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Turning an Economy Around: The Challenge in Zambia

For most of the period 1983-95, the Bank's long-term objective was to help Zambia diversify its economy, liberalize trade and markets, and reduce the role of the public sector. But throughout the 1980s, the strategy was undermined by Zambia's policy reversals and shifting attitudes to reform and by the Bank's short-term responses to the country's economic crises. This crisis-driven approach resulted in a lending program that focused on abundant but largely unsuccessful structural adjustment credits, with little investment in operations to promote growth, improve infrastructure, or strengthen social services. Although Bank assistance may have helped Zambia's economy avoid a more precipitous decline, it failed to reverse the decline. During this period, poverty worsened and all major social indicators further deteriorated.

Since a new, pro-reform government came to power in 1991, the Bank has shifted to a more balanced strategy, one that combines assistance for short-term adjustment with support for long-term structural reform and sector investments to promote growth and reduce poverty. The Bank is building this strategy around a participatory approach that relies on government ownership, beneficiary consultation and feedback, and donor coordination. A recent OED study cautions however that in a highly aid-dependent country like Zambia, with years of neglected infrastructure, shortages of skills, inadequate institutional capacity, and an economic environment still biased against entrepreneurship, economic recovery will take time and faces substantial risk.*

At independence in 1964 Zambia was the richest country in sub-Saharan Africa. Twenty years later it was one of the poorest. It had changed from an IBRD borrower to an IDA-only client, with nearly 70 percent of its population living in poverty. Zambia's decline was the result of steep decreases in the international price of copper, higher prices of oil and industrial inputs, falling copper production, economic and public sector mismanagement, and postponement of adjustment, which led the country into heavy debt. The government's strategy of public-sector-led industrialization supported by tight controls and financed by heavy borrowing exacerbated the economic downturn. By 1982 Zambia, already highly indebted, faced financial and economic crises.

Bank strategy

1980s: Liberalization overshadowed by stabilization concerns

In 1981 the Bank proposed a new strategy for Zambia emphasizing assistance for diversification, liberalization, and privatization. During 1983-95, the Bank committed about $1.4 billion to the country, 70 percent of which was in support of structural adjustment. The aim was to help Zambia diversify its exports away from copper and to establish efficient import substitution in agriculture and industry. At the heart of the Bank's proposed reforms were measures to free Zambia's economy from the plethora of controls on production and internal and external trade. But for most of this period the relevance of the Bank's strategy was overshadowed by the need to stabilize Zambia's economy and restore its creditworthiness.

With Bank assistance, the government began reforms several times between 1983 and 1986 to liberalize the economy and tighten fiscal policies. But each time, the government backtracked on reforms or softened its policies when the measures became politically risky. The loans, however, were

**Zambia Country Assistance Review: Turning an Economy Around. A World Bank Operations Evaluation Study, by Gladstone Bonnick, forthcoming. Available to Bank executive directors and staff and to the public through the Bank's Publications Department. 1-202/458-0616, fax 1-202/522-2627, e-mail books@worldbank.org. Précis written by Farah Ebrahim.*

Box 1: The Agricultural Sector Investment Program: a new project approach

The hallmark of the Agricultural Sector Investment Program (ASIP) is participation, providing decisionmaking by both the client and beneficiaries and donors and other project supporters. The ASIP:

- covers the country's entire agricultural program,
- is prepared by Zambian task forces, whose members are drawn from both the public and private sectors;
- is to be implemented within the institutional framework of the Ministry of Agriculture, Forestry, and Fisheries;
- requires, as much as possible, standard donor procedures for procurement, reporting, accounting, and auditing;
- relies on short-term technical assistance, with minimal use of long-term expatriate consultants;
- is flexible, allowing for annual reviews and adjustments; and
- is built around public sector reforms in the agricultural sector aimed at increasing decentralization and increasing participation. The program will go through several iterations with input from farmer unions, parliament and policymakers to make it truly participatory

disbursed (except for the second tranche of the first Economic Recovery Credit, which was not disbursed until 1991). The combined effects of devaluation of the kwacha and reduction of food subsidies resulted in food shortages, rising prices, and food riots and deaths, forcing the government to abandon the reforms in 1987. Along with abandonment of the reforms, the government allowed its arrears to the Bank to accumulate. Between 1983 and 1995, arrears forced the Bank to suspend lending to Zambia three times, the last time for four years, from 1987-91.

