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COVID-19 and the Challenge of Developing Productive Capacities in Zambia

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Abstract

The COVID-19 pandemic has tested the resilience of the Zambian economy and is exacerbating the development challenges confronting it. Since the onset of the pandemic, a plethora of studies have been carried out to examine the impact of the crisis on macroeconomic variables such as employment, output and poverty. But there have been no systematic studies on how it is affecting the development of productive capacities in Zambia, which is essential for sustained and inclusive recovery. The paper focuses on this neglected aspect of the economic consequences of the pandemic in Zambia. It identifies channels through which the pandemic has had a negative impact on the use of existing productive capacities and on the creation of new ones. It also discusses policy measures that the Government should consider adopting to strengthen efforts to foster productive transformation and build resilience to shocks.

Key words: Productive Capacities; COVID-19; Zambia

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Introduction

The COVID-19 pandemic, along with the associated health and economic crises, is undoubtedly the main development challenge currently facing Zambia and the rest of the world. Globally, the total number of COVID-19 cases as of 6 April 2021 was about 132.48 million and the number of deaths was about 2.87 million, with the United States accounting for 24 percent of cases and 20 percent of the number of deaths. In the first half of 2020, Zambia had an insignificant number of cases and deaths. But this changed drastically in the second half of the year with the number of cases increasing from 1594 at the end of June 2020 to 20,727 by the end of the year. This upward trend in the number of cases continued in 2021 reaching 89, 009 cases by 6 April 2021. A similar upward trend has also been observed in the number of deaths, which rose from 24 at the end of June 2020 to 1,222 on 6 April 2021.[1]

As a precautionary measure to prevent the spread of the virus and limit its impact on the health and wellbeing of its citizens, on 14 March 2020 the government imposed several restrictions, including a ban on non-essential foreign travel, suspension of tourist visas, mandatory quarantine for travelers from high-risk countries, closure of learning institutions, wearing of masks, suspension of some cross-border transportation services, and closure of non-essential businesses such as bars, gyms, hotels, restaurants and cinemas.[2] While these measures were necessary to contain the virus and prevent a health crisis, they have macroeconomic costs in the short and long-run.

The COVID-19 pandemic has tested the resilience of the Zambian economy and exacerbated the challenges of development facing the country. Before the onset of the pandemic, in the first quarter of 2020, the economy was grappling with, amongst others, problems of high debt and fiscal deficits, high poverty rate and inequality, food insecurity and slow growth. [3] The economy experienced relatively good macroeconomic performance in the first decade of the millennium, with real output growing at an annual average rate of 6.2 percent in the period 2000-2005, reaching a peak of 10.3 percent in 2010. And inflation declined significantly from an average rate of 21.2 percent in the period 2000-2005 to 8.5 percent in 2010 (figure 1). As a result of this positive performance the country moved from low to lower middle-income category in 2010. Unlike the first decade, the second decade of the millennium was characterized by low economic growth in Zambia, with real output growth of only 3.3 percent in the period 2014-2019. The slowdown in growth was due largely to lower copper prices, challenges in power generation associated with insufficient rainfall, and a decrease in agricultural output arising from persistent drought and locust infestations.[4]

The pandemic has made this fragile macroeconomic situation worse and increased the country's vulnerability to shocks. As a result of the pandemic, real output declined by 4.5 percent in 2020 which, given an annual average growth rate of 3.3 percent in the period

