Evolution of Service Sector in Zambia towards Greater Trade Orientation: An Overview

Introduction
The service sector constitutes a significant share of gross domestic product (GDP) in most of the developing countries in South Asia, Africa and the Caribbean region since these countries have an important stake in the Doha Round of negotiation on services liberalisation. Among the many issues being negotiated “Domestic Regulation” has become very important for developing and least developed countries (LDCs) while undertaking liberalisation of their service sectors.

The Doha Round points out national policy objectives to be a valid concern as long as these are not used to restrict trade. It strives to facilitate trade in services and yet focuses on achieving a level playing field between domestic and foreign service providers. However, the stress is on regulatory measures which can be applied to limit anti-competitive practices that may arise from market dominance by a few firms (domestic as well as foreign). Moreover, regulation can enhance consumer welfare by ensuring quality and appropriateness of services in the midst of a wide range of providers under progressive liberalisation on services.

Importance of Service Sector
Over the years, services has increasingly played an important role in economic activity and displayed more dynamism vis-à-vis other sectors. This has led to most countries seeking export markets for services. Expansion of the services offers room for increased foreign exchange earnings through exports and foreign direct investment (FDI) resulting from improved capacity and efficiency of the sector. Important sectors in this regard include telecommunications, energy, financial services, and transport as well as construction services (Mudenda 2006).

Depending upon the pattern of growth, it further contributes towards national development by enhancing efficiency in sectors which are key sources of national output and employment required to battle against poverty and illiteracy. Most importantly, it gives poor producers the much needed platform to bring in their productive capacities thereby overcoming the disadvantages of acting alone.

Contribution of Service Sector
The Doha Round assumes a vital importance for Zambia as services are the largest contributor to GDP and have increased for the entire period of 2001-06. For instance, services as a proportion of GDP (value added at 1995 prices) have increased by 26.7 percent from 40 percent in 1978 to 66.7 percent in 2006. Growth of services accelerated after 1993 mainly due to economic reforms that Zambia adopted under the auspices of International Financial Institutions (IFI).

A closer examination of the services sub-sectors (see Table 1) reveal that wholesale and retail trade, transport and communication, financial institutions and real estates and business are the largest contributors. The growth trends in the services are mainly due to the increased local and foreign investments triggered by the complete liberalisation of the economy in 1991.

Moreover, the privatisation of formerly government owned enterprises allowed for the injection of FDI in most service sub-sectors such as wholesale and retail trade, construction, financial and insurance and tourism as measured by restaurants bars and hotels. These services have contributed more than 70 percent of Zambia’s GDP growth since 2000.

The services sector has not only emerged as the important sector in the economy but its importance is also growing overtime. Contribution of services sector towards formal employment is dominated by manufacturing and agriculture sectors. The proportion of formally employed people in the sector has grown from 43 percent in 1964 to 68.3 percent in 2005 (see Figure 1).

At the same time contribution of the manufacturing sector remained stagnant at an average of 11 percent. The fall in the real number of people employed in the manufacturing sector can be explained by the closure of most industries that enjoyed protection from the import-substitution strategy that government pursued.

The growth of these sectors and employment therein are constrained by inadequate infrastructure services such as electricity, transport, development finance and technology.
Employment in agriculture although a major source of livelihood for the informal sector remains stuck at an average of 12.5 percent. Contribution of the services to employment generation and value added in GDP is likely to continue for many years to come as observed from the huge inflow of domestic investment and FDI. As a proportion of total pledges, FDI to the services has risen from 16.5 percent in 1995 to as high as 66 percent in 1999 before dropping back to 23 percent in 2006. The dynamism in tourism, transport and construction is supposed to generate more employment and alleviate poverty in the country because it has attracted the greatest share of FDI in services sector.

Zambia’s trade interest lies in tourism, transport and communication, banking, construction, medical services, etc., which are important to Zambia’s economic growth.

Liberalisation of Services

The liberalisation of the Zambian services sector has over the years been influenced by a number of developments in the domestic, regional and multilateral trading system. Under unilateral liberalisation, following the adoption of Structural Adjustment Programme (SAP), the Government of Zambia was forced to autonomously liberalise a number of service sectors that included communication, financial, energy, trade and distribution services and transport.

The reforms registered success in as far as the inflow of FDI in selected areas is concerned. The liberalisation of these sectors was complemented by other economy-wide reforms such as the liberalisation of the capital and current accounts without any strategic sequencing of the reforms.

Under the regional integration arrangement, efforts are being made within the Common market for Eastern and Southern African (COMESA) as well as the Southern African Development Community (SADC). The SADC member states have committed themselves to the liberalisation of trade in services in the region although not at a progressive rate as provided under the General Agreement on Trade in Services (GATS). The SADC region is currently negotiating the disciplines and modalities in order to harmonise trade in services regulations.

