

Zambia: Technical Assistance Report-Diagnostic Report on Governance and Corruption



ZAMBIA

TECHNICAL ASSISTANCE REPORT — GOVERNANCE AND ANTI-CORRUPTION ASSESSMENT

January 2023

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Acronyms and Abbreviations

ACA	Anti-Corruption Act No.3 of 2012
ACC	Anti-Corruption Commission
ACC Act	Anti-Corruption Commission Act of
ADR	Alternative Dispute Resolution
AG	Auditor General
AML/CFT	Anti-money Laundering and Combating the Financing of Terrorism
AMLIU	Anti- Money Laundering Investigation Unit
BO	Beneficial Ownership
BoZ	Bank of Zambia
BoZ Act	Bank of Zambia Act
CC	Commercial Court
CTR	Currency Transaction Report
CRM	Compliance Risk Management
CSO	Civil Society Organization
DEC	Drug Enforcement Commission
DPP	Director of Public Prosecution
DNFBP	Designated Non-Financial Businesses and Professionals
EFCC	Economic and Financial Crimes Court
EITI	Extractive industries Transparency Initiative
EPF	Environmental Protection Fund
ESAAMLG	East and South Africa Money Laundering Group
FIC	Financial Intelligence Center
FATF	Financial Action Task Force
FMIS	Financial Management Information System
FSAP	Financial Sector Assessment Program
GDA	Governance Diagnostic Assessment
GDP	Gross Domestic Product
GIZ	Deutsche Gesellschaft für Internationale Zusammenarbeit GmbH
IDC	Industrial Development Corporation
IMF	International Monetary Fund
JCC	Judicial Complaints Commission
JSC	Judicial Staff Commission
LEA	Law Enforcement Agency
MIM	Ministry of Information and Media
MER	Mutual Evaluation Report
MLC	Mining License Commission
MMMD	Ministry of Mines and Mineral Development
MoFNP	Ministry of Finance and National Planning
MLGRD	Ministry of Local Governments and Rural Development
MOJ	Ministry of Justice
MOI	Ministry of Information

NA	National Assembly of Zambia
NPA	National Prosecuting Authority
NRA	National Risk Assessment
NPBA	National Planning and Budget Act of 2020
PAC	Public Audit Act of 2016
PACRA	Patent and Company Registration Agency
PEP	Politically Exposed Person
PFM	Public Financial Management
PFM Act	Public Financial Management Act
PIMA	Public Investment Management Assessment
PPG	Public and Publicly Guaranteed
PP	Public Procurement
SOE	State-Owned Enterprise
SCC	Small Claims Court
SAC Act	State Audit Commission Act of 2016
SH	State House of Zambia
ST	Short Term
MT	Medium Term
TE	Tax Expenditure
UNCAC	United Nations Convention Against Corruption
VAT	Value Added Tax
ZCCM-IH	Zambia Consolidated Copper Mines
ZEMA	Zambia Environmental Management Agency
ZMK	Zambian Kwacha
ZPBI	Zambia Paying Bribes Index
ZRA	Zambia Revenue Administration
ZPPA	Zambia Public Procurement Agency

Preface

In response to a request from His Excellency Mr. Hakainde Hichilema President of Zambia, of November 18, 2021, an International Monetary Fund (IMF) mission undertook a governance diagnostic assessment from January 14 to May 6, 2022. The mission was led by Ms. Tina Burjaliani and was comprised of Mr. Enrique Rojas Ms. Nino Tchelishvili, Mr. Nate Vernon, Mr. Elie Chamoun, Mr. Riaan van Greuning, Ms. Aldona Jociene, Mr. Ron Snipeliski, Ms. Luisa Malcherek, Mr. Hans Weenink. The mission was assisted by a short-term expert Ms. Marja Hinfelaar. The mission met with the President of Zambia, advisors of the President, Members of the Parliament, the Bank of Zambia Governor, Deputy Governor and officials, officials from the Ministry of Finance, Ministry of Justice, Ministry of Mines and Minerals Development, Office of Auditor General, Ministry of Education, Ministry of Health, Ministry of Agriculture, Zambia Revenue Administration, Zambia Procurement Agency, Anti-Corruption Commission, Judiciary, Financial Intelligence Center, Drug Enforcement Commission, Industrial Development Corporation and Chamber of Industry and Commerce. The mission also met with members of civil society and international partners working on governance and anti-corruption issues.

