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MINISTRY FOR FOREIGN AFFAIRS

# EVALUATION OF SWEDISH DEVELOPMENT COOPERATION WITH ZAMBIA

Ds 1994:114

Report 6

**SASDA**

Secretariat for Analysis of  
Swedish Development Assistance

# SASDA

## The Secretariat for Analysis of Swedish Development Assistance

The Swedish government has appointed a committee with the task of analysing the results and effectiveness of Swedish development aid. A special Secretariat, SASDA, was set up on 1 March 1993 to carry out the work.

The Secretariat will work until the end of 1994 and will have as its main task to propose to Government suitable mechanisms for evaluations and policy analyses of Swedish aid. In its work SASDA will give priority to carrying out a set of selected studies world-wide, at country, sector and subject level and to studies of individual organisations to provide a basis for decisions on development co-operation in the future and to gain experience on how policy evaluations should be carried out. A major study concerns Sweden's co-operation with Central and Eastern Europe.

SASDA's point of departure is the aim of a better understanding of the mechanisms of development in order to enhance the results and increase the effectiveness of aid in achieving the five goals set by the Swedish parliament: increased resources, economic and social equality, economic and political independence, the democratic development of society, and the long-term management of natural resources and care of the environment.

The studies and analyses will be managed partly by the Secretariat's own staff and will include studies commissioned from different specialists in the committee's areas of priority.

The staff are :

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Dr Eva Julin	Senior Policy Analyst
Mr Enrique Ganuza	Senior Policy Analyst
Mr Per Johan Svenningsson	Senior Policy Analyst
Ms Kerstin Sandling	Assistant Secretary

Postal address: SASDA  
P.O. Box 16418  
S-103 27 STOCKHOLM

Telephone: +46-8 791 21 80  
Telefax: +46-8-791 21 88  
Visiting address: Klarabergsgatan 23, Stockholm



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Evaluation of Swedish Development Co-Operation with Zambia  
A Report for the Secretariat for Analysis of Swedish Development Assistance

by

Chris Adam  
Per-Åke Andersson  
Arne Bigsten  
Paul Collier  
Steve O'Connell

Department of Economics  
Göteborg University  
Viktoriagatan 30  
S-411 25 Göteborg  
Sweden

and

Centre for the Study of African Economies  
Institute of Economics and Statistics  
University of Oxford  
St Cross Building  
Manor Road  
Oxford OX1 3UL  
UK

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## FOREWORD

On the basis of a government report on forms of management and co-operation in overseas aid (SOU 1993:1) the Swedish Parliament approved a proposal to carry out country profiles and country studies as an essential tool for the management of aid to individual countries.

Examinations of the overall management of the bilateral aid programmes, in terms of results or the effectiveness of programmes in each country, have seldom been carried out in Sweden. The recipient country is an appropriate level at which to address the question of results because it is the level where bilateral funding allocations are made by the Swedish Parliament, where the strategy for results can be determined, where goals are set and where bilateral agreements are signed for programmes and projects. A country specific strategy would enable Swedish development co-operation agencies to focus on specific and measurable results, country by country.

The Secretariat for Analysis of Swedish Development Assistance (SASDA) has commissioned a number of country-case-studies in order to analyse the results achieved by Swedish aid, taking into account other donors' experience. The objectives are to analyse the effect and effectiveness of Swedish aid in the sense of appropriateness to the objectives set for aid, to analyse its cost-effectiveness, to make recommendations to improve its effectiveness and efficiency in development co-operation in the future, and to make proposals for the methodology to be employed in analysing and following up the effectiveness and efficiency of aid in country studies.

In this report, Professor Arne Bigsten, Department of Economics, University of Gothenburg, together with Dr. Chris Adam, Dr. Per-Åke Andersson, Professor Paul Collier and Ass. Professor Steve O'Connell, analyses Swedish development co-operation with Zambia for the period 1965/66-1991/92, and particularly on its development after 1980.

The opinions and conclusions of the authors of the report are their own.

Stockholm, August 1994.

Ingemar Mundebo  
Chairman



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## Part 1: BACKGROUND

### 1. INTRODUCTION

#### 1.1 Purpose

Sweden has been giving aid to Zambia since 1965. The total amount of aid disbursed is about 6 billion SEK at 1993 prices. A number of analyses of specific projects and programmes have been undertaken, but no comprehensive review of Swedish aid to Zambia has been done previously.

SASDA is conducting a broad analysis of Swedish aid, as part of which it has commissioned a number of specific studies, including four individual country studies. The Göteborg-Oxford team is responsible for two of those, this one on Zambia and another on Tanzania. These two studies have been done in parallel, which means that there is considerable overlap between them. Still, we have been requested to present two separate reports, rather than one comparative study. To make it possible to read each study independently, we include the common material in both reports.

Our main purpose is to examine the extent to which Swedish aid has been successful in achieving its stated objectives. A secondary purpose is to investigate the efficiency with which aid is handled by Swedish aid agencies. Finally, on the basis of our analysis we will discuss the implications for future Swedish aid to Zambia.

#### 1.2 Goals of Swedish Aid

The overall objective of Swedish aid is to improve the standard of living of poor people. More specifically, the Swedish parliament has decided that Swedish aid should contribute to economic growth, economic and social equalization, economic and political autonomy, democratic development of society, a sustainable use of natural resources, and



environmental protection.<sup>1</sup> Recently, the Swedish government has also decided that country allocation of aid is to be done on the basis of five criteria: 1) development towards a market economy, 2) democracy, 3) respect for human rights, 4) the efficiency of aid, and 5) a low military share of total government expenditures.

In line with current changes in Swedish management practice generally, there is an increasing emphasis on formulating goals for aid, and on measuring its results. As specified in the most recent documents from the foreign office, the overall goal for Swedish aid to Zambia is development which in the long term, and permanently, improves the living conditions of poor people there. To reach this goal, aid should specifically 1) support the economic reform process towards market economy and economic growth, 2) support democratization, and 3) support social development and poverty reduction.

The goals for Swedish aid to Zambia are thus very much in line with the general goals of Swedish aid. The goal of economic and political independence is not as much in focus as it was during the period of anti-apartheid policies, and is not explicitly mentioned now. Still, given the situation at present in Zambia with a very high aid dependence, it is obvious that for Zambia to attain self-determination there must be substantial economic growth. This goal may thus be subsumed under the growth objective. The environmental goal is treated more as a constraint, which leaves us with the above three goals, namely, growth, equality and democracy. In our terms of reference it is stated that we should focus on growth and distribution, which we will do.

In the recent agreement with Zambia it is stated that the level of Swedish assistance to Zambia would be based on performance in terms of democratic development, respect for human rights, economic reform and aid effectiveness. The latter requires more transparent and comprehensive reporting of the results, regarding overall policies as well as project follow up. Measurable goals should be established for each project and

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<sup>1</sup> See, for example, UD, Prop 1993/94:100, bilaga 4 s 58, Littera C: Internationellt utvecklingssamarbete.

programme. It is further emphasized that Swedish aid should be complementary to Zambian efforts. This implies that there is a need for increasing domestic resource mobilization and strengthening institutional capacity. Full responsibility for the planning and implementation, as well as the follow-up and reporting of the use of funds, should rest with the Zambians, as well as the full responsibility for coordinating donor support. We will consider to what extent these ambitions are met.

### 1.3 Approach and Scope of the Study

Our task is to investigate what the effect of Swedish aid has been on Zambian development. We will not be able to provide a wholly satisfactory answer to this question. To do so one would first have to establish a norm of comparison, a counterfactual. What would have happened without the Swedish aid? We do not have such a base line to compare with. Secondly, Swedish aid is a relatively small component of overall resources, which means that its impact is not easily identified. We therefore abstain from trying to undertake an econometric exercise linking Swedish aid to macroeconomic aggregates. Instead we attempt something more modest. We might call our study an essay of persuasion. We reason about the impacts on the basis of the information that we have and on the basis of our understanding of the workings of the Zambian economy and the constraints it faces.

In our analysis we distinguish between the direct and the indirect effects of aid. The direct effects alter production, incomes or consumption as a direct consequence of the project. The indirect effects are less easily identified. Aid to the public sectors releases resources which can be used for cuts in taxation and borrowing, or increases in expenditures. The private sector is indirectly affected, for example, via changes in relative prices. A proper identification of these indirect links is not easily done without a general equilibrium model of the economy, which we do not have. Our discussion of these links will therefore be tentative.

Foreign aid should assist countries in their development efforts. The long term aim is that

the recipient country should grow from its own resources. For this, domestic resource mobilization is essential. Possible negative indirect impacts of aid on such mobilization will therefore be considered. Domestic savings and tax efforts are two important variables to consider. We are also concerned with the development of exports, which in the longer term is a necessary prerequisite for self-sustained growth.

In our analysis we will first consider the direct effects of aid, that is, we will consider the effects of projects and programmes at the micro level. Then we will consider the indirect or macroeconomic effects on the economy.

#### 1.4 Outline of the Study

The study is structured as follows: In Chapter 2 we review briefly the factors determining economic growth in Africa and discuss some relevant aspects of the aid relationship. In Chapter 3 we show the overall flows of aid to Zambia, while Chapter 4 presents the Swedish support. Here we also discuss the motives for giving this type of assistance to Zambia.

Then follows our discussion of the results achieved. In Chapter 5 we examine the microeconomic or direct effects of aid. We review the major projects and programmes that Sweden has been involved in, based on evaluations and studies already undertaken. We do not do any evaluations of our own.

In Chapter 6 we present some estimates of the administrative costs of Swedish aid. Unfortunately, it is impossible to come up with reasonable estimates of cost-effectiveness without a major research effort. It is obvious, for example, that high administrative costs can be motivated by better results with regard to output quantity and quality. Simple ratios, therefore, tell us little. Still, we present estimates, with many reservations, to give a feel for how large a share of aid goes to administration.

Then, given the time and resource constraints we face and, as discussed before, the

relatively small Swedish share of total aid, what can we contribute to the discussion of the macroeconomic effects of Swedish aid? Part 4 provides a discussion of the links between the macroeconomy and aid, but we also analyze a range of theoretical issues that we think are central to decisions about future aid. We start in Chapter 7 with a macroeconomic overview of Zambia, covering changes in economic policies and economic aggregates. We also relate these changes to changes in aid flows. Chapter 8 is devoted to an analysis of aid dependency. Chapter 9 presents an analysis of policy conditionality and its impact, while Chapter 10 discusses the design of policy conditionality in the light of the former analysis. Chapter 11 discusses the size of the aid programme and the risk of Dutch disease in Zambia. Chapter 12 discusses the causes of corruption and possible responses. Finally, in Chapter 13 we spell out the policy implications of the macroeconomic analysis. The general reader may prefer to skip some parts of Chapters 9-11, which are somewhat theoretical.

The main task of this investigation was to look at the macroeconomic effects of Swedish aid and, particularly, to consider its impact on growth and income distribution. We have pointed out that it is virtually impossible to provide a sound scientific answer to these questions. Still, in Chapter 14 we summarize what we have learned about the impacts from our micro and macro analyses.

To conclude, Chapter 15 presents our policy conclusions and discusses the appropriate forms of future Swedish aid to Zambia, but we do not consider this to be the final word on this difficult issue.



## 2. GROWTH DETERMINANTS AND THE IMPACT OF AID

### 2.1 Introduction

The purpose of this study is to analyze the impact of Swedish aid to Zambia, with particular emphasis on growth and income distribution. This chapter first provides a summary of the review, in the parallel Tanzanian study of the factors that determine income growth in African economies and then identifies some important aspects of aid allocation. In later chapters we will analyze the impact of aid on the growth factors identified here.

### 2.2. Growth Determinants in African Economies

In any economy, the rate of growth is determined by the accumulation of physical and human capital, the efficiency of resource allocation, and the ability to acquire and apply modern technology. The policy question is how the environment could be changed to facilitate both the accumulation of production factors and their efficient allocation, and the introduction of better technologies. The experience of many countries shows that economic policies at the micro level should aim to develop and sustain efficient markets, while macro policy must be geared to guarantee macroeconomic stability. It has furthermore become obvious that an efficient economy requires a supporting environment of efficient institutions. In our discussion of the impact of aid, we will consider how it affects the variables identified here.<sup>1</sup>

A necessary, but not sufficient condition for growth, is investment. A major aim of recent adjustment programmes has been to increase private sector investment, and studies of the adjustment experience of a range of countries suggest that recovery of private investment is the distinguishing feature of a successful programme. Uncertainty

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<sup>1</sup> Svedberg, Olofsgard and Ekman (1994) provide a good review of recent work on growth determinants in LDCs.

and lack of credibility are important constraints on investment. These factors make investors shy away from irreversible long-term investments and they stimulate short-term speculative behaviour. When there is uncertainty, firms choose to place their money in liquid or financial assets. Investment expansion thus requires long-term macroeconomic stability, and for this to be credible, debt burdens may have to be reduced. A sound overall macroeconomic environment is thus a basic condition for investment, which is a requirement for growth.

A hotly debated issue with regard to the Asian NIC's is whether selective, non-neutral market interventions played an essential role in their success. The answer given by the "miracle-study" is a qualified "no" (World Bank, 1993). However, one area where experiences of the Asian NIC's suggest that there might be scope for non-neutral policy is with regard to export support. It is essential, though, that interventions be based on economic performance criteria, and that the bureaucracies that handle them are not corrupt. These preconditions seldom exist in African economies. Interventions in African countries should therefore not be selective, since this opens the door to various forms of corruption and inefficiency. The reasons for these different results in Africa and Asia must be sought in the structure of institutions.

A central question then is why growth supporting institutions develop. A government which is primarily concerned with its own survival does not necessarily set up ownership rules that are good for economic growth. With special interest politics at centre stage, there is bound to be static inefficiency due to distortions, investors are going to be cautious, and resources are going to be wasted in rent-seeking activities.

Many observers of African economies have noted the pervasive influence of politics on economics. A characteristic feature is that many of the policy interventions have been discretionary in Africa, while they have been more rule-based and institutionalized in the Asian NIC's. This selectivity of interventions has paved the way for the high level of corruption and rent-seeking in Africa (Bigsten, 1993). Many of the interventions were well-intended, but the power elite has also used the system to allocate rents as a



means of securing their power positions (Bigsten and Moene, 1992).

A notion that appears many times in the analysis of the Asian miracle is "shared growth", that is, the mass of the population must also see the benefits if they are going to participate actively. And it is not only the general citizen who must be included, but also the ruling elite must allow competing elites to progress, and must also allow new competitors to come in. The desire for total control has stifled many initiatives in African countries. For shared growth to come about, there is need for a bureaucracy of high quality, which is sufficiently insulated from pressure groups. Such an institutional set-up is not easily created. It is not enough to instill the relevant skills in civil servants. If they then are put into institutions where outside interference determines outcomes, they become frustrated and cynical. To avoid this result, the norms and behaviour in the society at large have to change. An open debate can contribute to such change and here African economies have taken strides in the right direction in the last few years.

### 2.3 A Choice Between Current and Future Consumption

Aid can be used either for consumption in this period, to thus improve the welfare of the current generation, or it can be invested to generate growth and increased future consumption. A choice is made by the recipient government on the basis of its preferences, but it may be constrained by donor conditionality. The smaller the share of the budget that is financed by aid money, the larger is the scope for the recipient government to allocate its own money in such a way that the impact of conditionality from the donor is neutralized. It is natural that some of the inflow of aid is used to increase the consumption of the current generation. This means that the domestic savings share is going to be smaller than before, even if the sum of domestic and foreign savings or investment is larger. It should also be noted that investment in human capital, in the form of education, is going to be recorded as current public sector consumption.

This seemingly simple choice between present and future consumption is in reality further complicated by a range of factors. Economies are, for example, exposed to uncertainty,

and incomes may fluctuate due to swings in commodity prices or commodity production or because of international cycles. The recipient may therefore choose to use aid for consumption-smoothing, rather than for investment, when the economy is facing problems. This should also be acceptable to the donor, when there is an emergency situation with, for example, drought and the threat of starvation.

### 2.4 Summing Up

The growth determining factors that we have identified in this chapter are thus investment in physical and human capital, technical progress, and the effectiveness of resource allocation. Changes in these factors do in turn depend on the character of the policy environment (appropriate prices and macroeconomic stability), institutions and governance. Variables to consider are thus the investment rate, accumulation of skills through education, relative prices such as the exchange rate, macroeconomic stability in terms of budget balance, external balance and monetary stability, institutional structures, and the quality of governance. We will in this study investigate the impact of aid on these variables, and we will in this context also have to discuss how the character of the aid relationship affects the growth impact.

## Part 2: THE STATISTICAL PICTURE

### 3. FOREIGN AID FLOWS TO ZAMBIA

#### 3.1 Introduction

This chapter presents overall foreign development assistance to Zambia. Being a relatively rich country, Zambia first started receiving foreign assistance as a result of the political situation in neighbouring Zimbabwe. The aid inflow was rather limited until the external shocks of the 1970's hit the Zambian economy. External assistance has since fluctuated around an increasing trend.

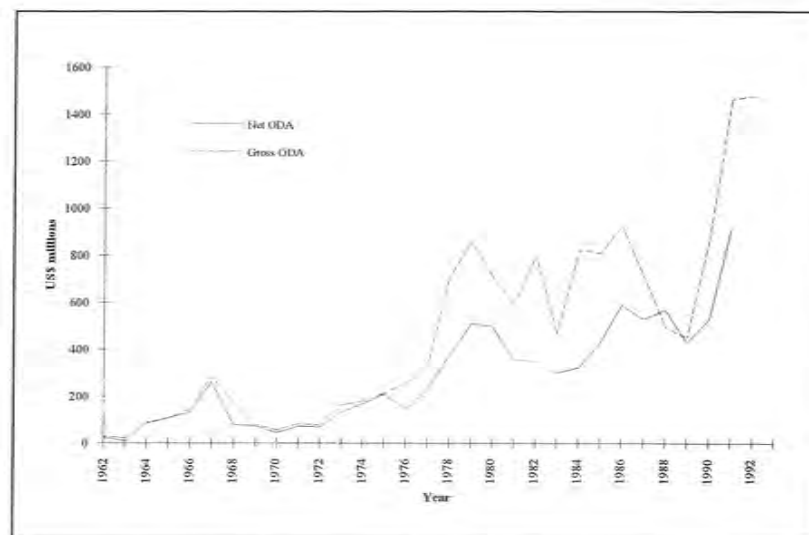
#### 3.2 Total Foreign Aid

Zambia was a relatively rich country at independence in 1964 and, after the fast economic growth of the next decade, the World Bank classified Zambia as a middle income country. Per capita GDP reached its peak in the mid 1970's at around 600 US dollars (current). In spite of its relative prosperity, Zambia soon became a major recipient of foreign development assistance, due to a combination of external and internal shocks. Figure 3.1 presents the overall external assistance to Zambia. While overall gross development assistance for 1961-1993 totals around 11 billion US dollars in current prices, Figure 3.1 shows that the inflow of external aid has increased over time, and especially during the 1990's the donor community has provided extraordinary support.

Aid during the first years after independence was mainly due to the situation in neighbouring Zimbabwe, where the UDI (unilateral declaration of independence) was declared in 1965. In 1968 the Zambian government introduced the Mulungushi reforms. The previous relatively liberal industrial policy was changed towards self-reliance and state ownership, and a number of companies were nationalised. The main donor country, the United Kingdom, responded by lowering its assistance. Aid increased again in the

mid-1970's, when oil prices increased, the copper price collapsed and the Zimbabwe liberation struggle intensified. Altogether, external assistance to Zambia increased 300 percent between 1974 and 1980 (Simson, 1985).

Figure 3.1: External Assistance to Zambia, 1961-1992, US\$ millions, 1992



Note. The data has been deflated by the USA GNP deflator.

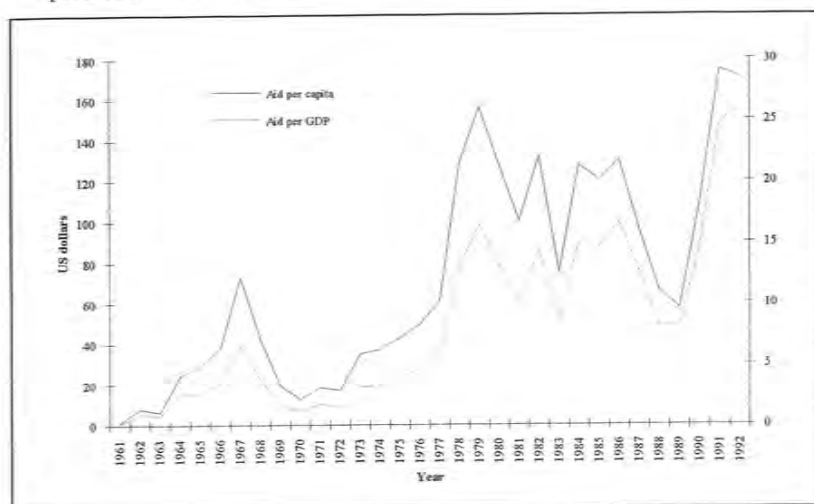
Source: OECD/DAC, various issues.

Aid to Zambia remained high during the 1980's, with peaks in conjunction with IMF and World Bank supported structural adjustment programs (SAP's) in 1985-1987. The number of donor agencies was as high as 150 in 1988 (UNDP, 1988). The introduction of a 'command economy' in mid-1987 caused an aid decline of around 100 million. The USA, UK, Germany, the World Bank and some others, stopped disbursing aid to Zambia completely, while many others only continued technical assistance (GRZ, 1988). Drought problems also caused aid increases in 1979/80 and 1991/92. Figure 3.2 shows that gross development assistance per capita increased rapidly in the late 1970's reaching 156 US



dollars in 1979. ODA per capita stayed above 100 US dollars for most of the 1980's and in 1991 peaked at 175 US dollars. The figure also shows external assistance in relation to gross domestic production, where a similar pattern is evident.

Figure 3.2: Gross ODA in 1992 prices in relation to population and production in Zambia



Note: The data has been deflated by the USA GNP deflator

Source: OECD/DAC, various issues. IMF, 'International Financial Statistics'.

Since Zambian use of IMF credits is not included in the statistics above<sup>1</sup>, Table 3.1 shows such flows. Zambia started to use IMF facilities in 1971, when the government negotiated a compensatory financing facility and purchased 13.6 million Zambian Kwacha<sup>2</sup>. During the Action Programme of 1978-80 Zambia increased its use of IMF facilities (both credits and loans). Large credits were also drawn in 1981 and in 1983-86. The repayment of the credits started in 1975, but first became substantial in 1982-1983.

<sup>1</sup> Funds from the regular programmes of the IMF and the World Bank are not recorded as ODA. Only flows from IDA, the Bank's soft-loan window, and from the IMF trust fund are channelled on concessionary terms and are thus recorded as ODA.

<sup>2</sup> Ndulo and Sakala (1987) show IMF-sponsored programmes between 1976 and 1985.

The repayments were never large enough to really affect the Zambian debt to the IMF, though, and thus this debt increased dramatically to a peak in 1984 at 754 million SDR. This was the last year in which Zambia received a net financial inflow from the IMF. Zambia has not been able to purchase credits from the IMF since 1986, and the actual support from the IMF today concerns only debt-servicing. The ongoing structural adjustment program is supported through a Rights Accumulation Program, where the Zambian government 'collects' rights to reschedule its debt (see Chapter 7).

Table 3.1: Financial flows between Zambia and IMF, 1971-1993, millions of SDR.

Year	Credits	Repurchases	Total GRA	Loans	Repayments	Total credit
1971	19	-	19	-	-	19
1972	19	-	38	-	-	38
1973	19	-	57	-	-	57
1974	-	-	57	-	-	57
1975	57	38	76	-	-	76
1976	38	19	95	-	-	95
1977	19	19	95	-	-	95
1978	149	-	245	-	-	245
1979	100	26	320	23	-	343
1980	50	44	308	20	-	351
1981	359	40	628	1	-	671
1982	34	86	576	-	-	618
1983	174	114	636	-	-	679
1984	148	71	712	-	1	754
1985	-	19	693	-	6	729
1986	104	123	674	-	8	702
1987	-	-	674	-	3	699
1988	-	-	674	-	-	699
1989	-	-	674	-	14	685
1990	-	15	660	-	4	667
1991	-	25	635	-	1	642
1992	-	26	609	-	-	616
1993	-	50	559	-	-	567

Note: Credits and repurchases refer to the general resource account (GRA). Total GRA is the outstanding credit on this account. Loans and repayments are related to the structural adjustment facility, the enhanced structural adjustment facility, and Trust Fund loans. Total credit is the outstanding GRA credits plus outstanding loans.

Source: IMF, International Finance Statistics.

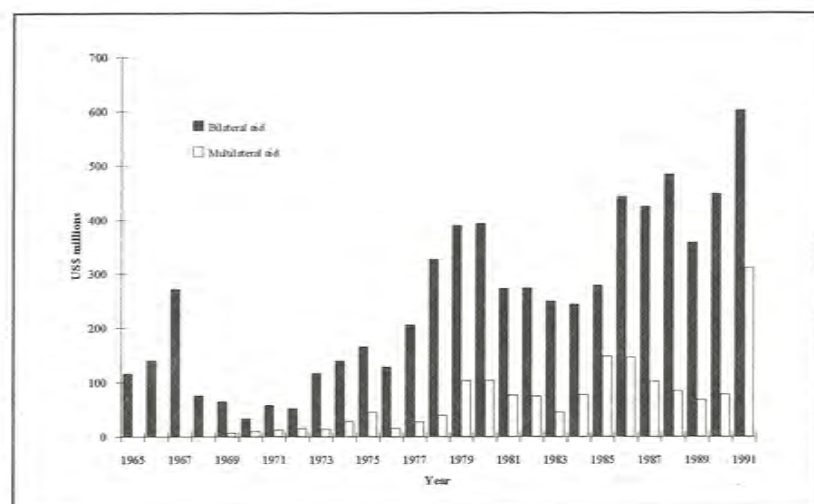


### 3.3 The Importance of Bilateral Assistance

Bilateral aid has been considerably higher than multilateral aid, but a number of bilateral donors have conditioned their assistance on SAP's, and thus on multilateral aid. Figure 3.3 shows that an increase in multilateral aid correlates with an increase in bilateral aid.

Zambia's former colonial power, the United Kingdom, was the major bilateral donor during the 1970's and contributed as much as 25 percent of total bilateral aid (Simson, 1985). The USA ranked second with 15 percent, and Sweden was third with a 13 percent contribution. Other important bilateral donors were West Germany, Japan, Canada and Norway.

Figure 3.3: Net bilateral and multilateral aid to Zambia, 1965-1991, US\$ millions, 1992 prices.



Note: The data has been deflated by the USA GNP deflator.

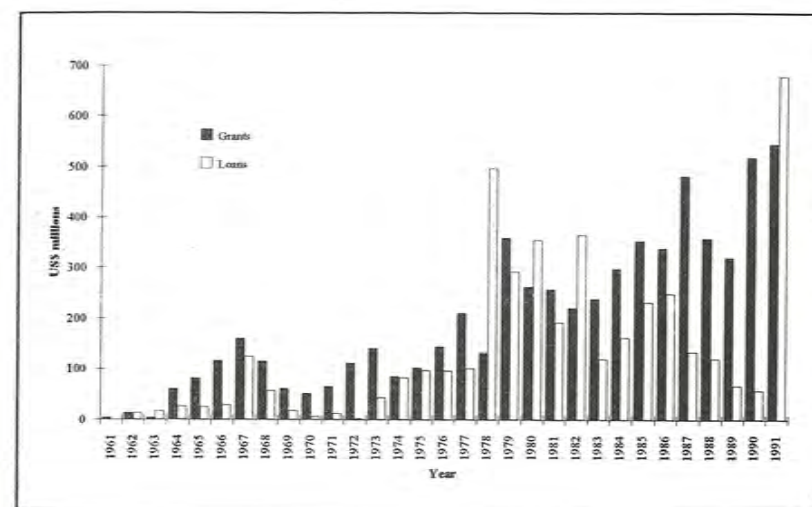
Source: OECD/DAC, various issues.

Although these bilateral donors continued to be important for the 1980's as well, their relative importance has changed. Japan has been the most important bilateral donor for the period 1981-1991, with a contribution of 474 million US dollars or 14 percent of total bilateral aid. Germany ranked second with 13 percent, while Sweden was third with 12 percent. Then follows the UK, USA, Norway and the Netherlands.

### 3.4 The Increasing Importance of Grants

External assistance is either in the form of grants or loans. Figure 3.4 shows that grants have been more common than loans for almost the whole period, except between 1978-1982 and in 1991. Furthermore, the share of grants increased during the 1980's. This

Figure 3.4: External assistance in the form of grants and loans commitments, 1961-1991, US\$ millions, 1992 prices.



Note: The data has been deflated by the USA GNP deflator.

Source: OECD/DAC, various issues.

comes as no surprise, since Zambia's worsening debt problem 'forced' the bilateral donors, at least, to provide their assistance in grant form.

Table 3.2 shows that the grant element of bilateral assistance was close to 100 percent until 1991, while that of multilateral assistance was around 90 percent. The rather low grant element for 1991 is due to loans from Germany and Japan. All other bilateral donors currently grant 100 percent of their aid to Zambia.

Table 3.2: Grant element of the external assistance to Zambia, 1988-1991

	1988	1989	1990	1991
Bilateral	94.6	97.2	99.1	69.7
Multilateral	92.7	89.6	96.8	84.4
Total	94.3	95.5	98.8	74.0

Note: The table focuses aid received while Figure 3.4 presents commitments.  
Source: OECD/DAC, various issues.

### 3.5 Sectoral Distribution of External Assistance

Most Western bilateral aid during the 1970's, including Sweden's (see Chapter 4), went to agriculture, infrastructure, health and education (Simson, 1985). In the 1980's the most important bilateral donors aided the following sectors (Chr. Michelsen Institute, 1986):

USA: Agriculture, transport and the adjustment program

UK: Technical assistance in education, health and construction

Germany: Infrastructure, water supply and industry

Netherlands: Agriculture and health in the Western Province

Canada: 75 percent to agriculture and rural development

Finland: Agriculture, forestry, transport, education and the energy sector

Sweden: Rural development, agriculture, education and health.

Table 3.3 shows the break-down of overall aid during 1985-1991. Traditional sectors for aid, such as production and technical cooperation, were becoming less important. Foreign assistance to agriculture actually declined, from 70 million US dollars in 1988, to only 28 million US dollars in 1991. Debt reorganisation and programme assistance increased in importance. The social sectors are also getting increased attention.

Table 3.3: External Assistance to Zambia by Sector, in percent

Sector	1985	1986	1987	1988	1989	1990	1991
Social sectors	13	9	17	18	26	6	33
Economic infrastructure	9	14	13	9	15	7	6
Production	35	16	42	20	16	20	6
Technical cooperation	16	15	17	32	31	23	9
Programme assistance	9	18	5	12	8	17	8
Debt reorganisation	13	24	0	5	0	19	40
Food aid	4	3	4	5	6	0	0

Note:  
 Social sectors = Education, health, water & sanitation and other social infrastructure.  
 Economic infrastructure = Energy and transportation.  
 Production = Agriculture, extractive industries and manufacturing.

Source: OECD/DAC, various issues.

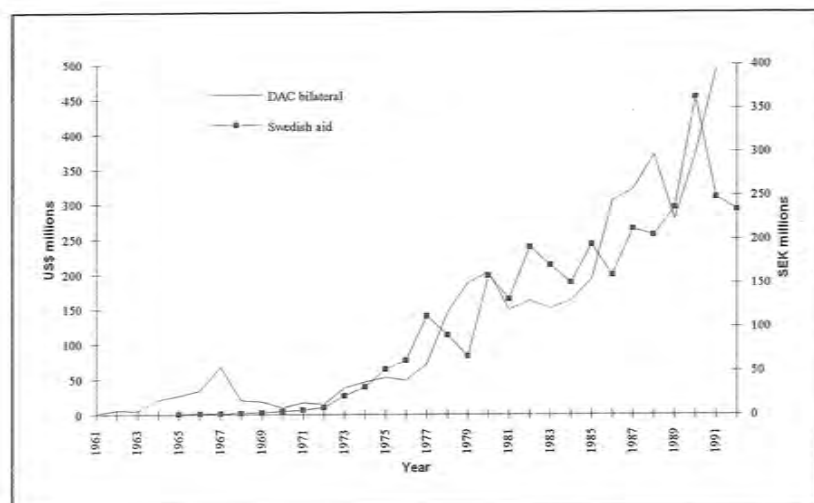
### 3.6 Sweden's Contribution

Sweden's bilateral aid has been rather stable over the years. Figure 3.5 compares Swedish aid with the other bilateral donors. The increasing trend is evident for Sweden and for the other DAC countries. There are some differences, though. First of all, Sweden's assistance seems to be more stable over the years, while the other DAC assistance shows larger variations, depending on macroeconomic policies. In time periods



when the Zambian government implemented adjustment programs, other DAC aid increased, as in 1978-80, 1985-1987 and 1989 onwards. Sweden's aid did not follow the DAC increase in 1978-79 in support of a SAP, and Sweden increased its aid in 1982 despite the low DAC level. When the other DAC countries increased their assistance in support of the 1985 SAP, Sweden did not. In general, it seems that Sweden has not conditioned its bilateral aid in the same sense as many other bilateral donors, and has instead followed a long term commitment to Zambia.

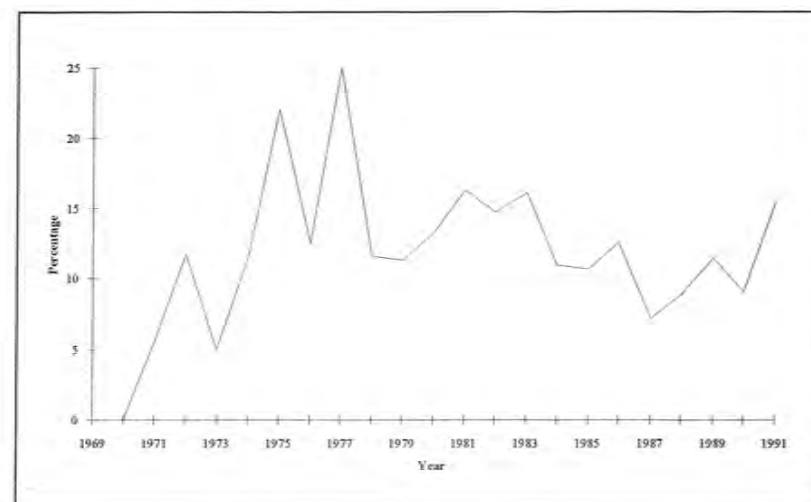
Figure 3.5: Swedish aid and bilateral aid from DAC countries



Source: OECD/DAC, various issues.

As mentioned before, Sweden's share in bilateral aid to Zambia has stayed around 12-13 percent for more than two decades. Figure 3.6 shows the annual changes in this share. The peaks in 1972, 1975 and 1977 are all due to infrastructural projects. The overall picture is that Sweden's share is slowly declining. This is mainly a result of other bilateral donors' renewed interest in Zambia.

Figure 3.6: Sweden's share in bilateral aid to Zambia



Source: OECD/DAC, various issues.

### 3.7 The Debt Problem and Debt Servicing

The total debt in 1993 was almost 2.5 times GDP and more than 6 times exports. The debt problem originated when the government treated the external shocks of the 1970's as temporary, stepping up external borrowing. External debt increased three times between 1975 and 1980. Credits were increasingly from non-concessional, private sources and the terms of lending were gradually hardened (Simson, 1985). The debt service payments as a percentage of exports rose from 11 per cent in 1975 to 24 per cent in 1980. If the IMF repurchases and charges are included, the debt service in 1980 approached 35 percent of export earnings. In 1982, substantial arrears accumulated for the first time, and the scheduled debt service ratio increased. In 1983 the government failed to meet its obligations and sought debt rescheduling. An agreement was reached with the Paris Club to reschedule 320 million US dollars. This agreement set a pattern for rescheduling with the non-Paris Club countries and other creditors (Simson, 1985).



Table 3.4 shows actual debt service honoured. Peaks occur in 1986, due to obligations to the IMF, and in 1991, due to obligations to the World Bank. In these years the debt service ratio is above 50 percent. When the 'command economy' was reintroduced in 1987, the government stated that the honoured debt service ratio would stay at 10 percent, but favourable copper prices caused a slightly higher debt service.