During the 1980s, the Bank's structural adjustment operations shared the objective of supporting reforms and increasing output by providing foreign exchange for imported inputs. Although the operations had conditions supporting the Bank's proposed liberalization measures, the conditions were often relaxed to ensure transfer of resources or were reversed after disbursement. The government was thus able to draw on Bank finances without following through on reforms. The result was an increase in Zambia's debt to finance greater immediate consumption at the expense of capital accumulation and future growth.

1990s: A more balanced approach

In more recent years, with a new government continuing reforms and inflation subsiding, the Bank has refocused its attention on a more balanced program. Its strategy for the late 1990s is threefold: (1) continue adjustment lending to help Zambia to stabilize its balance of payments, (2) improve the private sector environment through project lending in infrastructure and human resources, and (3) target the poor and vulnerable groups with specific programs in agriculture and social services.

The Bank is also adopting a new sectoral approach to program design and implementation, piloted through the Agricultural Sector Investment Program (see Box 1). The approach is expected to enhance the relevance not only of the Bank's program but also those of all donors and of the country.

Effectiveness of Bank assistance

Aid mobilization and coordination

The Bank's nonlending instruments, such as technical assistance and aid mobilization and coordination, were more effective than its lending. Over the 1983-95 period the Bank was effective in helping Zambia manage its enormous external debt. All of its instruments served this end well: the amount and composition of Bank lending, the quality and responsiveness of its economic and sector work, and the nature of its technical assistance and aid coordination. The Bank assisted Zambia in developing an adequate debt monitoring system, partly to facilitate the rescheduling of bilateral debt. During 1990-93 it helped reschedule $1.5 billion of debt, resulting in a substantial reduction of debt service and considerable debt relief. Its leadership role in consultative group meetings coupled with its analytical work helped convince donors to substantially increase their aid, helping to clear Zambia's arrears, enabling the Bank to resume disbursements in 1991.

Zambia's external debt remains one of the highest in the world, however, at $650 per capita. As a result the Bank will have to continue to play a pivotal role in mobilizing aid and in coordinating with donors, a task made more complex by the increasing disappointment of many donors with the country's performance. Since 1994, the focus of aid coordination has been to improve the efficiency and efficacy of sectoral support by avoiding duplication, the overloading of public sector management, and unrealistic demands on local counterpart financing.

Lending

The adjustment operations of the 1980s failed to achieve their objectives, either in effecting sustained policy reform or in improving the efficiency and productivity of the productive sectors. In contrast, the adjustment operations after 1991 appear to have been more successful, both in their support of policy reform and in serving as the basis for coordinated mobilization of balance of payments support from the donor community. Portfolio performance, which compared unfavorably with the average for the Africa region for most of the 1980s, has also improved. Projects with

successful outcomes tended to be small, require limited management, have appropriate technology, use foreign consultants, and provide some training.

Three factors in particular undermined the effectiveness of the Bank's assistance prior to 1991.

- *Weak ownership.* The national and social context of the structural adjustment program did not favor the sustainability of reforms. Outside a narrow group of politicians and senior officials, there was little ownership of the reform process. Political forces were sharply divided over development strategy and economic management, with some influential advisers and powerful political groups, including labor unions, still favoring a command economy.

- *Inadequate attention to the disadvantaged.* Failure to recognize the risk of reversal of the reform process is in part related to lack of attention to issues of poverty alleviation and equitable distribution of adjustment. Thus, the government, and by extension the Bank, did not sufficiently recognize the importance of the public sector in providing urban jobs or the immense social cost of efforts to curtail the fiscal deficit. Greater attention needed to be given to determining the pace of reform and the need to protect vulnerable groups, including the provision of safety nets.

- *Arrears and suspension of Bank disbursements.* As already noted, three times during 1983-95 Zambia's arrears triggered suspension of Bank disbursements. The suspensions undermined the viability of many projects, particularly in agriculture. Better provisions for supervision should have been made to mitigate the effects on ongoing operations, as well as for shutting down projects.

Progress toward objectives

Success in liberalization

Zambia's economic management improved considerably after 1992, especially in monetary and fiscal discipline. Government reforms reduced the primary fiscal deficit from 7 percent of the GDP in the early 1990s to 1 percent in 1995. The reforms have also made progress in freeing the economic environment for the private sector. Few distortions remain in the foreign exchange market, interest rates have been freed, and most restrictions on imports and exports removed. The Bank's economic and sector work strengthened the policy dialogue and helped implement the reform measures.

