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Country Development Strategy Statement

FY 1985

Zambia

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ZAMBIA

COUNTRY DEVELOPMENT STRATEGY STATEMENT

FY 85

AID/Zambia
Lusaka
February 1983

ACRONYMS

GRZ	-	Government of the Republic of Zambia
K	-	Kwacha
NAMBOARD	-	National Agricultural Marketing Board
Coops	-	Cooperatives
Line of Rail	-	Area of Zambia serviced by the railroads
MAWD	-	Ministry of Agriculture and Water Development

Exchange Rate:

K1	=	US$1.40	prior to 1973
K1	=	US$1.55	1973
K1	=	US$1.25	1976
K1	=	US$1.11	1982
K1	=	US$0.87	1983

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INTRODUCTION AND EXECUTIVE SUMMARY

Economic Situation

Zambia faces an economic crisis reflected by declining per capita income, severe arrears in external debt, large budget deficits and growing unemployment. Although Zambia has made commendable progress since Independence in developing its social and economic infrastructure and in building a relatively large manufacturing base, the economy is largely dominated by external factors. Zambia's manufacturing sector is dependent on imported inputs. The economy is characterized by a high level of consumer imports. The external prices for copper, cobalt and petroleum, as well as a dramatic decline in terms of trade have also contributed to the current economic situation.

Zambia's opportunity for balanced growth requires redirecting its investment in the productive sectors; regenerating production in the agriculture sector; and, making significant increased investments in the small farmer sub sector. Agriculture must form the basis of economic diversification and structural change. Zambia has good agricultural potential and the majority of the population earns its living from agricultural activities. However, policy and institutional changes are required for faster growth and the development of export potential in this area. These include appropriate production incentive structures, particularly pricing and marketing policies, and more effective agricultural research and extension services.

The constraints to achievement of growth in the agricultural sector are: (1) lack of a long-term strategy for agricultural development, (2) insufficient budgetary allocations for operation and maintenance of agricultural services and investments, (3) lack of effective quantitative and qualitative agricultural information needed for policies, decision-making, implementation and evaluation of agricultural programs and projects, and (4) inadequate capability for design and execution of development projects in traditional farm areas.

Recent Action by the GRZ

In order to bring some stability to the economy action is needed to reform Zambia's monetary policy, reduce deficits, restrict consumption and imports, redirect the country's energies to increased production and productivity, and restructure pricing policies.

Recent action by the GRZ in response to the current crisis and with pressure from IMF, World Bank and AID, has resulted in a 20% devaluation, lifting of most consumer price controls, increased producer prices for food items, reduced subsidies on essential commodities, restricted budget deficits, increased investment in agriculture and improved financial management of parastatal organizations.

AID Strategy

AID's overall development objectives have been to assist in increasing food production and small farmer incomes.

The short term objective has been to assist the GRZ in achieving economic stability primarily through reduction of food imports and increasing food production. Assistance has been provided to help meet the country's foreign exchange needs through CIP and PL 480 resources, while utilizing them to (1) encourage the Government to revise its policies, especially pricing policy, to provide sufficient incentives to expand production and (2) to decrease consumer subsidies.

The longer-term objective has been to assist GRZ to design an effective long-term strategy for increasing production by attacking the constraints to production (e.g., pricing, marketing, etc.) and by addressing the major policy and planning constraints in the Government.

AID/Zambia strategy has been focussed on reform and growth in the agricultural sector. Growth in agriculture as noted by substantially increased maize plantings each year from 1981-83 has occurred in spite of a number of distortions in the rest of the economy.

In response to a rapidly deteriorating Zambian economy during 1982 and its possible inhibiting effects on the agricultural sector the CDSS considers what macroeconomic reforms would need to be taken by the GRZ to continue to assure the cost effectiveness of AID investments in agriculture as well as longer-term prospects for continued growth.

In turn, the CDSS indicates that a substantially increased AID package would be required if the U.S. Government were (1) to take a leading position not only in support of macroeconomic reforms but also to encourage additional needed reforms; and, (2) to reinforce continued implementation of long term strategic restructuring of the economy. Other strategy options including continuation of AID's current agricultural sector concentration are also considered.

