issa INTERNATIONAL SOCIAL SECURITY ASSOCIATION

Crisis country case study

Zambia

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ISSA crisis case study: Zambia

Summary

Zambia's rapid growth during 2000–08 (real GDP growth averaging between 5 and 6 per cent) came to an abrupt halt in 2009 when GDP fell by -2.7 per cent. As a consequence of the crisis, Zambia experienced speculative flows in domestic bond markets, a deterioration in the terms of trade and a large reduction in demand for mining exports such as copper (which constitutes 70–80 per cent of exports and jobs).

In an effort to stimulate the economy and create jobs, the government offered large tax concessions to mining companies in 2009. Yet, these have been controversial given that poverty is widespread in Zambia and by definition, universal social security programmes are seen as key in mitigating the crisis. Non-contributory social assistance programmes remain severely underfunded where less than 0.2 per cent of GDP is allocated from both domestic and donor funds together.

A social protection strategy with plans to increase social security expenditure and coverage to informal workers (the majority of the working population) were included in the Fifth National Development Plan 2006–10, yet these are not all crisis responses but part of long-term nationally defined plans. Nevertheless, they do signify an increased capacity to be crisis-ready and will position Zambia to take advantage of global economic recovery.

Social security institutions covered

The National Pension Scheme Authority (NAPSA); the Workers' Compensation Fund Control Board (WCFCB).

Overview of the social security system

Zambia's social security system has evolved into a formal social insurance model, providing three statutory pension schemes (see table 1) for income replacement upon retirement, disability and survivorship and one work injury scheme providing employment injury protection.

The largest pension scheme is the National Pension Scheme Authority (NAPSA), a defined benefit scheme that is compulsory for all employees in the private sector and new employees of the public sector as from 1 February 2000 and the retirement age for both men and women is 55 years (early retirement is at age 50) (US Government 2010).

For persons employed in the public service before 1 February 2000, there is the Public Service Pensions Fund. It is a fully funded scheme that depends on contributions made by the employer (government) and members. The third defined benefit scheme is the Local Authorities Superannuation Fund. This fund covers employees of the local authorities prior to 1 February 2000.

The WCFCB provides employment injury protection to all private and public sector workers, although with some exceptions.

Table 1: ***Social security coverage, 2005***

	Active members	Per cent labour force	Per cent paid workers	Pensioners
NAPSA (Estimate)	355200	8.0	16.1	0
PSPF	106062	2.4	4.8	46122
LASF	13000	0.3	0.6	8250
Occupational schemes	40904	0.9	1.8	7173
WCFCB				17721

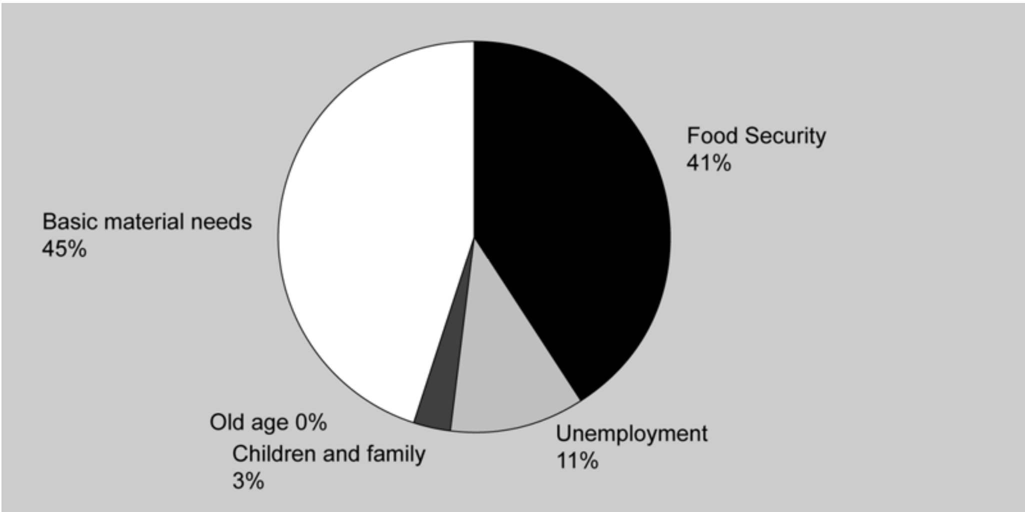
Labour force (15-54): 4416822; Paid workers (15-54): 2212336; Formal-sector paid workers (15-54): 435588.