[1] Data available at: https://www.worldometers.info/coronavirus/country/zambia/

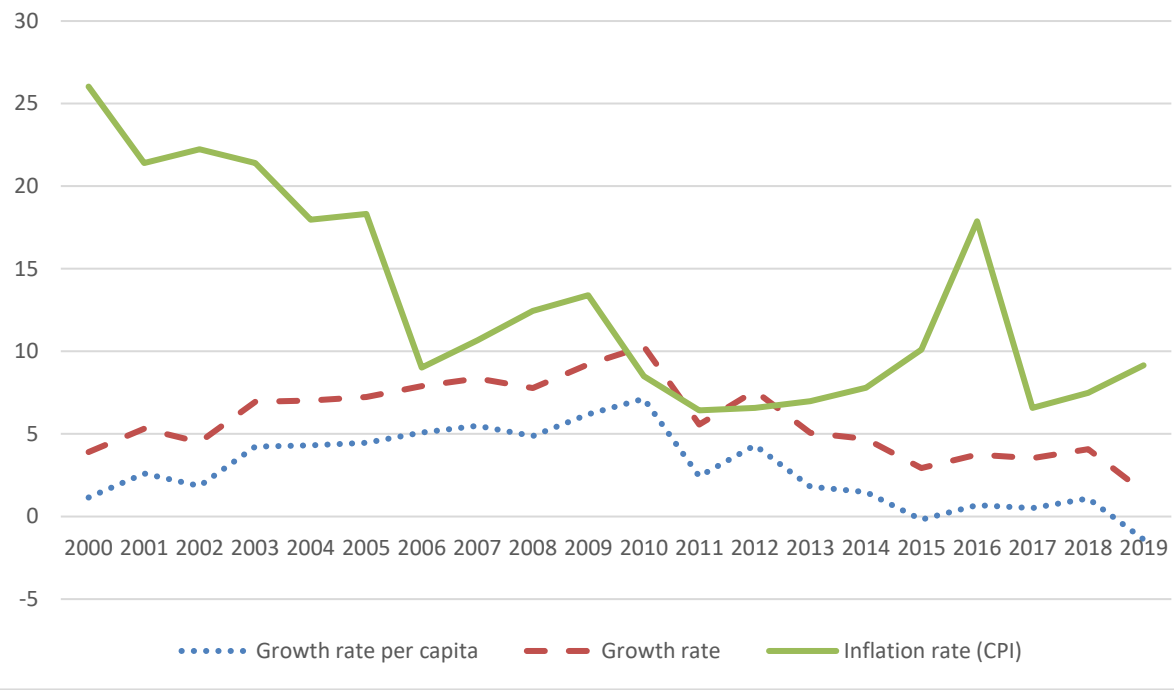
[2] A partial relaxation of some of these measures began on 24 April 2020.

[3] The dismantling of overdue payments on financial obligations (arrears) is also a major challenge for the government.

[4] At the triennial review of the list of least developed countries held by the Committee for Development Policy, from 22 - 26 February 2021, Cambodia, Comoros, Djibouti, Senegal and Zambia met the criteria for graduation from the LDC category for the first time (United Nations 2021).

2014-19, represents a deviation from trend growth of about 7.8 percentage points (table 1). This is a very significant and worrisome development because it is the first time the economy has experienced a negative growth rate since 1998.

Figure 1. Real output growth and inflation in Zambia (%)



Source: UNCTADstat

Table 1. Deviation of output growth in 2020 relative to trend growth (2014-19)

Output	Growth rate in 2020	-4.5
	Annual average growth rate (2014-19)	3.33
	Deviation from trend growth rate	-7.8
Output per capita	Growth rate per capita in 2020	-7.2
	Annual average growth rate per capita (2014-19)	0.3
	Deviation from trend growth rate per capita	-7.5

Source: compiled based on data from UNCTADstat and World Bank.

The negative impact of the crisis has been quite severe in the mining and tourism sectors. And significant decreases have been observed in foreign exchange earnings resulting in sharp depreciation of the local currency (Kwacha). These developments have had real consequences in the economy. For example, World Bank (2020) indicates that the poverty rate increased from 58.6 percent in 2019 to 60.5 percent in 2020, implying that about 706