This regional initiative takes cognizance of the GATS and other commitments that member countries are engaged. Thus they have adopted a three-track approach to negotiations namely, SADC plus, GATS plus and finally consolidation of the two approaches. Members have agreed that the liberalisation should aim at covering all sectors and

Table 1: Share of Services Sub-sectors in GDP 1994 - 2006

<table>
<thead>
<tr>
<th>Services sub sectors</th>
<th>Average 1994-98</th>
<th>1999</th>
<th>2000</th>
<th>Average 2002-06</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wholesale and Retail trade</td>
<td>14.8</td>
<td>18.5</td>
<td>18.4</td>
<td>18.4</td>
</tr>
<tr>
<td>Electricity, Gas and Water</td>
<td>3.2</td>
<td>3.0</td>
<td>3.1</td>
<td>2.8</td>
</tr>
<tr>
<td>Restaurants, Bars and Hotels</td>
<td>1.6</td>
<td>1.8</td>
<td>2.3</td>
<td>2.5</td>
</tr>
<tr>
<td>Transport, Storage and Communications</td>
<td>6.0</td>
<td>6.4</td>
<td>6.2</td>
<td>5.8</td>
</tr>
<tr>
<td>• Rail Transport</td>
<td>0.6</td>
<td>0.4</td>
<td>0.4</td>
<td>0.3</td>
</tr>
<tr>
<td>• Road Transport</td>
<td>2.3</td>
<td>3.1</td>
<td>2.9</td>
<td>2.6</td>
</tr>
<tr>
<td>• Air Transport</td>
<td>0.9</td>
<td>1.1</td>
<td>1.2</td>
<td>1.1</td>
</tr>
<tr>
<td>• Communications</td>
<td>2.1</td>
<td>1.8</td>
<td>1.8</td>
<td>1.7</td>
</tr>
<tr>
<td>Financial Institutions and Insurance</td>
<td>8.2</td>
<td>8.6</td>
<td>7.8</td>
<td>7.8</td>
</tr>
<tr>
<td>Real Estate and Business services</td>
<td>5.0</td>
<td>8.4</td>
<td>9.4</td>
<td>8.6</td>
</tr>
<tr>
<td>Community, Social and Personal Services</td>
<td>8.0</td>
<td>8.0</td>
<td>7.8</td>
<td>7.5</td>
</tr>
<tr>
<td>Public Administration &amp; Defence/ Public Sanitary Services</td>
<td>4.6</td>
<td>4.6</td>
<td>4.2</td>
<td>3.5</td>
</tr>
<tr>
<td>• Education</td>
<td>2.1</td>
<td>2.1</td>
<td>2.2</td>
<td>2.6</td>
</tr>
<tr>
<td>• Health</td>
<td>0.5</td>
<td>0.5</td>
<td>0.6</td>
<td>0.6</td>
</tr>
<tr>
<td>• Recreation, Religious, Culture</td>
<td>0.3</td>
<td>0.3</td>
<td>0.3</td>
<td>0.3</td>
</tr>
<tr>
<td>Personal Services</td>
<td>0.4</td>
<td>0.5</td>
<td>0.5</td>
<td>0.5</td>
</tr>
<tr>
<td>Construction</td>
<td>5.0</td>
<td>4.8</td>
<td>5.3</td>
<td>8.0</td>
</tr>
</tbody>
</table>

Prepared by the author from MoNP & Bank of Zambia, Macroeconomic Indicators
Note: % totals do not add up to 100 due to unadjusted FISM and Taxes on Products

Figure 1: Employment Trends in Goods and Services Sectors 1965-2005

Source: Prepared from Central Statistical Office data base
modes of supply and be achieved by 2015 and synchronise the programme with the COMESA activities.

In addition, the country also committed itself to liberalise other sectors in 1994 under the GATS framework. In signing the GATS in 1994, Zambia included five sectors: business services; advisory services; construction and engineering services; health and social related services; and tourism. It was more than the two to three sectors offered by the most LDCs and African countries.

Table 2 provides policy changes that have taken place in the services industry and the state of play vis-à-vis the commitments that Zambia has made. Zambia opened up most of the services industries without making any commitments. Since the country made block commitments, the commitments and the state of play do not vary in the committed areas. Thus the GATS negotiations provide the country with an opportunity to clarify and align its commitments with its development needs.

Impact of Liberalisation

The impact of the services liberalisation on the economy has remained mixed. The liberalisation of communication sector resulted in improved performance of the sub-sectors. The mobile telephone sector has resulted in the creation of value added products such as telecentres and directory services which have employed a number of Zambians. The sector has extended telecommunication services to rural people (MoFNP 2007). In the financial sector, establishment of more insurance companies has led to the reduction of the cost of non-life insurance services by up to 9 percent points to the country (Martinez 2006).