Table 3.4: Debt service and debt service ratio, 1980-1992

Year	Debt service	Debt service ratio	Interest as percent of exports
1980	411	25.3	8.7
1981	422	36.1	11.0
1982	335	31.0	12.8
1983	303	29.6	12.5
1984	246	25.3	11.7
1985	138	15.9	7.6
1986	386	52.1	19.7
1987	171	18.9	8.2
1988	190	15.2	6.3
1989	206	14.4	5.3
1990	202	15.1	5.7
1991	599	51.4	26.3
1992	358	29.3	13.5

Note: Debt service represents actual payments in current USD millions. Debt service ratio = debt service as percentage of export earnings.

Source: Börjesson, 1993.

The nature of the debt has changed rapidly during the last years as a result of attempts to address the outstanding debt burden (Table 3.5). First, the commercial debt has been reduced as a result of debt buy-back operations. The London Club debt has been reduced from 13 percent of total debt in 1985 to only 1 percent in 1993. Furthermore, the share of short-term debt has declined from 24 percent in 1989 to 14 percent in 1993.

The bilateral share of debt is around 40 percent, but additional debt relief is expected as a result of a Paris Club agreement of 1992. This relief would amount to around 1,000 million US dollar between 1992-95. Debt to the IMF has remained at around 18-

19 percent, while other multilateral debt has increased in importance from 16 to 26 percent between 1985 and 1993. Most of this debt is due to the World Bank and, as with the other Bretton Woods organisations, direct debt reductions are not constitutionally acceptable.

Table 3.5: Total Zambian debt, million US dollars.

	1985	1986	1987	1988	1989	1990	1991	1992	1993
Bilateral	1802	2212	2561	2578	2321	2887	2980	3069	2652
Multilateral	723	978	1232	1205	1239	1418	1514	1655	1752
IMF	801	858	991	940	900	949	918	1304	1304
London Club	575	646	673	652	671	542	481	128	97
Short-term	675	1051	1169	1464	1578	1440	1374	916	957
Total debt	4576	5745	6626	6840	6709	7237	7271	7073	6763

Sources: The World Bank, World Debt Tables. Republic of Zambia, Economic Reports (for 1992 and 1993).

To be placed in the right perspective, excessive external assistance during the first years of the 1990's has to be compared with the large financial outflow due to debt servicing. Table 3.6 shows that debt service in 1991 was more than twice the external assistance. When debt relief is added to the equation, Zambia had a net inflow of 100 million US dollars. Debt service is larger than external assistance for 1992 and 1993 as well, but with debt relief included, the net transfer amounts to 553 and 272 million US dollars, respectively. In spite of the large gross flows the net transfer has been rather limited during these years.

Table 3.6: Net external flows to Zambia 1991-1993, millions US\$

	1991	1992	1993
Commodity assistance	76	246	90
Balance of payments, World Bank	202	165	144
Balance of payments, others	264	326	155
Project assistance	244	191	234
Total external assistance	786	928	623
Debt relief	1158	551	359
External debt service	-1841	-926	-710
Net transfer to Zambia	103	553	272

Source: GRZ, 1994.

### 3.8 Summary

The division between multilateral and bilateral aid shows that bilateral aid has been, and still is, very important in Zambia. There is, though, a clear positive correlation between the two types of assistance. Zambia started to use IMF facilities in 1971, the debt rose dramatically in the early 1980's and 1984 was the last year in which Zambia received a net financial inflow from the IMF. The support today consists of debt servicing.

Foreign development assistance to Zambia is divided between grants and loans. Assistance in the form of grants has become more and more important as Zambia's debt has increased. Most bilateral donors now assist Zambia with grants, while the multilateral donors have a larger element of loans.

The sectoral division of external assistance shows large changes over the seven years for which data is available, but there is no trend visible. Aid for debt reorganization and programme assistance can easily be changed by donors from year to year, and the information indicates that this is in fact done.

Sweden's assistance have been more stable over the years than has overall bilateral aid, and the share of Swedish aid in total bilateral aid has been 12-13 percent for two decades.

The external debt stock increased rapidly in the late 1970's and substantial debt arrears started to accumulate in the 1980s. The nature of the debt has changed during the 1990's. The commercial and short-term debt has declined, while the multilateral debt has increased its share. The Paris Club is expecting to continue its relief of bilateral debt, which means that the share of multilateral debt will increase even more in the future.

### Appendix 3A.

Table 3A.1. Net and gross overseas development assistance to Zambia in current and 1992 prices, millions US dollars.

Year	Gross ODA	GODA 1992 prices	Net ODA	NODA 1992 price
1961	1	5	0	0
1962	6	27	5	23
1963	5	22	2	9
1964	20	88	19	83
1965	25	107	25	107
1966	35	144	32	132
1967	71	285	65	261
1968	45	172	20	76
1969	22	80	20	72
1970	16	55	13	45
1971	25	81	22	72
1972	25	78	22	68
1973	56	163	45	131
1974	67	179	63	169
1975	88	214	86	209
1976	111	254	62	142
1977	151	324	108	232
1978	352	703	185	369
1979	469	861	277	509
1980	422	710	295	496
1981	383	588	231	355
1982	554	799	241	348
1983	337	468	217	301
1984	615	823	240	321
1985	623	810	329	428
1986	730	926	464	588
1987	578	710	430	528
1988	417	496	478	568
1989	393	449	374	427
1990	794	871	481	528
1991	1417	1464	884	914
1992	1479	1479	-	-
1993	1098	-	-	-
Total	11430	14434	5735	8510

Note: The data has been deflated by the GNP deflator for USA.

Source: OECD/DAC, various.

Table 3A.2. Bilateral and multilateral aid to Zambia in current and 1992 prices, millions US dollars.

Year	Bilateral	Bilateral at 1992 prices	Multilateral	Multilateral at 1992 prices
1961	1	5	0	0
1962	6	27	0	0
1963	5	22	0	0
1964	21	92	0	0
1965	27	115	0	0
1966	34	140	0	0
1967	68	273	0	0
1968	20	76	0	0
1969	18	65	2	7
1970	10	34	3	10
1971	18	59	4	13
1972	17	53	5	16
1973	40	117	5	15
1974	52	139	11	29
1975	68	165	19	46
1976	56	128	7	16
1977	96	206	13	28
1978	164	327	20	40
1979	212	389	56	103
1980	234	394	62	104
1981	178	273	50	77
1982	190	274	52	75
1983	180	250	33	46
1984	182	243	58	78
1985	215	280	114	148
1986	349	443	115	146
1987	346	425	83	102
1988	407	484	71	84
1989	314	359	60	69
1990	409	449	72	79
1991	583	602	301	311
1992	n/a	n/a	n/a	n/a
1993	n/a	n/a	n/a	n/a
Total	4520	6909	1216	1641

Note: The data has been deflated by the GNP deflator for USA.

Source: OECD/DAC, various.



Table 3A.3. Official aid commitments as loans and grants to Zambia, current and 1992 prices

Year	Grants	Grants in 1992 prices	Loans	Loans in 1992 prices
1961	1	5	0	0
1962	3	14	3	14
1963	1	4	4	18
1964	14	61	6	26
1965	19	81	6	26
1966	28	116	7	29
1967	40	160	31	124
1968	30	115	15	57
1969	17	62	5	18
1970	15	51	2	7
1971	20	65	4	13
1972	36	112	1	3
1973	48	140	15	44
1974	32	86	31	83
1975	42	102	40	97
1976	63	144	42	96
1977	98	210	47	101
1978	66	132	249	497
1979	196	360	159	292
1980	156	262	211	355
1981	168	258	125	192
1982	153	221	253	365
1983	172	239	86	119
1984	223	298	121	162
1985	272	354	178	231
1986	267	339	196	249
1987	393	483	109	134
1988	302	359	101	120
1989	280	320	59	67
1990	474	520	53	58
1991	528	546	658	680
1992	n/a	n/a	n/a	n/a
1993	n/a	n/a	n/a	n/a
Total	4157	6217	2817	4277

Note: The data has been deflated by the GNP deflator for USA. Both bilateral and multilateral aid are included.

Source: OECD/DAC, various.

Table 3A.4. Sweden's aid disbursements to Zambia in 1991/92 prices, SEK millions

Year	Total disbursements	SIDA disbursements	'Country frame'	SIDA disbursements as % of country frame
1965	2	2	-	-
1966	5	5	-	-
1967	7	7	-	-
1968	9	9	-	-
1969	13	13	-	-
1970	20	20	-	-
1971	26	26	38	69 %
1972	39	39	71	55 %
1973	93	93	131	70 %
1974	131	131	179	70 %
1975	189	189	197	94 %
1976	203	203	203	99 %
1977	330	330	230	140 %
1978	282	282	258	95 %
1979	229	229	254	63 %
1980	384	384	280	122 %
1981	270	270	284	91 %
1982	345	345	294	116 %
1983	284	284	289	97 %
1984	241	241	270	86 %
1985	356	286	276	102 %
1986	230	230	287	78 %
1987	289	289	308	92 %
1988	271	270	302	85 %
1989	298	298	278	98 %
1990	593	593	252	151 %
1991	361	358	260	96 %
1992	391	382	270	85 %
Total	5892	5810	5210	

Source: SIDA EA-system.

#### 4. SWEDISH DEVELOPMENT ASSISTANCE TO ZAMBIA

##### 4.1 Introduction

Sweden's aid to Zambia was initiated shortly after independence, and the main rationale behind the assistance was Zambia's geopolitical situation as a front-line state. This resulted in a rather peculiar situation in the 1960's and 1970's, when the size of support for Zambia was primarily affected by the situation in South Africa and what was then Rhodesia. It should be observed, though, that the liberation struggles in Zambia's southern neighbours actually implied substantial costs to Zambia, especially since transport routes had to be changed.

The design of Sweden's support was based on the following characteristics of the colonial legacy: First, the economy was dualistic, with a marginalised traditional agriculture. Second, the regional inequalities were large. Finally, social infrastructure, including education of Africans, was largely neglected. Thus from the beginning Sweden's support emphasised rural development in agriculture, health and education, supplemented with technical assistance, some infrastructure projects and import support.

##### 4.2 Sweden's Overall Assistance

Sweden's support to Zambia started on a small scale in 1965 and was directed towards agriculture. There were two important objectives of the initial support from Sweden (Öståker, 1994). First, Sweden was to support Zambia's efforts to liberate itself from the influences and power structures remaining from the colonial era. Second, Zambia's geopolitical situation as a front-line state caused problems which Swedish aid could alleviate, and thus Zambia's efforts for economic and political independence from its southern neighbours were supported.

The post-colonial objective indicated that the principal target group for Swedish aid

should be the subsistence farmers. Support was directed towards improving food production, increasing rural standards of living and people's participation level. The front-line objective then indicated that Zambia should be a programme country.

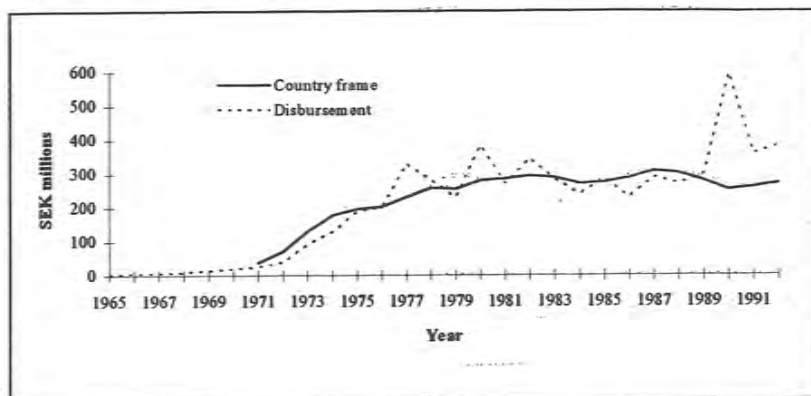
Figure 4.1 shows that after a careful start, assistance grew rather fast during the 1970's, as a result of the liberation war in Rhodesia and terms of trade changes. Aid levelled off in the late 1970's and the 'country frame' has since been rather stable at around 250 million SEK per year, in 1992 prices. The actual disbursements show a slightly different story. During the first years of the 1970's disbursements were well below the 'country frame', and this has also been the case for some years in the late 1980's. In years 1977, 1980 and 1982, SIDA disbursed considerably higher amounts than the 'country frame'. The substantial disbursement in 1990 includes an extra balance of payments support, and additional support to the power station at Kafue Gorge.

In the mid 1980's Zambia's economic difficulties resulted in a change of Sweden's aid goals, putting more emphasis on growth, though still concerned with equity. Support should strengthen Zambia's national and economic independence, promote economic growth, especially for the rural poor, and maintain standards of social services. Sector support programmes in agriculture, health and education were consolidated.

In the early 1990's, support for economic reforms and democracy became additional objectives. In 1993, Sweden adopted a new strategy for support to programme countries, but the main goals of economic growth and social equalisation remain.



Figure 4.1: Swedish 'country frame' and actual disbursements of aid to Zambia.



Source: SIDA, EA-system.

Table 4.1 shows that only a very limited amount of total donor assistance is channelled through other authorities than SIDA. In 1985 the Ministry of Foreign Affairs disbursed balance of payments support close to 50 million SEK, but otherwise the amounts are small. Before 1985, all payment went through SIDA.

Table 4.1: Payments from other authorities than SIDA, in millions SEK

	1985	1986	1987	1988	1989	1990	1991	1992
MoF	47.8	0	0	0	0	0	0	2.5
BITS	0	0	0	0	0	0	2.0	0
Sarec	0	0	0	0.4	0.4	0.2	0.3	2.2
Swede Corp	0	0	0	0	0	0	0	3.9
Impod	0	0	0	0.1	0	0	0	0
Total	47.8	0	0	0.5	0.4	0.2	2.4	8.6

Note: MoF stands for balance of payments support from the Ministry of Foreign Affairs.  
Source: SIDA, EA-system.

Swedish assistance is also channelled through non-governmental organizations (NGO's). This started in 1973, but the amounts were rather small, at around 1-3 million SEK. Table 4.2 shows an increase in 1988 and 1992, but still the amount is only around 2 percent of total disbursements.

Table 4.2 also shows support channelled through SADCC<sup>1</sup>. This concerns two projects, namely, a gene bank in Lusaka, and an energy project. The latter includes support to a training centre at Kafue Gorge, as well as technical assistance and rehabilitation of the national control centre in Lusaka. In 1991/92 support for the rehabilitation of Kafue Gorge power station was transferred from the 'country frame' to the SADCC framework, which explains the large increase that year. SADCC support as a percentage of total disbursements also increased, from 2 percent in 1989 to 9 percent in 1991.

Table 4.2: Disbursements by SADCC and non-governmental organisations, in millions SEK

	1985	1986	1987	1988	1989	1990	1991	1992
SADCC	---	---	---	---	6.0	5.7	31.1	31.3
NGO's	2.4	2.7	1.7	4.8	4.9	4.7	4.4	8.8

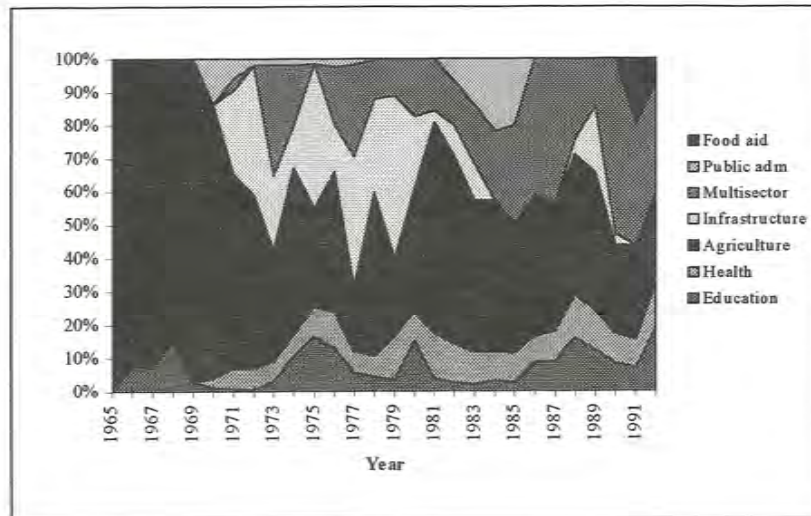
Source: SIDA, EA-system.

Figure 4.2 shows the sectoral distribution of Swedish aid to Zambia (See also Table 4A.3). In the 1960's, all support went to the agricultural and educational sectors, with agriculture the dominant recipient. In the early 1970's, support was extended to health and public administration. Furthermore, multisectoral and infrastructural support were provided, together with technical assistance in public administration. In the 1980's, the multisectoral support, mainly import support, has grown in importance, together with aid to the educational sector. Food aid was also disbursed in the early 1990's.

<sup>1</sup> Zambia has also benefitted from support to other SADCC projects such as the TAZARA railway and a microwave connection.



Figure 4.2: Swedish aid to Zambia by sector, 1965-1992



Source: SIDA, EA-system.

Infrastructure support consisted of three main projects. The Kafue Gorge power station was supported with technical assistance during 1971-1983, and Sweden also co-financed the rehabilitation of the power station in 1988-1993<sup>2</sup>. The construction of a telecommunication system was supported during 1974-1981. Aid to the transport sector consisted mainly of the purchase of railway wagons<sup>3</sup> from Sweden for 126 million SEK during 1975-1983. Public administration support has mainly been technical assistance in a variety of fields, such as statistics, labour market issues, and industrial development. Some public administration support still exists, but it is today labelled under the personnel and consultancy fund, under multisector support. The personnel and consultancy fund started in 1978. Agricultural, health, educational and multisector

<sup>2</sup> Kafue Gorge power station delivers 50% of Zambia's electricity production.

<sup>3</sup> This railway wagon project is, in the SIDA data, sometimes referred to as infrastructure support and sometimes as import support.

support will be discussed in more detail below.

#### 4.3 Assistance to the Agricultural Sector

Sweden's aid to Zambia started with support to agriculture, in the form of technical assistance to farming co-operatives, and support to the co-operative movement has remained important. Since 1991/92 this assistance is disbursed through SIDA's Division for Cooperation with Non-Governmental Organizations and the Swedish Co-operative Centre.

In the early 1970's the agricultural sector support was expanded to the planning and implementation of several programmes, such as the Intensive Development Zones Programme in Eastern Province and the construction of the Zambia College of Agriculture in Mpika. The co-operative idea was further supported with the construction of the Co-operative College in Lusaka, as well as other projects. The overall aim of support was to improve the living standards of subsistence and small scale farmers.

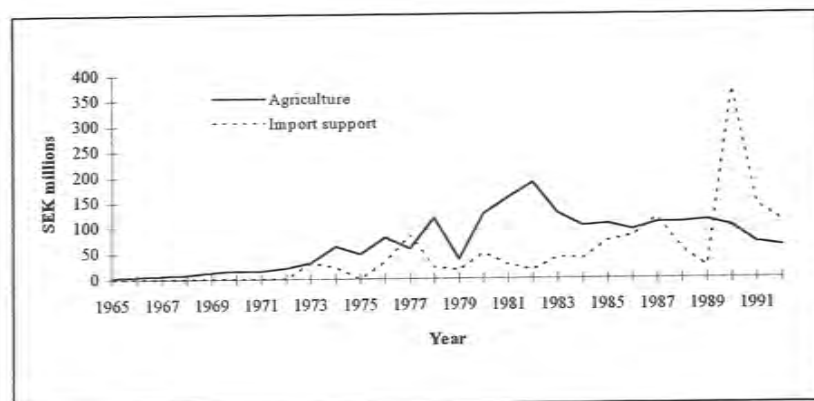
In 1978 agricultural assistance was changed into a sector support programme (ASSP)<sup>4</sup>. The principle was that Sweden should support programmes and projects planned and implemented by the Zambian government. The main objective was still to increase living standards for subsistence farmers in outlying provinces, but the tool for achievement this time was by improving productivity. Figure 4.3 shows that support also increased with the new support programme in 1978. After the drought year 1979/80, Zambia embarked on the Operation Food Programme, which Sweden supported by increasing its aid to agriculture. In 1983, the ASSP reached a peak of around 175 million SEK. Although declining during the following years, annual support stayed well over 100 million SEK in the 1980's. The support has continued to decline in the 1990's, however.

The ASSP consisted of the following projects and programmes in the mid 1980's: 1) the integrated rural development programme (IRDP), 2) support to the Planning Division at

<sup>4</sup> The sector support programmes have been criticized for merely being an aggregation of projects and not a programme support as such.

the Ministry of Agriculture, 3) the agricultural training and extension programme, 4) the co-operative development programme, 5) the research and seed programme, 6) the rural structures and equipment programme, 7) the survey and lands programme, and 8) the Prices and Income Commission (PIC). The support peak in the early 1980's was mainly due to a combined emphasis on co-operative development, IRDP, and training and extension.

Figure 4.3: Swedish aid to the agricultural sector and for import support in 1992 prices



Source: SIDA, EA-system.

The ASSP framework was abandoned in 1991, but the rural development objective remains. Support today emphasises environmental aspects, availability of loans and credit, basic infrastructure, agricultural research and seed development. The PIC support was phased out in 1988 and the IRDP support in 1992. As mentioned earlier, the co-operative movement today receives its support through SCC.

#### 4.4 Multisector Support

The multisector support shown in Figure 4.2 consists of both import support and the

personnel and consultancy fund, while the import support alone is presented in Figure 4.3. This support started in 1972 with purchases of equipment and material important in high priority areas such as the agricultural sector, transports and manufacturing. In 1977-78 import support was officially included in the Sweden-Zambia Cooperation Agreement. The general goal of this aid was to foster diversification, restructuring and growth (De Vylder, 1988).

Balance of payments support has increased in importance (Figures 4.2 and 4.3), and the structural adjustment programme in the 1980's received substantial support from Sweden. Figure 4.3 shows that import support increased steadily from 1982 to 1987. The increase in 1985-86 was partly a result of the balance of payments situation in Zambia, and the high priority which the Zambian government gave to this kind of aid. The increase was also made possible due to disbursement problems in the sectoral programmes. Large savings had accumulated, both within the health and the educational sector support programmes, since disbursements fell short of commitments. The import support increase was thus regarded as an expedient way to speed up disbursements to Zambia (De Vylder, 1988).

Swedish support remained after the re-introduction of the 'command economy' in 1987, but Sweden only accepted a one year agreement for the calendar year 1988. The macro-economic situation was investigated and import support channelled through the FEMAC-system was evaluated. The result was a sharp decline in import support the following year, since the evaluation showed that Sweden's goals with import support were not being achieved. Import support increased again in the 1990's when Zambia once again decided to restructure her economy. This time Sweden conditioned her balance of payments support on Zambia's relation to the IFIs.

The Swedish policy concerning tied versus untied import support has been affected by the structural adjustment efforts of the Zambian government. During adjustment periods the support has usually been untied, while more support was tied when Zambia reverted to a command economy (see Table 4.3).



Table 4.3: Percentage of tied import support, 1973-1991

1973	1974	1975	1976	1977	1978	1979	1980	1981	1982
0	0	-	0	0	0	100	0	55	0
1983	1984	1985	1986	1987	1988	1989	1990	1991	
100	0	0	76	32	5	56	0	0	

Source: SIDA, EA-system

Since 1991, SIDA has assisted a number of different projects at Bank of Zambia. This support covers bank inspection, information systems, computer services and management reforms.

#### 4.5 Health Sector Support

Swedish support to the health sector started in 1971, with a number of district public health nurses from the Swedish Volunteer Service. In 1977, this project was changed to financial assistance for a training course for medical assistants. The project was cancelled in 1979.

SIDA increased its support in 1975 when a four-year technical assistance agreement was signed. In 1978 SIDA also agreed to finance construction of a school for advanced training for nurses. Construction was finished in 1982.

Swedish support to the health sector increased substantially when support was channelled into a sector programme, the Health Sector Support Programme (HSSP), in 1979. SIDA's overall objective was to develop the basic health care system in rural areas, with priority on neglected areas. The role of the HSSP was to make it easier for the government to implement its primary health care policy<sup>5</sup>. In 1981, the GRZ stated its

<sup>5</sup> Expressed in the Ten-Year National Health Plan 1972-1980, the UNIP manifesto National Policies for the Next Decade 1974-1984 and the Third National Development Plan 1979-1983.

objective as a restructuring of the health care system toward a decentralised, preventive primary health care system.

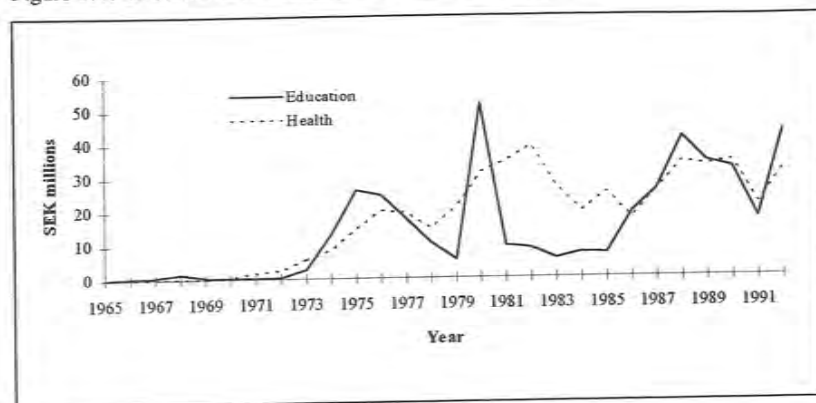
The HSSP consisted of a number of sub-programmes such as construction and upgrading of rural health centres, primary health care training, health planning and health information, transport, nutrition surveillance, essential drugs, and AIDS-related activities.

With the introduction of the HSSP, Sweden increased her commitment to the health sector, and disbursements reached a peak of around 40 million SEK in 1983 (Figure 4.4). The decline over the following 3-4 years was the result of various bottlenecks which resulted in a gap between commitments and disbursements. HSSP support increased again in 1987-88.

After the elections in 1991, the new Zambian government decided on a new health policy, and the Swedish support for 1994-1998 concentrates on health planning, sexual and reproductive health, and financial support for pharmaceutical purchases.



Figure 4.4: Swedish aid to education and health in 1992 prices



Source: SIDA, EA-system.

#### 4.6 Educational Sector Support

Swedish support to the educational sector in Zambia started soon after independence (Figure 4.1). Support increased dramatically in the mid-1970's when Sweden decided to provide assistance for a Technical and Vocational Teachers College (TVTC) in Luanshya, and for the Schools of Engineering and Mines at the University of Zambia.

The emphasis on higher education was drastically reduced in 1980, when Sweden changed from project to sector support. The Education Sector Support Programme (ESSP) put emphasis on primary education, teacher training, and special education for disabled people. The ESSP included the following six sub-programmes: 1) educational planning, 2) educational materials and equipment, 3) teacher training, 4) special education, 5) technical education and vocational training, and 6) support to the School of Engineering at the University of Zambia.

Swedish support through the ESSP should be used for improving educational standards, particularly as regards basic education and the educational needs of the rural poor.

Figure 4.4 shows that Swedish support reached its highest level in 1980 with the introduction of the ESSP. Disbursements were then rather low for a five-year period, partly as a result of various administrative bottlenecks. The introduction of the Self-Help Action Plan for Education (SHAPE) in 1986-87 resulted in an increase in educational support again.

#### 4.7 Summary

Sweden's support was from the very beginning emphasizing rural development in the fields of agriculture and health, with the objective of improving rural living standards. The support to education was initially geared towards higher education, but from the early 1980's the emphasis shifted towards primary education in rural areas. The assistance was further supplemented with technical assistance and three infrastructure projects in the 1970's, and import support in the 1980's.

The technical assistance and infrastructure support have largely been phased out. Programme support to agriculture, health and education has been of a long term nature and government policy changes have not really affected disbursements. These programmes have instead had problems of an administrative nature and actual disbursements have usually been much lower than planned. Disbursement problems that plagued the programme support were eased with the introduction of the (relatively) quick-disbursing import support programmes. This assistance has been made conditional on macro-economic policy reforms, although Swedish conditionality has been weaker than for many other countries.

During the 1990s there has been a shift in the structure of the Swedish programme. Support to agriculture has declined, while support to education and health as well as balance of payments support has increased in importance.

# Appendix 4A.

Table 4A.1. Country frame and total disbursements of Swedish aid to Zambia, 1965/66-1992/93, SEK thousands, current prices

Year	SIDA disbursements	of which: from country frame	of which: other disbursements	Disbursements from other organisations than SIDA	of which Ministry of Foreign Affairs	of which: other	Total Swedish disbursements
1965/1966	346	346	0	0	0	0	346
1966/1967	802	802	0	0	0	0	802
1967/1968	1079	1079	0	0	0	0	1079
1968/1969	1525	1525	0	0	0	0	1525
1969/1970	2324	2324	0	0	0	0	2324
1970/1971	3822	3822	0	0	0	0	3822
1971/1972	5198	5198	0	0	0	0	5198
1972/1973	8301	8301	0	0	0	0	8301
1973/1974	21191	21141	50	0	0	0	21191
1974/1975	32899	31514	1385	0	0	0	32899
1975/1976	52786	51670	1116	0	0	0	52786
1976/1977	62026	61426	600	0	0	0	62026
1977/1978	114640	112164	2476	0	0	0	114640
1978/1979	103580	90225	13355	0	0	0	103580
1979/1980	94692	66299	28393	0	0	0	94692
1980/1981	178574	158731	19843	0	0	0	178574
1981/1982	137916	131337	6579	0	0	0	137916
1982/1983	193562	190927	2635	0	0	0	193562
1983/1984	172403	170506	1897	0	0	0	172403
1984/1985	156534	150670	5864	0	0	0	156534
1985/1986	197582	194073	3509	47800	47800	0	245382
1986/1987	164572	158920	5652	33	0	33	164605
1987/1988	215827	211881	3946	0	0	0	215827
1988/1989	214480	204614	9866	492	0	492	214972
1989/1990	256495	236201	20294	400	0	400	256895
1990/1991	564311	362338	201973	384	0	384	564695
1991/1992	358384	248377	110007	2418	0	2418	360802
1992/1993	390151	233866	156285	8622	2500	6122	398773
Total	3706002	3110277	595725	60149	50300	9849	3766151

Source: SIDA, EA-system.

Table 4A.2. Country frame and total disbursements of Swedish aid to Zambia, 1965/66-1992/93, SEK thousands, 1992 prices

Year	SIDA disbursements	of which: from country frame	of which: other disbursements	Disbursements from other organisations than SIDA	of which Ministry of Foreign Affairs	of which: other	Total Swedish disbursements
1965/1966	2297	2297	0	0	0	0	2297
1966/1967	5093	5093	0	0	0	0	5093
1967/1968	6657	6657	0	0	0	0	6657
1968/1969	9196	9196	0	0	0	0	9196
1969/1970	13386	13386	0	0	0	0	13386
1970/1971	19989	19989	0	0	0	0	19989
1971/1972	25990	25990	0	0	0	0	25990
1972/1973	39264	39264	0	0	0	0	39264
1973/1974	92605	92386	219	0	0	0	92605
1974/1975	130609	125111	5498	0	0	0	130609
1975/1976	188974	184979	3995	0	0	0	188974
1976/1977	203445	201477	1968	0	0	0	203445
1977/1978	330163	323032	7131	0	0	0	330163
1978/1979	281738	245412	36326	0	0	0	281738
1979/1980	229155	160444	68711	0	0	0	229155
1980/1981	383934	341272	42662	0	0	0	383934
1981/1982	270315	257421	12895	0	0	0	270315
1982/1983	344540	339850	4690	0	0	0	344540
1983/1984	284465	281335	3130	0	0	0	284465
1984/1985	241062	232032	9031	0	0	0	241062
1985/1986	286494	281406	5088	69310	69310	0	355804
1986/1987	230401	222488	7913	46	0	46	230447
1987/1988	289208	283921	5288	0	0	0	289208
1988/1989	270245	257814	12431	620	0	620	270865
1989/1990	297534	273993	23541	464	0	464	297998
1990/1991	592527	380455	212072	403	0	403	592930
1991/1992	358384	248377	110007	2418	0	2418	360802
1992/1993	382348	229189	153159	8450	2450	6000	390798
Total	5810018	5084264	725755	81711	71760	9951	5891729

Source: SIDA, EA-system.



Table 4A.3. Swedish aid to Zambia by sector, 1965/66-1992/93

Year	Agriculture	Education	Health	Multi-sector	Infrastructure	Public adm	Food aid
1965/1966	100%	-	-	-	-	-	-
1966/1967	92%	8%	-	-	-	-	-
1967/1968	93%	7%	-	-	-	-	-
1968/1969	84%	16%	-	-	-	-	-
1969/1970	97%	3%	-	-	-	-	-
1970/1971	82%	1%	3%	-	-	14%	-
1971/1972	60%	1%	6%	4%	26%	6%	-
1972/1973	52%	1%	6%	-	39%	2%	-
1973/1974	33%	3%	6%	33%	22%	2%	-
1974/1975	50%	10%	7%	18%	13%	2%	-
1975/1976	25%	14%	8%	-	37%	1%	-
1976/1977	39%	12%	10%	16%	13%	2%	-
1977/1978	18%	5%	6%	26%	37%	2%	-
1978/1979	48%	4%	6%	11%	27%	-	-
1979/1980	23%	3%	13%	11%	48%	-	-
1980/1981	37%	15%	9%	17%	22%	-	-
1981/1982	62%	4%	13%	15%	4%	-	-
1982/1983	55%	3%	11%	13%	9%	7%	-
1983/1984	45%	2%	10%	17%	11%	14%	-
1984/1985	44%	3%	8%	20%	-	21%	-
1985/1986	38%	2%	9%	30%	-	20%	-
1986/1987	42%	9%	8%	41%	-	-	-
1987/1988	38%	9%	9%	44%	-	-	-
1988/1989	42%	16%	13%	24%	5%	-	-
1989/1990	41%	12%	12%	14%	20%	-	-
1990/1991	26%	8%	9%	53%	3%	-	-
1991/1992	28%	7%	9%	37%	-	-	20%
1992/1993	27%	19%	14%	33%	-	-	7%
Average	51%	7%	7%	17%	12%	3%	1%

Source: SIDA, EA-system.

Table 4A.4. Swedish aid to agriculture, education, health and for import support, 1965/66-1992/93, SEK thousands in current prices

Year	Agriculture	Education	Health	Import support
1965/1966	346	-	-	-
1966/1967	740	62	-	-
1967/1968	1003	76	-	-
1968/1969	1286	239	-	-
1969/1970	2259	65	-	-
1970/1971	3150	40	104	-
1971/1972	3137	43	332	-
1972/1973	4355	46	520	-
1973/1974	7047	625	1293	7065
1974/1975	15798	3253	2108	5695
1975/1976	13164	7288	4064	-
1976/1977	24249	7473	6126	9856
1977/1978	20508	6058	6746	29296
1978/1979	43514	3865	5444	8290
1979/1980	15128	2228	8643	6660
1980/1981	58546	23971	14486	22863
1981/1982	81203	4820	17494	13582
1982/1983	105382	4812	21902	9081
1983/1984	76594	3322	16245	24583
1984/1985	66744	4763	12696	24700
1985/1986	73312	4826	17300	49956
1986/1987	67214	13610	12356	58516
1987/1988	81067	19176	19096	89059
1988/1989	85749	32654	26843	45196
1989/1990	97805	29120	28249	19990
1990/1991	95982	30345	32366	353597
1991/1992	69335	17265	21352	143513
1992/1993	62983	43744	32419	115000
Average	1177600	263789	308184	1036498

Source: SIDA, EA-system.



Table 4A.5. Swedish aid to agriculture, education, health and for import support, 1965/66-1992/93, SEK thousands in 1992 prices.

Year	Agriculture	Education	Health	Import support
1965/1966	2297	-	-	-
1966/1967	4699	394	-	-
1967/1968	6189	469	-	-
1968/1969	7755	1441	-	-
1969/1970	13012	374	-	-
1970/1971	16475	209	54	-
1971/1972	15685	215	166	-
1972/1973	20599	218	246	-
1973/1974	30795	2731	565	30874
1974/1975	62718	12914	837	22609
1975/1976	47127	26091	1455	-
1976/1977	79537	24511	2009	32328
1977/1978	59063	17447	1943	84372
1978/1979	118358	10513	1481	22549
1979/1980	36610	5392	2092	16117
1980/1981	125874	51538	3114	49155
1981/1982	159158	9447	3429	26621
1982/1983	187580	8565	3899	16164
1983/1984	126380	5481	2680	40562
1984/1985	102786	7335	1955	38038
1985/1986	106302	6998	2509	72436
1986/1987	94100	19054	1730	81922
1987/1988	108630	25696	2559	119339
1988/1989	108044	41144	3382	56947
1989/1990	113454	33779	3277	23188
1990/1991	100781	31862	3398	371277
1991/1992	69335	17265	2135	143513
1992/1993	61723	42869	3177	112700
Total	1985065	403953	48092	1360713

Source: SIDA, EA-system.