Source: ILO (2008).

Non-contributory schemes

The Public Welfare Assistance Scheme (PWAS), Social Cash Transfer Schemes (financed by international donors), the Food Security Pack (FSP), the School-Feeding Programmes (funded by the WFP) and Project Urban Self-Help (public works programme) are prominent non-contributory transfers in cash or kind

Figure 1: ***Structure of social assistance benefits, 2006***



Source: ILO (2008).

Figure 1 illustrates the breakdown for public financed social assistance programmes which demonstrates the existing structure of targeting. The most basic provisions such as food and basic material needs constitute the vast majority (86 per cent) of social assistance benefits, leaving little room for other expenditures.

Impact of the crisis

In line with other heavy exporters, Zambia had limited assets tied up in the global subprime market and thus many commentators believed it would be spared from the financial turmoil. However, recent macroeconomic data from the African Development Bank (AfDB) and World Bank, and industry-specific findings from NAPSA and WCFCB surveys show that Zambia did experience a crisis.

Zambia's rapid growth during 2000–8 (real GDP growth averaging between 5 and 6 per cent (AfDB, 2010) came to an abrupt halt in 2009 when GDP fell by -2.7 per cent as seen in table 2.

Table 2: ***Change in real GDP, data before and after the credit crisis***

	Real GDP growth				GDP change
	Before crisis		After crisis		After crisis
	2008(e)	2009(p)	2008(e)	2009(e)	2008–2009
Zambia	6.3	6.4	5.5	2.8	-2.7
Africa	5.9	5.9	5.7	2.8	-2.9

Note: (p) Projections; (e) Estimation.
Source: African Development Bank (2009) projections; WEO database, Oct. 2008 and FAO.

The AfDB believe Zambia is vulnerable to global crises given the lack of fiscal space, a highly liberalized capital account and the fact that half of the population are extremely poor (International Labour Organization (ILO, 2008)). Zambia was a victim of speculative flows in domestic bond markets, and experienced deterioration in the terms of trade, as seen in table 3, and a large reduction in demand for mining exports such as copper.

Table 3: ***Zambia's deteriorating terms of trade***

	Exports of goods (US$ bn)						Current account balance (% of GDP)			
	Before crisis		After crisis		Estimated shortfall		Before crisis		After crisis	
	2009	2010	2009	2010	2009	2010	2009	2010	2009	2010
Zambia	5.76	5.62	2.73	3.00	3.04	2.62	(6.60)	(7.00)	(17.01)	(17.28)

Note: Figures are projections. Figures in brackets are negative.
Source: African Development Bank (2009) projections; WEO database, Oct. 2008 and FAO.

As mining constitutes a large part of the economy (70–80 per cent of exports and jobs), falling demand for copper had dire consequences for impoverished people and firms exposed to global market prices. In the five months to December 2008, copper prices on the London Metal Exchange fell to a third of their value, resulting in 8,500 job losses out of a total 30,000 mining jobs (Oxfam, 2010).

In turn, the WCFCB saw a loss in social security revenue as mine employers (major contributors) shut down. The WCFCB have also lost contributions from employers that have shed labour as a result of reduced activity (International Social Security Association (ISSA, 2009)). The NAPSA also claimed that their contributions fell, especially from those in the mining sector. The job losses include companies contracted by mining companies and the tourism sector which, according to the NAPSA, were hit hard by the crisis.

Investment performance

With lower export revenue and limited access to trade credit, the crisis was transmitted through its impact on government funds. In response to the ISSA survey, the NAPSA reported that their social security funds have fallen in value as the share price of their investments have tumbled.

Table 4: ***NAPSA investment performance***

	2008	2007	Last 3 years	Last 5 years
Nominal return (%)	13%	16%	23%	15%
Real investment return (%)	2%	2%	3%	2%
Total assets (ZMK)	1,900m	1,749m	806,042m	343,953m
Equities (%)	4%	5%	3%	3%
Bills and bonds (%)	27%	50%	28%	39%
Cash or equivalents (%)	12%	7%	30%	24%
Property (%)	3%	4%	8%	9%
Others (%) (GRZ Bonds)	54%	34%	31%	25%

Source: NAPSA response to ISSA questionnaire.

As depicted in table 4, nominal investment returns fell in synch with global financial market turmoil, yet real returns remained positive (2 per cent real return) and constant (as of end 2008). Moreover, total assets under NAPSA management continued to grow steadily over time – a positive development to help ensure their future liabilities can be met.

