Figure 9 shows gross international reserves in terms of months of imports. These peaked in 2009 with reserves of about five months of imports. These, however, fell to three months in 2011. The total reserves however increased in absolute terms. These increased from US$1,896.5 million in 2010 to US$ 2,166.9 million in 2011.

Figure 9: Gross International Reserves in Months of Imports



Source: Calculated from BOZ database

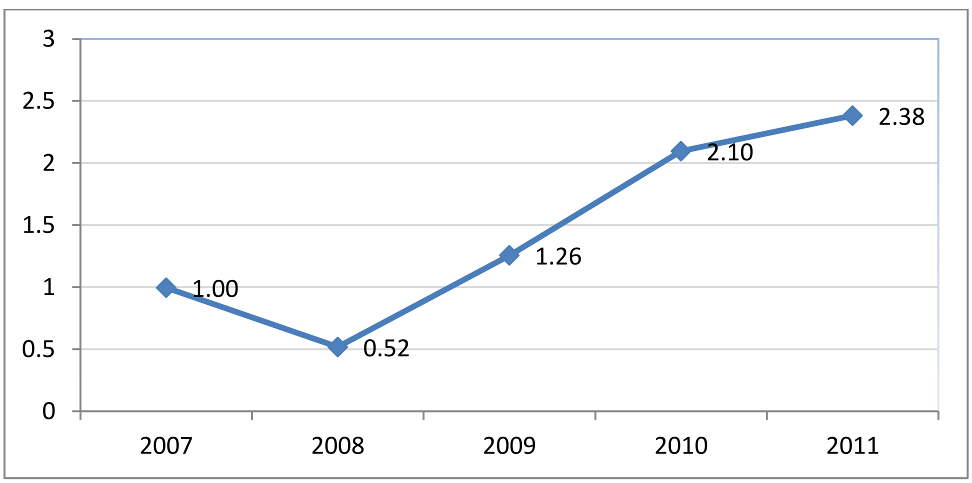
(d) Overseas Development Assistance (ODA)

Zambia has over the years benefited from generous ODA support from external donors. This has been an important resource inflow into the economy particularly directed at support to the health, education sectors and NGOs. The key donors are United Kingdom, United States, Denmark, Netherlands, Sweden and Norway. ODA inflows were in 2011 estimated at US$ US$ 397.3 million. This was an increase of about US$236.3 million over total ODA loan disbursements of about US$161 million in 2010.

Figure 10 below shows ODA inflows as a percentage of GDP. This demonstrates that there was a collapse of ODA inflows in 2008 but these have been significant and increasing since then. It is estimated that the inflows are 2.4% of GDP in 2011.

The ODA inflows into the economy are likely to be affected by political factors and are decided over a long-term horizon. It is therefore unlikely that short-term events will affect them adversely.

Figure 10: ODA as a % of GDP (2007-2011)

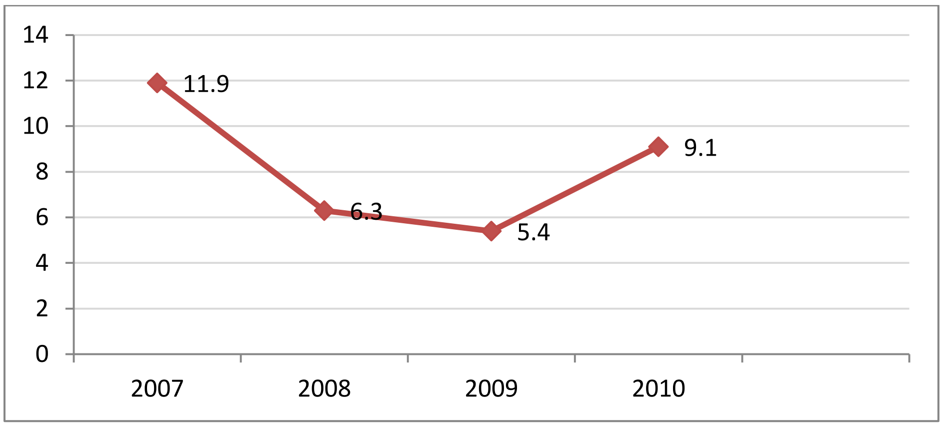


Source: Authors' Construction based on BoZ (2011), World Bank (2010) and IMF (2012)

(e) Foreign Direct Investment

There have been major FDI inflows into Zambia during the past decade. Most of the resource inflows have been directed at copper mining. The FDI inflows were partially affected by the global financial crisis of 2008-2009. FDI fell from US$1,324 million in 2007 to US$939 million in 2009 and further to US$695 million in 2009. These have since rebounded and doubled in 2010. They increased to US$1,729.9 million. Figure 11 below shows the share of the FDI inflows in GDP. This is estimated at 9.1 per cent of GDP in 2010.