## Part 3: DIRECT IMPACT OF SWEDISH AID

### 5. REVIEW OF MAJOR PROJECTS AND PROGRAMMES

#### 5.1 Introduction

In this chapter we discuss Swedish aid to Zambia on a sector and project level. We have not done any project evaluations of our own, which means that we base our analyses on existing evaluations and reports from various sources. We focus primarily on projects and programmes in agriculture, health, and education, but we also comment briefly on infrastructure, balance of payments, and management support. We start by putting the Swedish aid programme into context.

#### 5.2 An Overall Assessment: Policy and Decision-Making

In development plans and policy documents over the years, the Zambian government presented strategies for eradication of the negative aspects of the colonial legacy, and for introduction of a modern welfare state. Political ideology was based on President Kaunda's ideas on African socialism, called 'Humanism', which stipulated that the political system must be based on mass participation. Sweden, as well as many other donor countries, supported these strategies, but Zambia's track record on meeting the ambitious goals of its plans has been poor. The choice of a one-party state as the implementation instrument of the political philosophy of mass participation did not work, since a single party is hierarchical by its very nature, and will invest considerable powers in its leaders (Gertzel, et al., 1984). In retrospect, we also know that the more specific choice of strategies, for instance an industrial policy based on import substitution, could not produce the stated objectives.

During the first and second republics the government developed a political economic regime, based on state-ownership, taxation of agriculture, and a strong political constituency among the urban population. Incentives were created for urban workers and

the bureaucratic and parastatal elites to remain loyal to the regime. First, the Zambianisation process of the 1960's and early 1970's created new opportunities for the business class, and transferred wealth into the hands of indigenous industrialists. Second, urban standards of living were kept high through subsidies, price controls and currency overvaluation. Finally, urban employment was subsidised by copper. Inefficient parastatals could increase their employment, even in difficult times, through net lending via the government budget. Furthermore, the expansion of the social welfare sector and of the government and party bureaucracies created new employment opportunities. Thus, the welfare state was largely developed for a political constituency living in the urban areas with formal sector employment.

Sweden's assistance has had a clear emphasis toward rural development. Considering the colonial legacy, this was both understandable and appropriate. However, this assistance was never placed in a conducive policy framework. Sweden believed in plans and policy documents, instead of analyzing the "revealed preferences" of the government.

The conflict of interest between Zambian political economic regime, on the one hand, and the rural emphasis of Swedish assistance on the other, resulted in a number of implementation difficulties. Sweden demanded a large Zambian involvement in the aid programme in terms of manpower and finance, while the Zambian government had other priorities. Because of this conflict of interest, most programme and project initiation and preparation have been done by Sweden. Consequently, all three sector support programmes faced disbursement problems in the 1980's.

Sweden, even today, is finding it hard to incorporate Zambian policy-makers more directly into the planning process. However, the situation has recently improved with the new planning procedure for Swedish aid to agriculture. The Swedish Development Cooperation Office will also introduce this planning procedure for other sectors.

A broader dimension of the policy conflict also concerns the Zambian decision-making process. While Sweden's attempt to reach the grassroots demanded a decentralised

system, the one-party state implied an extremely centralised decision-making process. Already during the first republic, the dominance of the party, UNIP, and the popularity of the president resulted in a tendency towards 'presidentialism', where the president made decisions without involving the cabinet or the civil service. By the second republic centralisation of economic decision-making was complete. The president abandoned collective decision-making and merely relied on a small group of advisors. On this basis, economic policy was determined largely by historical, ideological, political and personal influences, rather than by systematic economic analysis (Andersson and Ndulo, 1992 and Gulhati, 1989). Economic management problems were further accentuated by what O'Neill et al. (1987) call the "shuffle-syndrome", with key personnel in ministries and parastatals being changed too frequently.

The problem is rather delicate, since sustainability of projects beyond external assistance depends on administrative commitment. If successful implementation demands that the centralised decision-making system be by-passed by donors, then the sustainability of projects is called into question. Attempts to by-pass the administration have also faced another problem: The centralised system results in poor manpower capacity at district level and below.

The manpower problem also has another dimension, a large outflow of professionals. The brain-drain problem in Zambia is as large as that in Ghana, Uganda and Ethiopia. This problem has severely affected implementation of the structural adjustment programme, and also more specific aid projects and programmes. Qualified counterparts are missing, and technical assistance personnel often become gap-fillers.

The 1991 constitutional arrangements have ushered in a new era in Zambia, with a new institutional framework of democratic government and independent media with recognition of professionalism and of private initiative, which will improve capacity for sustaining and internalising both the structural adjustment programme and other donor-supported activities. A democratic government implies elimination of presidentialism and of overly centralized decision-making. The cabinet and the ministries will have power



to manage their portfolios, while opposition is recognised. The creation of a professional civil service will help to create efficiency and accountability, and this will obviously have an impact on the nature and quality of economic decision-making (Andersson and Ndulo, 1992).

### 5.3 Agricultural Sector Support

The agricultural sector has been the largest recipient of Swedish aid, with almost 2 billion SEK in 1992 prices from 1965 to 1992 (see Table 4A:5 in Appendix 4A). The overall strategy of Sweden's support has been to improve the living standards of subsistence farmers in outlying provinces by improving their productivity. It is, of course, very difficult to assess such a broad objective. However, because assistance has been delivered as a broad agricultural sector support programme for a number of years, we can assess overall Zambian agricultural policy. This policy has failed in several ways. The production has not increased in line with the fast-growing population during command economy periods as between 1971-84 (see Table 5.1). Furthermore, agriculture has been dominated by a single food crop, namely maize<sup>1</sup> (see Table 5.2), and there is a huge import dependency on fertiliser. Producer prices were kept low, and marketing has been a continuous problem.

Sweden's emphasis on subsistence farmers' productivity was not supported by the Zambian government. Wood and Shula (1989) claim that Zambian plans and strategies confuse rural development with agricultural production. Kydd (1987, 1988) is of the same view, and points out that rural development has been of a "welfarist" nature. Public investments in rural development have been a kind of compensation to the people living there, instead of emphasising production. The potential of small scale farmers as producers has never been acknowledged, or perhaps not even understood, by Zambian policy-makers. Thus, the policy environment has not been conducive for Sweden's agricultural sector support.

<sup>1</sup> Maize production accounts for 70% of the total land area cultivated and almost 85% of crop production.

Table 5.1: Growth rates of the agricultural sector

Year	Annual growth rates
1971/74	1.6%
1975/84	1.2%
1985/88	12.4%
1989/91	-1.1%
1992/93	9.9%

Source: Andersson, 1990.

Table 5.2: Production of selected crops, 1988-1993 (in 1000 tonnes)

	1988-89	1989-90	1990-91	1991-92	1992-93
Maize	1,845	1,093	1,096	464	1,653
Sorghum	21	27	28	13	34
Millet	-	-	-	48	32
Beans	24	14	14	20	17
Tobacco	1	1	1	1	5
Ground nuts	30	25	28	7	27
Soya beans	21	27	28	7	27

Source: Olsson, 1993

A mission evaluation of the ASSP was made in 1983, but it failed to quantify the effect of the programme on rural development, since income distribution data was lacking. The mission believed, though, that the improvements in infrastructure, training, extension, co-operation and in the supply of inputs and credit must have had a beneficial impact on the target group, although no quantitative indicators are available either (Öståker, 1994). The mission claimed that the ASSP was well integrated in the Zambian administrative structure, and it recommended a continuation of the programme.

The stability of the support programme over time, as discussed in Chapter 4, is shown by the Swedish reaction to the reintroduction of the "command economy" in 1987. In the agreed minutes of the 1987 annual ASSP review, it was observed that the introduction of price controls would have a detrimental effect on agricultural



performance. The review also commented on "policy issues in agriculture and the role of ASSP", but failed to discuss the role of agriculture in the new policy environment. The ASSP continued as before.

Concern about the policy environment for agriculture has increased, however. In 1990, the Swedish University of Agricultural Sciences was given the task of implementing a "participatory planning process" in Zambia, and the 1992 annual review of ASSP included an analysis of the macroeconomic framework. Projects were discussed in relation to this analysis. Furthermore, Sweden today supports agricultural policy analysis at the Ministry of Agriculture.

Besides, the overall macroeconomic environment that was not conducive to agriculture, there was also the conflict of interest between Sweden and the Zambian government as discussed above, which implied implementation problems. For instance, two recommendations in the 1983 ASSP evaluation directly concern the relation between Sweden and Zambia. First, the mission recommended that more recurrent funds should be directed towards institutions serving agriculture. Second, it thought that efforts should be made to alleviate the shortage of trained and experienced personnel for accounting, financial control and auditing. Thus, the mission felt that agriculture had not been given by the Zambian government the high priority it should have had.

Government expenditures on agriculture during the 1980's are shown in Table 5.3. The agricultural sector's share of total expenditures remained in the range 11-16% from 1980-1987. The sudden decline thereafter is technical, due to reclassification of subsidies in the budget. Capital expenditures fluctuated considerably during the 1980's, and there seems to be a positive correlation between donor-supported structural adjustment programmes and government emphasis on agriculture. Finally, the table shows that personnel costs, primarily wages and salaries, have increased relative to total departmental recurrent costs, suggesting that other costs, such as for servicing and materials, suffered a relative decline. This, of course, affects the

government's ability to deliver essential services to farmers.

Table 5.3: Government resource allocation to agriculture, 1980's

Year	AE/TE	AC/TC	AR/TR	AC Index	Pc/Tc
1980	23	21	23	100	0.82
1981	13	17	12	82	0.83
1982	16	16	17	99	0.71
1983	11	21	10	103	0.70
1984	14	16	13	68	4.71
1985	11	6	12	66	3.60
1986	15	16	14	152	1.89
1987	15	26	13	160	0.84
1988	8	23	5	139	2.28
1989	4	14	1	85	1.92
1990	4	12	2	-	1.50

Note: From 1988, subsidies are not included in agricultural recurrent expenditures nor in total government agricultural expenditure. The shares for these expenditures are thus much lower since 1988.

AE/TE = Total government agricultural expenditures in relation to total government expenditures.

AC/TC = Agricultural capital expenditures in relation to total capital expenditure.

AR/TR = Agricultural recurrent expenditures in relation to total recurrent expenditures.

AC index = Index of agricultural capital expenditures.

Pc/Tc = Personnel costs in relation to total departmental recurrent costs.

Sources: IMF, 'Government Finance Statistics Yearbook', various.  
Republic of Zambia, 'Budget Address', 1989.  
Katongo, 1988.  
Andersson, 1990.

In a background paper to the 1990 ASSP assessment it was noted that from 1983 to 1990, no less than 204 consultancy studies had been requested. Almost a third concerned the Integrated Rural Development Programme (IRDP). The Development of Cooperatives and the Training and Extension projects were also studied frequently. The high number of studies indicates that the ASSP faced a number of problems in the 1980's. Concentration of efforts on fewer projects would have reduced problems and the resulting demand for studies. Greater donor co-ordination, with improved exchange of experiences, would also have facilitated implementation of projects.

Table 5.4: Support to agriculture, 1987-1992, million SEK, current prices

	1987	1988	1989	1990	1991	1993	Total	% of total
Planning	4.8	3.4	3.5	3.4	4.5	5.1	24.9	4
IRDP	17.9	18.4	22.6	24.9	18.4	13.8	115.8	20
Training	4.0	2.8	1.8	1.5	2.0	2.0	14.0	2
Extension	5.2	8.4	8.9	7.9	5.3	4.3	40.1	7
Cooperatives	25.6	24.6	27.6	26.0	26.3	22.3	152.9	26
Research & seeds	23.3	24.9	27.9	29.6	29.3	29.6	164.5	28
Survey and lands	7.4	6.2	7.0	7.9	7.7	8.7	44.8	8
Seed security	-	-	-	3.7	5.0	5.2	13.9	2
PIC	3.2	1.0	1.0	-	-	-	5.2	1
Total	91.3	89.6	100.3	105.0	98.5	91.4	576.1	

Source: Olsson, 1993.

Over the years since independence, the most important programme in agriculture has been cooperative development. The first Swedish assistance to Zambia in 1965 concerned cooperatives, and from 1987-1992, 26% of the ASSP went to cooperative development (see Table 5.4). Support for cooperatives today is a movement-to-movement programme, with around 20 million SEK contributed annually. The Cooperative Development Programme was evaluated in 1990, and the mission found that a functioning support structure had been created at the national level (Öståker, 1994). The fundamental weaknesses at the primary level had not been addressed, however. These were the low level of member participation and control, and poor financial conditions.

The Cooperative Development Programme has suffered both from centralized decision-making and from the conflict of interest discussed in section 5.2. First, the Zambian government has not put rural development very high on its list of priorities. Second, the cooperative idea was pushed on the small farmer community by the government (or donors), and it never became a grassroots movement. The Zambian Cooperative Federation became as top heavy as the rest of the Zambian economy, and the Zambian government also used ZCF as a kind of parastatal. The latter problem has

been acknowledged by SIDA. In a decision by SIDA in 1991<sup>2</sup> continued support is made conditional on the independence of ZCF from the government. The new government affirmed ZCF's independence in 1991, and support continued.

The Integrated Rural Development Programme (IRDP) was initiated in the early 1970's as the Intensive Development Zone Programme. This programme was not successful, and in 1978 it was changed into an IRDP, using an integrated approach with emphasis on the basic needs of least developed areas. The programme has received a large share of the ASSP. Table 5.4 shows that 20% went to IRDP during 1987-1992. But the programme has still not done well. Lack of a basic strategy for rural development, and inadequate local resources (personnel), made IRDP very expensive in relation to its contribution (Olsson, 1993).

The Zambian Agriculture Research and Seed Programme which started in 1981, has been most successful. Swedish support has consisted of technical assistance and funds channelled through Svalöf AB, a Swedish seed company. This was the first time that Swedish development aid to Zambia had been channelled through commercial companies<sup>3</sup> in both Sweden and Zambia (Öståker, 1994).

The programme was evaluated in 1986, and the overall assessment was positive. There was continuing concern about the overall goal of the programme, increased agricultural production. Although, the programme improved seeds, accomplishing this objective does not guarantee that the main goal will be achieved. The programme received a second positive evaluation in 1993.

Today, Zambia is self-sufficient in seeds. The relative success of the programme has led to a further emphasis on research and seeds, and as much as 75% of planned

<sup>2</sup> Insatspromemoria, Naturbruksbyrån, 1991-10-04.

<sup>3</sup> The Swedish government owned 50% of Svalöf, while 40% of Zambseed was owned by the Zambian government.



agricultural project disbursements are allocated to the programme in the budget for January-June, 1994. The remaining projects concern planning, training and extension.

Support to agriculture has changed during the 1990's. Disbursements have declined (see Chapter 4). The ASSP was abandoned in 1990, the IRDP has been phased out, and cooperative development is now movement-to-movement support. Future Swedish support to agriculture will concentrate on five projects (per the budget for January-June, 1994), concerning food crop seed, soil conservation, land delivery, supplementary institutional support, and agricultural production, processing and marketing in outlying areas. Donor co-operation has also improved, since the World Bank initiated and co-ordinates the Agricultural Sector Investment Programme (ASIP).

Overall, Sweden's support to Zambian agriculture has not been successful. The policy framework and macro-economic environment were not properly assessed. Continuous implementation problems resulted in a large number of consultancy studies. The ASSP evaluations were generally positive, but the results were limited. To sum up, a concentration on the more successful projects should have occurred much earlier than in the 1990's. There might be some "welfare effects" of the Swedish aid, but they have definitely not been achieved in a cost-efficient way.

#### 5.4 Health Sector Support

Over the years, the health sector has received around 480 million SEK in 1992 prices. Sweden was an important donor to the health sector, contributing around 40% of the health sector capital budget. The first Health Sector Support Programme (HSSP) evaluation (Agrell, et al., 1983) concluded that the programme was on the right track, although some sub-programmes faced problems. A later evaluation (Dahlgren, et al., 1989) arrived at a similar conclusion. HSSP was supporting government implementation of its primary health care policy, although the mission had problems quantifying specific objectives. The evaluation team recommended continued support,

with some changes in sub-programmes. HSSP was extended for three years and later prolonged another fifteen months.

Both evaluations blame problems experienced on the overall Zambian economic situation. However, part of the blame should also have been placed on the priorities of the government. The 1989 report notes the urban bias in health care, but it is merely exploited as an excuse for a continuation of the rural emphasis of HSSP. The rural emphasis of the HSSP is still correct from the viewpoint of Swedish development objectives, but expectations of government co-operation could have been more realistic.

The economic situation in Zambia has of course affected all government spending. Total government expenditure in constant prices declined continuously during the 1980's. Recurrent expenditure in 1987 was only 82% of 1980 expenditure. Given an annual population increase of 3.6%, expenditure per capita in 1987 was only 65% of 1980. Capital outlays declined even more. In 1987, gross fixed capital formation was less than half of 1980.

Government recurrent expenditures on health have also declined since 1982. In 1987, per capita expenditure was 40% below the 1980 level in real terms. Furthermore, the expenditure structure has been criticised for favouring tertiary services at the expense of primary services (Clark and Keen, 1988). The regional distribution of health services is very skewed. Per capita spending is 3.5 times higher in Lusaka than in remote rural areas, such as Northern Province, and the capital has a physician ratio which is seven times higher (UNICEF/Republic of Zambia, 1986).

A number of different studies have reported that a direct effect of the increasing cost of living, has been a substantial increase in malnutrition. Children have been the most vulnerable. For those under five years of age, both the number of admissions to hospitals and the mortality rate have increased. Between 1981 and 1986, admissions due to protein/energy malnutrition (PEM) increased by almost 80%. The mortality rate

went up from 14.7% to 19.0%. Other figures show that malnutrition, as the cause of all child deaths in hospitals, doubled from 13.3% in 1976 to 25.6% in 1984. UNICEF estimates that 43% of child deaths (0-5 years) in 1983 were attributable to PEM (UNICEF/Republic of Zambia, 1986). Figures for 1991 show that malnutrition had then increased even further (see Chapter 7).

Table 5.5: Government expenditure on the health sectors, 1980-1987, millions Kwacha. 1980 prices

Year	1980	1981	1982	1983	1984	1985	1986	1987
Government health expenditure	65.4	67.9	93.0	73.2	58.8	65.0	54.5	52.3

Note: Expenditure in current prices has been deflated by the official GDP-deflator.

Source: Republic of Zambia, Central Statistical Office, "National Accounts Statistics Bulletin No.2", Lusaka, January 1988.

The 1989 report pinpointed a major problem of sustainability in most sub-programmes within HSSP. A major component in the programmes is the intended transfer of knowledge, and thus the programme's ability to continue later without external support. A common problem was the lack of Zambian counterparts in the Zambian administration. The mission concluded that some SIDA-supported technical assistance personnel were gap fillers, and no transfer of knowledge could take place.

Implementation problems also resulted in a situation where despite government budget cutbacks available aid funds were not being fully utilised (Annual Review of HSSP, GRZ/SIDA, 1988). Sweden then increased support for recurrent costs within HSSP, and as much as 60% of Swedish support has since gone into basic supplies, such as drugs, and maintenance of basic health functions such as transports.

Table 5.6: HSSP budget 1986-1989, millions SEK

	1986 SEK	1986 %	1987 SEK	1987 %	1988 SEK	1988 %	1989 SEK	1989 %
Health planning	3.3	13	3.6	12	4.8	15	4.7	13
PHC training	2.7	6	1.6	6	1.6	5	2.4	7
Essential drugs	7.6	29	11.0	38	9.3	30	12.5	34
Nutrition surveillance	1.8	6	2.1	7	1.9	6	3.2	9
Rural health centres	4.6	16	3.6	12	2.9	9	3.6	10
Transport	6.0	23	6.9	24	8.5	27	8.0	22
AIDS	-	-	-	-	2.3	7	2.5	7
	26.0		28.8		31.3		36.9	

Source: Dahlgren, et al., 1989.

The 1989 report also claimed that the overall Primary Health Care Policy of the Zambian government had been ill-conceived and not properly followed up by competent personnel, in short a failure. The mission claimed that overall implementation of rural health care policy lacked sufficient support from key groups in the health establishment. Decentralisation lagged behind all plans, and the ministry's competence and capacity at provincial and district levels were limited.

The 1989 report also pinpointed another problem. There is no overall long-term strategic planning behind the inclusion of sub-programmes in HSSP, and thus they are not related to each other, they do not support each other. The mission does not see any disadvantage with this. We believe, however, that the implementation problems discussed above indicate that there are too many sub-programmes and that concentration would be desirable.

The Zambian government developed a new health policy in 1992, with more emphasis on primary health care. The most important components are: (1) decentralisation of health services to district level, (2) encouragement to the private sector to participate in the provision of health services, (3) introduction of fees, and (4) introduction of health insurance. Donor coordination has been improved and the World Bank is assisting the government with streamlining of donor assistance. The number of



programmes and activities will be reduced.

The Swedish health programme has not changed much over the years, although HIV/AIDS support is relatively new, since 1988. Table 5.6 shows that drugs, transport and planning programmes have been most important. The drugs programme finances essential drugs at 600 primary health care centres<sup>4</sup>. The distribution of drugs was a problem earlier, but the situation has improved as a result of donor co-ordination. The new Swedish policy demanding audited sector support reports caused disbursements to be unusually low in 1992. The health programme was on course, however, and problems of auditing were soon resolved.

Sweden's health sector support has faced various problems. Although evaluations noted the revealed preferences of the government, support was not changed. Concentration of efforts could have been effected earlier. Some implementation problems were solved by increasing the funding of recurrent costs. Sweden has been uneasy about this solution, but it seems acceptable in the current situation.

Sweden has been the largest donor to the health sector in Zambia, but here it has not had a very active role in the donor community.<sup>5</sup> Project initiation, preparation, implementation and coordination should be made by the recipient country, but when it fails to do so the donors should intervene. In the 1990's, Sweden became more interventionistic and assisted the Zambian government with the formulation of a new health policy. Sweden has also played a leading role in fighting HIV/AIDS, although the work is coordinated by WHO.

<sup>4</sup> There are about 1,000 centres in Zambia.

<sup>5</sup> Holland has informally played the role of donor coordinator of health sector support. Sweden has this function in education.

## 5.5 Education Sector Support

Sweden supported Zambian education with around 404 million SEK from 1965 to 1992 in 1991 prices. In the 1970's, Sweden supported a Technical and Vocational Teachers College (TVTC) in Luanshya. The project was first planned for the period 1973-1978, but it was extended to 1982. Total project cost came to around 35 million SEK in current prices. The project was evaluated in 1977 and 1983. Both mission reports claim that the project as a whole was successful, in spite of problems encountered in the building programme. Despite an initial enrolment problem, according to the 1977 evaluation, around 900 students actually graduated between 1975 and 1982. The 1983 mission failed to get information on the need for technical and vocational teachers, and thus had difficulties in evaluating the role of TVTC in the Zambian educational system. The 1977 mission, however, noted that the college appeared to suit Zambia's needs well.

In the 1970's, Sweden also supported the establishment of a School of Mines, with 20 million SEK. The project was then further supported with institutional co-operation between the University of Zambia (UNZA) and the University of Luleå, but this contract was cancelled after an evaluation in 1982. Additional institutional co-operation was initiated in 1979, between the UNZA School of Engineering and the Royal Institute of Technology (KTH) in Stockholm, and then, in 1982, between the UNZA Land Surveying Department and the National Land Survey of Sweden. After an evaluation in 1987, KTH took over the land surveying programme as well. These two training programmes cost 3-6 million per year in the 1980's, or approximately 10-14% of ESSP disbursements. Support to the School of Engineering was evaluated once again in 1993, and the project was considered successful. Institutional co-operation for another six years was recommended. The support is suggested to be phased out in favour of more general support to UNZA.

Projects discussed so far have concerned higher education. The introduction of ESSP in 1980 shifted emphasis to improving the quality of primary education. Sweden and

the other Nordic countries made up the most important donor group in primary education. Sweden was the only donor in special education for the disabled.

The effects of the economic crisis on the educational sector were pinpointed in Johnston, et al. (1987). The Zambian educational goals of increased quantity improved quality came into conflict. Access to education had increased, but resources had not. Due to rapid rural-urban migration, enrolment problems were largest in the main urban centres. While the national participation rate was 92%, it was only 78% in Lusaka, Ndola and Kitwe, with overcrowded classes and double and triple sessions. The continuation rate from primary to secondary school was only 23% in 1983/84.

The economic crisis caused a drastic reduction in the budgetary allocation for education. In 1987, the government's recurrent expenditure on education was only 40% of 1980 (Table 5.8). Per capita expenditure decreased from K21 to K7 in the same period. Investments also declined to around K20 million in 1985, financed up to 75% by development aid (Kelly, 1987). Today, government expenditures are limited to salaries for the teachers. Spending on educational materials ceased in 1986 (Johnston, et al., 1987). Costs for school supplies, including books and furniture, have been transferred to parents.

Table 5.7 Education sector support 1984-1989, SEK millions, current prices

	1984		1985		1986		1987		1988		1989	
	SEK	%	SEK	%	SEK	%	SEK	%	SEK	%	SEK	%
Educ. materials	14,2	54	23,0	67	19,2	56	11,7	44	20,8	51	17,3	38
Planning	1,5	6	2,6	8	3,1	9	3,0	11	3,4	8	5,4	12
Teacher training	0,7	2	0,1	0	2,0	6	2,5	9	4,1	10	5,4	12
DTEVT	0,7	3	1,9	6	2,6	8	2,6	10	3,6	9	6,5	14
Special education	3,5	13	3,3	10	4,2	12	3,1	12	3,2	8	4,5	10
UNZA	3,5	13	3,4	10	3,1	9	3,6	14	5,7	14	6,7	14
unalloc.	2,1	8	-	-	0,2	1	-	-	-	-	-	-
Total allocation	26,2		34,3		34,3		26,5		40,7		45,8	
Total disburs.	30,1		28,2		12,8		14,0		32,1		n/a	
% of allocation disbursed	115		82		37		53		79		n/a	

Note: Data categories do not always correspond to the information found in the EA-system at SIDA, and so we have not updated the table.

Source: Fägerlind, et al., 1989.



Table 5.8: Government expenditure on education, 1980-1987, millions Kwacha 1980 prices

Year	1980	1981	1982	1983	1984	1985	1986	1987
Education	120.4	77.6	94.7	88.9	69.3	77.2	67.2	48.6

Note: Expenditure in current prices has been deflated by the official GDP-deflator.

Source: Republic of Zambia, Central Statistical Office, "National Accounts Statistics Bulletin No.2", Lusaka, January 1988.

A comprehensive mission evaluation of ESSP conducted in 1989 (Fägerlind, et al.), again highlighted the economic crisis, but at the same time it noted that there was considerable under-utilisation of resources in the educational system, particularly regarding primary school teaching staff, and the production and distribution of educational materials and school furniture. One reason, of course, was that the economic decline meant that Zambian counterpart-funding was difficult to raise. The mission also noted that the inefficient production and distribution of educational materials did not seem to attract much government attention.

The 1989 evaluation also studied ESSP sub-programmes. The relative importance of the sub-programmes is shown in Table 5.7. Recently, the educational materials and equipment programme was relatively the most important in ESSP. Its share varied from 38-67% of disbursements during 1984-1989. But it had severe difficulties. With textbooks there were distribution problems. Production of exercise books ran out of paper, while production of teacher's handbooks had other production difficulties. School desk production had problems, but local production improved the situation.

The teacher training sub-programme aims for qualitative improvement in primary education by supporting primary teachers' training. Initially the programme was intended to support resource centres and production units, but neither of these efforts were successfully implemented. In 1987, these were replaced by the Self-Help Action Plan for Education (SHAPE), which aimed to encourage production projects at the schools. The programme is based on the philosophy of "education with production",

and it aims toward the integration of theory and practice, greater collaboration of school and community, and the utilisation of production processes both for the materials produced and for educational benefits (Öståker, 1994). The allocation to the programme increased from around 2 million SEK in 1985 to 5 million SEK in 1989, representing 12% of disbursement. The first phase of the project was positively evaluated. SHAPE was evaluated again in 1993, and the evaluation was again positive.

Other sub-programmes included support to special education, support to the planning unit at the Ministry of General Education, and staff development at the Department of Technical and Vocational Training at the Ministry of Higher Education.

The 1989 evaluation suggested that the overall profile of the programmes should be maintained, based on the positive finding of previous and current evaluations, despite the low utilisation of funds. The mission also recommended that feasibility studies should be undertaken for three new projects, namely, for women in development, literacy and post-literacy, and distance education, but the recommendations never resulted in new projects. Instead, later documents recommended concentration of ESSP efforts. Support to special education and staff development at DTEVT have been phased out.

Swedish support to primary education has faced a number of implementation problems. Education materials are produced by a state-owned company. Productivity could have been increased if the private sector had been involved, but this was not attempted. Resources should have been concentrated on the more successful projects. The ESSP sub-programmes also present different solutions. First, funding of recurrent costs has increased. Second, schooldesk production increased when it was decentralized. Third, the central administrative structure is by-passed by SHAPE.

## 5.6 Infrastructure and Balance of Payments Support

Sweden supported three infrastructure projects in the 1970's as noted in Chapter 4.

The telecommunications<sup>6</sup> and water power<sup>7</sup> projects have not yet been evaluated, while the railway wagon project was evaluated twice in the 1980s (SIDA, 1984 and Brandt and Christensson, 1984). The project included supply of railway wagons, spare parts, machinery and equipment, plus training and consultancy services, within the framework of Swedish import support. Aid was tied to purchases from Sweden. Project cost was estimated at 126 million SEK in current prices, and it lasted from 1975-1983. The evaluations show, that although the project was well done, it was still not efficient. By tying import support to purchases in Sweden, costs became unnecessarily high.

Import support has usually not been tied when structural adjustment programs have been supported (see Table 4.2). During the "command economy" period in 1988 and 1989, Sweden tied around 20 per cent of import support to purchases from Sweden or the SADCC countries. As a result, the state-owned company Contract Haulage got spare parts for their large fleet of Volvo and Scania trucks, and fertiliser was imported from the Swedish company Supra.

The ongoing structural adjustment programme has received considerable amounts of balance of payments support (see Figure 4.3). Part of it has been channelled through the OGL system, but Sweden has also been active in debt buy back operations. Since 1991, 150 million SEK has been used to pay Zambia's debt service of non-concessional World Bank loans, i.e. the fifth dimension. Sweden also supported Zambia's purchase of its commercial debt in 1993 with 60 SEK million through the so called sixth dimension.

Balance of payments support in the mid-1980s was already linked to the performance of the structural adjustment programme. Swedish conditionality<sup>8</sup> has gradually become tighter, and in the latest agreements between Sweden and Zambia, balance of payments

<sup>6</sup> The project cost is estimated at 57 million SEK in current prices, and it includes planning, technical assistance, training and purchase of telephone stations.

<sup>7</sup> The project consisted of technical assistance until rehabilitation started in 1988. The project cost within the country frame is estimated at 100 million SEK, while another 60 million was disbursed via SADCC in 1991/92 and 1992/1993. Furthermore, the project received an additional 95 million SEK as balance of payments support in 1991.

<sup>8</sup> White (1994) provide a good presentation of the evolution of Swedish policy conditionality.

support has been based on the condition that the programme continues. White (1994) consider Sweden to be a strong supporter of the reform process, together with IDA, UK, US and the Netherlands. Furthermore, Sweden encouraged a policy dialogue between the IFIs and Zambia in 1987/88. Sweden has also acted as a mediator at consultative group meeting during the 1990's. In spite of stricter conditionality, Sweden has only made one political reservation. Like many other donors, Sweden withheld disbursements when a state of emergency was declared early 1993.

The macroeconomic issues are discussed further in part 4 of this report.

## 5.7 Management Support

The personnel and consultancy (PC) fund has increasingly been used to improve institutional capacity in Zambia. Emphasis has been placed on macroeconomic analysis and improved implementation of the structural adjustment programme. In 1988, Sweden co-financed a study in macro-economic management concerning exchange rate policy and external debt management (Allsopp, et al., 1989). This report, together with frequent contacts between the authors and leading Zambian officials, played an important role in the re-introduction of an IFI supported structural adjustment programme in the 1990s.

Sweden has also co-financed successful projects at the Ministry of Finance and the Bank of Zambia. A macroeconomic advisory team at the Ministry of Finance has played an important role in the implementation of the structural adjustment programme. Bank of Zambia assistance concerns bank supervision, information system and computer services, and reform management.

## 5.8 Summary

The Swedish aid package has emphasised rural development, while the Zambian government has had an urban focus. Thus, there has been a conflict of interest between the Zambian government, on one hand, and Sweden and the other donors on the other hand, where the Zambian government accepted, but in practice largely ignored, donor



countries' priorities. Project initiation was largely done by donors, and implementation problems occurred when donors demanded a larger degree of Zambian involvement. For instance, in spite of the budgetary difficulties in the 1980s, all three sector support programmes faced considerable disbursement problems. Sweden then started to finance recurrent costs, and in 1989 around 50% of sector support went to this purpose.

Sweden has provided sector support to agriculture, health and education. Experiences from many African countries show that integrated agricultural development schemes are very difficult to manage, and in Zambia Sweden's support to IRDP and IDZ essentially failed. It was very difficult to support the farmers when the macroeconomic framework was not supportive. Sweden has finally, during the 1990's, phased out projects and decreased disbursements to agriculture.

The rural emphasis of support to health and education also faced problems due to the above mentioned syndromes. In spite of large implementation problems, the sector support programmes changed only little during the 1980s. Since all three programmes consisted of a mix of many sub-programmes, usually without connections to other sub-programmes, a concentration and focusing should have been effected.

Still, Sweden has supported some rather successful sub-programmes, namely, the seed programme in ASSP, the drugs programme in HSSP, the institutional co-operation between UNZA and KTH, and SHAPE within ESSP. The seed programme includes two commercial companies covering all links in the chain. The drugs programme is successful because of Sweden's coverage of recurrent costs. In SHAPE the government has to a large extent been by-passed, but the project has now entered a phase in which it aims at incorporation in the government policy framework to secure sustainability. The UNZA/KTH institutional cooperation project concerns has limited interference from the governments of Zambia and Sweden.

The 1990's have seen some important changes in the Swedish aid programme. The main change is emphasis on balance of payments support. This supports the macroeconomic reform programme, and will be further discussed in Part 4 of the report. The importance

of project aid has declined. Second, there has been a concentration of efforts on the more successful projects, but there is still scope for further concentration of efforts. Third, Sweden has introduced a tougher policy concerning disbursements, where audited annual reports are demanded before new payments are made. Initially, projects failed to produce reports and, for instance, in 1992 no disbursements to education and health projects were made. The Swedish stance is becoming more and more accepted. Audited reports are presented, and Sweden's control has improved. Also the initiation and planning procedures of projects have gotten better.

Swedish aid may be divided according to its four main macro-economic functions: 1) Administrative costs, 2) technical assistance, 3) resource transfer, 4) debt relief. Administrative costs include the cost of SIDA personnel as salaries, education, travel costs, etc. and other administrative costs. Costs relating to the Stockholm headquarter and the Lusaka development cooperation office are not included. The latter is though approximately 8 million SEK per annum. Technical assistance includes foreign experts working on contract, while resource transfer includes transfers of money, imports of goods, local costs and credits. During the recent period, balance of payments support was used to pay part of Zambia's debt to the World Bank. Since these disbursements were done outside the 'country frame', they are excluded from the presentation in table 6.1. Data has been obtained from SIDA's EA-system, which has been operating since 1989. Thus time series are limited to the past four fiscal years. Table 6.1 shows that, at an aggregated level, administrative costs have declined over the time period. Technical assistance also shows a possible declining trend, despite an upward jump in 1991/92.