Despite the above paltry successes, the services sector has not performed according to expectations. Mattoo A and L. Payton (2007) note that inadequate access to services like finance, communication and transport has not only hurt Zambians as consumers but have also perpetuated poverty by undermining the productivity of firms as well as their ability to participate in trade. Regardless of the significant foreign investment in the banking sector, access to banking services is low and unequally distributed in the country. Only 5,000 people out of 11.9 million hold 90 percent of the loans and only 8 percent of Zambia’s adult population had a bank account in 2005.

Efforts in the tourism sector have been concentrated on one area, i.e. the Victoria Falls where almost 82 percent of the tourists go and account for 93 percent of employment. The demand for Zambian medical workers within the international and regional countries like the UK, Namibia, South Africa and Botswana remains colossal.

Critics have pointed out that in 2007 it was estimated that only 50 percent of the required health staff was available as the remaining were working abroad due to which Zambia had to recruit personnel from other countries. The sequencing of reforms also affected the extent to which they were accepted.

For instance, the government liberalised agricultural output marketing before developing the necessary services for inputs like transport. This led to the collapse of the rural agricultural sector resulting in emerging farmers reverting back to subsistence farming. It has been observed that liberalisation of the economy was not home grown and did not have appropriate legitimacy in the country.

The inability of liberalisation of service to attract FDI is mainly due to the high cost of establishing a business, persistence of barriers to entry and competition in some sectors, the inappropriateness of regulation and weak capacity of regulatory bodies, the absence of meaningful policies to widen access to services and the inadequate efforts to deepen integration of regional markets. Looking at the success and failure, couple of domestic reforms and recommendations has been suggested. For instance, in telecommunications market access commitments could include the need to transfer technology and increased investment in rural areas to ensure wide access for all. In aviation, the country could offer full support towards the implementation of the continent wide liberalisation including Fifth Freedom Rights. However, the government still refuses...
<table>
<thead>
<tr>
<th>Sector</th>
<th>Major Policy Changes/Regulations</th>
<th>Openness to Services trade/State of Play</th>
<th>Status of WTO Commitments</th>
<th>Market structure</th>
</tr>
</thead>
<tbody>
<tr>
<td>Banking</td>
<td>1991-1994 market fully liberalised. Restrictions on interest rates, deposit rates exchange rates were decontrolled and the minimum capital requirement was reduced. Sector became attractive to private investors. New Act – Banking And Financial Services introduced in 1994 to strengthen supervision. The Act covers banks and non-bank financial institution. The 1996 Bank of Zambia Act empowered the central bank to implement monetary policy and supervisory policies. In 2007, the state sells 49 percent shares in state bank.</td>
<td>Mode 1: Capital market liberalised. Cross border lending and borrowing permitted by both households and banks. Mode 3: Private ownership up to 100 percent permitted. Foreign banks must be licensed in their home country. Banks may not engage into insurance business.</td>
<td>Zambia has not made any commitments in the financial sector. Committing the sector in its current form could encourage the foreign investment as it could strengthen policy predictability if its bound under the WTO. However, domestic regulations focusing on access by the poor are necessary.</td>
<td>13 commercial banks of which Six are foreign and command up to 67 percent of the total assets, 76 percent of the loans and 64 percent of the deposits.</td>
</tr>
<tr>
<td>Insurance</td>
<td>Only one provider existed between 1972 and 1992. Liberalised in 1992. It is regulated by the Pensions and Insurance Authority established under the Pensions Scheme Regulations Act of 1996and the insurance Act of 1997.</td>
<td>Mode 1 Cross border purchasing of insurance services is not permitted unless the service is evidently not available locally. This does not apply to reinsurance. Mode 3 Private and foreign ownership up to 100 percent shares is permitted. With the minimum requirements of • Proof of qualification and experience of principle officer • Declaration of Minimum capitals • Evidence of re-insurance programme • Detailed business plan • Ownership structure and biographies and paid up capital of Zambian Kwacha one billion (US$271,876.</td>
<td></td>
<td>There are five foreign owned and part-foreign owned companies controlling 17 percent of the market share, it terms of gross premiums.</td>
</tr>
<tr>
<td>Telecom (Fixed)</td>
<td>The 1994 Telecommunications Act separated the Post from the Telecoms. This opened up the fixed and mobile sectors to foreign participation In 2002, international services were liberalised</td>
<td>Mode 1: Call back services and voice cover Internet Protocol (VoIP) are illegal and there are high charges for call termination through the state owned incumbent. Mode 3: Private and foreign ownership is permitted with</td>
<td>No commitments were made in the sector. Although call back is perceived to be illegal, there is no domestic regulation that bars the use of this service.</td>
<td>There is no foreign investment in the sector.</td>
</tr>
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</tbody>
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| **Telecoms-Mobile** | at a licence fee of US$12mn.  
  The Communication Act No: 23 of 1994 established the Communication Authority of Zambia and empowered it to set rules and regulations for the operations of licences and suppliers of telecoms equipment.  
  The state owned firm is not subject to the authority’s regulations. | 30 percent local share holding.  
  Licences are allocated through a competitive tender.  
The international gateway at US$12mn is prohibitively high. |                                                                                                                     | Two foreign owned firms command 91 percent of the market share. |
| **Air Transport** | Mobile phones introduced in 1995. The licences were issued in 1997 to competing providers (Telecel-now MTN and Cetel in 2001.  
  Operations are licence by the Communications Authority since 1994 | **Mode 1**: Call back services and Voip are illegal*.  
**Mode 3**: Private and foreign owned firms are allowed to bid for competitively tendered licences, but 30 percent must be local  
  All players must use the State owned firm’s International gateway. |                                                                                                                     | There are two fully Zambian owned carriers that service the domestic routes.  
  International routes are served by South African, Ethiopian Kenyan and British Airways. |
| **Tourism** | Government liberalised the sector in 1991. The BASAs were in 1994 negotiated and licences were issued to a number of players following the liquidation of the state owned airline. | **Mode 1**: Committed to fifth freedom liberalisation according to Yamoussoukro Decision and to the COMESA through the COMESA legal notice No 2.  
**Mode 3**: There are no formal ownership restrictions.  
Airlines must be incorporated and have their principle business place in Zambia. Directorship of the company must be 50 percent Zambian. |                                                                                                                     | The sector is largely foreign owned in terms of value of assets although numerically there are more Zambian owned entities. 76 percent of the tour operators are foreign. |
| **Distribution** | The market is fully liberalised through the GATS commitment. | **Mode 3**: No restrictions on foreign investment.  
**Mode 4**: Limitations on the number of authorised intra-corporate transferees. | There are no commitments although the sector is highly liberalised. | The majority of the formal retail is foreign owned. The formal sector represents about 40 percent of the overall retail sector. |