Figure 11: FDI as a % of GDP (2007-2010)

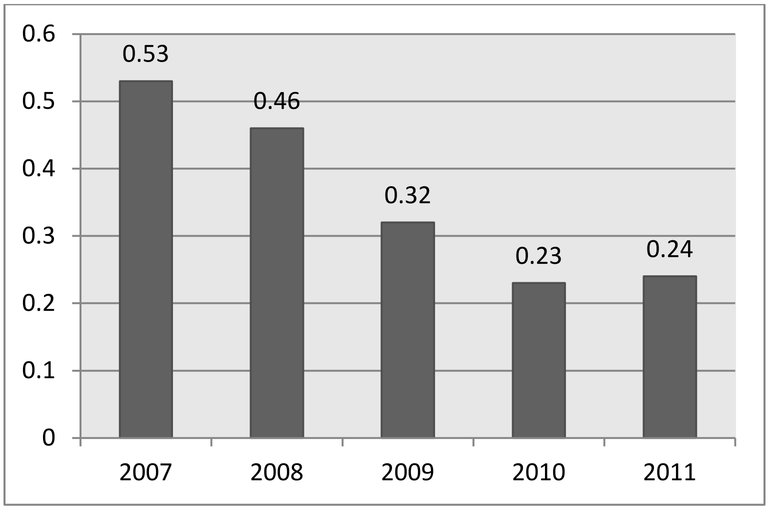


Source: BOZ database

(f) Remittances

Remittances have never been a major source of external resources for Zambia. Although there is a problem of data and underreporting of remittances through formal channels and that most remittances go through informal channels, available information indicates that these are insignificant compared to most African countries. During 2011, there was an increase of workers' remittances of about 3.6 per cent from about US$44.7 million in 2010 to US$ 46.3 million. However, the importance of remittances as a percentage of GDP has been declining over time. It declined from 0.53 percent of GDP in 2007 to 0.24 percent of GDP. This is demonstrated in Figure 12 below. This clearly shows the economy-wide insignificance.

Figure 12: Remittances as % of GDP, 2007-2011

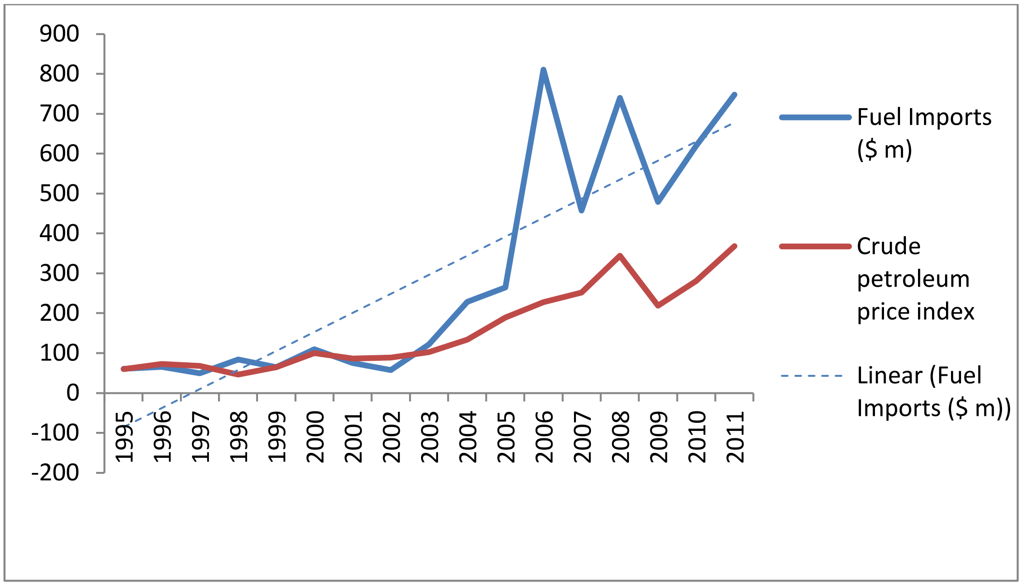


Source: BoZ (2012)

(g) Energy Crisis

Energy is a major input in to the Zambian economy. The major sources include fuel and electric energy. Any major world crisis which leads to increased world prices will negatively affect the economy. There are two major sources of energy. These are the imported energy and the internally generated energy. The shock will mainly result from the imported fuel which is mainly petroleum. In 2007 the country imported US$457 million of petroleum products. This was about 12.2 per cent of the total import bill. This increased to US$748.2 million in 2011. This was about 7.4 per cent of the import bill. A major increase in the prices of energy will therefore bring about a major shock to the economy. Rising energy costs will manifest themselves through higher fuel and transport cost in both consumption and production. Such a major shock can be ameliorated if the country made investments in the generation of its local energy i.e. hydro-electric power.

Figure 13: Fuel Imports and Crude Petroleum Index, 1995 -2011.



Source: UNCTAD Database

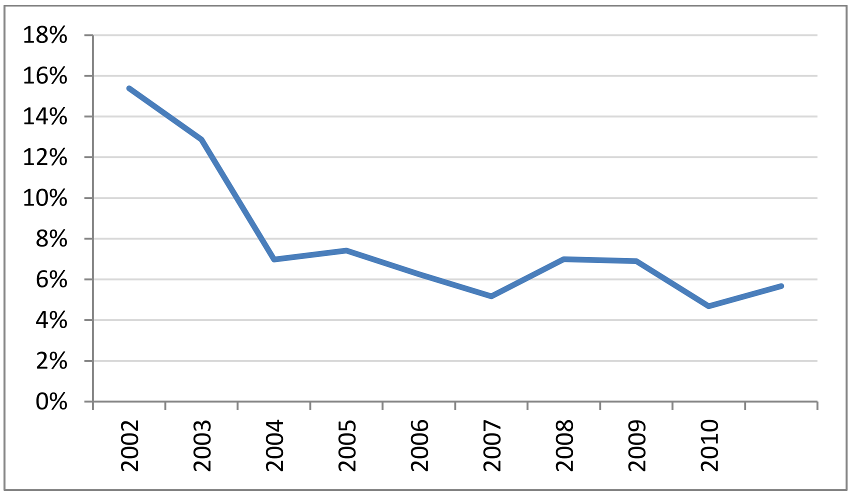
Figure 13 shows the trends in fuel imports and the crude petroleum price index between 1995 and 2011. This shows that the total import bill for fuel has continuously increased over the period. This can be attributed to the increased price of crude oil on the global market, the re-bound in copper production and the consequent increased demand for fuel in copper production, and the positive growth process that the economy has experienced over the period. However, one notices high import volatility for fuel during the period 2005-2011. Reasons to explain this are hard to find.