The share of administrative costs and technical assistance in resource transfer first declined for one year, increasing again for the other two years in the time period. In 1992/93, around one quarter of the aid disbursements went to technical assistance and administrative costs.

Table 6.2 shows the information above disaggregated to a sectoral level. The shares of administrative costs and technical assistance vary considerably between sectors. Public administration is mainly technical assistance, and thus a high percentage is to be expected while import support is pure resource transfer. The large increase in import support in 1990/91 is the main reason for the sudden large decline in the share of administrative costs and technical assistance shown in Table 6.1. Administrative costs have declined in all receiving sectors. Resource transfer has been rather stable in education and health, while it has declined in agriculture. Technical assistance in agriculture has been stable while administrative costs and resource transfer have declined.

Table 6.1: Macro-economic functions at an aggregate level, SEK million, current prices

	1989/90	1990/91	1991/92	1992/93
1. Administrative costs	20	15	10	10
2. Technical assistance	53	51	81	46
3. Resource transfer	181	297	156	178
Relation in %, 1 and 2 in 3	40	22	59	31

Source: SIDA, EA-system.

Looking at sector distribution we find, as one would expect, that in financial transfers such as import support, essentially 100% of the total disbursement is in fact a resource transfer to the recipient. At the other extreme, we have aid categories containing mostly technical assistance. In aid aimed primarily, for example, at public administration, the resource transfer is as low as 13%. These figures, taken by themselves, unfortunately tell us very little about what would be an appropriate cost structure for different types of aid. Even within the categories in the table, one would expect percentages to vary a lot across countries, according to the specific character of the activities undertaken. It is, of course, far from self-evident that projects are "better" if there is less administration or less technical assistance. Therefore, to go beyond these simple ratios and say anything sensible about aid effectiveness, one must do evaluations of specific projects and programmes.



Table 6.2: Macroeconomic function at the sectoral level, SEK millions, current prices

Sector		1989/90	1990/91	1991/92	1992/93
Agriculture	Administrative costs	12	10	6	6
	Technical assistance	20	21	20	22
	Resource transfer	66	65	42	34
	Relation in % (1+2 in 3)	48	48	62	82
Education	Adm. costs	3	1	1	1
	Techn. assist.	1	3	2	16
	Res. transf.	25	27	14	26
	Relation in % (1+2 in 3)	16	15	21	65
Health	Adm. costs	5	4	2	2
	Techn. assist.	1	0	1	0
	Res. transf.	23	28	18	30
	Relation in % (1+2 in 3)	26	14	17	7
Import support	Adm. costs	0	0	0	0
	Techn. assist.	0	0	0	0
	Res. transf.	20	174	77	67
	Relation in % (1+2 in 3)	-	-	-	-
Public adm	Adm. costs	0	1	0	0
	Techn. assist.	13	13	9	7
	Res. transf.	0	4	4	3
	Relation in % (1+2 in 3)	-	350	225	233
Infrastruc.	Adm. costs	0	0	0	0
	Techn. assist.	18	14	0	0
	Res. transf.	48	0	-	-
	Relation in % (1+2 in 3)	38	-	-	-

Source: SIDA, EA-system.

## Part 4: THE MACROECONOMIC IMPACT OF AID IN ZAMBIA

### 7. A MACROECONOMIC OVERVIEW OF THE ZAMBIAN ECONOMY

#### 7.1 Introduction

Aid has complex effects on the macroeconomy and political economy of recipient countries. Independent of the policy environment, the size of the aid flow has had implications for the effectiveness of aid and suggests that of concern to the donors should be the gains from aid on the margin relative to gains from other uses of the funds by the donor (such as addressing domestic fiscal problems or re-directing aid to other recipients). However a prior issue is whether the way in which aid is disbursed has consequences for its effectiveness, regardless of the size of the programme, and whether in the limit, the failure to address the policy environment may render an economy worse-off as a result of aid inflows. These concerns are especially true for Zambia where aid flows and aid-dependency have grown markedly since Independence, accompanied by a radical shift in the balance of power in the aid relationship between the donor community and the government. Understanding the role of aid in Zambia therefore requires us to go beyond an analysis of the movement in the principal macroeconomic aggregates relative to aid flows, and to consider some features of the relationship between aid and the policy process itself. This analysis, however, does not readily lend itself to the construction of detailed counterfactuals since the entire political economy of a country such as Zambia is itself determined by the aid flow. The role of aid has become so important that any counterfactual which attempted to eliminate (or reduce) aid and hold fixed all other aspects of the economic structure and policy configuration would be meaningless. Moreover, the role of aid is dynamic in that the presence or absence of aid will have profound effects on the structure of the capital stock (human and physical) over time and therefore on the effectiveness of future aid flows.

Zambia's transition from being one of the richest countries in Africa to one of the poorest took less than one generation. On the eve of the multi-party elections in October 1991

real per capita incomes had more than halved since 1970, gross national savings represented only 6% of national income, as opposed to 18% in 1970, while gross investment had fallen to less than 10% of national income, down from close to 40% in 1970. During the same period annual aid flows to Zambia rose from US\$13 million in 1970 to US\$481 million in 1990.<sup>1</sup> Measured in terms of import values (which reflects the depreciation of the US dollar relative to the cost of Zambia's imports) this was still an eight-fold increase over two decades.<sup>2</sup> During the 1970's aid was predominantly in the form of concessional loans which, combined with high levels of non-concessional borrowing, transformed Zambia into one of the world's most indebted economies. Total long-term debt rose from \$690 million in 1971 to \$7.26 billion in 1991 (equivalent to 262% of Gross National Product), representing an increase in per capita indebtedness of 463%, from \$160 per capita to \$900 per capita, despite an almost doubling of population over the same period. Only Somalia, Mozambique and Tanzania have a higher per capita external debt burden.

The decline in the country's fortunes since Independence has not, however, been uniform nor has it been entirely due to either external circumstances or inappropriate domestic policy responses. The tragedy of Zambia was that an extremely severe negative shock to its primary source of wealth, the copper industry, was exacerbated by bad management. *Ex post*, the government can be seen to have consistently implemented the wrong response to external shocks: the temporary positive copper price shocks of the late 1960's were incorrectly treated as being permanent (and unexpected) so that the government's response was to revise permanent income upwards and increase consumption, while the permanent negative price and production shocks of the 1970's and 1980's were perceived to be temporary and the government's response was to maintain consumption and draw down reserves or increase external borrowing. Thus at two crucial times the government incorrectly interpreted its external environment: as a consequence its policy choices were

<sup>1</sup> See Section 7.3 for details on the definition of aid and other external flows.

<sup>2</sup> OECD Geographica Distribution of Financial Flows to Developing Countries (various issues). At constant 1987 import prices the comparable figures are US\$54.4 million (1970) and US\$450.0 million (1990)

inappropriate and ultimately unsustainable.

The increased importance of aid flows to total income -- from an average of 3.7% of gross domestic income in 1970-74 to 31% in 1989-1993 -- has fundamentally changed the role of the donor community, including Sweden, in Zambia. The period since the first collapse of the economy in the early 1970's can be broken into three phases differentiated principally by the level of agreement between the donors and government over the stance of macroeconomic policy, the volume of aid involved, and the manner in which aid was disbursed. The first phase ran from the early 1970's to around 1983 where aid flows underwrote domestic policy responses to the external shock. These were broadly aimed at maintaining public and private consumption in the face of the decline in the national income and supporting the bias in domestic relative prices towards import-intensive consumption and capital intensive production. Aid flows were low (relative to other private and official capital flows) and were governed by quite light conditionality. During this phase aid substituted for domestic saving and investment -- which would have been the optimal response if the terms of trade shock had indeed been temporary -- while adherence to conditionality was endogenous to the external environment: conditionality was observed to trigger disbursement but once loan funds were disbursed and the balance of payments constraint relaxed, policy measures were often reversed. No substantial policy reform was undertaken during this period.

By the mid 1980's the aid relationship began to alter as the external community (both multilaterals and, latterly, the bilateral donors) revised their perceptions of the appropriate orientation of macroeconomic policy. Thus the second period from 1983 - 1989 was characterised by a series of heavily aid-supported, but ultimately unsuccessful, attempts at policy reform, the most dramatic of which was the abolition of the foreign exchange auction system in 1987 and the subsequent suspension of the policy dialogue between Zambia and the IMF.

The third, and current, phase in the aid relationship commenced in 1989 with the re-normalization of relations with the IMF and the adoption of a second orthodox



adjustment programme. This programme, accompanied by a significant increase in net aid flows to Zambia, has been characterised by a high level of agreement about policy orientation but this time within a much tighter contractual framework. Fundamental fiscal and monetary adjustment has been implemented and irreversible policy reform has been instituted. For reasons discussed below, however, reform has been delayed and the anticipated effects in terms of growth and investment have yet to manifest themselves.

This three-phase characterization will be used in the discussion of the aid relationship in Zambia later in this part of the Report. In order to fix ideas, however, it is useful to provide a brief macroeconomic summary of the Zambian economy since Independence. The summary is chronological but we shall concentrate on: (i) the evolution of income, consumption, saving and investment; (ii) external balance and aid flows; (iii) the fiscal stance; and (iv) policy reform. For obvious reasons this summary will tend to concentrate on developments in the late 1980's and 1990's. Finally to complete the overview Appendix 7A provides some background information on the role of the copper sector and the role of the state in the industrial sector since independence.

## **7.2 A Chronology of the Macroeconomy of Zambia**

### **7.2.1 The First Republic 1964-1974**

#### *Initial Conditions*

The economic structure of contemporary Zambia owes its origins to the favourable conditions enjoyed during the first decade of Independence. These years were characterized by relatively high prices for the country's principal export, copper, but just as the terms-of-trade created a false promise for the years ahead, so the economic control regime which was put in place at this time ultimately bore considerable responsibility for future decline. Although the principal sector of the economy was the copper sector which was dominated by foreign capital and labour, the economy also enjoyed a significant growth in manufacturing and construction albeit of a highly capital-intensive form. These sectors grew at 10% and 9% per annum respectively over the decade from 1965

compared to the aggregate growth rate of 2.4% per annum (mining declined and agriculture exhibited only moderate growth of 2.5% per annum). From the perspective of the 1980's and 1990's, these growth rates are relatively high, but two additional factors need to be considered. First, the growth rates for manufacturing and construction were from a very low base; more importantly, the growth was achieved at low levels of efficiency. Gross domestic investment averaged 20% of GDP from 1965-70 and approximately 35% of GDP from 1970-74, but the non-copper investment boom did not translate into growth. The incremental capital-output ratio (ICOR), which is a measure of the efficiency of investment, was exceptionally low. The ICOR averaged approximately 60 (i.e. a one unit change in output requires sixty units of investment) indicating a chronic inefficiency on the part of the economy in transforming investment into growth. A comparable figure for Indonesia for the period 1973-81 of 4.1 gives an indication of the scale of the inefficiency of investment in Zambia at this time.

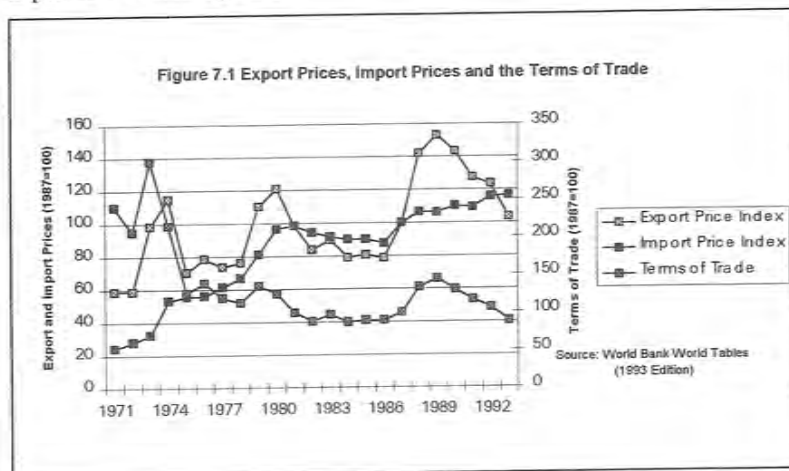
The relative inefficiency of investment during this period can be linked directly to the role of state ownership in the industrialization strategy, as discussed above. It was at this time that state-ownership became the dominant force in the Zambian economy, accounting for over 50% of output in the manufacturing sector by 1975 and a similar share of formal sector employment. Around it emerged policies which limited competition in domestic markets and protected industry from external competition and which saw an increasing proportion of output allocated by non-market mechanisms.

### **7.2.2 The Second Republic 1974-1991**

#### *Adverse External Shocks*

The period from 1974-80 was dominated by three adverse factors. The first was the consequences of the dramatic fall in Zambia's terms of trade which was more severe than almost every other sub-Saharan economy. Though it is common to think of the adverse terms of trade effect stemming solely from a fall in copper prices, the rise in import prices hurt the economy as much, not least because of the high capital-intensity of the production structure of the economy. Throughout the period from 1974-80 the export

price index was higher than it had been in the period before 1974 and by 1980 export prices had regained their 1974 level. By contrast import prices had doubled since 1974, and had reduced the economy's capacity to import by almost 50%. The 1974 capacity to import has not been regained.



Second the economy suffered as a result of military conflict in the region and the hardening of attitudes towards South Africa. In particular, the conflicts in Rhodesia, Angola and Mozambique sharply increased transport costs for Zambia's principal export, copper. Arguably, however, the most serious problem facing Zambia at this time came from the policy response to the worsening terms of trade. Part of the problem were the assumptions that the terms-of-trade decline was due solely to a fall in export price and that it was temporary. As a consequence the government sought to maintain aggregate macroeconomic balance not by reducing the level or composition of consumption (either private or public) but instead through reductions in investment and recourse to external finance. Thus consumption was broadly maintained at around 80% of GDP from 1975-80 while investment plummeted. This cut back in absorption was not sufficient to equate Gross Domestic Expenditure (GDE) with Gross Domestic Income (GDY) and the government was thus forced to increase its borrowing from overseas, particularly from commercial sources.

By 1980 the most acute phase of the terms of trade decline had passed. Having fallen by around 60% in the five years to 1980, the terms of trade declined by only 15% during the next five. Unlike the preceding period, this time the decline was almost entirely due to a steady decline in copper prices. However, it was at this stage that the consequences of the government's earlier strategy became serious. One of the principal distortions during the 1970's and the 1980's was of factor prices, a characteristic which was shared across the developing world as a whole. The exchange rate was fixed throughout most of the period (it was devalued in 1976 by 20% and then in 1978 by 10%); interest rates were set administratively, and were negative in real terms while public-sector real wages were raised by the presence of a large and highly-paid non-African labour force and through wage-leadership effects from the copper sector. As a consequence capital and foreign exchange were relatively cheap at official prices and labour relatively expensive: given the endowments of the economy (capital-scarce and labour-abundant) factor prices were inappropriate and did not clear the factor markets. Macroeconomic compatibility was thus maintained through an endogenous trade and financial policy using quantitative controls to ration foreign exchange, imports and capital. Controlled markets such as these necessarily require mechanisms for allocating rationed supplies: in Zambia during the 1970's and 1980's the principal mechanism was through state-ownership. Since capital and foreign exchange were effectively subsidized by the rationing mechanism, resource allocation in the state owned enterprise (SOE) sector became import and capital intensive.

This first phase of the Second Republic was not without policy responses but the history of negotiation with the IMF and other agencies up to 1983 was patchy. It focused principally on issues of short-term stabilization rather than fundamental (and therefore less easily reversible) adjustment efforts and their implementation was very closely related to the state of the current account; as economic circumstances improved following disbursement of the facilities, adherence to their conditions weakened and in many cases policies were reversed. By 1983 there had been no significant alteration of the fundamental structure of the economy. In the face of an overvalued official exchange rate, external balance was maintained by administrative fiat and quantitative restrictions, while the domestic budget balance remained excessive, with expenditure swollen by high



levels of consumer subsidy. It was from this time that the external debt problem began to emerge. Private creditors stopped lending to Zambia, short-term borrowing increased and debt service arrears began to emerge, while the stop-start character of relations with the IMF was accompanied by the sharp build-up in the outstanding stock of IMF Credits which came to dominate the aid relationship in the 1990's (see Chapter 3, Table 3.1 and White 1994, Table 3.1).

#### *Serious Attempts at Reform 1983-1987*

Efforts at reform were consolidated following the (one-party) elections in 1983 and the government entered negotiations for what was to be the first full-blown economic adjustment programme. The programme consisted of a series of IMF stand-by agreements, sectoral adjustment credits from the World Bank group and Paris and London Club rescheduling arrangements. The main objectives of the reform programme were an expenditure-reduction strategy concentrating on government expenditure and expenditure-switching measures centred around the introduction of an auction for foreign exchange. Though un-coordinated and plagued by slippage and policy reversals, the reform programme came remarkably close to success. Government succeeded in reducing budget expenditure by increasing consumer prices for maize and fertilizer but with revenue measures less successful the overall deficit increased. Similarly the foreign exchange auction was initially successful with the nominal exchange rate depreciating rapidly towards the marginal price of foreign exchange established in the parallel market. Just prior to the establishment of the auction in October 1985, the exchange rate was K2.2 per US\$. In the very first auction the rate depreciated by 55% and by mid 1986 the rate had depreciated to K7.12 per dollar. Over the same period the premium on the parallel market fell from 75% to approximately 30%. This progress was, however, reversed from May 1986 onwards as the government, concerned by the rate of depreciation on the market and the belief that the depreciation was fuelling a cost-push inflation, sought to stabilize the exchange rate by selling dollars forward. The losses incurred in this unsuccessful "Ponzi-scheme" were monetized which *did* raise inflation, further increasing the demand for dollars and directly fuelling concerns on the part of the private sector that the auction was not credible. As a consequence the auction began to

unravel as the private sector took speculative positions against the government and this unsustainable pressure undermined the government budget.

#### *The "Own-Resources" Programme 1987-89*

With the functioning of the foreign exchange market being undermined by a loss of credibility, the other early successes of the auction period were not sustained, and in December 1986 riots broke out in the Copperbelt in response to proposals to double maize prices through the removal of consumer subsidies. The programme continued throughout the early part of 1987 but on 1 May 1987 President Kaunda announced that the reform programme was "disintegrating the social fabric of the Zambia" and that a new programme, funded from own-resources would be implemented, known as the New Economic Recovery Programme. Zambia immediately suspended financial relations with the IMF and World Bank, although some low-level dialogue was maintained between the IFIs and government (an activity in which the Swedish government played an important role). The key features of this new programme were a moratorium on debt service (which was limited to 10% of exports net of allocations to government, ZCCM, ZIMOIL, and IATA); a fixed official exchange rate of K8 per dollar; and the re-introduction of import licences and other controls in goods and factor markets.

#### *Back in the Fold 1989-1994*

The own-resources programme was not sustainable, despite the unanticipated advantage of a favourable up-turn in the terms of trade. Factor and goods prices remained severely distorted, the parallel market premium soared to over 1000% in 1988, while total gross fixed investment fell below 10% of GDP for the first time in the country's post-Independence history. Ironically this policy reversal occurred just as export prices rose for the first time since 1978/79 and the economy enjoyed a short terms of trade boom. However, by 1989 the "own-grown" economic recovery programme had collapsed and the government of President Kaunda was once again forced to move back towards an orthodox adjustment programme supported by the IMF and World Bank. A coupon system was introduced in 1989 to reduce the budgetary cost of food subsidies; prices were widely decontrolled in June 1989; and a maxi-devaluation of 63% was instituted.

These actions paved the way for the signing of the Economic Reform Programme in September 1989 which was converted into a full-blown adjustment programme with a consultative group meeting in 1990 and a Paris Club agreement in July 1990. Finally, in April 1991 the IMF introduced its first-ever debt forgiveness scheme known as the "Rights Accumulation Programme" (RAP).<sup>3</sup>

Despite the powerful donor response, adjustment efforts were mixed during most of the first two years of the current programme, although some progress was registered in dismantling many of the domestic price controls and in re-establishing a liberalized foreign exchange and payments system.<sup>4</sup> The programme suffered a further set back at the time of the elections when the government sought to engineer a political pre-election boom, an event which was accompanied by a temporary cessation of aid flows by some donors in June 1991. The pre-election boom was unsuccessful and the government was defeated by the Movement for Multiparty Democracy in October 1991.

### 7.2.3 The Third Republic 1991-

The victorious MMD government was quickly faced with two serious problems. The first was the consequences of the election boom; the second was the devastating effects of the drought that hit the region in 1992. In retrospect the macroeconomic effects of the drought have been relatively transitory: government managed to run a more-or-less fiscally neutral emergency drought budget, while emergency grain deliveries and other drought relief were very successful in alleviating famine. What proved more difficult was the underlying problem of macroeconomic stabilization which has dominated economic

<sup>3</sup> The Rights Accumulation Programme was established in April 1991 sets quarterly financing targets for the government by specifying ceiling on reserve money creation, domestic credit to government and short-term external borrowing limits. Successful attainment of the targets entitles the government to accumulate "rights" with which to re-purchase (ie redeem) outstanding IMF Credits. The programme was initially structured to produce a complete elimination of arrears on IMF Credits by 1995.

<sup>4</sup> This included the introduction of an Open General Licence system for merchandise imports (February 1990) financed through a second exchange rate window which was eventually unified with the first window in April 1991. Licensing was abolished in November 1990, and a 50% export proceeds retention system was introduced. Parallel to these reforms ran a programme of tariff harmonization.

policy making in Zambia during the last three years. The stabilization-oriented conditionality enshrined in the RAP has become the centrepiece of the overall recovery programme, with the donor community in particular viewing the attainment of RAP targets as the principal indication of the Government of Zambia's commitment to the broader adjustment programme. However, despite the tight fiscal stance adopted following the 1991 elections macroeconomic stability worsened rather than improved and the RAP targets have been repeatedly missed. From mid-1991 until mid-1993 the rate of domestic inflation had increased markedly, reaching a maximum annualized rate of close to 400% in mid-1993.

Despite the ragged performance on stabilization, remarkable steps were taken by the government in the implementation of widespread and fundamental liberalization measures. The most powerful of these occurred in foreign exchange and asset markets. Bureaux de change were introduced in September 1992 and the official exchange rate was unified with the bureau market in December 1992. Domestic asset markets were substantially liberalized in January 1993 with the introduction of tender-based weekly auctions for Treasury Bills and the abolition of restrictions on commercial bank's lending rates, while the payments system was further liberalized in January 1994 with the abolition of exchange controls. Accompanying these reforms were the final abolition of all domestic price controls (although some price control measures were re-introduced during the drought period in 1992), the elimination of remaining subsidies on consumer goods, and continued trade liberalization.

However the centrepiece of public policy has been the introduction of a cash-budget proscribing the use of deficit financing from the central bank. It was the successful implementation of the cash-budget by mid-1993 which halted inflation virtually in its tracks. Annualized inflation dropped from over 385% in July 1993 to 15% in October and was briefly negative in November 1993. This has been achieved in large measure through the reduction in reserve money growth rather than as a result of establishing a balanced fiscal budget (although the fiscal balance is significantly smaller than in past years). The primary budget deficit (ie the budget deficit excluding interest payments on



domestic debt) shifted from a small surplus in the first six-months of 1993 to a deficit position for the remainder of the year (with the exception of November). The overall budget deficit for the full year was K1.9 billion or 0.1% of GDP. Due to high domestic interest payments (K71 billion, equivalent to 3.9% of GDP) the overall deficit for the year was 4.0% of GDP. Given the cash budget, the deterioration of the overall balance must have been accompanied by a switch in the source of deficit financing from reserve money to net foreign financing and domestic debt, the latter through the issue of short-dated Treasury Bills. Since early 1994 Treasury Bill financing has emerged as the principal source of financing but the debt has been issued at extremely high nominal and real interest rates. *Ex post* real interest rates have averaged over 50% per annum since mid-1993 and although there have been large month-to-month variations in these rates, the level has remained well above the world rate and certainly well above the expected rate of return on most other activities within the domestic economy. These high interest rates have contributed to a tight squeeze on domestic credit to the real economy which has exacerbated the direct costs of adjustment faced by the industrial sector in response to new relative prices in both the goods and factor markets.<sup>5</sup> Although there are sectors of the economy which should be in a position to benefit from the liberalization, such as the exportable sector, the anticipated supply-side recovery in the manufacturing and non-traditional exportable sectors risks being jeopardized by the joint effects of high interest rates and the transitional problems arising from Zambia's trade liberalization programme which is progressing more rapidly than in neighbouring countries (especially Zimbabwe and South Africa). This latter problem has emerged since domestic firms are unable to adjust their own output prices as quickly as the change in the domestic price of competing imported goods following trade and financial liberalization. Given the cost of working capital and the lower level of effective protection, the importable sector firms have been unable (profitably) to match import prices, particularly during the stabilization-induced appreciation of the Kwacha in the last quarter of 1993. In part this has been exacerbated

<sup>5</sup> These new relative prices have been brought about by three factors. First is the elimination of QRs; secondly the reduction in tariff levels; and thirdly the devaluation of the official exchange rate and the unification of the official with the market rate. The unification in particular removed an important implicit subsidy to import dependent enterprise able to access the official market. This subsidy represented a major component of their structure of protection.

by administrative weaknesses in the operation of the customs system.

It is clear that one of the expected consequences of liberalization is that certain import-substituting sectors are not viable at world prices and therefore are expected to shrink and their resources reallocated to expanding sectors -- this type of de-industrialization is an anticipated consequence of (and indeed an indicator of) successful liberalization. The problem facing Zambia at present is that high interest rates mean that the deindustrialization may be significantly greater than required over the medium term, particularly if current high real interest rates persist and lead to the closure of viable but insolvent enterprises or to the re-orientation of manufacturing firms to distribution activities, a phenomenon which is widespread throughout Africa at present. The high-interest rate strategy adopted to maintain price stability and internal balance is therefore not macro-compatible since the continued pursuit of this strategy will undermine the current balance. This will occur for two reasons. First, by making the costs of transition prohibitive and forcing up working capital and investment costs, output, exports and tax revenue will continue to decline, putting further pressure on the fiscal balance, increasing the borrowing requirement and further increasing interest rates. A vicious circle will ensue. There is already some evidence that this process has begun with a number of the largest manufacturing conglomerates rationalizing their manufacturing activity in favour of distribution. The second challenge to macro-compatibility is that the private sector may come to view the policy as incredible and will as a consequence take hedging positions against the government. Such positions may prove to be self-fulfilling so that again compatibility and stabilization will be lost. It is true that the current macroeconomic balance could be sustained if the anticipated effects of the liberalization of the capital account are forthcoming; this should bring domestic interest rates in line with (risk and exchange rate-adjusted) world interest rates, as foreign funds flow into Zambian assets in response to interest rate differentials. In the short to medium term, however, the combination of a high level of uncertainty on the part of the private sector and the thinness of the domestic financial sector seem to be combining to keep interest rates high.

The associated problem of the effects of accelerated trade liberalization is separate and, probably, more easily addressed. Here two issues emerge. The first is that though there are provisions for levying countervailing duties against imports deemed to substantially "harm" domestic producers for reasons due solely to trade policy, the system is not being effectively monitored and implemented by the government.<sup>6</sup> Secondly, as we discuss below, there is a concern that weaknesses in the customs system are failing to appropriately enforce border prices, particularly for final goods. One of the consequences of poor customs enforcement is the indirect feedback on the industrial sector through the budget: under the cash budget revenue shortfalls necessarily increase the government's demand for credit from the financial sector, putting further upward pressure on domestic interest rates.

Thus, despite the remarkable success in the implementation of the cash-budget, the achievement of relative stability has been expensive. The consequences of the reforms are examined in some detail below. The outlook for investment and output in both the traditional and non-traditional sectors, and the fiscal squeeze are discussed in Section 7.3, while the de-industrialization effects arising from the combined effects of high-interest rates and liberalized but imperfect asset markets, are addressed in Section 9 of this Report.

### 7.3 Aid, Debt and the Macroeconomy of Zambia

In this section we examine the principal macroeconomic developments in more detail and, in particular, examine the interaction of aid and macroeconomic performance. The link between aid and the growth (or decline) in per capita income is not direct, and in the absence of a well defined counterfactual it cannot be inferred that the increase in per capita aid contributed to the decline in per capita incomes in Zambia, or whether it augmented or subtracted from domestic tax effort. It is more valuable to consider the components of growth, and how aid can, and has, affected them. Conventional wisdom

<sup>6</sup> The core concern is with the failure of the system to afford relief against merchandise imports from South Africa which are subject to a 14% export subsidy.

recognizes that there are five key determinants of growth: savings and physical investment (both volume and quality); human capital investment; openness (ie a pro-export bias); and good governance. We shall examine each in turn, but first we shall discuss the main features of the aid flows themselves.

Some caveats and qualifications relating to the aid data are required to highlight the main features of aid to Zambia. First, the data presented here concerns only aid flows which are recorded by the OECD's *Geographical Distribution of Financial Flows to Developing Countries*. This records flows from the perspective of the lender, and when we refer to "total aid" we shall be using the series for *Total Net ODA Transfers* to Zambia. This is defined as ODA grants and Net ODA loans (ie "development" loans with a grant element in excess of 25%, net of amortization and interest), but excludes other official flows (including technical assistance grants, foreign direct investment and interest arrears that are capitalized as new inflows). We deal in the main with *net resource transfers* which is gross transfers net of interest payments, although when required we shall make the distinction between gross and net flows. Second, this definition of aid flows excludes commercial and non-concessional borrowing (including the use of IMF credits), both of which have been significant components of Zambia's external capital flows in the 1980's. As will be seen below, the large increase in net ODA transfers in the 1990's must be offset against significantly negative transfers on non-concessional flows arising mainly from the clearance of arrears to the IMF and World Bank, not least because a significant proportion of the aid flow is endogenous to the negative non-concessional resource transfers. Third, if debt is forgiven, the OECD data records this as a grant equal to the amount of the principal and interest due (or overdue) and a repayment equal to the amount forgiven. This increases both the *gross* disbursement and gross amortization although it does leave net flows unaltered. Fourth, the data for aid include foreign direct investment from DAC members. Finally, unless stated, the data are presented in constant 1987 cif-inclusive import prices. This causes a problem in the period from 1987 to 1991 when official prices are markedly below the parallel market price. To the extent that aid accrues in the first instance to the government at official prices, however, the measurement error may not too severe.



The aid history of Zambia is summarized in Tables 7.1 and 7.2 and Figures 7.2 to 7.4.

Figure 7.2 Net Aid Inflow

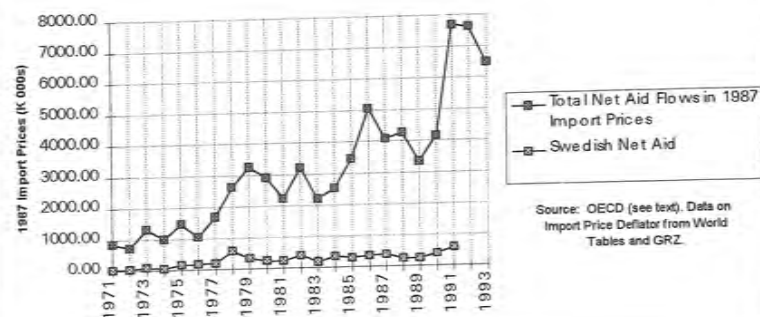


Figure 7.3 Ratio of Aid to GDP

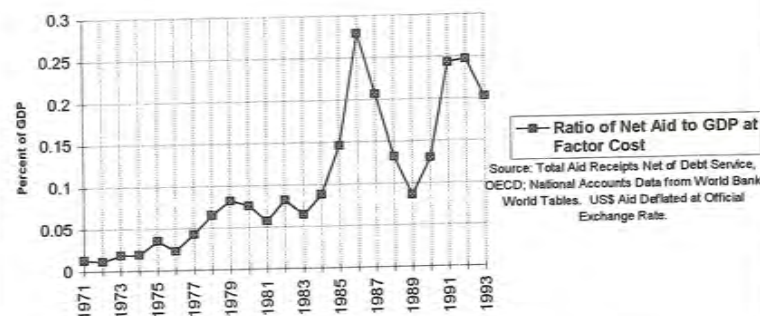
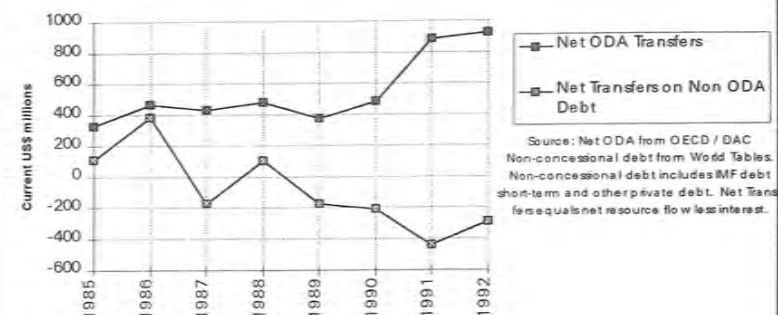


Figure 7.4 Net ODA vs Transfer on Non-Concessional Debt



Aid flows have shown a marked upward trend since the early 1970's, with a number of distinct phases around the trend. These are broadly an initial phase of consumption-smoothing aid in the 1970's, a protracted series of incomplete aid-financed reforms during the 1980's which culminated in the "big-push" of 1985 and the subsequent and spectacular policy reversal in 1987, and the current period of heavily aid-funded reform. Swedish aid averaged approximately 9% of total net ODA over the period from 1970 to 1990. This share rose sharply in the late 1970's when Sweden did not follow the line taken by other donors in slowing down the aid flow to Zambia. It did however come more into line in the 1980's when Sweden's aid disbursements followed the rest of the donor community. With the exception of around \$10 m of loans in the 1970's, Swedish aid has been exclusively in the form of grants.

Table 7.1: Aid Flows (period averages)

	1971-74	1975-79	1980-84	1985-88	1989-1993
Total Net Aid					
Current US\$ (million)	\$36m	\$143m	\$259m	\$425m	\$692m
Total Net Aid					
Current US\$ per cap	\$ 8	\$27	\$43	\$59	\$81
Total Net Aid US\$					
1987 Prices	\$103m	\$212m	\$275m	\$444m	\$616m
Total Swedish Aid					
US\$ 1987 Prices	\$6.2m	\$29.9m	\$29.7m	\$33.3m	\$53.6m
Total Net Aid US\$					
1987 Import Prices	\$23	\$41	\$46	\$62	\$73
per capita					
Net Aid as % GDP	1.6%	5.0%	7.4%	19.1%	18.2%

Sources: Data for 1971-91 from World Bank World Tables plus OECD External Aid Flows to Zambia; Data post-1991 from Ministry of Finance Lusaka (unpublished); Aid defined as Total Net ODA Transfers.

The first phase, from 1971 to 1974, saw aid used mainly to support public investment in the import substituting industrial sector investment, although as was noted above the efficiency of this investment was low. Private long-term capital dominated the external flows to Zambia, although following the collapse in copper prices there was a sharp switch in the source of external funds towards concessional and official non-concessional borrowing and grants. The aid flow ceased augmenting investment but rather substituted for domestic savings by underpinning consumption. Total net aid flows rose by approximately 200% from 1976 to 1980 in constant 1987 import prices.

Table 7.2: Gross external inflows (US\$ millions)

	1970-75	1976-80	1981-85	1986-91
Concessional	48.6	81.5	109.3	128.6
Non-concessional (Official)	33.9	62.2	64.3	45.5
Private	179.3	168.8	90.1	69.8
Short-term	0.0	0.0	23.8	100.2
IMF Purchases	25.4	100.4	159.7	20.3
Grants	7.3	42.6	86.1	367.5

Source: White (1994) Table 3.3

From 1978 to 1983 Zambia agreed terms for a series of IMF and World Bank stabilization programmes. None of these were successfully implemented. These years mark Zambia's first war of attrition between a donor community committed to the need for structural reform and a government constrained by a strong public sector constituency which was enjoying high but unsustainable fiscal transfers. Throughout the period fiscal reform and exchange rate liberalization were successfully thwarted, and aid flows stagnated despite the continuing decline in the terms of trade. In addition to sharply increasing debt to the IMF, the absence of recourse to commercial capital markets forced the government to maintain external balance by increasing arrears on external debt.