*Note: *Mode 1* refers to the domestic market and the local competition, while *Mode 3* refers to the international market and foreign competition.*
Box 2: Various Monopoly and Entry Restrictions

In telecommunication, the de facto monopoly of Celtel in the international gate way due to the prohibitive licence fees induce inefficiency in the sector as it inhibits the expansion of all other telecommunication market segments. Zambians argue that government could liberalise the gate way only after ensuring that effective competition has been attained in the sector.

In aviation, protection has continued to prevail and the liberalisation process has been tuned to ambiguous regional agreements. For instance, due to South Africa’s interest in its route to Zambia, the Fifth Freedom Rights has led to the denial of other airlines like the Ethiopian and Egyptian Air lines to fly between South Africa and Zambia.

In tourism, regulatory to entry and operation have excluded most Zambians from participating in the sector. Up to 74 licences are required which takes more than six months to obtain.

to grant Fifth Freedom Rights to third parties on some routes like South Africa - Zambia and Harare – Lusaka. If Zambia is to benefit from the financial services liberalisation it must bind the existing openness with clear market access commitments under GATS to create policy certainty. This sector remains inaccessible by over 80 percent of the Zambians.

General Lessons for Other LDCs

• Undertake a compressive survey of the services sector and build a data base that could be used for analysis to strengthen the policy making process.
• Train locals from both the private and public sectors in order to create a pool of qualified people who can guide the negotiating process at different levels.
• Constantly update current legal provisions to ensure that they meet the modern business practices.
• Regulate the inflow of commodities and resources to ensure that consumers get a fair price of the services.
• FDI contribute in reducing economic instability followed by human insecurity. It is therefore necessary for LDCs to invest in development of human skills who can take advantage of such investment.
• To overcome monopolistic tendencies in services sector, strengthen regulatory capacity of the sector specific regulators, provide elaborate institutional mechanisms, promote effective competition by promoting new entrants in the sub-sectors, etc.
• For its long-term interest in Mode 4, unilaterally introduce an automatic quota system depending on the size and sector of investment, to enable investors to recruit abroad for a small number of key positions to ensure that the national needs are met.
• Involve all stakeholders (civil societies, private sector, etc.) at every stage of the decisions making process from assessment studies, domestic regulations formulation to actual policy position formulation. This could help build domestic support.

Endnotes

1 The country has experienced an average of 5 percent real GDP growth rate since 2000.
2 The drop is in the proportion is not as a result of declining investment but due to rapid FDI increases in other sectors of the economy like mining and agriculture.
3 There is no legal backing to the illegality of call back-services.
4 This does not have any legal backing in the country.