The higher energy prices and the higher demand for energy are likely to have had an effect on the trade balance. However, it is difficult to discern its effect on poverty and competitiveness. One might argue that with many confounding factors, it is hard to discern the effects that the energy shock has had on the Zambian economy. Furthermore, the procurement and pricing system of petroleum products is arguably opaque and tends to limit the pass-through of increased energy prices to the domestic economy.

(h) Food Crisis

Food imports constitute about 5 per cent of total imports. These were US$ 213.3 million in 2007. They increased to US$ 381.6 million in 2011. An increase in global food prices is unlikely to create a major shock on the economy compared to an increase in energy prices. Figure 14 below shows the imports of food as a share of total imports between 2002 and 2011.

Figure 14: Food imports (% of imports of all products)



Source: Author's construction from UNCTAD online database

In the case of Zambia, increased food prices will adversely affect the trade balance but because of the small share of food imports in the total import bill this is unlikely to be significant. One adverse effect would be the pass through to domestic inflation and thereby its effect on poverty. This has to be studied further.

Defining the Country-specific Shocks

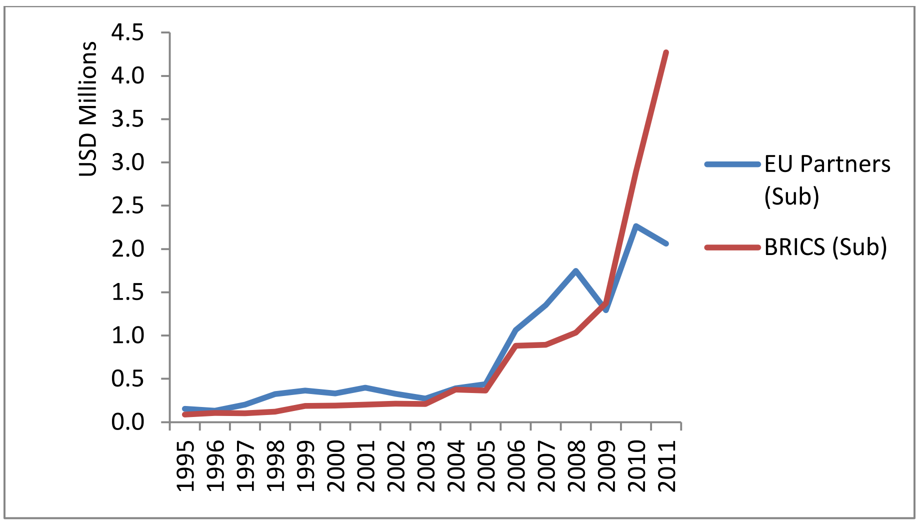
In this section we discuss the likely impact of the four global shocks on the economy. This is discussed within the context of key transmission channels.

Euro-zone Crisis

(a) Trade

The major transmission channel for the Euro-zone crisis would be through trade between Zambia and the Euro-zone countries. Slower growth in the EU can reduce demand for products from Zambia. These are mainly non-traditional products. The crisis would then negatively affect the economy through exports. This effect is unlikely to be significant because the country has a limited diversification of exports. The major export for Zambia is copper which is mainly exported to China through Switzerland. However, the major impact would be with trade with the Netherlands and Belgium which in 2011 was estimated at US$ 195,309 and US$ 52,754, respectively. These are insignificant amounts. On the whole there has not been so far a significant impact of trade with the EU as a result of the crisis. This is demonstrated in Figure 15. There was a slight fall of the value of exports of US$2.3 million in 2010 to US$2.1 million in 2011.

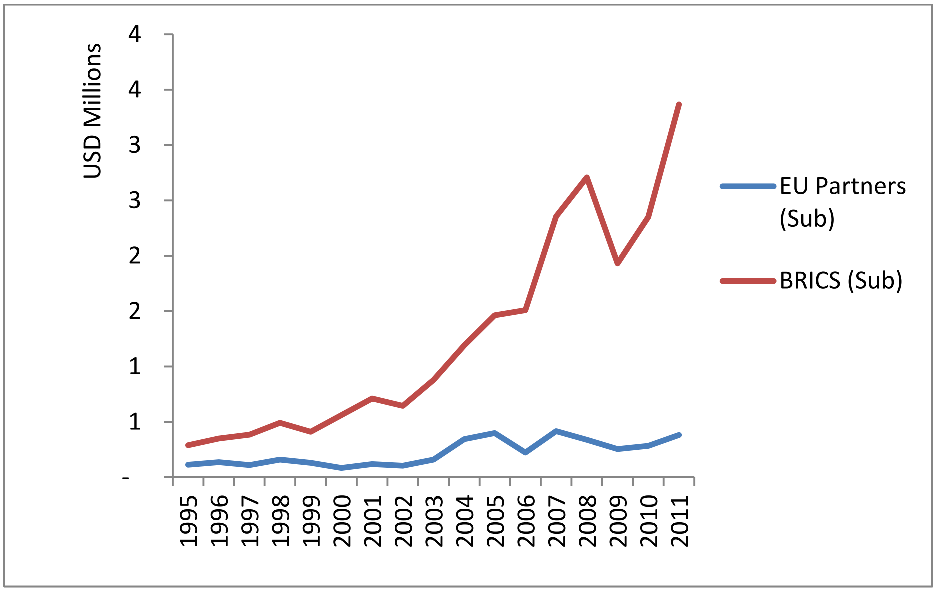
Figure 15: Total Exports to EU Partners and BRICS