The period 1983 to 1987 was one of concerted reform efforts supported by a substantial rise in aid inflows. Initially much of the net ODA flow was used to offset the net negative transfers on non-concessional borrowing from IBRD and IMF (see Figure 7.4). Three Paris Club and one London Club debt reschedulings were agreed from 1983 to 1986 covering \$1.1bn of the debt stock. Unlike the previous decade, this aid boom was also accompanied by a surge in gross domestic investment which rose by 63% in real terms from 1983 to 1987. However this was due primarily to the accumulation of inventories as the private sector hedged against the collapse of the auction by stockpiling



imported commodities. Fixed investment fell over the same period by 35%. The collapse of the auction signalled the termination of the reform programme and Zambia's relationship with the IMF. The bilateral and other multilateral donors in equal measure cut their net flow to Zambia back to the trend level of the earlier part of the decade, which was accompanied by a dramatic increase in arrears accumulation under the debt service moratorium introduced as part of the own resources programme. Zambia was however now severely rationed in the long-term capital markets so the scope for commercial borrowing was significantly less than in the late 1970's. Long term capital inflows fell sharply and were replaced to some degree by short-term, highly collateralized (and highly expensive) lines of credit.

In 1989, facing further adverse movements in copper prices and now also severe declines in production, President Kaunda once more re-negotiated with the IMF and World Bank. As with the 1983-1987 programme the aid response was large, although much of the net aid inflow was offset by high negative net transfers on non-concessional aid (Figure 7.4), so that total gross flows have been significantly higher than net in order to clear arrears accumulated.

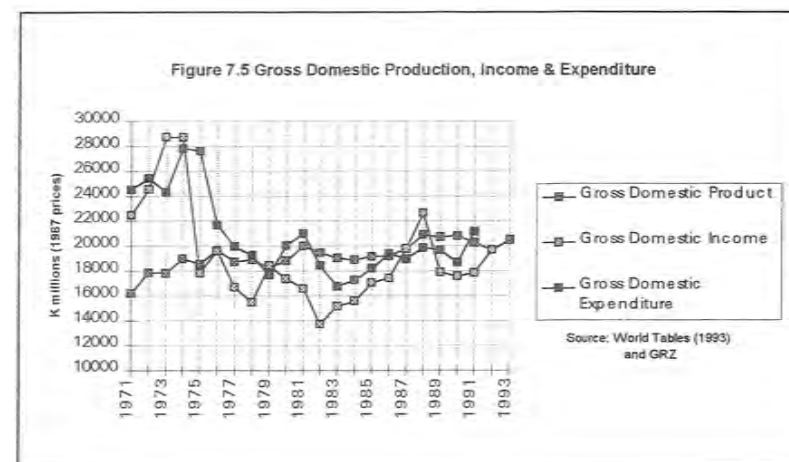
During the 1990's the debt stock began to decline. This reflected first, the fact that Zambia is now eligible for IDA credits so that the aid flow is now almost totally programme aid provided as balance of payments support grants. Secondly, the government has not contracted any new debt under the programme, except for debt created through the capitalization of arrears. Thirdly, the bilaterals (and the multilaterals where feasible) have extended their most generous debt re-scheduling terms to Zambia (see below). Nonetheless external debt and external aid flows remain extremely high.

A major difference between this and earlier aid-booms is that although the new government is pursuing a reform programme first negotiated with, and substantially implemented by, the government of President Kaunda, there has been a concerted effort on the part of the MMD government to signal that they are a different government and one that is committed to payments liberalization and fiscal balance. It is important to note

that this phase of reform has also enjoyed an investment recovery. Due to a lack of reliable national accounts data for 1991-1993 it is difficult to say anything about the composition of investment, although as with the 1985/86 boom there seems to be a significant re-accumulation of inventories.

#### *Aid, Production, Income, Savings and Investment*

Real GDP in Zambia has remained relatively constant over the years since Independence, rising more-or-less steadily from around K18 bn in 1970 (in constant prices) to approximately K20bn at the beginning of the 1990's, representing a growth of only 11% in almost 20 years. This stagnant growth contrasts with a population growth of over 100% over the same period, from 4.3 million to 9.2 million. Per capita GDP is currently 62% of its 1970-74 average. Being a very open economy, however, a more appropriate measure of the wealth of the nation is gross domestic income, not the domestic product, as it captures both the value of production in the domestic economy but also the change in the purchasing power of the economy's exports in terms of its imports. As Figures 7.5 and Table 7.3 indicate, the terms of trade losses in Zambia has been large, although the major declines occurred in 1974/75 and again in 1981-1984.



Since then gross domestic income has been more stable, albeit around a gentle decline over the period as a whole (reflecting the generally worsening terms of trade for the Zambian economy).

Table 7.3: National income and production (period averages)

	1971-74	1975-79	1980-84	1985-88	1989-1993
GDP per capita 1987 Prices	\$412	\$384	\$331	\$291	\$257
GDY per capita 1987 Prices	\$607	\$361	\$272	\$282	\$233
GDE per capita 1987 Prices	\$593	\$435	\$324	\$280	\$253
Private Consumption as % GDY	30.2%	49.5%	56.5%	57.3%	57.8%
Govt Consumption as % GDY	22.5%	34.1%	39.2%	25.2%	28.3%
Gross Fixed Investment as % GDY	40.4%	36.7%	22.8%	11.3%	9.6%
Gross National Savings as % GDY	19.4%	14.3%	4.4%	3.8%	0.2%

Source: World Bank World Tables (1993); OECD.

Aid flows can impact on sectoral growth in a number of ways. First, by easing the foreign exchange constraint (on both imported intermediate inputs and capital goods), capacity utilization may be increased. Secondly, aid augments the income of the economy and therefore demand effects will materialize. The sectoral distribution of demand will depend on to whom the aid inflow accrues (government or the private sector). In Zambia, strong supply-side linkages between the copper sector and the rest

of the economy, particularly in terms of import dependency, seem to dominate spending effects so that sectoral growth performance necessarily tends to follow the performance of the mining sector rather than movements in aid flows. Thus, as the terms of trade worsened and mining output contracted from the 1970's onwards, this fed back onto the capacity to import across all other sectors, although most particularly the manufacturing sector. The partial liberalization of the economy (which encouraged an inflow of private flight-capital) and the recovery of the terms of trade in the late 1980's supported a growth recovery across the import-dependent sectors (despite the continued shrinkage of the mining sector). The services sector, which was dominated by public administration, took the brunt of the expenditure squeezing effects of the adjustment programme.

As the economy has been stabilized in late 1993 the main focus of attention is on the growth response in the agricultural manufacturing and non-traditional export sectors. As with many economies in transition, however, the measurement of sectoral growth and investment is typically extremely difficult. Official statistics are at their most unreliable at this time, and in Zambia we are faced with a further problem arising from the existence of different "official" GDP estimates generated by the main institutions in government. First, the CSO's own (revised) estimates suggest a very high level of real growth in 1993 of 9.3%. Part of this is accounted for by the recovery in agriculture and electricity generation following the drought years of 1992 but even so these figures also suggest that manufacturing grew by over 5% in real terms. Not only is this at variance with the CSO's own Census of Industrial Production data, but on any reasonable criteria these figures seem unrealistically high. For this reason they have not been used in the Ministry of Finance's own macroeconomic projections agreed with the IMF. The latter assume that in 1993 agriculture and electricity recovered sharply from their drought-afflicted level in 1992 with agricultural output almost 60% higher than 1992 (when it had fallen by 40% over 1991); electricity output is estimated to be 4.4% higher (after a 4.3% fall in 1992); mining output is estimated to be constant; while all other sectors are assumed to have grown by 1% in real terms.



Table 7.4: Sectoral GDP growth rates

[prov]	1971-74	1975-84	1985-88	1989-1991	1992-93
GDP Total	3.5%	0.2%	1.8%	-0.1%	1.1%
Agriculture	1.6%	1.2%	12.4%	-1.1%	9.9%
Manufacturing	7.9%	0.4%	3.6%	0.3%	-1.6%
Mining	1.3%	-2.1%	-3.2%	-5.4%	5.2%
Construction	1.0%	-4.9%	-1.4%	-4.2%	-0.7%
Services (incl. public admin)	5.9%	3.9%	2.6%	3.7%	1.5%

Source: World Bank Zambia: Prospects for Sustainable and Equitable Growth (1993) 1992-93 figures from IMF/GRZ.

It is obviously not possible to refute or confirm these figures but some comments are worthwhile. First, the assumption that the non-agricultural and non-electricity sectors grew at an even rate of 1% seems unlikely. Although we do not have independent estimates on domestic demand, we do know that total exports declined in value terms in 1993<sup>7</sup>. Most of the decline was due to a collapse in copper exports, but at the same time official estimates did not indicate any growth in non-traditional exports. Thus *domestic* expenditure must have accounted for all of the estimated growth in demand in the non-copper sectors. For these sectors to have enjoyed the necessary increase in aggregate real demand for domestic output would have been surprising given the extremely tight monetary and fiscal conditions, and it is probably more likely that there was some decline. This is confirmed by preliminary evidence on the composition of imports which indicates that while the real value of imports fell in aggregate this decline was spread equally across final goods, capital goods and intermediate goods. If domestic output had

<sup>7</sup> Total exports fell from \$1110 million to \$949 million. This fall was not offset by a corresponding terms of trade gain.

in fact increased we may have expected a rise in intermediate imports and a fall in final imports. This was not observed. Furthermore we know that during 1993 there was a dramatic contraction in public services, while the construction sector contracted very sharply in the face of high inflation and latterly high real interest rates.<sup>8</sup> The sectors that may have seen a sharp growth would include the financial sector and the informal sector, and the latter is not included in the official statistics.

Some further evidence on the industrial sector is presented in the Census of Industrial Production (CIP). These figures are at variance with the national accounts; while the two sources broadly agree about the growth in electricity, the Industrial Production data paints a bleaker picture across manufacturing as a whole and across the mining sector in particular. Total manufacturing is estimated to have fallen by 8% in 1993 (although the CIP indicates growth in 1992 whereas the IMF/MoF figures indicate a decline) with the big collapse in output being felt in the textiles (a fall of 32%), paper and chemicals (-8%), and non-metallic manufactures (-23%) sectors, while output in the food processing sector is constant. The inter-sectoral movements in manufacturing do, however, accord quite well with our priors as earlier evidence suggests that the textile and non-metallic sectors, especially those components under public ownership, enjoyed very high levels of effective protection from tariffs, quotas, and preferential access to foreign exchange and credit.<sup>9</sup>

Reconciling these two sets of figures is therefore problematic. One of the principal difficulties concerns the collection of data for the CIP. While most observers would agree that there has probably been a contraction in many sectors, particularly manufacturing, the large changes in the composition of output can lead to a systematic over-statement of the fall in production. For example if the census register is only updated periodically reported output figures will capture closures of firms on the register but will not record the output of new firms not yet on the register. Moreover if the liberalization is

<sup>8</sup> This point is supported by interviews with Price Waterhouse, a number of commercial banks and the construction sector (Minestone Ltd.)

<sup>9</sup> See Adam (1993) *Privatization in Sub-Saharan Africa*

accompanied by a reduction in average firm size (which seems to be happening in Zambia) and the industrial census is concentrated on large firms there will be a further systematic under reporting of industrial output. This is an endemic problem with economies in transition as witnessed by the evidence from Eastern Europe where catastrophic declines in officially measured output cannot be consistent with expenditure and balance of payments-based evidence which suggest that output has fallen by substantially less.

However, although the CIP may not provide an accurate measure of total output, it does provide some evidence on the "established" formal industrial sector, which is clearly experiencing a significant contraction in output. This trend is confirmed by the membership of the Zambian Association of Chambers of Commerce and Industry (ZACCI) which represents the established industrial sector in Zambia. In 1993 17% of ZACCI member closed down and a further 20% are expected to close in the first half of 1994.<sup>10</sup>

Evidence of gross investment is even more difficult to obtain not least since the last official national accounts estimate for investment was 1991. One source of information, albeit skewed in its coverage, is the Investment Centre which is responsible for the issuing of licences under the Investment Act. Over the period from 1992 licences with an indicative investment value of US\$ 500m have been issued and an actual investment flow of approximately \$80 million has been realized. This investment flow is approximately 2.5% of 1993 GDP. Most of this has been rehabilitation investment although there has been some growth in certain exportable sectors. This is especially so in the areas of mining exploration and horti- and floriculture. The latter sectors have enjoyed a high level of support from foreign investment involving both CDC (Commonwealth Development Cooperation) and the EIB (European Investment Bank) investment facility. What is striking however is that most of the new investment handled by the Investment Centre is foreign investment: the largest investment activity in Zambia

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<sup>10</sup> Figures from Chairman of the ZACCI Committee on the Economy (personal interview)

at present is CDC's rehabilitation investment in the sugar sector. With the exception of some small privatization purchases (which totalled approximately K975 million (US\$1.5 million)), domestically financed investment has yet to recover. This is true both in terms of investment in plant and equipment, but also in construction where the overwhelming bulk of projects being carried out are public sector rehabilitation projects.<sup>11</sup>

#### *Income, Expenditure and Consumption*

Aside from the significant fall in 1975/76, gross domestic absorption (GDE) has followed GDY closely but with a two-year lag, and GDE is smoother than gross domestic income, as consumption theory would suggest. What is particularly interesting, though, is the evolution of consumption and income over the same period. Following the collapse in GNY following the terms of trade shock in 1974-75 the absolute value of private and public consumption did not alter and therefore jumped sharply as a share of the (now lower) national income. This is exactly what would be expected if the income shocks were perceived to be temporary since consumption is a function of permanent income. However throughout the period to 1982 consumption did not fall, even as it became clear that the terms of trade shock was not short-lived. This was true for both public and private consumption. Only after 1982 did total consumption decline, principally as a result of a contraction in public consumption instituted in the wake of the renewed reform efforts of the 1980's.

The resumption of the IMF programme in 1989 coincided with a sharp jump in public consumption and in 1991 the pre-election boom provided a further upward shift. However if comprehensive data for 1991-1994 were available it would reveal an extremely sharp contraction in public consumption to around 10%-15% of GDY, almost half its value in the mid 1980's. The current reform programme has seen Zambia make the transition from being a high to a low public spending economy. Unfortunately however, this sharp contraction in public expenditure has been matched by a collapse in government revenue so that the net claim of the government on the rest of the economy

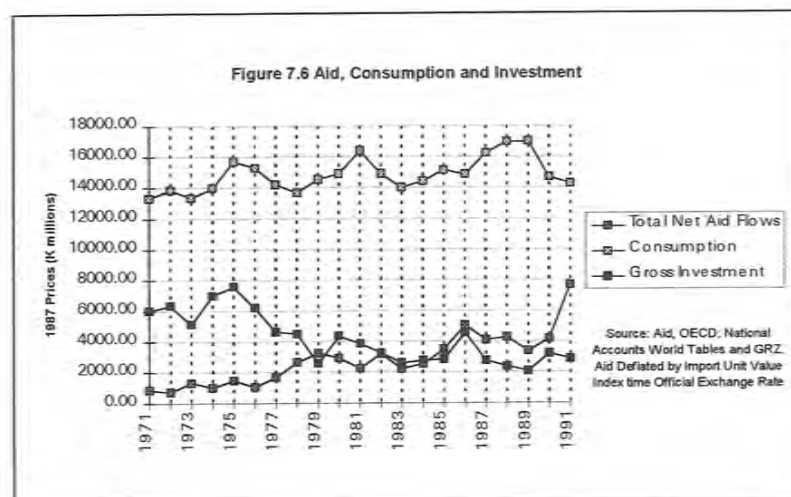
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<sup>11</sup> Interview with Minestone Ltd.



has not altered dramatically.

Aggregate consumption can be maintained in two ways. The first is by changing the composition of domestic absorption from investment to expenditure, and the second through augmenting domestic resources with foreign savings. Zambia pursued both strategies during the period to 1982. Up to 1974 gross domestic savings averaged between 25% and 35% of gross domestic income, but after 1974, savings fell sharply as the economy (both the public and private sectors) sought to maintain their consumption level (Figure 7.6). Over the period to 1980, gross domestic savings (GDS) fell to around 15% of GDY and remained at this level until 1991. With the absence of reliable national accounts data past 1991, we cannot observe how aggregate savings have behaved during the Third Republic reforms, although there is evidence that despite the rise in real interest rates aggregate savings have declined further in response to the sharp contraction in real income, especially following the drought.



Domestic gross fixed investment fell with similar alacrity from an average of around 35% - 40% of GDY in the early 1970's to 20% by the early 1980's and continued to decline

to around 10% of GDY by the early 1990's. Particularly noticeable in the latter half of the 1980's (especially during the policy reforms of 1985 and again in 1989/90) was the rapid increase in inventories. This may in part be a genuine re-stocking as the easing of the foreign exchange constraint raised capacity utilization, but may also indicate some degree of speculative activity on the part of the private sector in response to uncertainties about the credibility of the reforms.

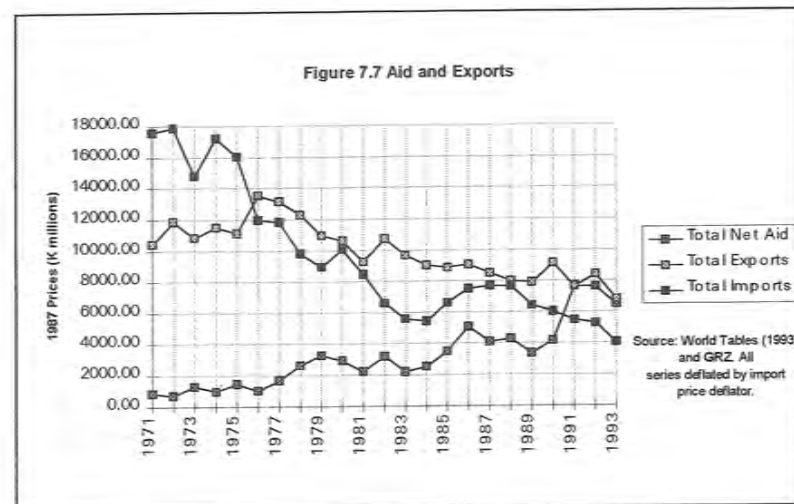
The decline in aggregate domestic investment was the first way in which consumption levels were maintained: the second is by increasing foreign savings and drawing down reserves. This latter was particularly important in response to the first terms of trade shock in 1974. The current account declined dramatically during the late 1970's as Zambia maintained absorption levels supported by both official transfers and also non-concessional loans.

To summarize: at a first cut it would seem that in Zambia the effect of aid has been the reverse of what would be expected, or at least desired. This is certainly true in the early years where aid seems to have frustrated adjustment initiatives and to have propped up an unsustainable policy regime. As aid has increased so consumption has risen, investment slumped and the domestic savings fallen. This same conclusion is hard to draw in the later period where inference is complicated by the cumulative effects of much greater macroeconomic disequilibrium prior to the start of the aid programme (for example in 1985 and especially in 1989), by the short-run effects of policy reversal, and perhaps more profoundly by the fundamental changes to the functioning of the economic system as a result of policy reform that to the aid resources themselves. It is a moot point as to whether in an economy such as Zambia the political environment could have sustained the same level of policy reform without the same level of (net) aid flow.

#### *Aid, Export Performance and External Balance*

Since part of the motivation for aid in Zambia is to offset the loss of import capacity as a result of the decline in copper export revenue, we would expect to see a negative relationship between copper exports and aid. This is shown in Figure 7.7. By the same

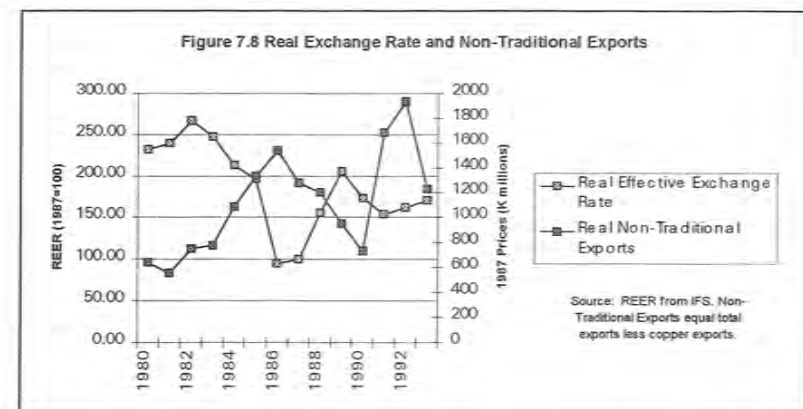
token we would anticipate a positive relationship between aid and imports as aid substitutes for lost import capacity. However in Zambia import capacity has typically been influenced more by movements in export earnings than aid and as a result the dramatic collapse in real exports was accompanied by a fall in imports as well. Aid inflows offset this to a degree but not enough to sustain import levels.



However an additional function of aid is to promote export diversification away from copper to non-traditional exportables. The theory on this issue is discussed in Section 11 below, but there are two main issues to consider. On the one hand conditional aid can provide the incentive to introduce trade enhancing measures such as the abolition of protection, the liberalization of the foreign exchange and payments system and nominal devaluation. On the other hand the inflow of aid in support of these reforms will affect domestic relative prices through a spending effect which, if traded and non-traded goods are normal, will create an increased domestic demand for both tradables and non-tradables. In a small economy such as Zambia the demand for tradables will be met at an unchanged world price through imports, but the supply of non-tradables can only emanate from the domestic market which necessarily requires a rise in the

relative price of non-tradables and a shift away from the exportable sector. If this resource shift away from the exportable sector is large then aid may be harmful to export diversification and growth. This latter point is particularly germane in the context where there are positive externalities from export growth. Once again, however, this is easier to state than to evaluate since it is virtually impossible to ascertain what the counterfactual would be in the absence of aid.

Historically, aid supported an inward-oriented development strategy which included heavy taxation of exportable agriculture (tobacco, cotton) and other non-traditional goods (particularly the gemstones sector and light manufacturing). Protection was strongly import-biased, while the heavy implicit taxation of export earnings further strengthened the anti-export stance. From the earliest reform measures the reversal of this bias was a key priority. Figure 7.8 suggests that there is a strong relationship between non-traditional export growth and the real exchange rate. Following the introduction of the reforms of 1983 non-traditional exports grew by almost 80% in two years (albeit from a low base), while the policy reversal and the dramatic appreciation of the real exchange rate from 1986 saw the growth in the non-traditional sector reverse and by 1990 export levels were no higher than in 1983. Again the 63% maxi-devaluation and the liberalization measures which commenced in 1989 promoted a depreciation of the real exchange rate and a moderate growth in non-traditional exports.





Since 1991, which was characterized by a relatively stable (if slightly appreciating) real exchange rate, non-traditional export growth has been very weak, but not because of problems in the external management of the economy. Access to foreign exchange (especially for exporters) has been liberalized while the administrative barriers to trade have been substantially removed, and the further liberalization of trade has removed the previous anti-export bias in the economy. The problems for export growth have been solely in the domestic economy. Two effects are at work. The first is that domestic inflation has exceeded the rate of depreciation of the nominal exchange rate so that the real exchange rate has appreciated. The second is that the tight domestic fiscal and monetary policies aimed at reducing inflation have imposed a serious squeeze on domestic credit to the private sector of the economy. These issues are taken up again in Section 11 of the paper.

#### *Aid and Fiscal Adjustment*

One of the concerns about large aid inflows is the risk that it may undermine the fiscal performance of government. This can happen in a number of ways. On the revenue side aid inflows may weaken the government's revenue collection effort and lower revenue. This may, of course, be optimal if aid grants in fact displace distortionary domestic taxes, although it is not necessary that the substitution is this direct. A second revenue effect may arise if, as is the case with many aid funded programmes, the import tax base shrinks as a result of a greater share of imports being eligible for exemption from duty by dint of being aid-funded. On the expenditure side aid may worsen the fiscal balance if the aid-funded projects are non-fungible and incur local counterpart contributions. In this case the government, which would not have chosen to implement the project itself, is required to increase government expenditure on local counterpart components of projects. Finally, if aid is tied to imports from a donor country, aid may have a trade-diverting effect which is to be borne by the budget.

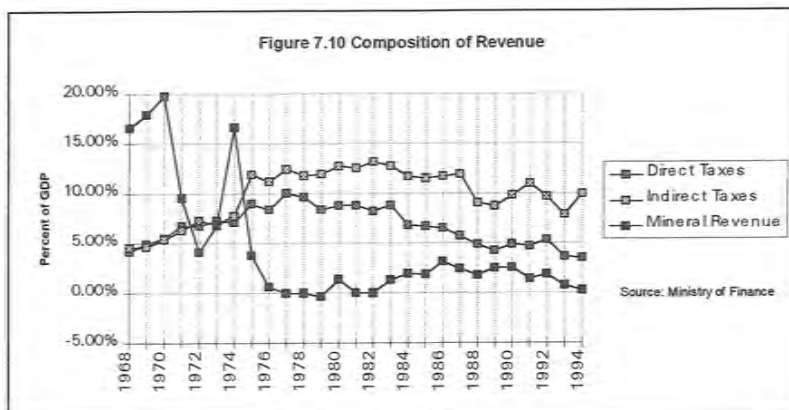
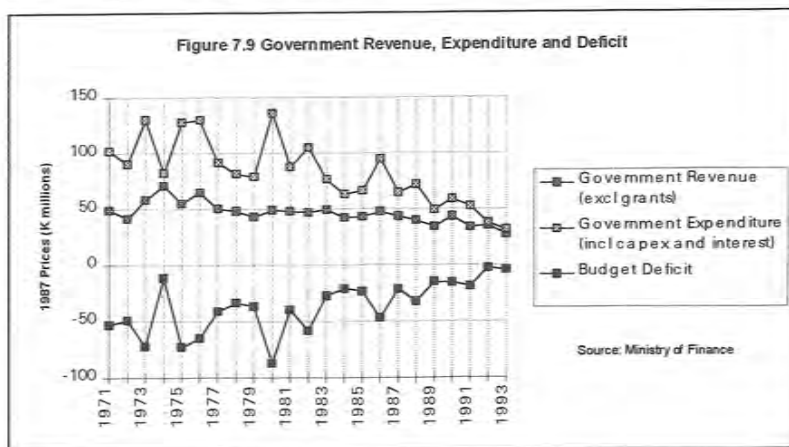
The indirect fiscal effects of aid are more complex and to do justice to them requires a level of analytical detail which is beyond the scope of this report. For example, to ascertain the fiscal consequences of the resource movements consequent on an aid-

induced real appreciation, we would require a detailed description of the composition of government revenue and expenditure between tradable and non-tradable goods as well as a model of how the private sector spending effect itself is distributed.

In Zambia, the most powerful link between aid and fiscal performance is through policy conditionality. All the aid-supported reforms have had some fiscal conditionality, although this has varied over time. Initially conditionality was light and attached to global deficit and domestic credit targets. These were frequently overshot or were met through measures which did not fundamentally alter the overall fiscal stance in the medium term (for example by increasing off-budget expenditures and increasing arrears with the parastatal sector). Fiscal conditionality under the current reform programme is significantly more comprehensive. Conditions attach not only to the level of budget deficit and its financing, but also to the composition of expenditure and the structure of revenue. At present fiscal operations in Zambia are proscribed in the following ways. First, overall expenditure is constrained by the operation of the cash-budget which prohibits borrowing from the Central Bank. Expenditure can be financed only out of domestic revenue, through the sale of Treasury Bills, and from net non-project government revenue. Second, under the Economic and Social Adjustment Credit of the World Bank, social sector spending thresholds for health, education, sanitation and social welfare must be met to trigger balance of payment support. Third, the government has been required to eliminate subsidies on maize and on agricultural inputs, and to reduce budgetary transfers to Zambia Airways. Fourth, public sector retrenchment and civil service reform is a condition of World Bank credits. Finally, the government has honoured a commitment to explicitly itemize military expenditure. On the revenue side, conditionality binds on commitments on tariff reduction and the removal of quantitative restrictions.

These latter reforms have had a major impact on the overall structure of the fiscal account in Zambia. As figure 7.9 indicates, the 30 years from independence have witnessed a sharp decline in government recurrent and capital expenditure. In the early years of the First Republic recurrent expenditure exceeded 40% of GDP. The high level

reflected a number of rigidities within the structure of public finances, many of which remained in place throughout the 1980's.



First, the development strategy adopted in the late 1960's envisaged a significant increase in public provision of goods and services. In addition, government had embarked on programme of "Zambianization" in public sector employment which involved not only increases in the volume of public sector employment but also saw an increase in the average real wage. Third, as noted, the costs of providing consumer subsidies on maize

were borne directly by the government budget. An important characteristic of each of these expenditure commitments was their strong demographic linkages (the absolute level of expenditure was a function not of income growth but of population growth), and the difficulty with which they could be reversed. Under the various reform programmes that were instituted in the 1980's, and particularly the programme from 1989 to the present period, there has been a very sharp decline in expenditure as a percentage of GDP, from a level of 45% of GDP in 1980 to 30% in 1990. The reduction in recurrent expenditure has however, been most marked in the years since 1990, falling to approximately 12% of GDP by 1993. This reduction in recurrent expenditure has been accompanied by a similar decline in government-financed capital expenditure (as opposed to direct donor-financed projects), which has fallen from around 15% of GDP in 1980 to less than 3% in 1993.

The tight expenditure squeeze has gone unrewarded, however, since it has been accompanied by a continued decline in the share of revenue in GDP. Total revenue fell from around 35% of GDP to around 12% of GDP in the two decades since 1974. The decline has occurred in two stages. During the period from 1975-80 all the decline was as a result of falling profitability of the copper sector. From 1980 onwards, revenue from copper recovered but direct taxes and taxes on non-copper production and trade declined sharply. This result is not inconsistent since though there are strong linkages between the copper and non-copper economies such that the tax revenue raised from both should be similar, the recovery in mineral revenue in the mid 1980's did not emanate from a recovery of profits in the sector but rather as a result of the switch from taxation on profits towards taxation on production. The revenue decline has persisted during the 1990's. Total domestic revenue fell below 15% of GDP in 1993 while the target for 1994 does not anticipate a recovery above this level. The revenue collapse is one of the major concerns to the donor community and the government. A number of contributory factors may be identified, many of which are attributable to the indirect effects of aid. In part the revenue collapse can be attributed to Tanzi-effects where inflation erodes the real value of delayed tax collections, and in part to what may have been an overly revenue-generous tax reform in 1993. Additionally, the rise in formal sector unemployment (and



the squeeze on real wages) has reduced the real value of PAYE receipts, while the negative effects of the aid-induced real exchange rate appreciation has undermined the profitability of the tradables sector. In the latter case the real appreciation also reduced the domestic value of ad valorem taxes levied on the foreign currency value of imports. Second, the tax structure is biased towards taxation of consumption goods, particularly consumer imports, so that the general squeeze on real incomes and lower consumption has reduced the real value of taxation.

The focus of the 1994 Budget has been towards revitalising the domestic tax effort. The bulk of the anticipated recovery is expected to come from an growth in incomes and profits and the beneficial effects of exchange rate depreciation (reversing the appreciation of 1993). However two additional policy initiatives are aimed at bolstering this recovery. The first is the quasi-privatization of revenue collection through the establishment of the Zambia Revenue Authority and the transfer of customs collection responsibilities to the private firm SGS, while the second is the introduction of a value-added tax by 1995. The former may be expected to generate some short-term results in terms of a reduction of tax evasion and collection of back taxes, but it is unlikely to generate a higher long-run revenue collections, while the VAT is likely to be at most revenue neutral since domestic indirect tax rates are already estimated to be close to their revenue-maximizing level.<sup>12</sup> The medium-term outlook for revenue is therefore relatively bleak, unless real growth exceeds expectations.

#### *Aid and Social Sectors*

Poverty measures and human development indicators for Zambia are sparse but the evidence that exists indicates that there has been a significant worsening of both. Table 7.5 summarises the available data. As can be seen, there has been a marked increase in absolute poverty (as measured by the number of people falling below a fixed, calorie-based, poverty line) between 1975, just at the height of the boom period, and 1991.<sup>13</sup>

<sup>12</sup> Given that a switch from a sales tax to a VAT involves the loss of the "cascade" effect of double taxation of inputs, it is possible that the switch to a VAT is revenue-reducing.

<sup>13</sup> It may be possible to get additional data from the just-released World Bank Zambia Poverty Assessment

The most dramatic difference between the two years is the exceptionally sharp increase in urban poverty. This must reflect not simply the decline in real wages in the urbanized copper sector, but also the reduction in the value of civil service and parastatal employment, and the progressive reduction in the subsidy on the principal urban wage-good, maize (although the major reductions in subsidies occurred after 1991). The decline in the relative affluence of the urban sector is reflected in the reduction in the Gini coefficient of income distribution. The distribution of income is more equal now than in the mid 1970's but it is clear that this has come about not through a marked increase in rural welfare but rather as a result of a dramatic decline in urban income, much of which was in the form of the fiscal transfer of the rents earned from the copper sector.

Table 7.5: Zambia: poverty, human development and income distribution

	1975	1980	1985	1991
<b>Poverty</b>				
% Below 1980 Basic Food Basket				
Urban	4.2			42.7
Rural	51.1			54.2
Total	33.9			49.4
<b>Income Distribution</b>				
Gini Coefficient [1]	0.45			0.21
<b>Human Development</b>				
Life Expectancy	48.1	48.1	48.3	49.7
IMR per 1000 [2]	110	97	-	107
MMR per 100,000 [3]	-	110	-	200
Child Malnutrition (%)	20	6	14	23
Immunization (%) [4]	-	47	81	68
Primary School Enrol. (%)	79	88	96	88
Female	72		91	85

Source: World Bank Economic and Social Adjustment Credit Proposal (1994)

Notes: [1] Gini coefficient bounded between 0 and 1 with 0 implying full equality; [2] Infant mortality rate; [3] Maternal Mortality Rate; [4] for polio and measles.

Understanding how aid has affected these outcomes requires a definition of the no-aid counterfactual, which as we have noted above is virtually impossible, although we know

that without aid, current consumption would undoubtedly be lower. What may be more important, though, is that the nature of the aid relationship will have inter-temporal effects on income distribution and poverty. For example the consumption-smoothing aid inflow in the 1970's allowed the existing regime to remain macro-compatible and therefore to prop-up otherwise unsustainable consumer subsidies to the urban sector, and to support growth-retarding policies which in the absence of aid would have been abandoned. The current fiscal conditionality, by contrast, has unwound this inter-temporal transfer to current generations from future generations, and has forced/supported a shift in consumption from the urban to the rural economy, and hence the reduction in the inequality of income measure. Moreover, to the extent that current policies are growth-promoting the current fiscal stance is effecting a transfer from the current to future generations.

#### 7.4 Summary

In this chapter we have reviewed the principal macroeconomic developments in Zambia and have discussed some of the main linkages between aid flows and macroeconomic aggregates. The picture that emerges is relatively straightforward. Over the period as a whole, despite a sharp increase in aid flows to Zambia there has been a general deterioration of the macroeconomy and a corresponding decline in welfare indicators. In the first phase of the aid relationship in the 1970's, shared views about the nature of the external shock and therefore lightly conditional aid flows validated the government's economic policy stance. Only when it was clear to both the donors and government that the economic downturn was permanent did comprehensive aid-funded macroeconomic reform start to be implemented, but this was after a decade of disagreement between donors and government. The overriding consequence of this lost decade was that the adjustment required to restore was more extensive and more costly in the short-run than would have been the case under a process of continuous adjustment, and so the benefits flowing from policy reform (whether aid supported or not) were often swamped by stock-adjustment effects which have accumulated over the last two decades. The two decades of inward-oriented policies meant that the current stock of physical capital is dominated

by import-intensive tradable capital, is concentrated in the previously heavily protected import-substituting sector; and remains predominantly state-owned. Similarly the human capital is overly concentrated in the formal public sector, in administrative and clerical rather than entrepreneurial and managerial occupations, and in risk-averting rather than risk assuming activities. Finally, administrative capacity is concentrated in the area of control by fiat rather than control by market-based regulation, while after two decades of policy reversals the "stock" of goodwill, or government credibility, is low.

Since private markets will not transform these "incorrect" asset stocks, both physical, human, and intangible into "correct" ones -- not least since without some centralized coordination the social rate of return to re-structuring the asset stocks may exceed the private returns -- a primary function of aid, and in fact the area where aid donors may have their strongest comparative advantage, is in underwriting the transitional costs of restructuring the capital stock. Because of poor design and the government's access to alternative sources of financing, the two decades of significant aid flows have done a poor job in financing this transition so that by the 1990's the capital stock was severely distorted. Only with the emergence of much tighter forms of policy conditionality after 1989, and the decline in the relative power of the government to oppose the donor-led adjustment programme, have steps been taken in the fundamental restructuring of the economy. In view of the enormous stock adjustments required, it is not surprising that it is difficult to discern any dramatic turn-around in macroeconomic performance.

