Note
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International Growth Centre

Growth promotion through industrial strategies in Zambia

1. Introduction and summary

This brief provides a summary of the findings of a study investigating the current and potential opportunities for growth promotion through industrial strategies in Zambia. The study analysed trends and patterns in industrial performance over time, as well as industry-level capabilities and competitiveness; scoped high potential sub-sectors, with particular attention to resource-based industries and regional markets; and reviewed at broad level the policy framework for industrial development.

Zambia's manufacturing sector has performed relatively well during the past decade. During the 2000-2013 period, the manufacturing sector grew by 5.5% CAGR. This highlights a mildly positive trend, just below the 7.2% CAGR of total GDP. Employment in the manufacturing sector increased fourfold from 55,600 people in 2005 to 216,700 people in 2012. Approximately one third of total manufacturing jobs were in the formal sector. Whilst mining dominates FDI inflows, an increasing share of FDI has been targeting the manufacturing sector. Manufacturing FDI stock totalled US$ 1.3 billion in 2012. According to industrial index data, two sub-sectors emerge as having particularly high potential: food, beverages and tobacco, and metal fabrication. Cement had a very strong growth but has limited potential for further downstream processing and industrial development. Turning to Zambia, export performance confirms that these two sub-sectors had, to different degrees, shown considerable level of dynamism and international competitiveness in recent years. The trade data shows interesting patterns in relation to non-traditional exports: these are fast-growing, directed at regional markets; and there is a small but growing share of value added products. Apart from copper semi-fabricates, these consist of cement, animal fodder, milling products, essential oils, iron and steel products.

2. Zambia's industrialisation opportunities

In light of the trends discussed above and the sectoral priorities identified by the Zambian Government, the paper focuses on opportunities in the agro-processing sector and in copper and iron/steel fabrication.

Agro-processing sector

Food and beverages is the largest component of household consumption in Zambia, and in the region (with the exception of South Africa and Namibia). In absolute terms, in Zambia, Namibia, and South Africa, food and beverages consumption levels are higher in urban households then in rural ones. The rise of the urban middle class is critical because it is driving consumption of processed foods and beverages. In Zambia's, the largest contributors to food imports are fish, dairy, bakery products, prepared fruits and vegetables, and miscellaneous edible preparations. It should be noted that, in some product categories, regional imports are growing faster than world averages. This demand is met by South African producers and, increasingly, by Asia and Latin American ones.

The potential to tap the urban demand for processed foods can build on increasing levels of foreign and domestic investment in agricultural production of such as soybean, wheat, poultry and sugar. Urban and rural demand for processed foods nevertheless is increasingly structured around supermarket retail chains. This requires a tailored strategy which understands supermarkets' procurement strategies and which includes the design, together with buyers and suppliers, of an effective supplier upgrading programme. While agro-processing is estimated to account for 60% of Zambia's manufacturing sector, upgrading into value added products and participating in supermarkets' value chains require tackling very specific challenges related to competition, transport costs, firm capabilities, and policy and regulatory restrictions at national and regional level.

Three sub-sectors with high growth potential are identified under agro-processing;

- Sugar products
- Vegetables and milling products
- Soya bean to poultry value chain

Zambia's low-cost production of cane sugar and soybean makes downstream processors potentially competitive in the domestic and regional markets for sugar confectionery and other sugar-based products, animal fodder and broiler meat. The pricing strategies of upstream firms involved in sugar and animal feed production however have hampered the competitiveness of local downstream industries. Addressing competition concerns in the upstream stages of the value chain is therefore a priority for Zambia's agro-processing industrial strategy. Moreover, reducing transport costs to regional urban centres could turn Zambia's into the regional supply hub for animal fodder, meeting the burgeoning inputs demand from the poultry industry across the region.

As far as prepared vegetables are concerned, there are substantial import replacement and regional export opportunities. For cereals, Zambia is seizing these opportunities, and has become a competitive exporter not only of maize and wheat, but also value added products such as flour and bakery products (breakfast cereals, biscuits). A more detailed analysis is required at the product level, assessing key input costs, issues of quality and standards, linked investments such as in packaging, and branding and distribution including through the growing footprint of supermarket chains. These issues should form part of a strategy to participate in supermarkets' value chain, expand in the region, and move to diversified and value added products.

Engineering sub-sector

The paper reviews Zambia's strategy for the engineering sub-sector, in particular on copper fabrication and iron and steel products. In this context, important opportunities are identified for manufacturing linkages to the copper mining sector.

The regional configuration of the mining supply chain is very important. While local sourcing of equipment and other mining inputs in Zambia is currently low, the growing demand in the Zambia and DRC Copperbelt presents an opportunity for Zambia to position itself as the sub-regional hub for the supply of products and linked aftermarket services. Aftermarket services are important in terms of employment and skills development, and can lay the basis for future assembly operations. The DRC offers Zambian suppliers an opportunity to reach larger economies of scale for activities which have been unviable for the domestic market (for example re-conditioning of equipment). Already, re-exports of mining equipment to the DRC figure among Zambia's top export products.

The other key regional partner in this regard is South Africa, which is the hub for mining related capital equipment and services to the region. The Copperbelt is South Africa's most important export market. South African based Original Equipment Manufacturers have an established presence in the Copperbelt which is important in terms of employment and training. In designing its local content policy, Zambia should consider leveraging cooperation with the region, and in particular, with South Africa, tapping into its capabilities and competences, and the DRC, which could turn Zambia into a sub-regional hub for higher value added activities. The region should contribute to a broader strategy for the engineering sector which would aim, among others, at increasing sub-contracting opportunities and relaxing skills and capital constraints.