Source: UNCTAD database

On the other hand imports from the EU have continued at about the same level. Total imports from the EU are estimated at US$ 381,788 in 2011. This is a very significant amount especially compared to imports from the BRICS countries. Figure 16 below shows the trend of imports from EU between 1995 and 2011.

Figure 16: Total Imports from EU Partners and BRICS

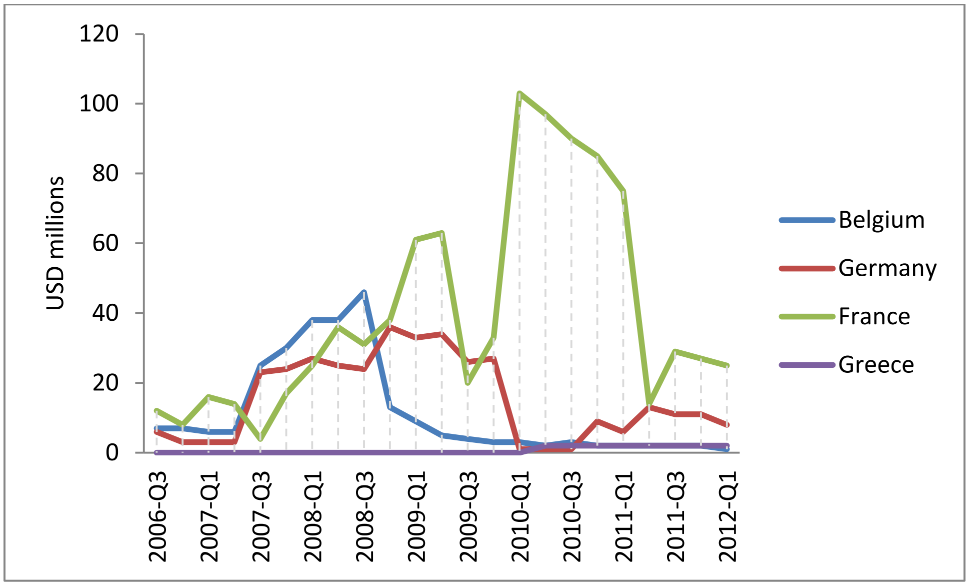


Source: UNCTAD database

(b) Private Capital Flows

Zambia is relatively isolated from the financial spillovers emanating from the Euro-zone crisis because it has limited financial linkages with Europe. The only bank with strong linkages is Rabo Bank. The bank is a major partner in ZANACO. Furthermore the participation of investors from Europe on the stock exchange is limited. Figure 17 shows foreign claims on Zambia by EU banks.

Figure 17: Foreign Claims by Nationality of Banks



Source: BIS

These are insignificant. The largest claims are from Germany and France. The claims from France seem to have peaked at US$103 million in the first quarter of 2010. The total claims for all European foreign banks are estimated at US$36 million for the first quarter of 2012. There seem to be insignificant amounts and are their collapse is unlikely to bring about any major impact on the economy. However, the crisis might affect investor confidence and lead to changes in market sentiments that might affect the success of the sovereign bond that the country has been trying to float on the global market.

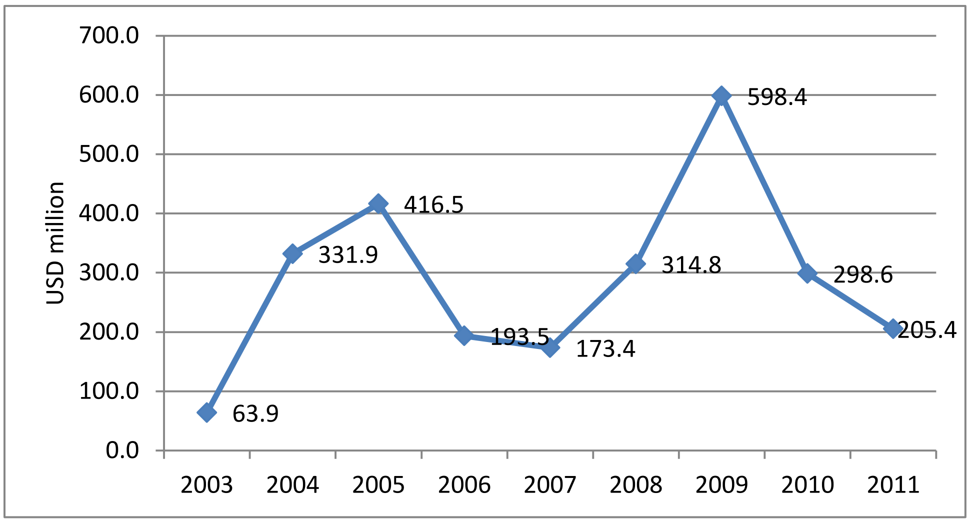
(c) Foreign Direct Investment

Much of the FDI that has taken place in the country in the recent past has been in the mining sector. There has also been some FDI in the manufacturing and services sector. Most of the FDI inflows are from Switzerland, France, Netherlands and United Kingdom. The most significant is the FDI inflow from UK which totalled US$250.6 million in 2010. Most EU countries involved in FDI are not members of the Euro-zone. The crisis is therefore unlikely to have any impact on the FDI flowing into the country from the EU.