However with this as the background it is not particularly useful to examine aid from the perspective of its flow impact (for example the effect of aid on imports or aid on revenue). It may be more fruitful to evaluate the contribution of conditional aid to the implementation of policy reforms that will support the necessary asset transformation. The next four chapters consider different aspects of this transition.



## Appendix 7A

### Copper and the Zambian Economy

Copper mining has been the mainstay of the Zambian economy for the past 65 years. During the period before Independence in 1964 the economy developed primarily around a core of international mining companies,<sup>14</sup> who enjoyed a boom during the immediate post-World War II period. Many of the structural problems facing the country now have their roots in the development strategy adopted at this time. The most significant were the emergence of a highly dualistic agricultural sector, which emerged as a consequence of policy directed towards maintaining the supply of low-wage labour to the mining sector. This was achieved through the combination of an agricultural taxation policy aimed at keeping the price of the staple wage good low to consumers -- achieved by a policy which strongly favoured the commercial "line-of-rail" agricultural sector by providing high subsidies on fertilizer for example -- and by actively promoting labour migration from rural areas to the Copperbelt. Smallholder agricultural, and especially diversification within agriculture was discouraged.

By Independence the copper sector had expanded dramatically. Production had reached approximately 675,000 tonnes per annum and accounted for 93% of total exports, 71% of government revenue and 40% of GDP. Over the three decades since then, the copper sector has been in decline. Although not significantly diminishing its share of total exports since the collapse of copper prices in the mid-1970's, it has contributed significantly less to government revenue and GDP than before. Copper revenues share of total revenue (excluding grants) fell from an average of 51% in 1964-74 to less than 4% in the following decade before recovering to around 10% in the period since 1986 (see Table 7A.1).

<sup>14</sup> Anglo-American Corporation of South Africa and Roan Selection Trust International - a subsidiary of AMAX Corp of the USA but incorporated in the UK.

Table 7A.1: The copper sector

	CU[1]	C/GDP[2]	C/REV[3]	C/X[4]	PRICE[5]
1965-69	653	42.3%	60.8%	93%	194
1970-74	683	29.4%	39.0%	94%	154
1975-79	651	14.2%	3.2%	91%	83
1980-84	578	14.0%	3.2%	92%	75
1985-89	459	14.0%	8.2%	85%	73
1990-93	418	7.5%	12.0%	82%	80

Notes: [1] Copper production in thousands of metric tonnes; [2] copper sector share of GDP; [3] mineral taxes as percentage of total revenue excluding grants; [4] share of copper in total exports; [5] US cents per pound in constant 1982 prices.

Over the same time the share in GDP more than halved from around 36% to just under 15%. Aside from the obvious effects arising from the sharp fall in copper prices (see below), much of the decline in the sector reflects an erosion of the comparative advantage Zambia once had in copper. Production, which reached its historical peak in 1969 at 760,000 tonnes, has been declining ever since and by the early 1990's average production levels were around 400,000 tonnes per annum. Reserves have declined in quality since the mid 1970's,<sup>15</sup> and they have become increasingly expensive to mine as shafts have deepened, while the lower than anticipated utilization of processing plant has increased operating costs. The declining comparative advantage of the sector has been exacerbated by a history of poor management of ZCCM, the parastatal copper mining company<sup>16</sup>, and a government policy towards ZCCM which has emphasized political rather than

<sup>15</sup> Gulhati (1989) reports that the in 1973 it took 43 tonnes of ore to produce one tonne of finished copper and 53 tonnes in 1983.

<sup>16</sup> State acquisition in the mining sector began in 1969 with the Presidential declaration that 51% of equity in mining companies (existing and new) would transfer to the state but at a fair book-value. From Jan 1 1970 the foreign-owned companies were re-organized into Nchanga Consolidated Copper Mines (NCCM) and Roan Consolidated Mines. The government's own holding company ZIMCO held a 51% controlling interest in the companies. From 1973 the government began to take a more active role in management of NCCM and RCM and in parallel created the Metal Marketing Company, MEMACO. NCCM and RCM merged as of 1 March 1981 as ZCCM which was 60.3% owned by ZIMCO with the minority shareholding spread between Anglo-American, Andrew Sardanis (currently owner of Meridian Bank) and the remainder being held by offshore investors.

commercial objectives for the sector. Copper production was thus at the centre of the political economy and as a consequence was the victim of frequent policy reversal (most notably in the area of taxation) and inconsistencies in the objectives of the managers which were frequently directed towards revenue rather than profit maximization.

### State Ownership and the Industrial Sector

A central feature of Zambia post-independence, as with many African economies, was the rapid growth of public intervention, and state-owned enterprises (SOEs) have been important instruments in that intervention. SOEs were created (or acquired) for a variety of reasons, but mostly in a relatively *ad hoc* fashion. Thus they owe their existence to perceived market failures in goods or factor markets; to protectionist and nationalistic concerns; in response to concerns about control of the "commanding heights"; as a means of public sector employment generation; and frequently, as a result of rescue operations in which government acted as residual legatee to failing private sector operations whose failure was often due to the structure of the macroeconomic control regime in the first place. Measured in terms of aggregate impact (by output, employment, market share etc) the sector is skewed, being the dominant mode of production in the utilities sector, transport and the capital-intensive industrial sectors and those enterprises in the manufacturing sector which existed behind high tariff and non-tariff barriers and which enjoyed preferential access to credit. The SOE sector in Zambia was, by the end of the 1980's amongst the largest in sub-Saharan Africa, tracing its origins to the early post-Independence period of the late 1960's when, following the ideological commitment for state intervention in the economy outlined in President Kaunda's Mulungushi Declaration, the state embarked on a programme of nationalization of existing private sector firms, including the mining sector enterprises, and of heavy public investment in new SOEs. By the mid 1980's the sector accounted for 35% of GDP, 13% of total external debt, almost 60% of total investment, and 45% of formal sector employment while net budget transfers to the sector totalled almost 10% of total expenditure.<sup>17</sup>

<sup>17</sup> World Bank (1984).

The sector (including companies in which government does not have full equity) consisted of 145 enterprises, 130 of which fell under the control of the Zambia Industrial and Mining Corporation (ZIMCO), the parastatal holding company.<sup>18</sup> Of the 20 or so non-ZIMCO SOEs the largest are Zambia Consolidated Copper Company (ZCCM) which is 60% government owned, the oil sector SOEs (Indeni Petroleum Refineries, Tazama Pipelines and ZIMOIL), Zambia Airways, Zambia Railways, Zambia Electricity Supply Corporation and the Posts and Telecommunications corporation. The ZIMCO companies are generally smaller, consisting of enterprises across the entire economy, but operating in sectors which are, at least in principal, tradable. Thus ZIMCO has a presence in agriculture and agro-industry (10% by number), manufacturing and non-copper mining (35%) energy and transport (25%) and services, real estate and finance (30%).

Table 7A.2 summarizes the limited data that exist for the industrial SOE sector: all data are based on the World Bank 1984 *Industrial Policy and Performance* report. However the period from 1984 until the beginning of the macroeconomic transition in 1989 did not witness any significant change in industrial structures. If anything the events of that half decade probably increased the dominance of the SOE sector.

Table 7A2: Zambian manufacturing sector: SOE market share, protection and efficiency 1984

Sector	SOE Share	ERP	DRC	K/LGr pa[80-84]
Food	72%	166%	0.47	2%
Light Manuf.	55%	114%	1.60	15%
Heavy Manuf.	64%	44%	3.00	18%

Note: ERP = effective rate of protection; DRC = domestic resource cost, K/L = capital-labour ratio.

The public sector was particularly dominant in the manufacturing sector, although food processing was highly protected but efficient while manufacturing was less heavily protected but dramatically less efficient. Moreover the capital intensity of the manufacturing sector was increasing very dramatically. This growth rate is remarkable given that not only is it certainly higher than the rate of growth of output, but was occurring at a time when SOE employment levels were high and also rising. Although we do not have evidence of the composition of the capital stock this seems to reflect the

<sup>18</sup> Zambia Privatization Agency Progress Report (Dec 1992).



importance of the high level of implicit subsidy enjoyed on imported capital investment -- a subsidy which was supported by a low level of nominal and effective protection on imported capital goods which were 8% and 35% respectively for the period covered in table A2.

Although not definitive, this evidence indicates substantial market dominance by state owned enterprise in well-protected import substituting sectors, with enterprises operating with an excessively high capital stock. The agro-industrial sector, which is the dominant non-copper export sector in Zambia seems more efficient, less capital intensive and, having a larger number of medium-sized enterprises, less concentrated. A web of extensive government control over strategic decision-making at the enterprise level completes the story, where the subordination of economic to political considerations severely reduced managerial incentives and efficiency (see Bates and Collier (1993)).

## 8. AID, GROWTH AND DEPENDENCY

Aid is primarily motivated by the desire to alleviate poverty. This can legitimately be driven both by altruism and self-interest: for example, fear of the long term consequences of a large and alienated impoverished population. However, aid gives rise to the disutility of paternalism and dependency. This is made more tolerable if the aid relationship is seen as temporary, but this in turn implies that aid should enhance growth. Donors should therefore wish there to be a high savings rate out of aid, but should not be disturbed if this is less than 100%. A rate of 100% would only be justified if the donor attached no weight to the alleviation of current poverty, yet this is the dominant rationale for aid. The World Bank's latest study *Adjustment in Africa* claims that 60% of aid is invested, which if correct would seem to be a reasonable compromise between current poverty alleviation and future growth.

The role of aid in the growth process implies that market forces are inadequate, for example, due to big push externalities. However, since the formulation of these ideas (in the 1950s) the world capital market has expanded enormously, and non-African developing countries have both attracted very large capital inflows and achieved high domestic savings rates. Africa has almost completely missed out on world capital flows and has a low domestic savings rate. This can be interpreted as strengthening the need for aid as long as these failures are not attributable to the aid relationship.

Both public and private financial creditors must take some view as to what to do in the event of poor economic performance. Poor performance can be attributable to risk. Since Africa is a high risk environment (for example, due to external shocks), the contractual structure of capital flows should address the issue of who bears this risk. The negative shocks of the 1980s revealed that African governments were bearing too much of the risk associated with capital inflows. As a result, contracts could not be honoured and so capital providers, public and private, were required to bear much of the risk *de facto*, through renegotiation of debt payments. The need for renegotiation demonstrated the inadequacy of the previous contracts: insufficient attention had been paid to

contingencies. With regard to private capital inflows, the high risk environment would have been better suited to equity than to bank loans since capital suppliers would then have explicitly borne the risks which, with bank lending they only bore implicitly. Public capital providers have no direct equivalent to the choice between equity and bank lending, but the same considerations apply. Contracts in which payments from Africa in return for the initial inflow are unrelated to the contingencies which powerfully affect the capacity to make those payments are inappropriately specified and run the risk of default and renegotiation. Default is intrinsically highly undesirable because it undermines the sanctity of contract and thereby weakens the reputation of the defaulting party in all future contracts.

Contingencies should therefore be included explicitly in the aid contract to minimise the risk of unavoidable default. Additionally, donors should want to include contingencies as a means of providing insurance which the private market has failed to supply. For example, during a drought or a temporary decline in the terms of trade it is appropriate for aid to cushion consumption. Rather than this been done by means of ad hoc emergency relief, it is better made more reliable by incorporation into the aid contract. Thereby, governments know that they have some insurance, whereas with emergency relief they have an incentive to allow problems to escalate into photogenic crises.

Were risk the only reason for poor performance contingent contracts would be simple. However, in providing insurance, donors face the standard moral hazard problem (although the aid community tends to use the language of dependency). The moral hazard problem is that the recipient of the aid will change behaviour, for example, making less tax effort. One solution to this is that aid contracts should be conditioned only upon observable circumstances over which the recipient has no control, such as the terms of trade and the weather. Additionally, the contract may specify certain observable aspects of effort, such as tax revenue. This latter approach leads into a discussion of conditionality which is deferred until section 10.

A third reason for poor performance is if the donor has made errors. These can be of two

types. The donor and the government may have agreed upon an economic policy which subsequently comes to be understood as not being best-practice. For example, the rural development policy agreed between Sweden and the government of Tanzania during the 1970s can now be seen to have been mistaken in many respects not readily knowable at the time. In such cases, poor performance is endogenous to the aid programme but not culpably so (as long as the donor and the government jointly learn as best practice evolves). A more radical way in which donors might make errors is if they overestimate the scope for development. In such a case, performance would only be poor relative to an erroneous counterfactual. However, on the whole development performance other than in Africa has exceeded expectations, and so arguments along these lines would need to be Africa-specific.

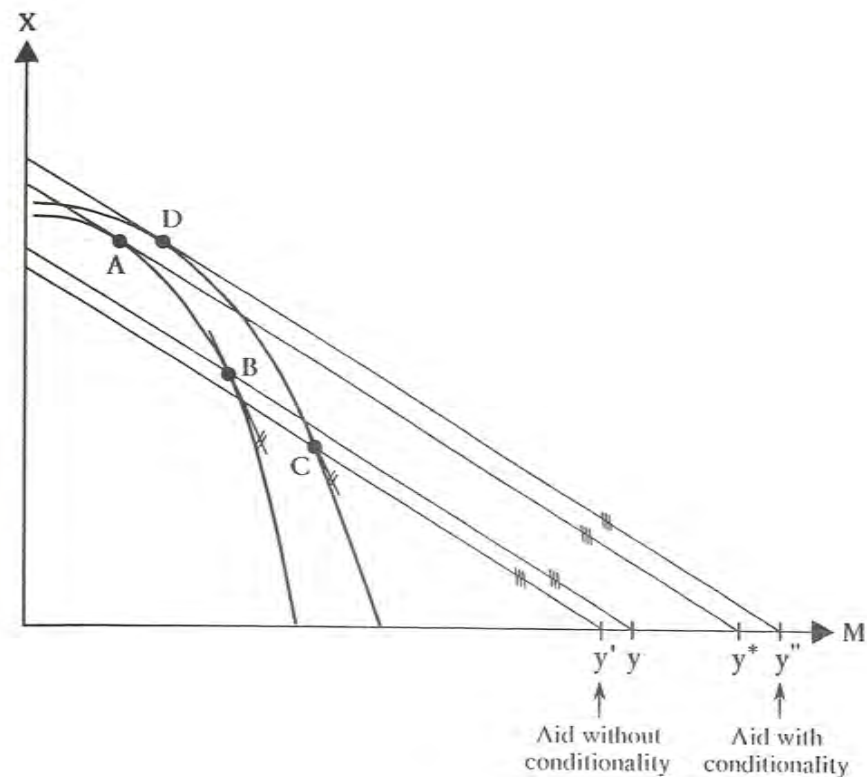


Since the mid 1980s in Zambia the question of the donor community's leverage over the recipient country's policy environment has come to the fore. Addressing this issue focuses attention on the quality of the policy environment and on the disbursement mechanism involved (whether the aid is conditional or non-conditional, programme or project aid, for example).

A very simple example illustrates how policy distortion can make the contribution of aid negative. Consider a two-sector small open economy described by the production possibility frontier shown in Figure 9.1, which is assumed to operate with a capital intensive importables sector ( $M$ ) and a labour intensive exportables sector ( $X$ ). Being small, it faces given world prices for both goods so that production at world prices would be at  $A$  which would produce a national income, measured in terms of the world price of importables, of  $y^*$ . Suppose however that domestic policy favours heavy protection of the import-substituting sector. Domestic relative prices are then given by the tangent at point  $B$  which corresponds to a level of national income  $y$ , measured in world prices. The domestic price distortion thus lowers national income relative to the free-trade configuration.

Consider now what happens to the economy with an aid inflow which is devoted entirely to investment (so that we ignore the fungibility between consumption and investment). Given the structure of domestic prices the aid inflow will be attracted into the capital-intensive import-competing sector, and production will occur at  $C$  which *lowers* future GDP relative to the no-aid situation. If, however, the aid flow were accompanied by conditions requiring the elimination of protection, production would move to a point  $D$  and a *higher* future GDP. Only if it could enforce this conditionality would a donor concerned about output growth at world prices give aid to this economy. The example just cited is extreme but it makes the central point that the effectiveness of aid is not intrinsic to the macroeconomics of aid itself, but rather to the interaction of aid and the policy environment.

Figure 9.1: Aid and Growth



Despite its obvious limitations this caricature example is probably highly appropriate to the Zambian situation of the 1970s and 1980s. Factor market distortions where capital and foreign exchange were relatively cheap and labour relatively expensive produced exactly this kind of capital-intensive import-substituting policies where domestic investment was dominated by the parastatal sector which was able to command highly distorted factor prices. It should be clear that given these initial conditions the effectiveness of aid without policy reform will be limited and may even be negative. In the remainder of this section we therefore focus on some issues of aid and conditionality. We commence with a discussion of why such policy distortions may exist in the first place and how this may lead the emergence of policy conditionality, either demanded by the donor or requested by the recipient government. An important extension to these results is the case where for various reasons the donor cannot fully monitor the true effort of the recipient government. Aid flows can substitute for efficient policy action on the part of the government, and this is a particular problem when the donor is unable to determine whether particular outcomes are due to bad luck (arising from external shocks) or to slack economic management. Understanding these moral hazard features in the relationship between the donor and recipient government points toward a set of design issues.

#### *The Emergence of Inappropriate Policy Environments*

There are three reasons why the policy environment may remain poor. The first is that governments may simply be mis-informed as to the consequences of a policy. A good example of this was the view that maintaining an overvalued official exchange rate was a means of avoiding cost-push inflation. If government believed this, then it would not of its own accord devalue the official exchange rate even though had it done so it would have found its previous views to have been incorrect.<sup>1</sup>

A second reason for the existence of what are seen by the donors as "bad policies" is that donors and the government have divergent preferences over policy choices. We do not

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<sup>1</sup>This argument is made in the context of Uganda by S.Morris (1994).

need to discuss in detail why preferences may diverge, but possible explanations would include different weights placed on investment over consumption, divergent views on the trade-off between current employment and future growth, and the choice between import protection and export promotion as a means of fostering growth. A further source of divergence arises where the donor and recipient hold different views about distributional issues. For example, there may be domestic political constraints on governments requiring the use of transfer mechanisms. An overvalued official exchange rate is one such mechanism which taxes exporters surrendering their export proceeds at the official rate and subsidizes importers with access to foreign exchange priced at the official rate. Even though such transfers may be necessary for a government to remain in power, donors may not acknowledge these political constraints.

A third case for bad policy is where both the government and the donor agree that the policy is bad but the government faces reputational problems such that it cannot signal its commitment to new policies. Credibility problems of this form are endemic to policy reform because of the intrinsic time-inconsistency of government actions. Governments have the sovereign power to alter economic policy (for example through tax rates) and the knowledge that they have an incentive to alter the tax rate once the private sector has made irreversible commitments (ie investments) will deter the private sector from acting in the first-best interests of the government. If the latter were able to offer a means of pre-commitment to a set of policies, such credibility problems disappear. Getting around this problem requires that governments either find mechanisms to pre-commit themselves not to reverse policy changes or find mechanisms to create a reputation for not reversing previous policy.

#### *Aid and Conditionality in the Face of Bad Policy*

Conditionality, and particularly macroeconomic conditionality, has emerged as an important component of adjustment lending in the 1980s and 1990s. While conditionality may in part reflect bureaucratic or managerial requirements within the donor country, or may also simply represent a convenient form of packaging and coordinating the donor community's policy advice, by far the most important motive is in terms of using aid to



address inappropriate policy environments. Of the three reasons why a bad policy environment may exist, the first is the easiest to deal with. Conditionality provides a means of forcing governments to "see the error of their ways". We need not, however, dwell on this case. The more interesting cases are when there are disagreements between the donor and the government and where there are credibility problems. A simple model of aid and disagreement can be found in Appendix 9A to this chapter. The model considers a simple case where there are only two activities which can be financed by aid, namely the creation of infrastructure and the provision of patronage. Throughout it is assumed that donors receive utility from aid flows but their weighting of the relative value of the two activities financed by aid differs from that of the government (this is the essence of the disagreement, and we assume that the donor has a larger weight on the provision of infrastructure than the government). Moreover there is some opportunity cost to the aid dollar, either in terms of domestic uses or as an allocation to another country. Finally it is assumed that even though donors may place a low weight on patronage, it may not be possible for political reasons to reduce the amount of such goods financed through aid.

The principal implications from the model are as follows. First, where there is disagreement between the donor and the recipient conditionality can serve to allow aid to flow, and, more importantly, it allows aid flows either to be larger, or at least more efficient, than when there is disagreement. By more efficient we simply mean that the allocation of the aid between infrastructure and patronage reflects the preferences of the donor. Conditionality in this situation serves to commit the recipient to reducing the relative price of the infrastructure in terms of patronage. See Figure 9A.1

Secondly, if the donor has strong bargaining power it may be possible to sufficiently alter the relative cost of infrastructure in term of patronage that the gain in terms of the provision of infrastructure may be greater than the aid inflow. In such circumstances the aid inflow is associated with a greater-than-proportional increase in infrastructure and a decline in the level of patronage relative to the non-aid position. Conversely, in the situation where the recipient has bargaining power, conditionality would be pareto-

improving but the gains from conditionality would accrue to the recipient. The increase in infrastructure provision would be less than the aid inflow and the level of patronage would rise above the no-aid position. See Figure 9A.2

Third, political solvency conditions may place a lower bound on the supply of the patronage goods and this will therefore limit the gains to conditionality enjoyed by the donor. Figure 9A.3.

More generally, the position of the contract curve will reflect the level of disagreement between the donor and recipient, the opportunity cost of aid to the donor, and also the domestic resources of the recipient. Changes in any of these factors will shift the whole contract curve. Movements along the contract curve, on the other hand, reflect the bargaining power of the parties, although the model presented here does not provide an explanation of the bargaining power. Nonetheless it is possible to consider the effect of changes in the determinants of the "outside option" of donor and recipient. First, as the donor and recipient increasingly disagree in their preferences between "infrastructure" and "patronage" the contract curve will flatten and for each aid level the contract curve level of "infrastructure" will be higher. Second, as the own resources and the outside option for the recipient deteriorates then the contract curve extends towards the x-axis and if the donor enjoys bargaining power this will move the outcome in favour of the donor. Third, as the donor's opportunity cost of aid increases, and as its outside option improves, the maxima of the donors utility curves move to the right and thus all points on the contract curve move horizontally in favour of the donor (ie for each level of aid), the provision of infrastructure is higher and the provision of patronage is lower than before.

These simple results are quite consistent with the evolution of conditionality over the two decades from the mid 1970s in Zambia. First, as Zambia's domestic resource mobilization, particularly from the mineral sector, weakened so conditionality emerged; similarly conditionality emerged during the early 1980s as the donors and government first began to disagree about the appropriate policy response to the collapse of the copper

sector. Second, the emergence of stronger domestic pressures for more open accountability in aid flows and cuts in total domestic revenue forced up the marginal cost of aid to the donor and hence shifted the contract curve in favour of the donor. Third, the decline of the Zambia's credit-worthiness in the private capital markets and the disappearance of the former Eastern bloc as important non-DAC aid donors has weakened the government's outside option.

By this interpretation the emergence is of stronger conditionality in Zambia over the 1980s reflects changes in the relative outside options of the donor community and the government *within a framework of disagreement*. From this perspective the evolution of increasingly tighter conditionality since 1989 and particularly in 1991 is of particular interest since it may be anticipated that disagreement as to the appropriate form of policy reform has reduced substantially. From the perspective of the previous discussion this would be expected to shift the contract curve back in favour of the recipient.

That this is not the case leads us into the third case discussed above, namely where the government and donor are in agreement as to the appropriate policy framework, but where there are impediments to the government moving to the preferred configuration. The first set of impediments occurs when reform is blocked by politically powerful coalitions which, for political reasons, the government is unable to bypass. If we re-cast the earlier discussion in terms of the differing preferences between the blocking coalition on one-hand, and the government/donor on the other, the same analysis applies. If in the case of Zambia we imagine the blocking coalitions being, for example, the parastatal management or public sector unions, then the evolution of tighter conditionality since 1989 is consistent with government being in agreement with the donor, with conditionality being able to alter the behaviour of the blocking coalitions. An interesting example of this type of conditionality is the recently agreed Economic and Social Adjustment Credit (ESAC) between the World Bank and Zambia. The government (in particular the technocratic wing of the government) has demonstrated a commitment to maintain a suitable level of social sector spending, an objective shared by the World Bank. Other coalitions within the MMD party and government have not shown the same

commitment to this sector. By specifying exact targets for social sector expenditure, the ESAC conditionality strengthens the hand of the technocratic wing of government in the manner described above.

### *Signalling Credibility*

The alternative explanation for tighter conditionality in the 1990s relates to the pure signalling problem faced by the government. One way of characterizing this is to think of government being either committed to reform or not; from the perspective of the donors they will disburse aid handsomely to true reformers and less so to uncommitted reformers: lending to committed reformers give the donors more bang for its buck since the government will lower the cost of the donors preferred good in terms of the patronage good. However the donor cannot tell what type of government it is dealing with, since it will be in the interest of the uncommitted reformers to masquerade as true reformers to attract the donor funds and then to allocate them according to its own preferences. There is a clear incentive for the true reformers to signal their type and one way in which this can be done is to demand a conditionality that is sufficiently tight that only committed reformers would be prepared to accept the terms of the contract. In this manner conditionality can be used to separate committed from uncommitted governments. There is strong evidence that the evolution of the Right Accumulation Programme since 1991 as been used by government as such a vehicle. The government have publicly embraced the RAP and on a number of occasions undertook measures that exceeded the RAP requirements in order to signal their commitment. There is considerable evidence that the current government has successfully signalled its "type" to the donor community.

The problem of credibility goes deeper however, and concerns the question of the time-consistency of government policy. The governments of sub-Saharan Africa do not have a good track record on policy consistency. This lack of credibility undermines reform since the private sector will not respond to relative price changes for fear of government reneging on its policy (for example by reintroducing controls on foreign exchange), particularly if conditionality is temporary. As long as adjustment costs are important for



the private sector, resource movement will be less responsive to relative price signals when governments have low credibility than when their credibility is high. In the limit the lack of credibility in government may be self-fulfilling, in that the private sector's actions based on the incredible policy will force that policy to be reversed. Governments thus have an incentive to use aid (and also the design of aid) to purchase credibility for its programme so that the private sector will respond to government's policy reform. This requires, of course, an implicit threat in the conditional contract that failure to adhere to the contract conditions on the part of the government would be met by a cessation of aid on the part of the donor.

It is unclear whether the donor community is credible in Zambia. In the past the donors have not imposed sanctions against the government for failure to fulfil the terms of the contract. Part of this is the recognition that in a number of cases the failure of the government to achieve targets was not as a result of weak commitment on the part of the government but rather poor design of the contract (this is discussed in more detail below).<sup>2</sup> Conditionality in and of itself will not therefore solve the problem of providing a commitment mechanism for governments. Detailed discussion of how conditionality may be designed to meet these objectives is deferred to Section 10.

<sup>2</sup> There is a more serious concern that the donor community in Africa, particularly the multilateral institutions, cannot make credible threats against policy default since to do so runs the risk of precipitating a wholesale collapse of the adjustment programme in Africa on which the reputation of these institutions rests.

## Appendix 9A: A model of aid and conditionality

### 1. The motives of donor and recipient

There is a conflict of interest over the allocation of resources, particularly aid flows between two alternative uses, "patronage" (P) and "infrastructure" (I). The recipient government gets positive but diminishing marginal utility from both objectives and seeks aid inflows in order to increase its own utility. For simplicity, we assume that the recipient's utility function takes the separable form

$$(1) \quad U(I, P) = u(I) + v(P), \quad v', u' > 0, v'', u'' < 0.$$

In the absence of aid, the recipient has total resources T to allocate between the two activities. If the price of each activity is 1 and the amount of aid received is A, the recipient's budget constraint takes the form

$$(2) \quad I + P = T + A.$$

Figure 9A.1 shows the recipient's allocation of total resources with and without aid in amount A, assuming that the aid comes without conditionality. The 'no-aid' point is N, with utility level  $U_0$ ; since both infrastructure and patronage are normal goods, increases in aid will be allocated to both activities on the margin. We have assumed for simplicity only that U is homothetic, so that the expansion path associated with changes in total resources, OR, is a ray from the origin.

The donor's preferences reflect three key features. First, the donor has limited resources and therefore has alternative uses for each dollar of aid, which may be to reduce domestic taxes or to allocate to another country. Second, disagreement is a matter of degree and we want to allow for cases in which disagreement is either negligible or dramatic. Third, disagreements (if any) are fundamentally over the relative weight to be placed on the recipient's domestic objectives. We can capture these features by assuming that the donor's utility depends not only on the recipient's utility but also on the donor's own

domestic activity,  $D$ :

$$(3) \quad V(I, P, D) = U(I, P) - \theta v(P) + \delta D$$

The case of complete agreement<sup>3</sup> is where  $\theta = 0$ : in this case, the donor takes the recipient government's utility as its own and is only constrained by the existence of competing demands at home. Disagreement occurs when  $\theta \neq 0$ , and we will focus on the case in which  $\theta = 1$ . In this case, the two players differ radically over the value of patronage: the recipient values it but the donor does not value it at all.<sup>4</sup> We have assumed in (3) that the donor's utility is linear in its domestic activity,  $D$ ; this simplification eases the analysis and is natural to the extent that aid is a very small portion of total government expenditure by the donor.

The donor's budget constraint takes the form

$$(4) \quad A + D = R,$$

where  $R$  is the total revenue available for aid or domestic uses. We can therefore rewrite the donor's preferences, using (1), (3) and (4), as a function of  $I$  and  $P$ :

$$(5) \quad V(I, P) = u(I) + (1-\theta)v(P) + \delta(R + T - I - P).$$

Figures 9A1a and A1b show the donor's indifference curves for the cases of agreement and disagreement. It is clear from (5) that these have zero slope at the value of  $I$  satisfying  $u'(I) = \delta$ , and that (given the concavity of  $u$ ) movements to the left or right

<sup>3</sup> If there is no conflict between the recipient government and its own constituents, then 'agreement' means roughly the same thing as 'altruism'. But in general the two diverge, and disagreement between the donor and the recipient may not indicate a failure of altruism on the part of the donor but rather a difference between how the two players trade off the welfare of different groups within the recipient country.

<sup>4</sup> Disagreement would be even more radical if  $\theta > 1$ , since in this case the donor gets negative marginal utility from patronage; one can also imagine a situation in which the recipient cares only about patronage. The latter case can be approximated by setting  $\theta = 1$  (the donor doesn't care about patronage) and allowing the marginal rate of substitution between  $I$  and  $P$  to go to infinity (the recipient always chooses arbitrarily small  $I$ ).

of such points leave the donor worse off. In the agreement case, a symmetrical statement can be made about  $P$ : the indifference curves are vertical at the value of  $P$  satisfying  $v'(P) = \delta$ , and utility falls with vertical movements above or below such points. Indifference curves are therefore ovals in the agreement case, centred on the 'bliss' point  $B$ ; in the disagreement case, they are inverted parabolas centred on the same  $I$  axis.

We also identify the indifference curves corresponding to the 'no-aid' levels of utility  $U_0$  and  $V_0$ . It is clear that 'gains from aid' are available in either situation. In the agreement case, both donor and recipient are made better off by increases in aid that move the solution up the recipient's expansion path towards the donor's bliss point. There is no gain for the donor in trying to move the recipient off the expansion path; the two players have identical marginal rates of substitution at all points on that path. At point  $B$ , further increases continue to make the recipient better off but by less than the donor's opportunity cost ( $\delta$ ). The donor is therefore made worse off. The 'contract curve' of Pareto-efficient agreements is the (heavily shaded) portion of the expansion path between the donor's bliss point and the point at which the donor's utility falls back to the no-aid level.

In the disagreement case, the set of points at which donor and recipient have identical marginal rates of substitution is given by the upward-sloping curve  $CC$ , which originates at a point of zero patronage and rises up to cut the expansion path from below. The contract curve is the (heavily shaded) portion of  $CC$  that lies between the no-aid utility levels.

## 2. Equilibria without conditionality

How much aid will be provided? The answer depends on the strategic environment. In this section, we assume that the donor chooses the amount of aid and makes a 'take-it-or-leave-it' offer to the recipient, with no attempt to enforce conditionality of any sort. In this 'Stackelberg' environment, the donor knows that the recipient will choose a point on its expansion path once the aid has been transferred. The donor's task is therefore simply to choose its own most preferred point on the recipient's expansion path, subject to the



constraint that aid be nonnegative.

The solution in the agreement case is apparent from Figure 9.A1a. The donor simply chooses its bliss point, equating the marginal utility of both  $I$  and  $P$  with the opportunity cost  $\delta$  (which is the marginal utility of the domestic activity). Not surprisingly, the players end up on the contract curve. Under disagreement, the donor chooses the unique point of tangency between one of its indifference curves and the recipient's expansion path, provided this point lies above the no-aid point  $N$ . It is apparent from the figures that aid is lower when the players disagree than when they agree. Moreover, the disagreement outcome is off the contract curve and is therefore inefficient. The form of inefficiency is dramatic: both  $A$  and  $I$  are lower in the Stackelberg equilibrium than they are at any point on the contract curve.

### 3. Costless Conditionality

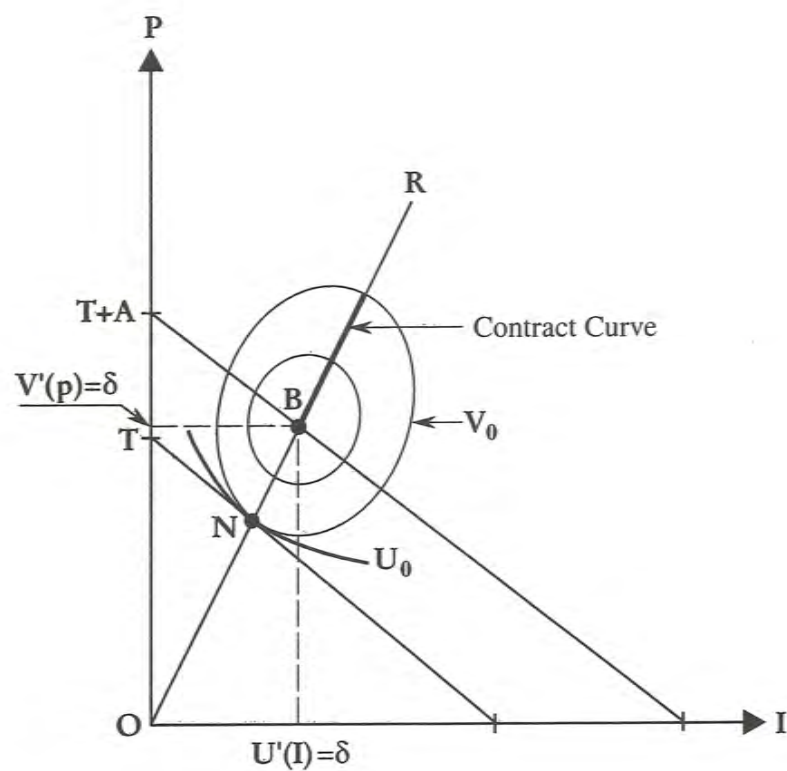
There is no role for conditionality when the players agree.<sup>5</sup> The equilibrium in the absence of conditionality is on the contract curve; the players therefore start at a Pareto efficient allocation, from which it is by definition impossible for the recipient to bind itself to an action that will increase the utility of both players. Figure 9A2 shows the case in which the donor's offer is of the form  $[A, I]$ , where  $A$  is the amount of aid provided and  $I$  is the minimum amount of spending on infrastructure allowed in the aid 'contract'.

In effect, the recipient is binding itself to lowering the effective price the donor must pay (in terms of aid) for an additional unit of infrastructure. Both aid and infrastructure spending are unambiguously higher in the 'binding' equilibrium, and both players are better off. It is clear, however, that the contract curve cannot be reached through a pre-emptive move by the recipient that lowers the effective price of aid to the donor. The contract curve can be reached, however, by contracts of the form  $[A, I]$  — indeed, any allocation to the right of the recipient's expansion curve and in the interior of the region

<sup>5</sup> There may not even be a role for conditionality targeted to credibility when the donor's preferences over domestic objectives are identical to the recipient's. The donor's threat to cut off aid will be just as incredible as the recipient's promise to perform the desired action.