The mission wishes to express its sincere appreciation for the excellent support and cooperation given by officials and staff of these various agencies. The mission is also grateful to civil society and staff of international partners for sharing information and providing valuable insights. The mission appreciates the support provided by Ms. Allison Holland, (IMF Mission Chief for Zambia), Ms. Preya Sharma (IMF Resident Representative in Zambia), Mr. Slavi Slavov (Senior Economist and other IMF staff. The mission is thankful for the administrative assistance provided by Ms. Alexandra Rajs.

The report is based on information collected in January – June 2022. The mission notes that several reform initiatives were launched or advanced by the authorities of Zambia after June 2022, including the adoption of the new Bank of Zambia Act in August 2022. The mission team reflected the new initiatives in the GDA report, to the greatest extent possible.

Executive Summary

At the request of the authorities of Zambia, an interdepartmental (LEG/FAD/MCM/FIN) Governance Diagnostic Assessment (GDA) mission was conducted during January 14 – May 6, 2022.¹ In line with the IMF's 2018 Framework on Enhanced Fund Engagement on Governance,² the diagnostic assessment focused on governance weaknesses and corruption vulnerabilities in macroeconomically critical priority areas of: (i) the anti-corruption and anti-money laundering; (ii) fiscal governance (e.g., public financial management, revenue administration, oversight of State Owned Enterprises, natural resource management, and procurement); (iii) enforcement of contract and protection of property rights; (iv) central bank governance and operations, and (vi) financial sector oversight.

Zambia is a large, land linked, resource-rich country with a rapidly growing population of approximately 17.9 million. It borders eight countries (Angola, Botswana, Democratic Republic of Congo, Malawi, Mozambique, Namibia, Tanzania, and Zimbabwe) that serve as an expanded market for its goods. Zambia is a stable multi-party democracy with elections held every five years. The current President, H.E. Hakainde Hichilema of the United Party for National Development, was elected in August 2021, after defeating then-incumbent President Edgar Lungu of the Patriotic Front.

Zambia's pre-existing economic hurdles were aggravated by successive shocks of drop in copper prices (2015-2016), major droughts (2015-2016 and 2018-2019) and the Covid-19 pandemic.

While policy adjustment mitigated earlier shocks, policy resolve began to wane as the country entered the 2021 election cycle. As the COVID-19 shock unfolded, financing pressures emerged, the Zambian Kwacha (ZMK) depreciated, and inflation spiked, all of which increased the external debt burden. Unencumbered reserves shrank to about [\$972] million by end-October 2020 (about [2.4] months of imports), against a projected external debt service of at least [\$1.3 billion] in 2021 and signs of significant unmet FX demand. As public debt ballooned, the government defaulted on its Eurobonds in November 2020 and stopped servicing most external debt. Real GDP shrank by 2.8 percent in 2020, with services, transport, manufacturing, and tourism taking the brunt of the COVID-19 shock. A broad-based moderate recovery started in 2021, with real GDP rebounding by 4.6 percent, though with some key sectors still held back by supply chain disruptions (mining) or weather (agriculture). The recovery continued this year, with real GDP expanding by 3.5 percent in 2022Q1, mostly driven by public sector. Inflation has receded from its peak of almost 25 percent in mid-2021 to 9.7 percent in October 2022, in line with the appreciating Zambian Kwacha.

Consistently high fiscal deficits, inefficient public investment and weak controls on spending led to Zambia accumulating large fiscal and external imbalances. In 2014-2019, external public and publicly guaranteed (PPG) debt had more than quadrupled. Zambia fell into arrears on external debt service and defaulted on a USD 42.5 million payment on its Eurobond and numerous other commercial loans with foreign creditors in 2020. Following this, external PPG debt reached 78 percent of GDP by end-2021, including \$2.3 billion of principal and interest arrears, and \$1.3 billion arrears to

¹ The data collection through remote meetings with stakeholders continued through June 2022. The authorities provided updates on ongoing reform initiatives in October 2022.