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3. Policy notes, recommendations & conclusion

Key messages

- Zambia's manufacturing sector has shown encouraging trends in terms of contribution to GDP growth, employment, FDI inflows, and export performance
- The best growth performance in the manufacturing sector has been from: food, beverage and tobacco; cement; fabricated metals. However, agro-processing has dominated this performance accounting for 60% of manufacturing
- Growth in domestic manufacturing has been driven by the domestic market and regional exports.
- Apart from commodities such as sugar, tobacco and cotton, there are small but rapidly growing exports of processed goods such as animal fodder, milling products, essential oils, and fabricated copper and steel products.

Moving the industrial agenda forward

To advance the industrialisation agenda, three key issues deserve attention;

Linkage development and capabilities

- Linkage development has been looked at in the context of value chains into the mining sector and supermarkets. Recent research estimates that the mining sector's demand for goods and services will increase to up to US$ 4 billion per year by 2030. Whilst there are many local suppliers based in the Copperbelt, the challenge is to increase local value addition in terms of the goods and services produced locally.
- Linkage development strategies to facilitate entry and competitiveness into the mining and supermarkets value chains require a combination of government and firm interventions. Government needs to tackle factors such as access to credit and a national quality assurance system.

Regional economic integration

- The region has become the largest destination market for Zambia's non-traditional exports such as sugar, animal fodder, cement, engineering products, milling products and fresh vegetables. Specifically, the regional market for sugar confectionery and prepared foods has grown at above world average rates. The DRC market has also absorbed fresh vegetables exports that once were directed at EU countries.
- The trade agenda within Zambia's regional integration efforts remains important because it tackles less explicit market access barriers such as NTBs and trade facilitation issues.
- However, the growth of Zambian exporting firms into the DRC market shows that even in the

absence of trade arrangements, or any formal trade for that matter, the regional market can offer more lucrative opportunities for Zambian firms than deep sea markets.
- Regional industrial cooperation can offer important opportunities for Zambia to strengthen its position in selected regional value chains. The example of the mining supply chain is illustrative. Access to and participation in the DRC mining supply chain is critical for Zambia to become a sub-regional hub for mining inputs. This market can increase the economies of scale for local manufacturers and service providers.
- A regional strategy should take into account the position of the main regional hub for mining supplies, South Africa. South African Original Equipment Manufacturers are increasingly targeting the Copperbelt market. Regional cooperation should support Zambia in meeting its objectives of value addition, sub-contracting and skills development by leveraging South Africa's private investment and institutional cooperation. Zambia could consider a scaled down bilateral cooperation programme, focused on specific, achievable objectives within a limited time-frame. This could support the broader SADC and Tripartite frameworks by providing a pilot programme and lessons for future multi-country programmes.

Competition, regional integration and competitiveness

- Low levels of competition mean that prices of key products do not reflect the costs of production and undermine the competitiveness of downstream activities. In the case of cement, high prices and profit margins compared to other countries in the region have made construction in Zambia more expensive.
- In sugar, while Zambia is one of the lowest cost producers in the world, its prices are relatively high compared to its neighbours. In addition to the harm to consumers this also undermines businesses manufacturing sugar confectionery products, as well as the wider set of food products for which sugar is an input.
- In the case of poultry, it has been observed that the industry is very concentrated and that day-old chicks, required by broiler producers, have been priced at double the level in South Africa.
- These examples all point to the need for a progression from support for upstream investment to ensuring that competitive upstream production flows through to downstream and diversified activities.
- Regional integration cannot be achieved where conflicting trade policies across countries, inefficiencies in transportation, and strategic behaviour of firms undermine competitive rivalry across borders.

4. Conclusion

There are a number of cross-cutting factors hampering competitiveness in Zambia's industrial growth: inputs, finance and exchange rate volatility, transport costs, and skills. In the case of transport costs, Zambia is already implementing a number of reforms and investment in infrastructure and trade facilitation. Financial instruments have been rolled out but they still haven't been effective yet in relaxing firm capital constraints. Finally, government policies still lag behind with regard to skills development and inputs markets. In terms of the overall policy framework for industrial development, policies rarely turn into specific strategies to support implementation, which overall remains weak. Consequently, a number of policy instruments, such as the ZDA Act and the Commercial, Trade and Industrial Policy, have had limited impact in fostering industrial development. Action should be aimed at focusing on policy implementation and on high potential sub-sectors would help Zambia make significant progress in meeting its industrial development goals.

About IGC Zambia

The IGC started its engagement with Zambia in 2010, and established the country office in 2011, located at the Zambian Institute for Policy Analysis and Research (ZIPAR).

The most significant achievements to date have been in the Domestic Resource Mobilisation area. A close working relationship has been established with the Zambian Revenue Authority, Ministry of Finance and with the ZCCM-IH, the holding company for the Zambian government minority shareholdings in the privatised mines. Recent work on 'Short Run Determinants of [the] Exchange Rate' has also largely helped to strengthen relationships between the IGC and the Bank of Zambia. Moreover, IGC research contributed to government considerations of policy and strategy for taxing the mining industry, taxing the informal sector, the effectiveness of the VAT tax regime, as well as for the developmental strategies of ZCCM-IH. John Sutton's Enterprise Map of Zambia was also extremely well received by government and business and has direct policy implications, strategic value, and forms a basis for future applied policy research.

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