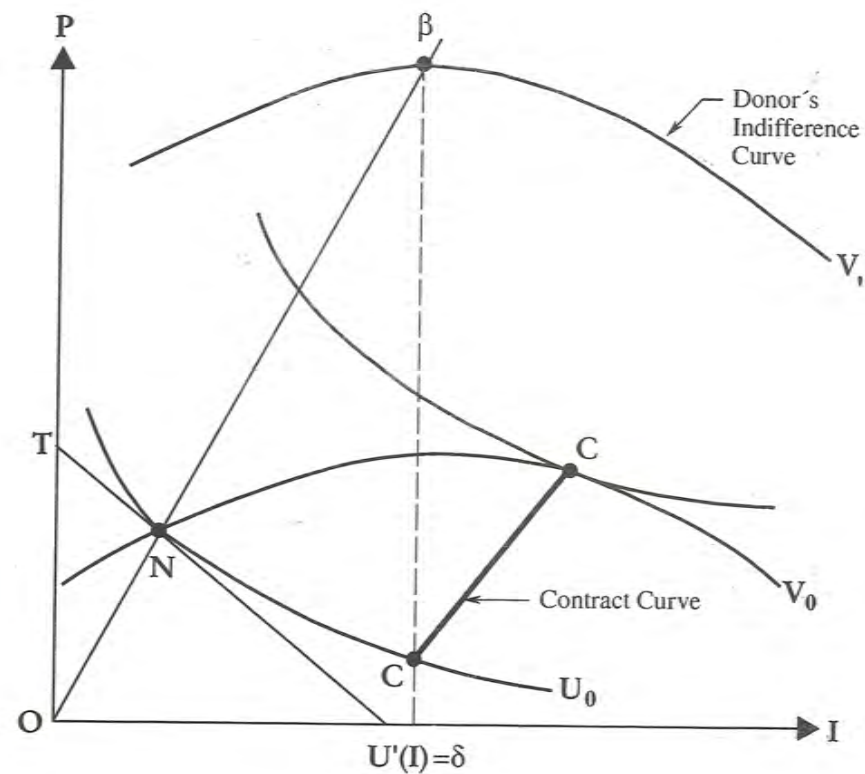
circumscribed by  $U_0$  and  $V_0$  can be reached by a contract of this form. These place a minimum level on the desired activity — or equivalently, a maximum level on patronage — and in that sense mimic conditionality clauses familiar from actual aid relationships. The Stackelberg equilibrium is at point 1, where aid is devoted entirely to infrastructure and all the gains from conditionality have gone to the donor. An alternative (perhaps less natural) Stackelberg equilibrium, in which the recipient makes a take-it-or-leave-it offer, is at point 2, on the other end of the contract curve. Bargaining equilibria will generally lie in between.

**Figure 9A.1a: Agreement Between Donor and Recipient**



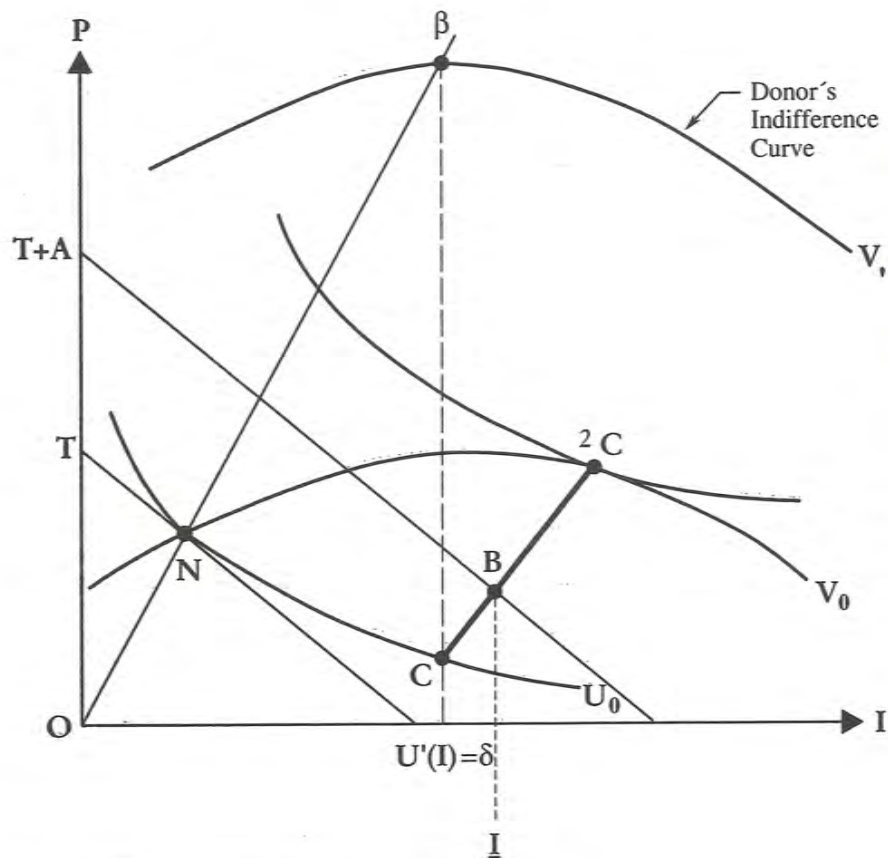
**N:** No-aid point  
**B:** Agreement

**Figure 9A1.b: Disagreement between Donor and Recipient with Conditionality**



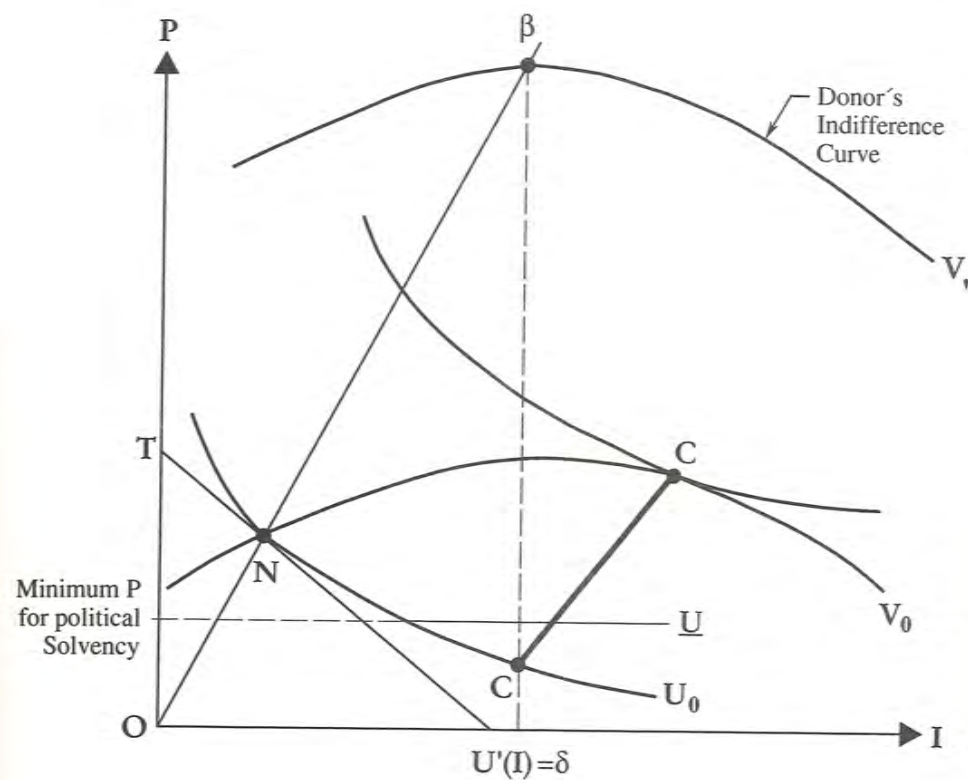


**Figure 9A.2**



Contract [A, I] provides outcome at B

**Figure 9A3: Disagreement with Binding Political Solvency Constraint**



The arguments of the previous section discussed possible ways of explaining the emergence of conditionality in the aid relationship. There are two important design issues that need to be addressed. The first issue is how "incentive" or *ex ante* contracts can address the moral hazard problems which arise when the donor is unable to separate bad luck from weak effort on the part of the government. The second concerns whether a contract should be designed as an "incentive" to perform good policy or whether it should be a "reward" for having done so. We deal with each in turn.

#### *Moral Hazard and Conditionality*

The contracts and conditionality discussed in the previous section make the implicit assumption that once agreed, the conditions of the aid disbursement can be monitored and verified. In reality the problem is less clear. The problem facing the donor is that it wishes to finance the formation of infrastructure but at a low cost in terms of government slack or "patronage". The infrastructure, however, is produced by combining aid and the own resources of government,<sup>1</sup> but the observed level of government resources is due partly to the state of the world and partly the policy reform and the effort put into tax collection. The problem is a standard principal-agent one with the following feature. If the recipient is risk averse, in the sense that it prefers the certain equivalent level of aid across different states of the world, and the donor is risk neutral the efficient risk-sharing arrangement is for the donor to bear all the risk and to provide the recipient with a constant aid flow. However, if the recipient is given such a contract it will have an incentive to relax domestic tax effort in all but the worst state of the world so that the aid is allocated partly towards infrastructure and partly towards substituting for domestic tax effort. Knowing this the contract offered by the donor will not be a constant aid flow contract but will be a function of the outcome. However a feature of the contract will be that good outcomes are "over-rewarded" relative to their level of tax effort or policy

<sup>1</sup> Even if the full cost of the infrastructure was met by the donor we can assume that the donor's principal interest in seeing the infrastructure function effectively which requires some own-resource input.

reform while poor outcomes are "under-rewarded" because the donor cannot distinguish luck from effort.<sup>2</sup> In other words, in order to provide an incentive for the government to put in a high tax effort some of the insurance effect is sacrificed.

This form of contract can be seen to play itself out in a number of country programmes, including a particularly clear case in Zambia in 1991-94. Unlike the earlier aid packages of the 1970s (such as the IMF Trust Fund and Standby arrangements) the current programme trades off the insurance benefits of a constant aid flow with incentives defined in terms of some observable outcome. The Rights Accumulation Programme (RAP) is typical of this approach and is a conditional contract defined in terms of two observables; growth in reserve money and domestic credit to government. Although *ex post* it has proven relatively straightforward to determine the effort level of government, this was not so when the IMF was evaluating the outcomes. During the 1992/93 fiscal year, when the economy was faced with extremely bad luck in the form of the drought, performance under the RAP was poor and no Rights were accumulated by government. This occurred even though *ex post* it was clear that effort by the government was indeed high. However due to the unobservability of effort, this government was "underpaid". Again in late 1993 higher than expected capital account inflows responding to high domestic interest rates led to an increase (relative to the counterfactual) of reserve money. As a consequence no rights were accumulated even though *ex post* it was clear that the government's domestic monetary and fiscal stance was tight. An example of the opposite result may come from Uganda where a particularly good harvest during the stabilization period led to an "overpayment" of aid.

If donors are interested in reducing the deviation from the efficient risk-sharing contract and governments who are committed to good governance are risk averse, there is an incentive from both sides to tighten conditionality in order to distinguish luck from effort. This is easily achieved by defining the contract contingently in terms of some measure which is observable to both parties and is correlated with either the state of the world or

<sup>2</sup> see Ray Rees (1985) The theory of Principal-Agent Part I. Bulletin of Economic Research.



the effort of the government. Since this gives both parties additional information on the state of the world it is easier to infer whether a poor outcome was due to poor effort or a bad state of the world. The loss of efficiency in the contract is relative to the case where the donor can directly view the state of the world.<sup>3</sup> It is important, however, that the additional information is outside the control of the government. In most cases this will be some indicator such as the international terms of trade when the economy is a price taker. Alternatively, contracts could be specified on a tournament basis where aid flows were conditional on both the absolute outturn and the outturn relative to neighbouring or comparable economies. This latter contract obviously controls for common regional effects although not for unobservable country-specific effects.

Contingent contracts are however relatively rare. The principal exception for Zambia concerns revenues accruing solely from movements in the international copper price. The Rights Accumulation Programme targets for domestic credit are adjusted downwards (upwards) if copper revenues exceed (fall short of) the level anticipated on the basis of an unchanged world copper price.

#### *Conditionality: Ex post or Ex ante?*

There are two viable and alternative approaches linking aid to policy. One is detailed *ex ante* conditionality backed by credible threats of aid reduction. In this approach the donor specifies desired policy and monitors adherence to it. The ideal version of this model is one in which the specification and monitoring are so tight, and the penalties so severe,

<sup>3</sup>An example illustrates the case (see Rees (1985)). The recipient can choose three levels of governance,  $Q = \{1, 2, 3\}$  and there are two outcomes for  $I$  and  $Z$   $\{0, 1\}$ . Suppose the individual probabilities for  $I$  and  $Z$  are

$Q =$	1	2	3
$I = 0$	0.8	0.5	0.2
$I = 1$	0.2	0.5	0.8
$Z = 0$	0.9	0.5	0.1
$Z = 1$	0.1	0.5	0.9

Clearly, if we only looked at  $I$  then the recipient will be paid well ( $I = 1$ ) when in fact the governance level is low ( $Q = 1$ ) 20% of the time. If the contract is defined over  $Z$  and  $I$  then the joint probability  $\{I = 1, Z = 1, Q = 1\}$  is only 2%. Conversely, of course the risk of not being paid for full effort ( $Q = 3, I = 0$ ) fall from 20% to 2% ( $Q = 3, I = 0, Z = 0$ ). Note also that the payment for full effort ( $Q = 3$ ) when conditions are good ( $Z = 1$ ) and a good outcome is now  $0.8 \times 0.9 = 0.72$  which is lower than the contract solely on  $I = 1$ . Thus good luck is not overpaid (because it is due to a good luck) and bad luck is compensated for

that moral hazard problems are avoided and the government implements precisely the programme desired by the donor.

The alternative approach is for donors to use *ex post* evaluation without specifying in detail how performance will be evaluated other than as a contest between a group of potential recipients (in other words a much more general form of the tournament contract noted above). The ideal version of this approach is that governments compete to design and implement programmes which they judge that donors will regard favourably when the programmes are evaluated.

The advantage of the *ex ante* approach is that, if successful, policies change precisely as the donor desires and so the policy objective is completely achieved. The disadvantage is that the donor rather than the government owns the programme. The lack of government ownership has four detrimental features. First, it has connotations of neo-colonialism and so may be offensive. Secondly, it precludes capacity-building in government, particularly in the area of policy making since there is no learning by doing. Thirdly, the government has some informational advantage over the donor and so, if it chooses to do so, is likely to be able to stay one step ahead in terms of meeting measured performance indicators in ways which do not actually deliver what the donor wants. Fourth, and arguably most important, the government cannot accumulate reputation because it cannot demonstrate that its actions in implementing policies are chosen rather than imposed.

*Ex post* conditionality on the other hand has the advantage that governments must own the programmes which they implement, with the consequent advantages of ownership. Ownership may provide the opportunity for reputations to be built independently of the donor, while it may alleviate the worst of the moral hazard problems associated with the *ex ante* contracts. However there are also a number of drawbacks. The first is that should a government choose to misuse aid it is free to do so during the period for which aid has been unconditionally pre-committed. Secondly, the "beauty contest" phenomena may be severe as governments compete to catch the eye of bilateral donors each of whom

may have separate and possibly inconsistent objectives. Coordination between donors then becomes an important issue, not just periodically, but also continuously.

Between these two very different, but viable, approaches is the middle ground of lightly specified *ex ante* conditionality which characterised early adjustment programmes. Such programmes are liable to three types of failure. First, because contingent events are not adequately specified, performance can fall below specified requirements for reasons beyond the control of the government. The donor then faces the choice between adhering to the conditions and thereby withholding aid, and condoning a breach of the conditions, thereby weakening credibility. Secondly, performance can fall below specified requirements because of government choices, and the donor is then faced with the choice of whether to withhold aid and, if so, for how long. Failure to withhold can be presumed to remove the subsequent credibility of conditions, but donors have sometimes chosen to withhold aid only for a short period before reopening negotiations. This produces both a low price for breaching the conditions and volatility (discussed below). If conditions are to be imposed, then their design should be that they are breached only by choice (i.e. contingencies are fully specified) and that the penalties are so severe (subject to credibility) that they will never be called. Thirdly, the programme might fail despite the government's adherence to the letter of the conditions because it has found ways of evading them. For example, if the government is required to reduce budget subsidies to state-owned companies, it may achieve this by removing the budget subsidy but offsetting the effect by requiring state-owned banks to lend to them. This meets the letter of the condition but fails to achieve the true objective of the condition because of poor specification. The logic of failures of this type is gradually to close loopholes by adding more detailed conditions. That is, there is a tendency for this type of conditionality to evolve into the first of the two more viable options.

Historically in Zambia conditionality has been of the former type with the donors and IFIs specifying the conditions required for disbursement of each tranche of funds. Of late, however, there has been the emergence of a form of *ex post* conditionality, particularly in the area of governance. This is most marked in Kenya where the aid

moratorium by the IFIs and bilateral donors elicited a domestically-generated reform programme built around various developments in the area of governance and economic liberalization. The donor community have responded with a significant increase in aid flows. The events of the December 1993 Consultative Group meeting may be seen in the same light with the donors indicating concerns to government but without specifying any conditions *ex ante* so that the ownership of the subsequent policy reform was firmly Zambian. As with Kenya the donor community responded with a significant increase in aid commitments in March 1993.

Why should we worry about the creation of reputations? African governments have a poor track record on policy reversal. This is as true in Zambia as anywhere else as the experiences of the mid- 1980s indicates. Because African governments have a poor reputation, the intrinsic problems of the time-consistency of policy reform is particularly acute. Private investors everywhere know that governments will always have incentive to change policy after investors have made moves that are if not irreversible, at least costly to reverse. This is a natural part of the investment decision, but because African governments have a credibility problem much more severe than those in other regions, the acquisition of mechanisms that promote reputations is important. There is a considerable contrast between the reputational consequences of these three approaches to monitoring: loose *ex ante* conditionality; tight *ex ante* conditionality; and *ex post* evaluation. Loose conditionality invites default. This is costly not only because it fails to achieve its objectives but also because the government acquires a reputation as a defaulter. Tight conditionality, as discussed above, precludes the scope for the acquisition of reputation. By contrast, *ex post* evaluation increases the incentive for the government to acquire reputation. These differences may have important effects upon growth. Private investment in Africa is low partly because of the limited credibility of reform programmes: hence, an aid relationship which induces, rather than discourages reputation-building is likely to have repercussions on the rate of private investment and through this onto the growth rate.

It is not obvious that external donors will themselves have sufficient credibility with



which to underwrite the credibility of the government. In all cases donors as well as governments have a credibility problem since the domestic private sector (and foreign investors) are not certain that donors will implement penalties. This problem is obviously worsened if *ex ante* conditionality contracts are not adequately specified in terms of contingencies, as discussed above. However, even when well-specified, the breach which triggers withdrawal will generally be of a technical nature, and although such breaches have the advantage of being clear-cut, they have the disadvantage of seeming too trivial for sustained withdrawal so that expected penalties may be too light to discourage default. By contrast, *ex post* evaluation has the disadvantage of being less clear-cut: an overall judgement is being made about the past record of government A versus government B, so that a bad government might anticipate that there is more scope for fudging over poor performance. However, this has the offsetting advantage that, once the decision is made to withdraw, the grounds are non-technocratic and so the withdrawal is more credibly persistent. Whichever strategy donors choose to follow, credibility can only be built up through reputation, and this is likely to require that, until reputation is acquired, there will be instances of bad default as a result of which donors must make sustained withdrawals.

Other external agencies can assist in underwriting policy reforms and making others less reversible. The most noticeable at present is the government's commitment to the COMESA treaty under the PTA which commits signatories to a zero tariff on intra-regional trade within the next two years *and disallows any reversal of the tariff from its current position*, while Zambia's membership of MIGA provides a further external agency through which to acquire credibility.

Reputations are not, however, the only mechanism for circumventing the problems of time-inconsistency in government policy. The alternative is to introduce *ex ante* strategies which will make it very costly to renege on policy commitments in the future. For example the creation of an equity-owning electorate through a wide share-ownership scheme simultaneously creates short-term support for reform and establishes an interest-group whose political support would be lost if a range of economic policies were reversed

in the future.

*Ex ante* conditionality defined over essentially short-term and quite costlessly reversible policy measures such as budget targets, sectoral expenditure allocations, credit targets and other nominal macroaggregates are most clearly prone to policy reversal and will, as a consequence, elicit short-term responses by the private sector. New investment, to the extent that it exists, will be concentrated in the high-turnover low fixed cost sectors, such as finance, retail and import-export trade. The sectoral investment response may be quite substantial but the form of the investment reflects the intrinsic time-inconsistency of the policy reforms. To a significant degree this is the type of investment experienced in Zambia from 1989 to 1992/93.

Other forms of policy adjustment may engender a less reversible investment response by creating irreversible changes in the domestic political economy that create or expand the private sector thereby created a potential lobby rendering policy reversal expensive. Many of the reforms of the last two years point in this direction. For example the abolition of foreign exchange licensing and the liberalization of the capital account have created a class of entrepreneurs whose wealth has been diversified into foreign as well as domestic assets and who would suffer significantly if asset market policies were reversed. If the private sector shares this calculus and believes that this form of pre-commitment will reduce the risk of time-inconsistency then private sector investment should respond accordingly. If a longer term investment response occurs then the problem of government credibility and policy reversal may be expected to diminish further as the class of people who would be potentially hurt by policy reversals will be growing. Thus while the policy reform programme is not owned initially by the government, the principal benefit of ownership may accrue anyway by creating conditions where the incentive for government to act in a time inconsistent manner decline.

It is clear that this argument must rest on the ability of newly created interest groups to offer a credible threat that policy reversal will be costly to government. Here the shift

towards multi-party elections may be very important, and the *ex post* conditionality which has been used by many donors as a means of encouraging democratization will provide the *ex ante* conditionality with an important fillip by providing groups benefitting from economic reform with the political weight to ensure that reforms are not reversed.

While the move towards multi-party democracy provides the framework for enforcement of reciprocal threats in Zambia, and there has been far-reaching progress on the liberalization of asset markets, there has been only limited progress in the area of privatization (see Adam 1994). This is the one area where the creation of an interest group capable of checking policy reversals could easily be created. The privatization programme has, however, been seriously stalled since 1992. By the end of the first quarter of 1994, which is approximately two years into the programme, only three of the 19 First Tranche companies had been sold, a further six were in the process of sale and final stages of negotiation with the new management in place, while the remaining ten companies have been either re-advertised or undergoing re-negotiation. Total revenue to date from privatization has been extremely limited, totalling less than \$1.5 million to date. Of the 32 Second Tranche companies, four have been handed back to their former owners, a further four (including Chilanga Cement and Zambia Breweries) are in the final stages of negotiation, while the remaining firms are still in early stages of negotiation or are yet to be offered.<sup>4</sup>

Under the initial plan the entire 11 Tranche programme covering 144 enterprises was expected to be completed within 5 years. It should have come as no surprise that the programme has been delayed due to the drawn-out stabilization process, but the delay has highlighted a further important constraint to rapid privatization, and one which is entirely germane to the discussion above concerning aid effectiveness and the policy environment. This is the question of the reform and sale of the parastatal financial institutions and in particular ZNCB. One of the principal reasons for the continued existence of many SOEs -- and through them the relative inefficiency of investment -- is their access to credit from

<sup>4</sup> ZPA Status Report as at 31 March 1994.

the parastatal banking sector. As long as the ZNCB remains as a state-owned bank so will the soft budget constraint. If this soft budget constraint was eliminated through the reform of ZNCB, a (possibly large) number of smaller SOEs would either close down or be forced to undertake reform measure independently of the ZPA managed programme. ZNCB is currently 62nd on the list of firms to be privatized and it is unlikely that progress will be made on its sale soon. However the externalities to privatizing ZNCB first may be extremely high, not least in breaking the perceived log-jam since for these other firms efficiency effects of privatization will emerge by default. The by-products of a switch in the sequencing towards the financial sector firms seem two-fold. First it ensures that commercialization occurs by default for those firms scheduled for late privatization; second it reveals early on to prospective buyers the true value of the firm operating under private market conditions; and finally it may well release resources from the privatization management programme which can be devoted towards the development of regulatory and competition policy.

#### *Donor coordination - net vs gross aid flows*

Before leaving this section it is useful to note an important issue of the design of conditionality, namely the question of the coordination of donor commitments under conditional aid contracts. We have already noted the gap between gross external flows (principally aid) relative to the net current account deficit. In 1993 for example, though the current account deficit before interest and transfers was \$250 million the total gross flow of funds (excluding debt cancellation) was \$600 million, of which \$350 million was required to finance debt service to the donor community. The projections for 1994 reveal the same feature whereby gross funding requirements of \$1.25 billion are anticipated against a current account deficit excluding interest and transfers of \$500 million. Of the remaining \$750 million financing gap only \$250 million will be provided by means of debt cancellation and rescheduling, so that the balance of just under \$500 million will be allocated to debt service. Aside from the accounting problems this creates, there are three issues which should be of concern to the donor community. First, as balance of payments data indicate, since Zambia's current account deficit *before interest and official*



*transfers* is substantial, in the order of 14% of GDP,<sup>5</sup> its basic capacity to service external debt obligations out of its own resources is zero without unsustainable compression of domestic absorption. Thus to all intents, the country's external debt is only serviced when the donor community provides the resources to do so. Therefore since *in aggregate* the creditors whose debts are being serviced are almost exclusively the Paris Club plus the World Bank and IMF (ie the creditors are the donors), half of the gross flow from the donors to Zambia represent payments to themselves. On a superficial level, it is worth noting that directing funds through the Bank of Zambia is a relatively inefficient means of making a payment from, say, Stockholm to Washington, or indeed from one side of 18th Street in Washington DC to the other!

A second and more serious concern is the administrative costs and monetary management implications of these large gross inflows and outflows. This is more important at present in Zambia where financial markets are shallow and stabilization is fragile (so that the government does not yet have the credibility to use standard instruments of monetary management to buffer the impact of external flows on the domestic economy). Relatively small changes in the magnitude and timing of gross flows can therefore have large implications for fiscal, monetary and exchange rate management. The problem is particularly acute when external debt service payments are not well synchronized with aid inflows. For example in 1993 gross donor inflows are by far the most volatile item in the country's foreign exchange budget with a monthly standard deviation of \$33.5 million while debt service is amongst the least volatile (\$11.5 million). Since government has no discretion over the timing of debt service payments and no control over the disbursement of donor funds, this places a heavy adjustment burden on the other items of the cash flow. Normally, if levels were adequate changes in reserves would be used to buffer these synchronization problems. That is one of their primary functions. However in Zambia, changes in reserves are subject to RAP targets, and therefore may not be always be able to fulfil this discretionary function. In order that the RAP obligations are fulfilled, adjustment must therefore fall on other items, namely the

<sup>5</sup> US\$500million / US\$3600 million

priority uses, imports funded through the OGL, and service account payments, as well as the nominal exchange rate. During 1993 all these mechanisms were periodically used to maintain the cash flow.

The third reason why the disequilibrium between aid and net resource transfers may be a problem is that it constitutes a disincentive to private capital inflows. This obviously begs the question of whether in the absence of the current debt stock private capital would voluntarily flow into Zambia. Past evidence suggests that it would if the copper sector in particular was seen to be profitable. Indeed as we noted above while initially commercial lenders were willing to lend to Zambia during what was seen then to be a temporary terms-of-trade shock in the mid 1970s, they withdrew only as it became clear that the shock was permanent and the commercial return of their investment fell. Before then, however, Zambia was seen as a commercially viable economy. It seems reasonable to assume that if macro-stability was to obtain private capital could be expected to flow into Zambia again. At present there is very little private capital flowing into Zambia, and that is dominated by development finance institutions (CDC /EIB etc). One reason is the credibility of the government's policy direction, but it may also be due to the extremely high level of outstanding official debt. The debt overhang has created the impression (which is probably correct) that commercial debt will be subsidiary to official external debt and as a result will be less likely to be serviced in the face of adverse external shocks. Under such circumstances reducing the stock of official debt may therefore bring commercial finance back into the economy. A similar argument follows for foreign direct or portfolio investment. If investors believe that the high level of official debt service will make restrictive exchange and payments policies more likely (as debt service problems will be addressed by placing restrictions on other capital account flows), FDI will be discouraged.

To summarize, although debt forgiveness may not alter the net official flow to Zambia it would bring about other benefits. First it would reduce uncertainty over the foreign external flows and with it lead to a reduction in the administrative burden on the BoZ. Second, it will enhance the possibility of a re-commencement of short and medium term

private capital thereby enhancing the net flow of resources to Zambia. Finally, debt forgiveness would help to focus attention on the current account as carrying an appropriate economic signal as to the external balance of the economy. It is often argued that full debt forgiveness is not optimal as it would deprive external creditors of any leverage over the government to pursue "good policies" (assuming that good policies are desirable for reasons other than as a means to ensure repayment of debt). In practice, in the long run, leverage is likely to be mainly a function of the *net* flow particularly when, as in the Zambian case, there is no realistic possibility of the debtor fully self-financing the gross outflow. Lowering the gross in and out flow to Zambia is therefore unlikely to lead to any appreciable loss of influence on the part of the donor community but rather may lead to a more efficient management of the aid relationship.

## 11. THE SIZE OF THE AID PROGRAMME - DUTCH DISEASE EFFECTS IN ZAMBIA

Even in the absence of the types of policy distortion discussed above, large aid inflows present potentially serious problems of macroeconomic management. In this section, we focus on potentially dysfunctional effects of aid that operate through the real exchange rate. Inflows as large as those received by Zambia substantially augment the economy's income and tend to increase desired spending on all goods, both traded and nontraded. But the direct supply effect of the inflow is in terms of traded goods only. The result is an excess demand for nontraded goods, which tends to push up the relative price of nontradeds and produce a shift of labour and other factors of production into the nontraded goods sector. This effect is the source of a potential "Dutch disease", whereby the gains from foreign inflows are undercut by a loss in external competitiveness.

In the face of a substantial and permanent aid inflow, some loss of competitiveness -- required to achieve an intersectoral shift of resources -- may well be a desirable response. This is because the aid represents a permanent increase in the permanent income of the country and a permanent increase in the consumption of non-traded goods is warranted. Nonetheless, the reduction in domestic capacity to produce traded goods can be costly. There are three possibilities which may be applicable to Zambia.

The first is if aid flows turn out to be temporary, resources will have to be shifted back into traded goods production. Since sectoral resource movements are costly, this two-way movement -- first into nontraded goods and then out -- may lower welfare relative to what would have prevailed under a smaller initial real appreciation and resource movement. The gains from temporary aid can therefore be undercut if the government or private sector treat it as permanent -- thus spending most of it in the current period -- and incur large adjustment costs to shift resources intersectorally only to incur those costs again when the aid turns out to be temporary. High adjustment costs will exist if, as in Zambia, nominal wages are rigid so that a contraction of the non-tradable sector generates unemployment rather than wage adjustment. Similarly if there are significant



fixed costs facing firms in the traded goods sector (either in terms of information, marketing, specific human capital etc) then a short-run appreciation of the real exchange rate will force exporting and import substituting firms to close and the sunk costs will be lost. To offset the re-entry costs any subsequent depreciation will have to be larger than the prior appreciation.

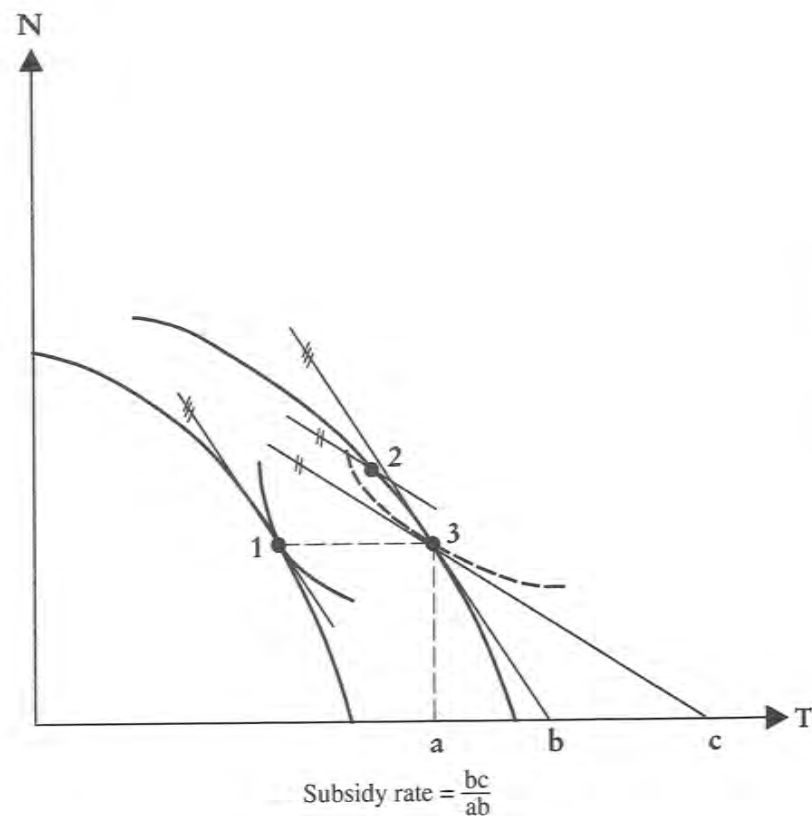
The second case where aid-funded temporary appreciations can be costly is if domestic capital markets are imperfect. Even if the boom is perceived to be temporary, the current appreciation will drive some firms out of business if they cannot finance the short-run losses by borrowing against future profits. This problem is exacerbated if, as in Zambia in late 1993, speculative asset demands for local currency exacerbate the appreciation. Then, the real exchange rate appreciated by approximately 50% in the months from October to December 1993 and asset holders responded to high domestic interest rates, with the direct consequence that many traded sector firms closed operations. In the second half of 1993 alone 17% of the membership of the Zambia Chamber of Commerce and Industry closed their operations while a number reduced their domestic value added by switching from manufacturing to distribution. The hardest hit firms were in the tradable sector and included ZCCM.

The third and potentially most important case in the long run, is when the sectoral allocation of resources matters for growth, and particularly if there are important positive spillovers from sectors producing for world markets. While the exact nature of these spillovers is unclear, the evidence favours manufacturing and other non-traditional exports over primary commodity exports and tariff-protected sectors over quota-protected sectors. To the degree that aid inflows increase spending on domestic markets, they will raise relative prices in these sectors and shift resources away from the growth-promoting outward-oriented sectors, both in the short run and over time. This undercuts the recipient's "gains from aid" and it is even conceivable that higher aid may make the country worse off, by reducing the present value of growth spillovers by more than the direct contribution of aid to permanent income. This version of Dutch disease is more important when aid is permanent than when it is temporary. There is a direct analogy

between the unfortunate effects of aid in this situation and the unfortunate situation of being well endowed with exportable primary products (since these are not particularly associated with growth spillovers). In both cases, the country's static 'comparative advantage' (here broadly construed to include nontradables) is shifted away from the positive spillover sectors, and this compounds itself over time producing lower growth.

The common feature of these examples is the excessive contraction of the traded goods sector during the period of high aid inflows. This makes the ultimate reduction of aid more painful than it otherwise should be. The Dutch disease effects of aid are, however, largely avoidable through policy intervention and in terms of policy, the point to be emphasized is that cutting aid is never a first-best response to Dutch disease problems. There is always a configuration of policies such that an extra dollar of aid makes the recipient better off. For example, if there are positive growth spillovers from sectors competing in world markets, these sectors can be given a production subsidy, either directly or via subsidized credit. Figure 11.1 illustrates this point by demonstrating that a production subsidy to the traded goods sector can neutralize the effect of an aid inflow of the sectoral allocation of resources. The aid inflow appreciates the real exchange rate and shifts production from point 1 to point 2. However point 3 can be attained by a production subsidy to traded goods at the rate  $bc/ab$ . The subsidy separates the relative prices faced by producers (which remain at the pre-aid rate) from the consumer prices which move against non-traded goods and therefore offset the spending effect.