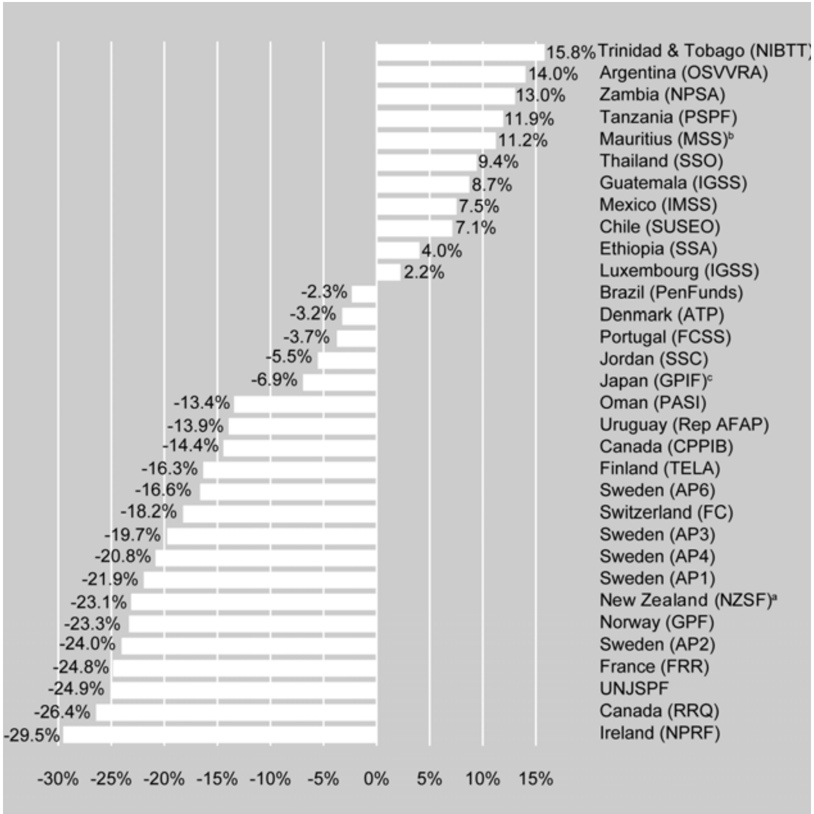
Judging from a global comparative perspective, NAPSA returns were better than a number of other social security funds as shown figure 2.

As for the WCFCB, the institution reported a loss of equity since 2007 as share prices of their investments fell.

Administrative capacity

Persistent and heavy reliance on grants and non-reimbursable aid and loans from the International Monetary Fund (IMF), World Bank, AfDB and European Commission (76 per cent of government investments are financed by foreigners) reflects Zambia's administrative limitations in funding social security. Irrespective of the crisis, non-contributory social assistance programmes remain severely underfunded where less than 0.2 per cent of GDP is allocated from both domestic and donor funds together.

Figure 2: ***Investment performance of public social security funds and sovereign wealth funds in 2008***



Note: (a) June – December 08; (b) Year ended 30.06.08; and (c) April-December 08.
Source: ISSA 2009.

Responses to the crisis

Despite Zambia's limited fiscal space, a social protection strategy is included in the Fifth National Development Plan 2006–10 and efforts have been made to consolidate social assistance programmes. The strategy was designed to counteract the effects of the crisis, with a strong focus on saving and/or creating jobs to stimulate aggregate demand.

Industry-specific support

In an effort to stimulate the economy's largest employer – the mining industry – the government offered a large tax concession in 2009. The government has also acquired mining firms that would otherwise have gone bust and in some cases bailed out companies.

Attention was focused on economic diversification and revitalizing traditional sectors of the economy such as agriculture. This included the opening of new farming blocs, investing in tourism projects and opening a multi-facility economic zone with tax concessions to lure a greater number of local and foreign investors.

Pension protection and social transfer cutbacks

Generally speaking, the government was reluctant to extend social transfer programmes in the form of cash, in-kind benefit, and school feeding or healthcare costs. While public sector pensions (which account for over 75 per cent of social protection expenditure) were protected, total contributions to social protection decreased. The proportion of Zambia's marginal social protection budget allocated to non-pension activities shrank from 24 per cent in 2008 to 19 per cent in 2009 (ODI, 2009).