(d) Official Development Assistance

Financial consolidation in Europe may lead to declines in ODA to Zambia. However, the major donors to Zambia are the United Kingdom, United States, Japan, Sweden and Denmark. Among the EU countries none of them is a member of the Euro-zone. The crisis is therefore unlikely to reduce the ODA support to Zambia. Indeed, donor inflows were relatively higher in 2011 than they had been prior to domestic financial misappropriation scandals in the health and transportation sectors in Zambia in 2009, which saw the reduction of donor inflows in 2010 and 2011 (Figure 18).

Figure 18: Donor Inflows (2003-2011)



Source: Bank of Zambia Database

(e) Remittances

Remittances have never been an important resource inflow into Zambia compared to other countries. However, the crisis is likely to lead to a weaker euro which will negatively affect the value of remittances to Zambia from Europe. There might, however, be an indirect effect from South Africa. South Africa, which is more exposed to global shocks, may transmit the Euro-zone crisis to the region and Zambia (WEO, page 74). This can be spread to Zambia through reduced worker remittances to Zambia from South Africa. On the whole, there does not seem any significant effects through this channel from the Euro-zone crisis to Zambia.

BRICS Slow Down

In this section, we discuss the impact of the halted economic growth of the BRICS countries. As Table 1 below shows, the pace of economic activity in the BRICS countries has slowed down. This scenario is expected to continue during the 2011 to 2013 period. The sluggish growth is prominent in India and South Africa who are important partners to Zambia. We analyze the likely impact of this downturn in terms of the key transmission mechanisms. These are trade, FDI, remittances and ODA.

Table 1: Real GDP Growth for BRICS Countries, 2011 -2013 (annual % change)

Year	*2011*	*2012**	*2013**
Brazil	2.7	3.0	4.1
Russia	4.3	4.0	3.9
India	7.2	6.9	7.3
China	9.2	8.2	8.8
South Africa	3.1	2.7	3.4

* Projection

Source: IMF (2012) World Economic Outlook: 61

(a) Trade

The slow-down in economic activities in the BRICS countries is likely to be exhibited through the trade channel. This is likely to have a big effect on Zambia because trade is becoming increasingly important with the BRICS countries.

However, the slowdown does not seem to have affected Zambia's trade with the BRICS countries. Zambia's total exports to the BRICS countries doubled between 2010 and 2011. This was from US$2.9 million to UDS$ 4.3 million respectively. The trade is now double that with the EU. Despite the economic slowdown, Zambia's exports to all BRICS countries increased. The biggest increase was with exports to China and South Africa. These increased between 2010 and 2011 to US$3.1 million and US$1.1 million from US$ 2.2 million and US$0.6 million respectively. It can therefore be asserted that the BRICS slowdown had an impact on the exports between Zambia and the BRICS countries in the sense that the growth in exports would have had been more in the absence of the economic slowdown.

A similar behaviour is revealed by the pattern of imports from the BRICS countries. These increased by 43.4 percent between 2010 and 2011 and totalled US$3.4 million in 2011. The dominant sources of imports were China and South Africa. These supplied 10 percent and 33 percent of total imports respectively.

Among the BRICS, China provides a major export market for copper exports in Zambia's trade structure. On the Other hand, South Africa's market absorbs some non-traditional exports from Zambia such as sugar cane and copper wires. However, Zambia does not export much of her products to India, Russia and Brazil. South Africa is Zambia's major source of imports followed by China among the BRICSs. The major imports for Zambia are manufactured products and intermediate inputs such as machinery parts and vehicles, from South Africa and China. Medical and surgical equipment comprise the major imports sourced from India. Brazil and Russia do not account for a significant amount of Zambia's imports.

(b) Private Capital Flows and FDI

There are no data available to trace the private capital flows between Zambia and the BRICS countries. Only Brazil banks report their claims to the Bank of International settlements. Its flows are insignificant. Total foreign claims on Brazilian banks were estimated at US$28 million in 2011. These dropped to US$ 21 million in the first quarter of 2012. On the other hand Table 2 below shows us a picture of the FDI inflows for the BRICS countries. It is difficult to discern a pattern on FDI flows because of the unavailability of the data. However, indications are that there are significant FDI inflows from China, India and South Africa and that the economic slowdown has not significantly adversely affected them.

Table 2: Investment pledges, 2007-2012 (US$ millions)

Year	Russia	India	China	South Africa	EU
2007	-	79.5	690.8	216.0	198.0
2008	8.8	557.0	5,808.3	236.8	108.9
2009	-	106.2	114.5	33.1	173.9
2010	3.9	293.2	1,125.8	338.1	163.4
2011	-	438.8	583.6	201.6	175.3
2012*	-	89.3	384.9	67.1	-

* For first quarter, 2012

Source: ZDA database

Table 2 shows the distribution of the amount of pledged investment at the Zambia Development Agency from the BRICS countries and the EU. These are mere pledges but can show us the likely activity in FDI in the country. It is estimated that on the average 15 per cent of the pledges are realized as actual investment. The table shows that the dominant pledges come from China, South Africa and India. Most of the investment pledges from China have been in mining, manufacturing and construction sectors. There is a reduction in the value of pledges but this downward trend had already started in 2009 and is unlikely to be as a resulted of the economic slowdown in China.