**Figure 11.1: Aid Inflow and Production Subsidy**



## 12. CORRUPTION

Perhaps the highest-profile issue in Zambia at the present time is the concern about corruption and whether it is being caused by the aid inflow. This concern may well be warranted, and it would be surprising if the large volumes of aid flows had not sparked off some degree of envy-led corruption. It would be wrong, however, to infer direct causality from aid to corruption. In particular there are a number of reasons why corruption is simply *appearing* to increase rather than actually increasing, and in fact the increased visibility of corruption and/or rent seeking may be a natural by-product of the effects of liberalization. The first reason is simply that we may just be observing more corruption due to the processes of democratisation and liberalisation. One of the consequences of the former is to open up the political debate, particularly in the press. The press in Zambia, particularly the *Weekly Post* has been vociferous in its reporting of issues of political corruption, in particular high-level abuse of office.

Second, the processes of trade liberalization, exchange rate unification, and price decontrol have removed a number of important "hidden" transfer mechanisms.<sup>1</sup> The mechanisms were not explicitly corrupt but did provide significant income transfers from "losers" to "winners". The allocation of foreign exchange in an official market which undervalues the dollar relative to the parallel market is the most obvious transfer mechanism lost through liberalization, but others include the abolition of import permits for goods subject to quantitative restrictions and the elimination of untaxed benefits in-kind accruing to government and parastatal employees. The income loss associated with removal of these transfer mechanisms creates pressure to replace these with alternative mechanisms, but these new mechanisms may be more easily identifiable. The prime example of a less covert transfer is the illegal issue of customs exemptions which became prominent in the early part of 1994. This is an example of where there may be an increased in observed "corruption" but this is a direct substitution for the loss of transfers accruing under the earlier control regime.

<sup>1</sup>See Coate and Morris (1994) for a discussion of this issue.



A third and related explanation for the increased observed public-sector corruption is that not only has the extent of control over economic activity shrunk but administrative systems within government have become more sophisticated and computerized. The combined effect of the elimination of multi-staged administrative controls to regulate a wide range of economic activities -- often through complex systems of discretionary waivers and rebates -- by a system of fewer, simpler, administrative requirements, and more sophisticated systems has significantly reduced the opportunity for covert corruption and increased the probability of detection. The most dramatic turn-around due to the removal of administrative controls is felt to be in the area of agriculture which had previously been ridden with corruption flowing from the administration of consumer and producer subsidies.

There are however reasons why corruption is genuinely increasing in Zambia, particularly during the current time. Again these effects may be an outcome of the adjustment process itself, although as we shall see not they are not intrinsic to adjustment. First, falling public sector real incomes have probably increased corruption by reducing the cost of being sacked for corruption. In general the expected return to corruption is thus higher. Raising real incomes will clearly redress this effect but only if the probability of losing your job is non-negligible (you need both carrot and the stick). At present the probability of being sacked for abuse of office is still very low, mainly since monitoring and accountability in African governments is severely underdeveloped.

This problem translates directly into an expected rise in corruption during times of public sector retrenchment. Arithmetically retrenchment raises the probability of losing your job. If the retrenchment is not merit based so that there is no way in which the incumbent can alter the probability of being retained or retrenched, then corruption will increase. If, on the other hand, the retrenchment exercise is managed on a merit-basis where the individual's probability of retrenchment is determined by his or her own actions, the problem of corruption is diminished.

One important implication of this result is that if merit-based retrenchment is not possible for political reasons, or not chosen, then there are serious costs to pre-announcing the plan, and even more serious problems in delaying its implementation. This was seen very clearly in the first quarter of 1994 with the announcement of reforms to the customs and revenue collection system in Zambia. The Zambia Revenue Authority was created in January but was planned to become effective only in April 1994. The Authority had the power not to renew existing civil service contracts and although it was felt that new contracts would be issued to senior officials in the Customs and Inland Revenue departments, the contract allocation amongst middle and junior level official (principally those staffing the border posts) was not expected to be merit based. The first three months of 1994 saw a disastrous fall in customs revenue collection despite a steady flow of taxable goods. Customs revenue was only 55% of target in January 1994 and 48% in February, and only climbed towards its target level in March as the ZRA became active. The decline in tax effort was attributed entirely to a surge in under-declarations by customs officers prior to the introduction of the ZRA. Since their future tenure was not linked to individual performance during the last three months of the old system, no officer had an incentive not to increase their rent-seeking. This incentive was strengthened by the knowledge that the ZRA customs system would become increasingly computerized and the exemption system less discretionary, so that future opportunities for extracting rents were expected to decline for those officers retained rather than retrenched.

The parastatal sector is vulnerable to this type of corruption and abuse of office, particularly since there have already been serious delays in the implementation of the privatization programme. Again, if the incumbent management and workforce in the parastatals believe that their actions will have little or no effect on the probability that they will be retained post-privatization or commercialization then they will face incentives to increase the slack in the operation of the parastatal and increase the level of corruption and asset-stripping. This issue is seen by many to have serious implications

for the viability of the sector and for the political credibility of the government.<sup>2</sup> The government has already taken steps to accelerate the privatization process but given the long delays in achieving stabilization and uncertainty about the investment strategy, the pace of privatization is unlikely to accelerate greatly (although see our discussion above on the question of sequencing). Given the likely delays and the perception of incumbents that their actions will have a limited impact on their future tenure, possibly the worst strategy for sale is to pre-announce a sequence and to attempt to adhere to it. The initial programme classified the sector into 11 tranches to be sold over a five year period from 1992 to 1997. Already there has been considerable slippage so that it is unlikely that the sale programme will be completed before the end of the decade.

An alternative strategy would be to adopt a privatization strategy which emphasises reform and privatization of the financial sector parastatals first (see above) combined with a "first-come-first-served" approach for the remainder of the sector. This would address the problems discussed above of letting the market deal with the reform of small parastatals by removing the soft budget constraint associated with the lending of parastatal financial institutions, and offer incumbents improved incentives not to asset strip. The latter arise from the reduced certainty about the timing of the sale of enterprises and whether retention of staff will merit-based. An added component of the first-come-first-served strategy would be the promotion of managerial buyouts of parastatals which provide the strongest incentive against asset stripping both by management (for obvious reasons) and by employees since the benefits accruing from monitoring employee behaviour will accrue directly to the (former) managers.

A final explanation for an increase in corruption following liberalization is that, at least at the early stages, democratisation means public sector tenure is less secure, mainly in higher level posts. Corrupt officials and ministers consequently raise their "rate" of extraction of rents. Obviously one of the principal objectives of democratization is to increase accountability of public servants with the express purpose of reducing

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<sup>2</sup> Interviews with business and financial sector representatives in Lusaka (April 1994) confirm this.

corruption. The two forces are most likely to be imbalanced in the short run as the decline in expected tenure of office may be more rapid than the emergence of systems and norms of accountability, so that observed corruption rises in the short run.

Any donor response to a rise in observed corruption must depend on the diagnosis of the cause, and in particular whether it is due simply to corruption being more visible, and whether the effects are transitional. Many of the reforms already instituted in Zambia have embodied concerns about enhancing greater accountability of institutions to shareholders or the electorate. This is clearly part of the privatization programme and the creation of a "privatized" revenue collection process. More generally, capacity and constituency-building institutional reform holds out the greatest promise for developing accountability. However, as the above examples illustrate, one of the consequences of institutional reform is that the process of reform itself may engender corruption-increasing activities on the part of interest groups likely to suffer from the reform. Since indigenous systems and norms of accountability under a liberalized framework may be slow to emerge, the key design issue facing donors then becomes the design of reforms which provide the right incentives to the "losers" so that corruption is minimized.



Since the 1970s Zambia has become highly aid-dependent. Even if there was a total elimination of debt the recurrent *net aid transfer* to Zambia would still be substantial, and even on the most optimistic scenarios it is unlikely that Zambia will graduate from this status soon. Even with sustained policy reform, debt cancellation and good luck Zambia can expect to be faced with a significant external financing gap well into the 21st century. This is amply illustrated in the Government of Zambia's submission to the March 1994 Consultative Group Meeting.<sup>1</sup> The resource balance (ie the current account balance excluding interest and official transfers) exceeded 8% of GDP in 1992. As the government noted, this is not a sustainable level of borrowing for the medium term, but the long-term projections for Zambia (prepared by Government and the World Bank) anticipate that this resource gap can be halved by 2000. To do so, however, requires real growth to average 5% over the remainder of this century, import dependency to fall (imports are expected to grow by only 3% per annum), and domestic savings to rise from their current level of approximately 6% of GDP to 17%. Underpinning this level of domestic policy response is the assumption that copper sector will recover, partly with an upward drift in prices and through the successful exploitation of the new Konkola mine. If Zambia enjoys the good luck and good management that has eluded it in the past, and the above scenario actually holds true, the resource gap before interest charges is still anticipated to be approximately \$400 million in 1994 prices. This compares to a current level of approximately \$500 million. The aid requirement faced by the bilateral donors would be even larger if debt service to the IFIs and on other non-concessional debt is not cancelled or rescheduled. By the Government's calculations the gross financing requirement will still remain close to \$1 billion by 2002. If the underlying macroeconomic conditions slip relative to the optimistic scenario, either through poor policy or bad luck, the net and gross financing requirements will necessarily be that much higher.

The starkness of this aid requirement contrasts with the evidence from 1974 to the current period where large and increasing aid flows seem to have been associated with poor and

<sup>1</sup> Government of Zambia *Achieving External Viability with Growth in Zambia* Notes to the Zambia Consultative Group, March 1994.

declining macroeconomic performance. The simple correlation does not strongly suggest that large aid flows will improve the macro-economy. This is, we feel, a false inference, particularly since the aid environment has changed radically since the 1970s. In the 1970s the relationship was characterized by light conditionality and frequent policy reversal. The 1980s saw a significant "hardening" of donor perceptions and the reform efforts of the mid 1980s were supported by high aid flows and tighter conditionality (but still essentially reversible). The 1985-97 programme *came very close to success*. What forced its collapse was insufficient commitment by the government and (possibly) a failure to realize how "front-loaded" the political and social costs of adjustment were, particularly on the powerful urban classes. The 1990s aid environment is looking more successful, even though it too has been plagued by very high short-term costs, again falling predominantly on the urban sector.

The biggest problem facing the current programme is that the "flow" responses to policy reform, which are broadly positive, risk being swamped by "stock adjustment" effects which are likely to have negative effects on output, incomes and growth in the short to medium term. Foremost amongst the stock-adjustments required in Zambia are the stocks of physical and human capital. The stock of physical capital is excessively import intensive in its own composition and in terms of the production function it sustains while the stock of human capital is biased towards the urban sector and in particular towards formal public sector employment. In addition, the entrepreneurial class in Zambia has been conditioned to a large extent by the pervasive role of the state in economic management, both in ownership and in factor pricing. As a consequence the link between individual risk and reward was distorted and the development of market-based entrepreneurial capacity was retarded.

Two important features distinguish the current reform programme from its predecessors, however. The first is that it has been accompanied by political reform which, though a long way from representing the accountability and reciprocity model anticipated by the donors, served to undermine the power of blocking coalitions opposed to reform and replace them with even more powerful pro-reform elites. Secondly, the form of conditionality is *beginning* to encompass policy reforms which cannot be easily reversed without significant political costs to the government.

Having said this there are concerns about the effectiveness of aid. In general the solution to the problem of aid effectiveness is not to cut aid, but rather to re-examine the policy options. This creates problems in Zambia at present given the strongly expressed views of government that there is no positive role whatsoever for policy interventions. Thus many of the conclusions drawn about offsetting the adverse effects of aid with, for example, production subsidies must be placed in the context of a government (or at least a Ministry of Finance) who do not believe in government's capacity to credibly administer positive policy.

We turning finally to the specific issues that surround the current aid programme and which have implications for the design of aid programmes.

The high gross aid inflows to Zambia since 1991 have generated some short-run Dutch disease problems which have undermined the profitability of the tradable sector and the supply response of non-traditional exports. In part the real appreciation that has been experienced in recent months in Zambia has been aid-driven (there is evidence of an excess supply of dollars in the foreign exchange market), but it is more directly a response to a large shift of private sector asset demand out of foreign assets and into government securities in response to very high real interest rates. The consequence of this is a sharp appreciation in the nominal exchange rate which has driven up the real exchange rate.

This short-term dutch disease seems to be exacerbating the longer term problems of the tradables sector facing high adjustment costs, particularly given their inherited capital stock. Even without the nominal appreciation of the Kwacha, imperfections in the credit market mean that many firms are closing even though they may be profitable at the new relative prices. The resource shift out of the tradable sector is therefore greater than would be required if firms were able to borrow against future profits and represents a sub-optimal level of de-industrialization.

In both these cases, and specifically the latter, policy interventions aimed at restoring the long-run relative price structure are feasible. Amongst these, directed subsidized input credit to the tradables sector can be used to finance firms through both the short term appreciation of the

real exchange rate and also finance the stock adjustment. This policy intervention is also warranted in the third case we considered above namely where there are externalities in the non-traditional export sector where the marginal social return to credit to this sector is higher than the private. Questions of re-introducing subsidies in an economy such as Zambia is fraught with difficulties not least since many of the problems of the past may be traced to the adverse effect of soft budget constraints being underpinned by subsidized factor prices. There is certainly some validity to this argument but current circumstances are different and the arguments for selective short-term credit subsidy may be easier to defend, both on export externality grounds, and to the extent that the purpose of the subsidy is not to address permanent market failures but rather transitional problems associated with aid inflows and stock-adjustment problems.

The most significant policy reforms in Zambia have occurred during the current reform programme designed around tight *ex ante* conditionality. This seems an important component in neutralizing the adverse time-consistency effects associated with the light and easily reversible conditionality of the 1970s and 1980s. One of the key mechanisms for establishing irreversibility is through the creation of coalitions how would be hurt by future policy reversal but powerful enough to credibly threaten the government's position if this reversal were to materialize. Privatization may offer an important vehicle to government. In addition to the direct effects of reducing the size of the SOE sector, if privatization can also provide the government with a means to signal its credibility it will provide a powerful demonstration effect for other private investment.

However if there is to be a concentration on tight *ex ante* conditionality it is important to make it more state-contingent. Aside from ensuring that aid flows reward effort rather than luck, state-contingent contracts are also necessary if reputations are to be forged. While it is always possible to re-contract after the state of the world is known, this is an inefficient form of contract and it fails to permit the donors and the recipient government to establish their credibility to the domestic and foreign private sectors *ex ante*.

Finally, the design of policy reform may need to consider more directly the link between



incentive effects and corruption and asset stripping. Observed corruption has increased markedly, and although some is clearly the result of greater transparency, part is due to the direct consequences of the transition. In the latter case the introduction of incentive effects, particularly for public sector management is essential.

The overall conclusion is that despite the failures of past aid programmes the glass in Zambia is probably "half full" rather than "half empty." There is evidence that economic flows are responding to new relative prices, but that in a number of crucial areas these positive flow effects may be swamped by large stock adjustment problems. Since the donor community has a comparative advantage in financing the short-term transitions associated with these stock-adjustments any policy response probably should not envisage a reduction in aid, but should ensure that aid management is focused towards improving incentives and creating the conditions for governments to create reputations through implementation of irreversible policy measures.

## Part 5: SUMMING UP

### 14. IMPACTS OF AID TO ZAMBIA

#### 14.1 Introduction

We have noted a severe decline in income and in welfare indicators in Zambia over a period of two decades, at the same time as the aid inflow has been increasing. However, it is very difficult to disentangle the effect of aid in general and Swedish aid in particular in Zambian economic growth. We have not been able to say with any certainty what the aggregate decline would have been without the aid. We have, however, discussed the impact of aid on some growth determinants. We revisit this discussion briefly.

#### 14.2 Direct Impacts of Swedish Projects and Programmes

Zambia was made a Swedish programme country due to the geo-political situation with liberation struggles in Rhodesia and South Africa rather than because of concerns about poverty, since Zambia in the 1960s enjoyed favourable prices for its principal export, copper. Nonetheless the colonial legacy of Zambia meant that serious structural weaknesses in the economy were apparent. The Swedish aid package sought to redress these imbalances. First, the economy was dualistic, with a marginalised traditional agriculture. Second, the regional inequalities were large, and, third, African education and other social infrastructure were largely neglected. Thus Sweden's support was from the beginning emphasizing rural development in the fields of agriculture and health, with the objective of improving rural living standards. The support to the educational sector was initially geared towards higher education, but from the early 1980s the emphasis was redirected towards primary education in rural areas. The assistance was further supplemented with technical assistance and three infrastructure projects in the 1970s, and import support from the 1980s.

The technical assistance and infrastructure support have to a large extent been phased out.

Programme support to agriculture, health and education remains together with import support. The programme aid has been of a long term nature and governmental policy changes have not really affected the disbursements. During the 1980s the IFIs and donor community as a whole switched towards balance of payment support as the principal means of support to Zambia. Swedish support has been made conditional on macroeconomic policy reform, although its import support conditionality early on was weaker than for many other donors. For instance, after the reorientation in 1987 many donors only remained with technical assistance, while SIDA kept its import support for another year to evaluate the situation and, furthermore, took part in the persuasion of the Zambian government to reintroduce structural adjustment. Sweden has then remained in the macro-economic field and is co-financing a macro-economic team at the Ministry of Finance.

While the Zambian government acknowledged her colonial legacy in development plans and policy document, the actual policy implied a further aggravation of the dualistic economic structure. The industrial policy based on import substitution implied an emphasis on urban areas. The government also struggled to develop a 'welfare state' and there were initially considerable improvements in health and education, but the urban bias remained also in these fields. Altogether, the relation between the Zambian government and the donor community can be described as a gap of interest. While the government had a clear urban bias, most donor countries emphasized rural development.

Sweden's aid has mainly contributed to human capital investments and the objective of improving rural living standards has to a certain extent been met. Although the production targets for the agricultural sector support were not reached, Swedish aid to Zambia was geared to help the poor strata of the population, but its effectiveness in this regard was hampered by the political environment.

### 14.3 Macro Effects

Real per capita incomes were a third lower in 1993 than they were in 1975. This

dramatic fall was due in part to adverse terms of trade shocks throughout the 1970s (copper prices fell dramatically in 1974, but then stabilized while world import prices doubled between 1975 and 1980). However, much of the subsequent decline in real incomes was due to the failure to adjust to the change in the country's permanent income. Initially financed by commercial creditors and latterly by the IFIs and donors, the government sought to maintain consumption at the cost of declining real investment and increasing external debt.

Historically aid supported an inward-looking development strategy which implied a heavy taxation of the exportable sectors. The aid made it possible to preserve an overvalued exchange rate, which of course was detrimental to export growth. This pattern of development has left Zambia with a structure of physical capital dominated by import-intensive capital, which is concentrated in the import-substituting sector and is largely state-owned. In the same way the development strategy has meant that too much of human capital is concentrated in the public sector.

During the 1970's and 1980's the policy environment was highly distorted and the parastatal sector was able to dominate investment. We do argue that the interaction between aid and the policy environment is a very important determinant of the impact, and that the lack of policy reform in Zambia eroded the impact of aid on growth.

The failure to implement necessary policy reforms in the early part of the 1980s reflected both the relative strength of the Zambian government (in accessing commercial capital markets), and the delay on the part of the IFIs and donors to revise their own evaluation of the appropriate macroeconomic framework for Zambia. As a consequence, Sweden along with other donors and IFIs, continued to provide aid to support Zambia without rigorously enforcing policy conditionality. After more ambitious attempts at adjustment started in 1985 and especially in 1989 the picture is more mixed. In this period aid has possibly helped to speed up the economic reform process. Aid-flows and aid-dependence have grown markedly, accompanied by a radical shift in the balance of power in the aid relationship between the donor community and the government.



Zambia did at independence inherit a highly skewed income distribution, and donors were rightly concerned about equity. Unfortunately the impact of aid interventions on income distribution was limited. In the 1970's the country still had one of the highest degrees of income inequality in the world (van der Hoeven, 1982). Since the 1970's there has been a marked increase in poverty. The most dramatic change is the sharp increase in urban poverty, although rural poverty still remains higher. However, the Gini coefficient has been reduced during the crisis, that is income distribution has become more equal. This has, however, not come about through an increase in rural incomes, but it is the result of the decline in urban incomes.

It is useful to distinguish the direct effects of Swedish aid, which we discussed above from the indirect effects. The macroeconomic disincentive effects of aid comes through three channels. First, long-term aid flows may support an overvalued exchange rate by validating an unsustainable exchange rate. Even when the exchange rate is liberalized in Zambia this problem persists. Overvaluation will be a disincentive to necessary resource shifts towards the exportable sector and away from the import-substituting sector. Second, aid may undermine the domestic tax effort of the government. This is currently a major concern in the donor community, but we are uncertain about the character of the present problem. It may be due to the reform process itself and thereby temporary. Third, there is a concern that aid may lower the domestic savings rate as aid is used to increase current consumption as well as current savings. This was the case at least in the late 1970's and early 1980's. Still, we do not think that these problems justify a reduction in aid now but, as has been acknowledged in Zambia since 1985, raise important issues in the design of conditionality (see further discussion in Chapter 15). Ever increasing conditionality has emerged in Zambia, particularly since 1991, and the scope of conditionality has widened to embrace issues of governance and corruption.

The recent debate on adjustment policies in Zambia has been fierce, and there are obviously many things that could be and have been criticized. Still, we do believe that the situation now is different from the one in the 1970's and 1980's, and that the policy changes that have been undertaken have changed the economic environment in a profound

way. Relating to a recent debate in Zambia about ways of looking at the situation we would argue that the glass is "half full" rather than "half-empty". We would therefore not argue that there is cause for a general reduction in aid to Zambia due to policy failures.

It is obvious that Zambia will have to be a major recipient at least of gross aid for the foreseeable future. A withdrawal of donor support at this stage would lead to a collapse of the adjustment programme and reverse the improvements that have been achieved. Aid is never the major determinant of development towards the goals as stated in the Swedish aid programme. Sweden is giving development assistance, but in the end it is the efforts and policies of the recipient country that matter most. Aid can facilitate the process though, if it is backed by sound policies.

Sweden's support has not been much different from that of other donor countries and thus the problems Sweden has faced are common to those of other donors. The emerging recognition that a significant part of the economic crisis in Zambia is domestically generated and requires a domestic solution has had an important impact on the foreign aid relationship. This augurs well for the success of continued aid. Sweden should continue its support of the structural adjustment programme coordinated by the IFIs. However, a number of specific issues have to be addressed. (Many of the specific conclusions from the earlier analysis given in chapters 5 and 13 are not repeated here.)

First, as a result of previous economic mismanagement, Zambia has incurred an immense external debt which cannot be serviced without substantial support from the bilateral donors. Currently approximately 70% of the total external finance flow to Zambia is re-allocated to debt service, principally to the IFIs. The donor community may wish to consider a more rapid coordinated reduction in the external debt stock.

Second, the reform measures which have already taken place in Zambia - both with respect to macroeconomic reforms and budgetary control - will have benefits for the implementation and management of programme aid, particularly in the health and education sectors. Despite past implementation failures, Sweden ought to continue its programme support to Zambia. It seems appropriate to concentrate on programmes, where donors finance a slice or some components. This means that the projects are part of the prioritization process of the government, which hopefully increase its commitment, reduce complexities of reporting and possibly lead to a more consistent policy. The introduction of the cash budget has strengthened the role of the Ministry of Finance vis a vis the other ministries. One can now somewhat more confidently put money into the ordinary budget process.

Third, programme support to agriculture should continue, since agriculture now enjoys a significantly more liberalized and pro-agriculture environment. Sweden could finance

a slice of the ASIP programme. In general it seems that efforts in agriculture have failed when very comprehensive approaches have been tried. The earlier Swedish programmes in agriculture were complicated and overambitious and never worked well. It is best to concentrate on simple but basic components of the social and economic infrastructure such as roads and some other basic economic infrastructure, education and health. This should be done within the respective sectoral ministries and not in the form of integrated rural development programmes. Donor interventions related to production should be directed to the creation of an enabling environment for the private sector.

Fourth, assistance to institutional development should continue. Support to macro-economic management has been successful. For support to public institutions to be sustainable in the longer term, it need to be linked to civil service reform.

Fifth, Zambia may now experience some short-run Dutch disease problems, which further exacerbates the adjustment problems of the tradables sector. A policy intervention supporting the long-run relative price structure would therefore seem desirable. One could, for example, consider subsidized input credit directed to the tradables sector. The main concern here is the ability of the government to implement such a reform in an effective way. The administrative forms must therefore be carefully considered.

Sixth, donor coordination should improve and SIDA should coordinate with other donors and maybe swap projects. There should be further concentration of efforts. It should be noted that if we chose to allocate money to activities which are listed by the government of Zambia, we are in practice anyway supporting the whole budget. Concentration is therefore not the same as ignoring other important needs. Lack of capacity within the aid organization is a further reason for concentration. It will also make it easier to develop professional competence and also allow more analysis to be put into the fewer activities that SIDA would be involved in.

Finally, the most significant policy reforms in Zambia have occurred during the current reform programme designed around tight *ex ante* conditionality. Still, the investment



response has been muted, and the government's credibility is still in doubt. A key mechanism for establishing irreversibility of reforms is through the creation of coalitions that would be hurt by future policy reversal, but which are powerful enough to threaten the government's position if this reversal were to materialize. Privatization provides the government with a means to signal its credibility. It will provide a powerful demonstration effect for other private investment. Support for more rapid privatization is therefore desirable.

In general, the donor community should focus on improving incentives and creating the conditions for governments to create reputations through implementation of irreversible policy measures. We have argued that ex post conditionality can provide strong incentives for reforms.

To some extent there has already been a move towards ex post conditionality already, with less of total aid being disbursed within country frames and more under thematic programmes such as democratization, environment etc, and with the behaviour of the donors for example at the CG meeting in 1994. The latter was to a considerable degree geared towards ex post evaluation, and commitments exceeded the financing gap for the first time as donors sought to "reward" Zambia for good performance (the sacking of drug dealing ministers).

The donors as a whole or individual donors should not shift completely towards ex post conditionality. There is a clear role for ex ante conditionality - not least in terms of providing a means of transfer of advice and expertise and providing some pre-specified contractual obligations, but also for the reasons that we just mentioned about the creation of constituencies which will "punish" governments for reneging on ex ante commitments. It is best to think of the aid and conditionality relationship as a two part contract with prior payments within a state-contingent ex ante-conditionality framework and then further aid flows based on ex post considerations.

There is a need for improving the design of ex ante conditionality to focus more on state-

contingency in contracts. There are two important reasons for this. First, if conditionality is not state contingent then the typical conditionality contract will reward good luck and punish bad luck. If the donors are not in a position to separate good luck from "effort" then ex post conditionality will reinforce this, and there will be a bias in the allocation of aid money towards those enjoying good luck. The second reason is that the most convincing arguments for a shift towards ex post conditionality revolve around the question of reputation. Part of the inability to generate reputations is that the ex ante conditionality, which is not state contingent, typically does not allow any revelation of effort or commitment for the reasons discussed above. Credible governments have an incentive to demonstrate commitment or effort and this can be achieved better with state contingent contracts.

There will be some need for donor coordination also with regard to ex post conditionality. What is required is to find the appropriate balance between ex ante and ex post. For example, governments may have cash flow problems such that although they are committed to reform they are unable to implement reforms without additional aid resources provided ex ante. Similarly, although ex post conditionality does not specify conditions for the potential recipient it is still important that the rules of the game are made clear and that they are internally consistent between donors.

A shift towards ex post conditionality would also make it easier to allocate aid as general budget support, which we have argued is desirable for a number of reasons. In the case of ex post conditionality, once the decision to disburse is made - ex post - the donor must logically relinquish any claim on how the resources are allocated within the country. If the government is truly of the "right type" then it will manage the resource flow and the countervalue funds in a manner consistent with the wishes of the donor. If the recipient government spends it all on non-productive expenditure, inflation and patronage, then (a) the donor has misjudged the type of the country and (b) the country will not win the contest for aid money the next time. With the ex post approach the rules of the game

will allow the donor to distinguish good and committed governments from bad ones.<sup>1</sup> A shift towards a general form of support of the Zambian government, giving it increased responsibility and ownership could help restore the quality of government.

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<sup>1</sup>There is one caveat to the argument that there should be no conditions on disbursement of the ex post conditionality and that relates to the Dutch Disease problems. Suppose for example the attribute the donor is rewarding ex post is export diversification. In this case the winner will receive an aid "price" which by appreciating the real exchange rate may undermine the benefits gained in pursuit of the price. It may be necessary, therefore, to ensure that the implicit tax on exporters associated with the aid inflow is offset by some subsidy or compensation, wither by way of a subsidy on exported output, export production (possibly on the cost of credit) or on investment.

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## List of persons interviewed

Prof B. Bolnick, HIID Advisor, Ministry of Finance.

Mr T. Bull, Director, Zambia Chambers of Commerce and Industry.

Mr S.J. Caley, Executive Director, Standard Chartered Bank, Lusaka.

Mr S. Falk, SIDA, Lusaka.

Ms Christina Gamstorp, SIDA, Stockholm

Mr Mike Hammond, ODA.

Mr H. Hellebust, Economist, NORAD.

Fr. P. Henriot, Jesuit Centre for Theological Reflection, Lusaka.

Mr John Hill, IMF Resident Representative.

Mr A. Johnsson, Ambassador, Embassy of Sweden

Mr Malambo, Head of Division, Bank of Zambia.

Prof. M. McPhearson, HIID Advisor, Ministry of Finance.

Mr J.P. Melo de Sampaio, Economic Counsellor, EC.

Mr K. Moore, Director General, Investment Centre, Lusaka.

Dr Mukoto, Permanent Secretary, Ministry of Agriculture.

Dr S. Musokotwane, Director, Bank of Zambia.

Mr Musova, Ministry of Health.

Mr M. Mutukwa, Price and Waterhouse, and Chairman, Committee on the Economy, Zambia Chambers of Commerce and Industry.

Prof B. Mweene, Advisor to the Budget Office, Ministry of Finance.

Dr Abraham Mwenda, Department of Economics, UNZA

Ms Eva Nauckhoff, SIDA, Stockholm.

Mr L. Ndalamei, Senior Researcher, Bank of Zambia.

Mr E. Ndjovu, Acting Director of the Budget, Ministry of Finance.

Dr M. Ndulo, Department of Economics, UNZA.

Mr G. O'Reilly, Managing Director, Minestone Ltd, Zambia.

Dr O. Saasa, Director, Institute for African Studies, UNZA.

Mr. M. Stirling, Resident Representative, UNICEF.

Mr K. Tikkanen, SIDA, Lusaka.

Dr J. Todd, World Bank.

Mr H. van der Heijden, Advisor on External Cooperation, National Commission for Developing Planning, Office of the President.

Mr P.G. White, Senior manager, Meridian BIAO Bank, Lusaka.

Mr Fred Winch, USAID

Mr C. Ågren, SIDA, Lusaka.

## **TERMS OF REFERENCE**

Review of Swedish development co-operation with Zambia

### **1. BACKGROUND**

The new government report of forms of management and co-operation in overseas aid (SOU 1993:1) proposes the elaboration of country profiles and country studies as an essential tool for the management of aid to individual countries.

Over the period 1965/66-1991/92, Swedish aid payments to Zambia have amounted to 3,3 milliard SEK (c. 5,5 milliard SEK in constant January 1992 prices). Sweden is today one of the largest donor countries. No comprehensive analysis has been made of Swedish aid to Zambia which takes account of other donors' experience or places emphasis on the results achieved by Swedish aid.

This is the background to SASDA's intention to carry out a review of Swedish aid to Zambia over the period 1965/66-1991/92, and particularly on its development after 1980.

### **2. OBJECTIVE**

The review will :

- a) analyse the effect and effectiveness in the sense of appropriateness to the objectives set (or 'external' effectiveness) of the aid given;
- b) analyse its cost-effectiveness (or 'internal' efficiency);
- c) make recommendations to improve its effectiveness and efficiency in development co-operation with Zambia in the future.
- d) make proposals for the methodology to be employed in analysing and following up the effectiveness and efficiency of aid in other country studies.

### **3. CONTENT**

The study should provide answers to the following questions:



- a) What has Sweden supported in Zambia?
- b) Why has Sweden supported Zambia in this way?
- c) What results have been achieved?
- d) Is Swedish development co-operation with Zambia reasonable in relation to the country's structure of production, economic policy and political conditions?
- e) Has Swedish aid been cost-effective?
- f) What have other donors done in Zambia and what do they intend to do in future?
- g) What should Sweden do in the future?

### 3.1. What has Sweden supported in Zambia?

The analysis will be based on a comprehensive time-series of Swedish aid to Zambia, broken down as follows:

- 1) by authority (Ministry of Foreign Affairs, SIDA, BITS, SAREC, Swedecorp);
- 2) by channel (bilateral co-operation, multilateral co-operation, NGOs, companies);
- 3) by final product (sectors: direct production, social sector, services, imports, public-sector management, policy);
- 4) by macroeconomic function (external consultants, local costs, imports, credit, debt operations);
- 5) by final recipient (public sector, private sector).

The analysis will also highlight information about commitments, payments, carry-over of funds and types of grant. It will be supplemented by a short description of the contributions made.

### 3.2. Why has Sweden supported Zambia in this way?

The study will examine:

- 1) applications from recipients;
- 2) policy considerations by the responsible authorities and the government;
- 3) discussions between donors and recipients;
- 4) decisions; and
- 5) communication of decisions to the recipients with special emphasis on comments or observations about content and execution.

### 3.3. What results have been achieved?

This part of the study will analyse, summarise and draw conclusions from:

- 1) evaluations carried out by Sweden;
- 2) evaluations made by other donors;
- 3) evaluations made by Zambia;

More detailed consideration will also be given to contributions which are of particular importance in Swedish aid to Zambia.

The review will analyse the macroeconomic effects of Swedish aid and the effects of total aid on Zambia. Analysis will focus on the effects on growth and distribution in general, on selected sectors (of interest for Swedish aid), and on aspects of fungibility or additionality (effects on savings, public expenditure and investment). The 'crowding-out' and 'crowding-in' effects will be examined if possible.

The management of aid flows will be analysed with regard to the recipients' economic policy, financial programmes and budgetary process (rates of exchange, equivalent value in local currency and incorporation in the state budget). It assumes that effective aid demands that the recipient takes steps to implement different co-operation programmes and makes the hypothesis that good macroeconomic management of the flow of aid is a condition of effectiveness.

Has Sweden applied the concept of conditionality? If so, what requirements does it set? Report and follow up on conditionality.

### 3.4. Is Swedish development co-operation with Zambia rational?

The reasonableness of Swedish contribution will be considered with respect to:

- 1) the recipients' resource base and economic strategies as reported in policy documents (development plans and analyses);
- 3) the recipients' priorities as shown by analysis of Zambia's national budgets (current outlay and investment plans);
- 3) public expenditures review;
- 4) analyses made by the World Bank, IMF and possibly other donors;
- 5) analyses carried out or commissioned by Sweden;
- 6) the democracy objective of the recipients.

### 3.5. Has Swedish aid been cost-effective?

The review will include a broad analysis of administrative costs per aid project to Zambia.

### 3.6. Aid from other donors

Development co-operation with other donors will be covered, analysed by channel, product, macroeconomic function and recipient.

### 3.7. What should Sweden do in the future?

Working from points 1-5 above, the review will make recommendations for the future orientation of development co-operation.

Particular attention should be paid to the recipient country's strategic planning documents for the future, the World Bank's and IMF's future-oriented analyses and estimates of the need for financing.

## 4. RESPONSIBILITY FOR EXECUTION OF THE REVIEW

The study will be carried out by Arne Bigsten at the Department of Economics, University of Gothenburg, who will be responsible for planning and for discussions with SASDA. He will also be responsible for recruitment of research assistants to work on the project.

## 5. TIMETABLE

The study will begin on 15 September 1993 and the final report be presented to SASDA on 1 June 1994. SASDA and Arne Bigsten will agree a date for interim reports as the review proceeds.

## 6. INTERIM REPORTING

Bigsten will present his final report in English with a summary in Swedish (c. 20 pages) to SASDA on 1 June 1994 at the latest. A preliminary report will be presented during April 1994. The report may be published in a series of SASDA reports by agreement with the author.

The final report will be in WordPerfect 5.1 or 5.2 in printed form and on diskette.

## SASDA

### MEMBERS OF THE COMMITTEE

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