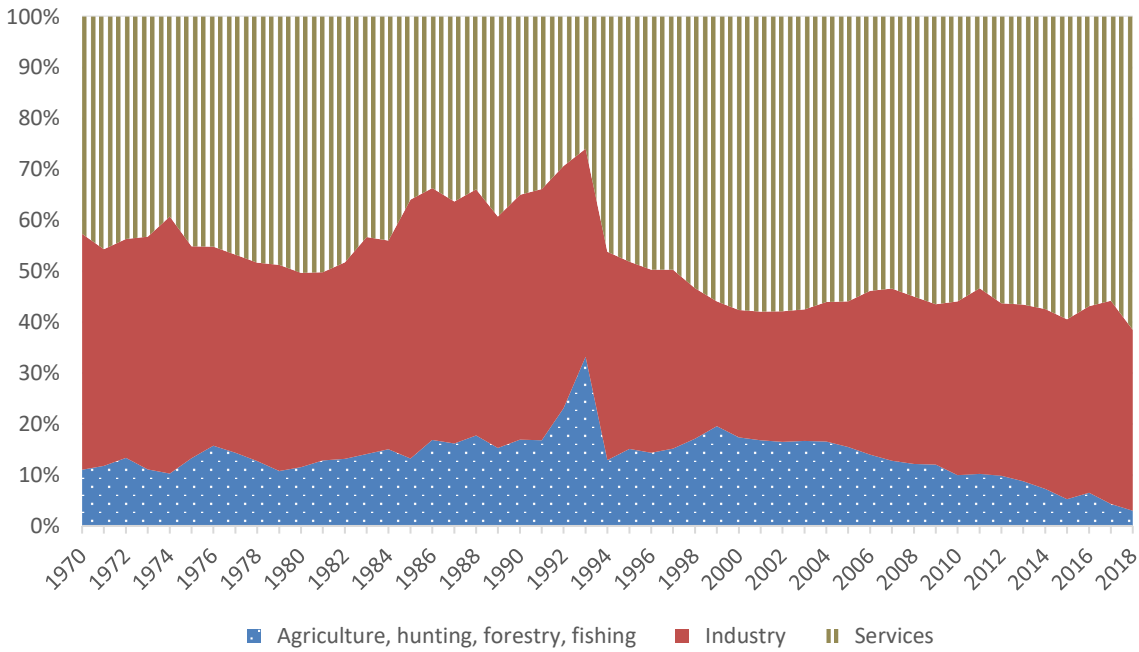
900 additional people fell into poverty in 2020. In addition to these short-term costs, the pandemic will also have medium- and long-term costs, particularly on the productive capacities of the economy. So far there is a lot of focus on how to address the short-term costs of the crisis and the long-term consequences have received relatively less attention. Against this background, the current paper focuses on how the crisis will affect the development of productive capacities of Zambia and offers recommendations on what should be done to mitigate these impacts and build the resilience of the economy to current and future shocks.

The rest of the paper is organized as follows. Section 1 presents an overview of the production and export structures of the Zambian economy while section 2 highlights and analyzes trends in the development of productive capacities in Zambia before the onset of the COVID-19 pandemic. The impact of the pandemic on the development of productive capacities is discussed in section 3 while section 4 identifies policies needed to mitigate the negative impacts of the pandemic on the development of productive capacities and build resilience of the economy to current and future shocks.

1. Overview of production and export structures

As in other African countries, the production structure of the Zambian economy has changed significantly over the past five decades (figure 2). In 1970, the primary sector (Agriculture, Hunting, Forestry and Fishing) accounted for 11 percent of output value added while the secondary (Industry) and tertiary (Services) sectors accounted for 46 and 42 percent respectively. The share of the primary sector reached a peak of 33 percent in 1993 and then declined significantly reaching a low of 3 percent in 2018. Regarding the secondary sector, its share reached a peak of 51 percent in 1985 and then declined to 35 percent in 2018. The share of the tertiary sector rose from 42 percent in 1970 to 50 percent in 1980 and 61 percent in 2018. Unlike the primary and secondary sectors, since 1998 the share of the tertiary sector has been above 50 percent and increasing, reflecting the fact that it is the dominant sector of the economy.

Figure 2. Output Value Added per Sector (% of GDP)



Source: compiled using data from UNCTADstat.

In terms of dynamics of the sectors, over the period 2011-2019, Financial Services had the highest annual average growth rate (6.5 percent) while Agriculture was the only output category that experienced negative growth (-0.9 percent). Interestingly, although both output categories had a wide difference in growth performance, they both exhibited high output volatility, with Financial Services recording a volatility of 10.7 percent and agriculture 10 percent (table 2). Manufacturing is quite different from the other output categories in the sense that it had relatively high growth (4.5 percent) and low volatility (1.7 percent), indicating that it plays an important role in terms of building resilience to shocks. The weak performance of the agriculture sector in terms of share of output, growth, and volatility is worrisome given the importance of the sector in employment and food security. In 1990 agriculture accounted for 70 percent of total employment in the

country. Although its contribution to employment has declined over the past decade, in 2019 about 50 percent of the labour force was in agriculture. It should be noted that the declining share of agriculture in employment is necessary to boost labour productivity and induce meaningful structural change, particularly into higher productivity activities in manufacturing and modern services.