Most of the investment pledges from South Africa are in agriculture and manufacturing while those from India are mostly in mining and manufacturing. These do not show any firm downward trend. The investment pledges from India actually increased to US$438.8 million in 2011 from US$293.2 million in 2010.

(c) Remittances and ODA

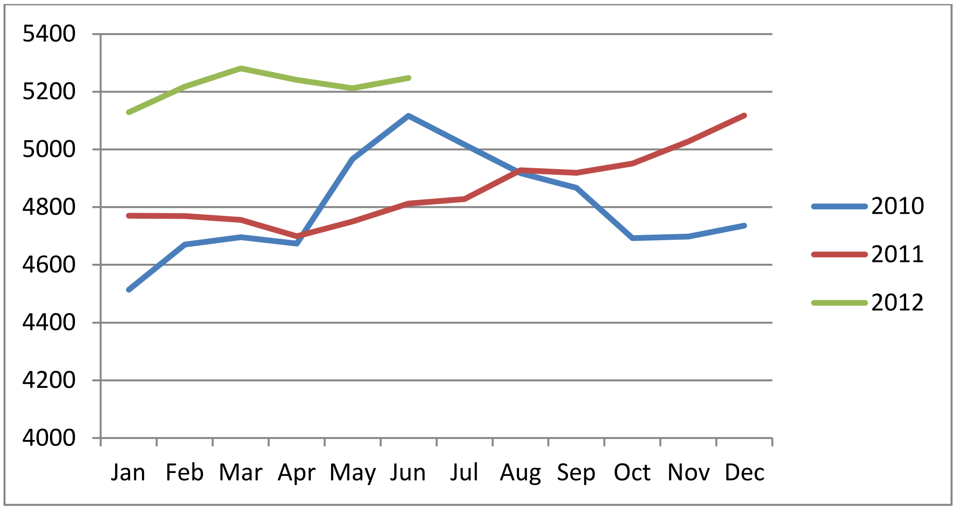
The other possible channels of transmitting the economic slowdown in the BRICS countries are through remittances and ODA. However, all the countries are not significant sources of ODA. The exception is likely to be China. Remittances are likely to be significant with workers' remittances from South Africa. However data on workers' remittances from South Africa are not available. It is therefore difficult to ascertain the size of the flow of workers' remittances from South Africa. China has provided significant amounts of ODA to Zambia. This has gone into the building of schools, health centres and stadiums. However, it is difficult to get this information. It is however, unlikely that this flow of ODA has been recently affected by the slowdown in the growth rate of the Chinese economy.

Understanding Possible Growth and Development Effects

Inflation Rate and Exchange Rate

There is a strong correlation between the exchange rate and copper prices. Because of the dominance of the copper sector in the pattern of exports, the two are positively correlated. Zambia has maintained a flexible exchange rate system. This has proved ideal for responding to crisis and therefore for building macroeconomic stability which is necessary for the growth process to take place. The flexible exchange rate worked well to help resolve the 2008/09 global crisis. The monthly trend in the exchange rate is shown in Figure 19 below. However, during 2011 and 2012 the exchange rate has been under pressure and has continuously devalued. It increased from K5, 129 per kwacha in January 2012 to K5, 212 per Kwacha in May 2012. This behaviour is more a result of the political uncertainty in regard to policy direction that arose out of the change in government after the 2011 elections rather from any external shock. The inflation rate has also been reined in and continues to decline during 2011 and 2012. The inflation rate was estimated at 8.7 per cent in 2011 and is expected to decrease further to 5.6 per cent in 2012. However, the low inflation rate would be threatened if there was an external shock to the country emanating from increased food and energy prices.

Figure 19: Trends in the Monthly Exchange Rate (K/US$), 2010, 2011, and 2012

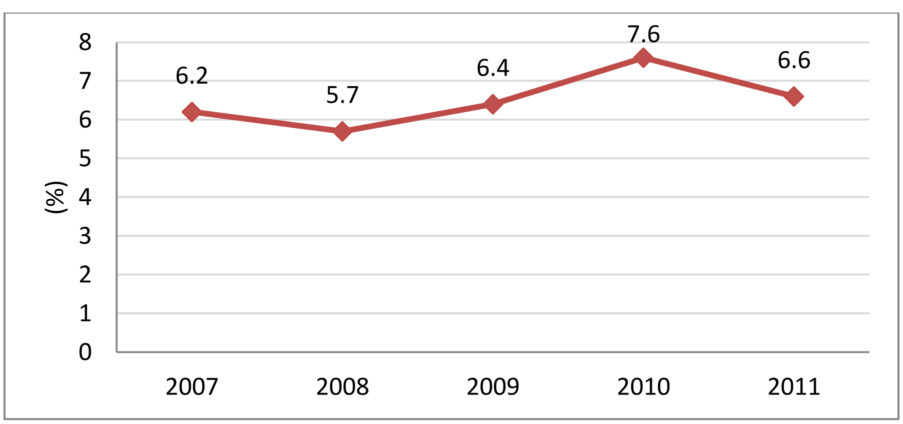


Source: Bank of Zambia Database

Growth and Employment

The country's real growth rate has been positive for the past decade. This is expected to continue. The 2008/09 global economic crisis adversely affected the growth process. It, however, rebounded in 2009, only to fall again in 2011. The pattern in the growth in the economy is shown in Figure 20 below. The economy is expected to grow by 7.7% in 2012 and 8.3% in 2013 (IMF, 2012a).