² IMF Framework on Enhanced Fund Engagement on Governance, 2018.

external suppliers (budget arrears and external IPP arrears). Total PPG debt reached 132 percent of GDP. The IMF-supported program intends to put Zambia on a path of debt sustainability, improved fiscal governance and gradual economic recovery.

In this challenging environment, the authorities sought the IMF's assistance to analyze governance weaknesses and corruption vulnerabilities and make specific, country-tailored and feasible recommendations to address governance and corruption risks in wide-ranging areas.

The GDA revealed serious governance weaknesses and corruption vulnerabilities across all state functions, but those with particular macroeconomic impact are present in public financial management (especially in relation to planning and monitoring of large investment projects), granting and managing contracts in the mining sector, transparency in public procurement, including adequate monitoring of Politically Exposed Persons (PEPs), autonomy of the central bank and effective financial sector oversight (especially oversight on banks with government ownership), Beneficial Ownership (BO) transparency and land management. These weaknesses and vulnerabilities highlight several themes, including weak transparency and accountability mechanism in public service, weak legal frameworks for key institutions and lack of coordination and clarity in the roles and responsibilities in key governance and anti-corruption functions.

Specific weaknesses in each area can be summarized as the following:

- Effectiveness of the legal and institutional frameworks related to Anti-Corruption and Anti-Money Laundering (AML): Anti-corruption and AML frameworks are in place but require upgrades to address specific governance weaknesses and corruption vulnerabilities. The most significant governance weaknesses are demonstrated in the limited transparency and absence of an effective access to information framework as well as limited autonomy and capacity of key oversight institutions and inadequate coordination mechanism among them. Corruption vulnerabilities are exacerbated by the legacy of impunity, weak accountability frameworks and sustained challenges in effective enforcement of anti-corruption laws. Lack of risk-based approach to AML supervision and delayed implementation of the legal framework on BO transparency are significant governance weaknesses elevating corruption risks. Inadequate monitoring of PEPs, ineffective application of sanctions, and limited resources to investigate and prosecute money laundering increase corruption vulnerabilities.
- Fiscal Governance: Significant governance weaknesses were identified in fiscal governance that elevate corruption risks. Due to the nature of corruption vulnerabilities in Zambia, the GDA mission team focused on areas of fiscal governance such as public financial management (PFM), public procurement (PP), effectiveness of governance and anti-corruption frameworks of Zambia's Revenue Administration (ZRA), as well as management of natural resources, which is a significant revenue-generating sector in Zambia and the oversight of State-Owned Enterprises (SOEs).
 - PFM suffers from historic governance weaknesses concentrated in poor management of large public investment projects, lack of capacity at district level to manage increased budgets associated with the fiscal decentralization, limited use of technology and weak expenditure controls.
 - Public procurement remains one of the key areas of governance inefficiency and vulnerability to corruption, especially in sectors where public spending is particularly high

(e.g. agriculture, road construction). The recent PP related legislative upgrades should be followed by effective implementation. Efforts to increase the control of PEPs in procurement, are underway but remain impeded by the incomplete implementation of the BO register, so risks of corruption remain elevated.

- Corruption vulnerabilities in Revenue Administration are high in the Value-Added Tax (VAT) refund process. Here too, corruption is facilitated by a lack of BO transparency for legal persons and other arrangements that enable concealment of ill-gotten proceeds. Significant governance weaknesses are present in the organizational structure and the compliance risk management systems in the ZRA.
 - Mining legislation is generally robust, but implementation is impeded by the resource constraints. The Ministry of Mines and Mineral Development (MMMD) lacks capacity and resources for effective operation, including lack of digitalization, which constitute significant governance weaknesses. Corruption vulnerabilities are present in granting, transfer and oversight of mining licenses.
 - SOEs raise high concerns too. The lack of a legal framework for ownership, corporate governance, oversight, transparency and accountability of SOEs generate governance weaknesses that negatively impact performance. Corruption vulnerabilities are present as the legal framework allows opportunities for political interference and patronage.
- *The Bank of Zambia (BoZ)* faced governance weaknesses, derived primarily from the Bank of Zambia Act (BoZ Act). Subsequent to the Governance Diagnostic Assessment mission, the BoZ Act was amended and important legal reforms were enacted in August 2022. The amended BoZ Act is substantially in line with IMF recommendations and significantly strengthens the Bank of Zambia's autonomy and governance arrangements.
 - *Financial sector oversight*: While there is a good progress in aligning legal and regulatory framework with international standards, there are remaining constraints in performing the oversight function effectively. The governance weaknesses related to supervisor's operational independence, accountability, transparency, decision-making, enforcement of prudential requirements as well as insufficient human resources limit oversight function and increase opportunities for corruption. The weaknesses in governance-related prudential framework cannot ensure adequate safeguard for the integrity of the banking sector. Increased corruption vulnerabilities are present for banks and specialized financial institutions with Government ownership.
 - *The contract enforcement* legal framework is well developed but access to dispute resolution mechanisms is limited due to insufficient number of courts and adjudicators, as well as ineffective alternative dispute resolution (ADR) mechanisms constituting major governance weaknesses in the system. Addressing corruption vulnerabilities in *protection of property rights* requires, *inter alia*, streamlining procedures for transforming customary land into State land. Detailed procedures for land management, especially at the level of local authorities and full operationalization of land tribunals are needed to address governance weakness in protection of property rights.