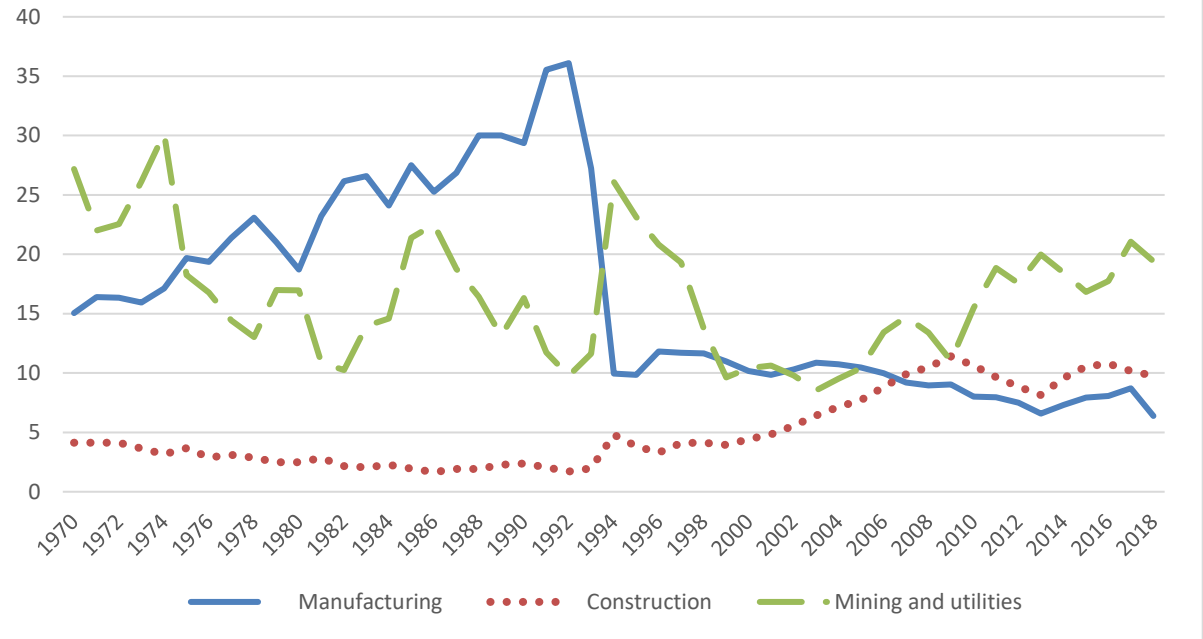
Table 2. Average Growth and Volatility by Sector, 2011-2019

	Growth	Volatility
Agriculture	-0.9	10
Mining	1.7	4.2
Manufacturing	4.5	1.7
Other industrial activities	4.5	6.1
Wholesale and retail trade	4.7	6.7
Financial services	6.5	10.7
Other non-financial services	5.8	4.2
Gross value added	4.1	1.8
Taxes	4.3	2.1
GDP	4.1	1.8

Source: MOF and MNDP (2020).

Within the industrial sector, manufacturing was the most dominant activity accounting for the bulk of industrial output until 1993. Its dominance reached a peak in 1992 when it represented 36 percent of GDP in Zambia. Since then, there has been a significant decline in manufacturing value added triggered largely by the adoption of the structural adjustment programme (SAP) in late 1991. As a result of SAP, the government instituted several structural reforms including privatization of state-owned enterprises, decontrol of agricultural prices, deregulation of interest rates, floating of the currency, liberalization of the banking sector, removal of quantitative restrictions on trade, and liberalization of marketing boards. The privatization of state-owned enterprises coupled with the liberalization of trade in 1993 led to further weakening of the manufacturing sector, as reflected in the dramatic decline in manufacturing value added from 36 percent of GDP in 1992 to 27 percent in 1993 and 10 percent in 1994 (figure 3). Since 1994, the share of manufacturing value added has followed a declining trend. And the shares of other industrial categories (such as construction and mining and utilities) in output have increased with each of these categories accounting for a larger share of GDP than manufacturing. The declining share of manufacturing in value added does not capture the fact that some progress has also been made in manufacturing development over the past few decades. For example, real manufacturing value added increased from $595 million in 1994 to $1766 million in 2018. The 2018 represents a 4.5-fold increase in real manufacturing value added (MVA) compared to its value in 1970. Another way to appreciate the relative progress that has been made in manufacturing development is to examine trends in real MVA per capita shown on the right-hand side axis of figure 4. In 1970 real MVA per capita in Zambia was $94. It fell to a low of $65 in 1995 and since then has been on an upward trend, reaching $102 in 2018. Notwithstanding these positive developments, it is clear that the country's manufacturing performance, relative to its potential, has been quite weak and that the government has to double efforts to better harness the potential of manufacturing for development.

Figure 3. Composition of Industrial Output (% of GDP)



Source: compiled using data from UNCTADstat.

Figure 4. Trends in Manufacturing Value Added (in constant 2015 dollars)