Figure 20: Real GDP Growth Rate (%)



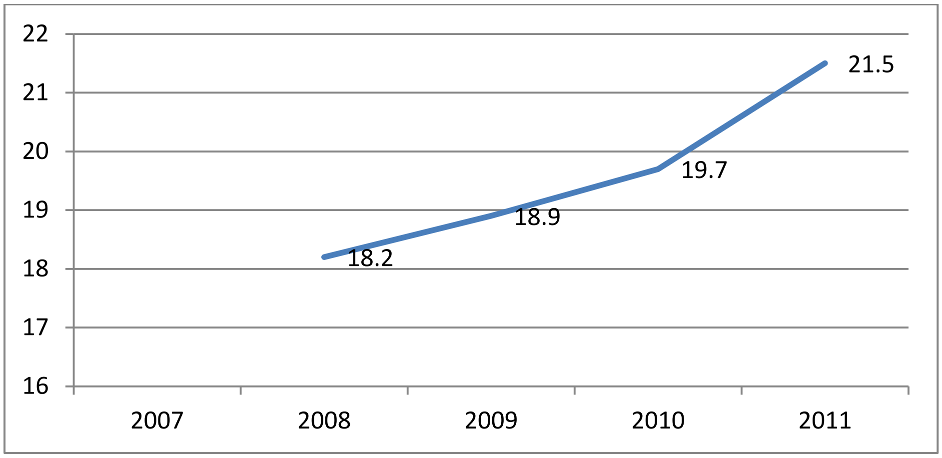
Source: Calculated from BOZ database

There are indications that the growth rate can surpass 9 per cent if copper prices continue to increase, macroeconomic stability is sustained and major structural reforms are implemented. These structural reforms include major investments in the power sector and in the fuel procurement and storage systems. The governance and institutional arrangements of these sectors need to be reformed. However, it looks like the Euro-zone crisis and the economic slowdown in the BRICS countries has not affected the growth process in the country.

Fiscal Revenues

One of the major factors that have contributed to the sustained economic growth in the country is the improved macroeconomic management that has been sustained over time. One aspect of the improved macroeconomic management is the generation and management of increased fiscal revenues. Fiscal revenues have been increasing during the past decade. This is shown in Figure 21 for the period 2008- 2011. Fiscal revenues as a percentage of GDP increased from 18.2 % in 2008 to 21.5 % in 2011. The major source of this increase comes from personal tax revenue. There are still comparatively low amounts being contributed by the mines. Zambia's mining revenues have been low compared to other mineral produces. This is despite a relatively high share of copper exports in GDP (IMF, 2012a: 15). In order to increase the fiscal revenues for enhancing infrastructural investments and development there is need to reform the tax system such that it captures more revenue from the mines.

Figure 21: Total Revenue (% of GDP)



Source: Bank of Zambia Database

Poverty and Income Distribution

Zambia's economic growth has been positive and sustainable during the past decade. Even the 2008/2009 global financial crisis barely dented the growth process. However poverty remains high and extreme poverty endemic. The key challenge of the country is to use the sustained growth to resolve poverty, especially extreme poverty. The past growth has not sufficiently impacted the rural areas and sectors where the poor are most numerous. Most of the investment has been in capital intensive sectors such as mining, construction and services (IMF, 2012, p75)

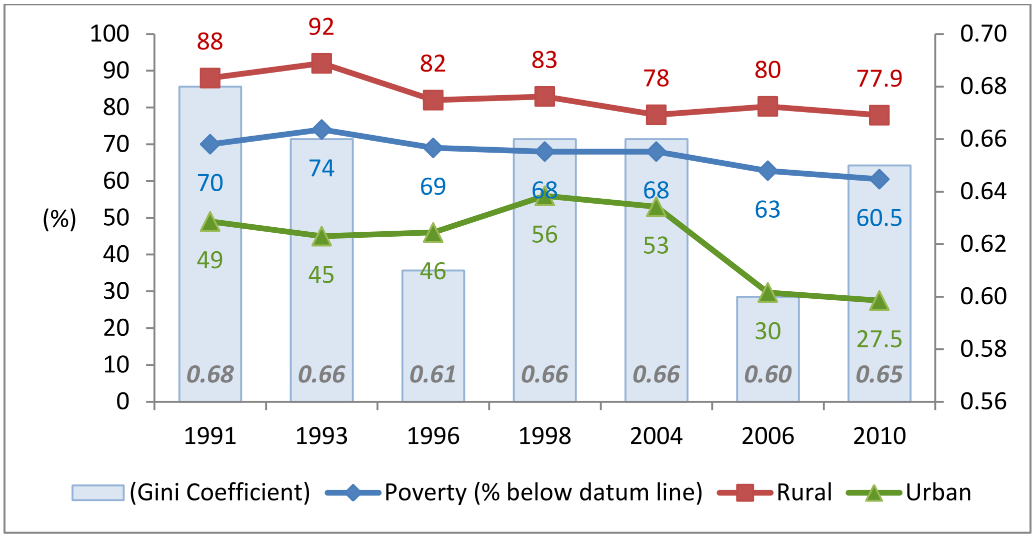
Table 3 below shows the poverty situation in the country. It is estimated that 61% of the population live below the national poverty. The situation is worse in the rural areas where about 78% of the population live below the poverty line compared to 28% in urban areas.