Issues to be addressed

Privatization and diversification need greater Bank attention. Progress in privatization was slow before 1995 but has picked up considerably since then. The government passed the privatization act and established a privatization agency and trust fund. Of the 160 state-owned companies eligible for sale, negotiations were completed on 23 companies and completed for only 13 by early 1995. But by the end of 1995, 100 more companies had been privatized. Privatization of mining has been announced, and negotiations with bidders are expected to begin in early 1997.

Although the share of nontraditional exports has risen from 10 percent to 15 percent of total exports during the last decade, earnings from them are still small. Growth is still constrained by insufficient infrastructure and a lack of sustained real depreciation in the exchange rate.

Poverty and the social sectors. During 1983-94 poverty in Zambia increased in relative and absolute terms. Nearly two-thirds of the population lives in poverty, and the outlook for early poverty reduction is not good. This suggests that other strategies will be needed. Safety nets are only short-term measures. The more effective response will be to improve the productivity of the poor and increase their access to social and economic services. (See Box 2.) Bank assistance needs to focus on Zambia's health and education systems, whose decayed conditions are major impediments to poverty reduction.

Box 2: Helping vulnerable groups: the Bank's poverty assessment

A 1994 assessment of poverty in Zambia identified the country's high population growth as a major hindrance in reducing poverty. The assessment, based on a household survey, identified lack of productive assets, such as oxen, storage facilities, and farm implements for rural families, as the major obstacle to greater productivity of the poor, and malnutrition, poor health, and low educational levels as the main constraints on the development of human capital. The assessment's main recommendations are to raise the growth of smallholder agriculture by improving rural infrastructure and technology and by supporting private marketing and storage. For the urban poor, the main objective is removing obstacles to microenterprise development, improving basic urban services, and providing greater access to education and health. The assessment also recommended a program of labor-intensive public works to provide a safety net to vulnerable groups

***Bank management**, in its response to the study, agreed with most of the review's assessments and recommendations, but not with the suggestion that the Bank should have forced the pace of privatization earlier, or that it should have made better provisions for supervision or closing down ("mothballing") projects during loan suspension. It noted that until recently the necessary local capacity and consensus had not developed sufficiently for privatization to take off. With regard to handling projects during suspension, management noted that the*

Bank has too often tried to resurrect projects after a lengthy suspension, while Zambia would have been better served if the Bank had closed the existing operations and developed and approved new ones that better reflected the new economic policies.

Management agreed on the importance of job-creating growth, improved public expenditures, and efficient social safety nets for poverty alleviation in Zambia. It pointed to two ongoing Bank-supported Social Recovery Programs; to planned sector investments in education, roads, and urban development, whose policy frameworks will particularly help the poor; and to reforms in trade, labor, and land markets, which are all designed to promote more labor-absorbing growth. A participatory monitoring system, established as followup to the 1994 Poverty Assessment, will track poverty rates and will monitor performance indicators.

Management noted that planned adjustment operations will emphasize reform of labor and land markets and other constraints on private investment and diversification. The Bank will continue to substitute sector investment and project lending for adjustment lending as debt-service requirements are further reduced. On the need for better risk management and sustainability analysis, management agreed that the risks of reversal and slowdown are still high and the reform process fragile. But there is also a downside risk of underfinancing the existing program, thus undermining economic growth and public support. Ultimately, risk will only be reduced by further debt reduction.

Management noted that the Bank's ability to maneuver is limited by Zambia's high debt obligations, which force high balance of payments support. Where countries fail to meet their debt service obligations to the Bank, the Bank is legally forced to stop lending and disbursements. Projects are difficult to sustain without continued supervision and adaptation. Management will maintain its activist role in consultative group meetings and will increase cooperation with donors involved in sector investment programs.

The ***Committee on Development Effectiveness*** *of the Bank, in discussing the study, highlighted the following: the need for sector and country strategies to reflect clearly the lessons of past experience and to avoid formulaic responses in articulating goals and objectives; the critical importance of borrower ownership and commitment to reforms; and, in that context, the need for more expert monitoring and analysis of political realities and sensitivity to the political dynamics and concerns of those likely to be affected by reform; the importance of capacity building and participation by government officials and donors in Bank economic and sector work; the need for an active Bank role in aid coordination and strengthening of the resident mission for that purpose; and finally, the need to redress the balance between finance for debt servicing and finance for investment projects.*

As to the appropriate sequencing of reforms in Zambia, some members support management's view that privatization should not have been forced earlier, while others agreed with OED that liberalization required privatization, and still others noted that reform of the public sector was key. Where disbursements are to be suspended, the committee noted that policy dialogue, economic and sector studies, and supervision should normally be continued, though in special cases, such as civil war, even those activities may have to cease.

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