The report identifies on near-term reform steps and structural policy measures that require more time and resources but are necessary for sustainable change. It is acknowledged that addressing effectively all governance weaknesses identified through the GDA would require careful sequencing, continued strong political will, significant resources and prolonged efforts, including with support from Zambia's international partners. To facilitate the reform planning process, the mission identified priority recommendations, which focus on the first round of reforms in the key state functions. The priority recommendations are expected to serve as the catalyst in a transition to stronger governance and more effective, sustainable anti-corruption reforms.

Table I. Priority Recommendations				
Measure		Authority	Objective	Timeline ³
1	Adopt a legal framework that guarantees public access to information	MOJ, MOI SH, NA	Strengthen transparency and accountability	ST
2	Introduce necessary measures to ensure that top anti-corruption and AML officials such as Director General of ACC, Director General of DEC, Director General of FIC, DPP are selected and appointed through transparent, merit-based and participatory processes.	MOJ, SH, NA	Strengthen transparency and accountability	MT
3	Prepare, with participation of civil society, academia and legal profession, a comprehensive reform strategy to strengthen the independence, professionalism and efficiency of the judiciary and prosecution authorities.	MOJ, Judiciary	Strengthen AC& Oversight institutions	MT
4	Operationalize PACRA's beneficial ownership register, including ensuring the availability of accurate, complete and up-to-date beneficial ownership information and imposing effective sanctions on entities for non-compliance.	PACRA, MoFNP	Strengthen transparency and accountability, reduce AML/CFT risks	Immediate
5	Prepare a time-bound action plan and roll-out E-Government Procurement.	ZPPA	Strengthen PFM	Immediate
6	Mandate the use of the FMIS system for all transactions currently able to be undertaken through the system.	MoFNP	Strengthen PFM	Immediate
7	Mandate regular preparation and external publication of tax expenditure reports on measures expected to result in significant foregone revenue.	ZRA, MoFNP	Strengthen fiscal governance	ST
8	Increase internal audits in VAT refund process and customs warehouse management, as well as in other processes where IT systems are not fully integrated or are unstable.	ZRA	Strengthen fiscal governance	ST
9	Strengthen the MMMD's capacity to properly scrutinize license and transfer applications, and monitor the associated commitments on safety and environment, work programs, and production	MOFNP, SH, MMMD	Strengthen fiscal governance	ST
11	Bring the Public Audit Act of 2016 and the State Audit Commission Act of 2016 into force by issuing the statutory instrument by MoFNP	MoFNP	Strengthen AC & Oversight institutions	Immediate
12	Develop and reinforce supervisory processes for banks and other financial institutions with Government ownership to address specific risks and challenges associated with these special entities.	BoZ	Strengthen financial sector oversight	MT

³ The recommendations are classified as Immediate – to be implemented in up to 6 months, ST – Short Term to be implemented in six to twelve months, MT – Medium Term that may require up to 24 months.

All recommendations coming out of the diagnostic shall contribute to the formulation of governance and anticorruption policies and programs, improvement of the legal and institutional frameworks, as well as governance and anti-corruption reform measures agreed to in the Extended Credit Facility Arrangement (ECF) for Zambia.