Table 3: Poverty Indicators in Zambia

Indicator	Year	Value
Incidence of poverty (% of population below poverty line	1998	National 72 Rural 83 Urban 49
	2006	National 63 Rural 80 Urban 30
	2010	National 61 Rural 78 Urban 28
Population below USD 1.25 (%)	2006	68.5
Gini Coefficient Index	2006	54.6

Source: ADB (2012) African Economic Outlook., page 269, IMF (2012a) Zambia Country Report.

Figure 22: Poverty and Income Distribution (Gini-Coefficient) Trends



Source: Author's construction from CSO data

This situation has changed little for decades. Worse still the income distribution in the country is very uneven with a Gini co-efficient of 54.6 in 2006, according to ADB (or 60.0 according to the Central Statistical Office).With such a profile of poverty, any economic shock will adversely affect the poor and rural population more proportionately than the urban and rich population. This situation needs to be resolved by coming with policies that support the reduction of poverty while maintaining macroeconomic stability.

The Scope for and Constraints of Policy Responses

There is need for clear and consistent policies to continue the sustained growth that is taking place and to create a buffer for external shocks. This is what happened with the 2008/2009 global financial crisis. As discussed about the Euro-zone crisis and the halted economic growth of the BRICS countries did not have a discernible effect on the economy. The most important policies in this regard are the monetary, fiscal and exchange rate policies. Because of the extreme poverty situation in the country, there is also need to devise meaningful social policies.

The government has pursued a prudent and tight monetary policy with the aim of reducing inflation to about five per cent while maintaining macroeconomic stability. This is not only a pre-condition for countering any economic shock, but also for sustaining the growth process. This has worked well and the government has been able to reduce the inflation rate to very low levels of about 6 per cent during 2012. The inflation is expected to drop further to about 5 per cent in 2013.

The government fiscal policy is to maintain macroeconomic stability through pursuing a limited expansionary fiscal policy that would restrict the budget deficit to no more than 3 per cent of GDP. This policy is also necessary for sustaining the growth process and in creating a buffer for external shocks. Fiscal soundness and macroeconomic stability is a priority in times of certainty, since the outcome is not certain (Massa et al, 2011: 6). However, the fiscal policy needs to go further so that it has growth –enhancing expenditures that are not in conflict with macroeconomic stability. Such policies are necessary to help resolve the poverty situation in the country.

The other key policies that can support the growth and development process are the exchange rate and social policies. The government has pursued a flexible market determined exchange rate policy. This policy has worked well for Zambia and is important for containing economic shocks and crisis. It is also necessary for macroeconomic stability and as an incentive for the diversification of the economy. Furthermore, with the underlying poverty situation in the country, government needs to develop an active social policy. Such a policy will protect the key social expenditures that will in the long run help resolve the poverty situation and a social protection policy that will deal with situations of extreme poverty. These should be buttressed by policies that improve human capital, ensures the generation and longevity of public infrastructure and that reform the investment climate.

Conclusions

The primary objective of this study was to discuss the potential impacts of the external economic shocks on the country during 2011 and 2012. These are the Euro-zone crisis, the BRICS economic slow-down, the global energy and food crisis. The study aimed at looking at the key transmission channels through which the above crisis can impact the economy. We also looked at what the country is doing about it.

An analysis of the transmission channels show that the Euro-zone crisis has had little impact through the transmission channels and its negative effects have not adversely affected the economy. There has been no discernible effect on private capital flows, remittances, ODA and trade. This can be explained by the fact that Zambia has limited financial linkages with Europe. The major exports to Europe are non- traditional products. Even these are limited and are concentrated with Netherlands and Belgium. Most FDI inflows are from Switzerland, France, Netherlands and the United Kingdom. These are insignificant. Remittances and ODA are insignificant and do not seem to have been negatively affected.

A look at the effects from the BRICS economic slow-down on the economy reveals similar findings. The impact here is likely to come from trade and FDI. There has been no adverse impact on trade, or at least trade with BRICS continued to grow, especially exports to China and South Africa have increased. The flow of remittances is likely to be significant with South Africa but it is difficult to analyze the impact because of the lack of data. There is no evidence of significant ODA flows between Zambia and the BRICS countries, excluding China. There might be significant flows of ODA from China but information is lacking.

There are two major external economic shocks that observers elsewhere thought might have had a severe impact on the economy. These were anticipated to have direct effects on the economy. They are the global fuel and food crises. From this study, the global food crisis is unlikely to a significant adverse effect on the economy because the proportion of food imports is small. These might have effects through the increased inflation rate and thus adversely affect and worsen poverty levels among households. However, increased energy prices will have a direct negative effect on the economy.

The study has shown that over the past decade, the country has built some resilience to external economic shocks through sustaining positive growth and macroeconomic stability. This is because economic conditions have been favourable with high copper prices on the global market. This effort has also focused on prudent fiscal and monetary policy and a supporting exchange rate policy. This needs to be sustained to further reduce vulnerabilities to future economic shocks.

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Appendices

Available by request from the authors.