Although Zambia has specific social security arrangements for formal employees, the majority – more than 63 per cent of all paid employees – say that their employers are not contributing to social security or that they do not know if the employer contributes (ILO, 2010). To combat non-compliance and lower contributions as a result of the downturn, the WCFCB are pursuing employers that have not registered with the fund. The WCFCB have pursued debts and attempted to diversify and reorganize their portfolio to include higher yielding investments.

Lessons learned

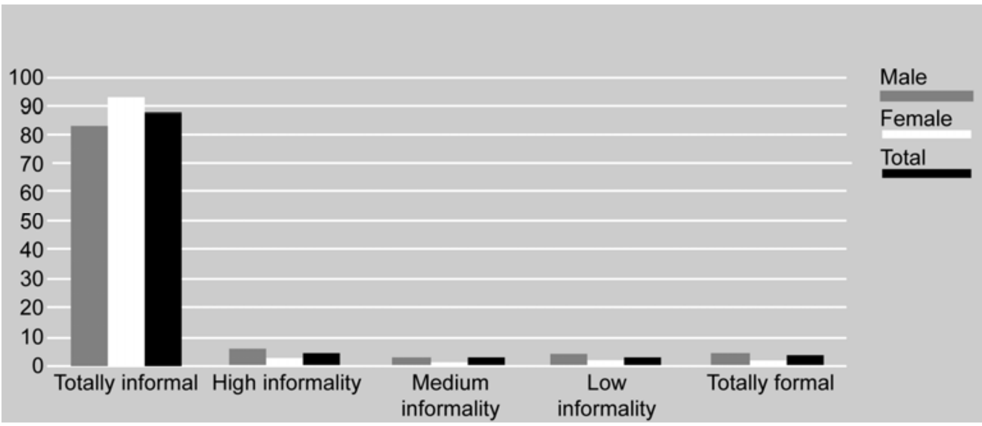
Unavoidably, policy circles in Zambia have learned that their limited social safety net means that recovery will be weak. Fuelling aggregate demand via tax breaks and higher incomes in export sectors such as mining can only go so far. Strengthening existing social safety nets, establishing new ones and protecting social expenditures can help address the human and social impacts of the crisis and boost much-needed private consumption. Indeed, the government's proposed social security extension signals positive intent, yet these are not all crisis responses – some were part of long-term nationally defined plans. Nevertheless, they do signify an increased capacity to be crisis-ready and represent a preventive measure already in place.

Both the impacts of the crisis (increased unemployment and poverty, and deteriorating terms of trade), and Zambia's responses to mitigate them, closely mimic those of its neighbours. Yet, what sets Zambia apart (among other things) is its relatively successful social security fund performance with returns far exceeding those of most countries. Being prudent and only marginally exposed to volatile instruments has paid dividends for the NAPSA and WCFCB.

Despite this relative financial success, the NAPSA and WCFCB cover only formal sector workers – the minority of Zambia's working population (see figure 3).

The majority of Zambia's working population have no formal "social protection floor", i.e. no minimum cover such as cash benefits or unemployment insurance as is commonplace throughout Africa.

Figure 3: ***Degrees of informality for all employed persons (%)***



Source: ILO (2008).

Conclusion

The total effect of the crisis on Zambia is difficult to ascertain for two reasons: events are still unfolding and data limitations exist. Based on available information it is clear that Zambia's economy slowed and the crisis has had an adverse effect on the budget. Furthermore, Zambian social security institutions have confirmed a loss of revenues, mainly due to a decline in contributions and investment income.

The government's latest Medium Term Expenditure Framework (MTEF) and the 2010 budget are both based around the intention of trying to position Zambia to take advantage of the global economic recovery. Economists believe the fiscal outlook is indeed better in 2010-11 (registering a lowering fiscal deficit of 2.6 per cent of GDP in 2011) (Economist Intelligence Unit (EIU, 2010)). Nevertheless, the issue of diversification away from the economy's dependence on copper mining is and continues to be a major topic and worsening economic conditions are expediting government efforts to expand social security expenditures.

Some degree of social security coverage is not only a human right but the lack of it is a serious financial liability for Zambia's economic growth potential. Accumulating human capital for future growth necessitates universal social safety net provision for the vulnerable, i.e. the majority of the population including HIV/AIDS sufferers. There is arguably little trade-off between economic recovery spending and social spending given Zambia's predicament.

On a more positive note and taking a longer-term perspective, Zambia could turn the crisis into an opportunity to bring the economy onto a structurally higher growth path. This could include enhancing competition in the financial sector, streamlining labour market regulations, developing financial markets and strengthening governance.

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