I. Major Development Problems

A. Overview of the Economic Structure and Performance

1. Prior to Independence 1/

Many of Zambia's current problems date back to the British colonial period and the brief interlude of federation with Southern Rhodesia and Nyasaland (Malawi) before Independence in 1964. The British needed cheap labor to work in the copper mines, so they imposed a Native Tax payable only in cash to force the Africans to work for pay. They reserved the best agricultural land for large-scale expatriate farmers and relied on them to produce cheap maize instead of developing the indigenous farming system. The European producer price for maize was higher than the African producer price, although both of them were kept below the import price and maize consumption was subsidized to keep the cost of labor down. Tax revenue, much of it coming from the mines, was spend on urban infrastructure and services to benefit the European population, while the rural areas and African agriculture and education were seriously neglected. Traditional systems of agriculture actually eroded due to the loss of labor from the rural areas, their exclusion from the main markets and the absence of a rural road network.

2. Overview of Performance: 1962-1979 2/

For several years after Independence rising copper prices kept government coffers well-filled. Large amounts were invested in education, transportation and energy facilities and a variety of rural initiatives and projects. Despite the latter, the fundamental rural problems remained. Urban improvements were primarily focussed on large-scale projects and modern industry. The industrialization policy was highly concentrated on import substitution/ consumer goods industries. Development programs failed to achieve a solid base for expansion of employment and income-generating opportunities. In the words of President Kaunda himself, "........ most of the industries set up .... are heavily dependent on imported raw materials and other essential production inputs; the technology imported has been capital intensive and least suited to the Zambian market. Above all,

1/ The following discussion is based on an excellent summary contained in ILO, Basic Needs in an Economy Under Pressure, ILO/JASPA, Addis Ababa, 1980, pp 5-6

2/ From ILO, op.cit., pp.6-11

the planning process has remained weak, both in terms of its impact on decision-making and in terms of its ability to establish a system of monitoring progress of implementation of development projects and programmes." 3/

Longstanding rural/urban disparities have persisted and increased, as have the wage differentials between those employed in the so-called "formal sector " of the economy and in the informal sector. Government services have remained much less effective for low-income groups, particularly for the rural majority, than for high income groups, and have probably deteriorated since independence. Despite the recent international shocks it has suffered, much of the weakness in the Zambian economy is due to internal and structural factors. This can be highlighted in terms of four critical trends:

a) The continuing adverse movement of the rural/urban terms of trade against the rural population. From 1965 to 1980 the prices of agricultural goods generating income for the rural population declined by around 65 percent relative to the prices they must pay for urban products they need.

b) The rise of average real urban wages in the formal sector by an average of 9 percent a year to a peak in 1973, thereafter falling by nearly 20 percent but remaining 40 percent above their 1965 level, has been matched by little or negative increase in labor productivity. Zambia became a high-wage economy as far as the "formal" sector was concerned, despite the rapidly growing numbers of unemployed and underemployed low-income workers accumulating in the urban and rural informal sectors.

c) The rapid expansion of industry has been based largely on large-scale capital-intensive techniques, depending heavily on imported inputs, thus providing little employment per unit of investment and resulting in a very small income multiplier effect from domestic sources of supply. Only 23,000 jobs were created in the manufacturing sector during the 14 years from 1965 to 1979, despite the huge sums invested initially in new enterprises and the continuing subsidies required to maintain production in some of them.

d) Government expenditure, both recurrent and capital, has remained heavily biased towards urban centers, with the proportion going to rural areas actually declining in many respects and the bulk of agricultural expenditures going for subsidies.

3/ Republic of Zambia, Third National Development Plan, 1979, p.iii.

These four trends result not so much from impersonal market forces as from a series of political and administrative decisions. They reflect the relative political weakness of the majority rural population vis-a-vis urban residents and the strength of the formal sector urban workers and their labor unions. They may also reflect the application of misguided policies and actions which were intended to satisfy basic human needs but have by and large resulted in greater disparities and in some cases brought about the opposite effect.

The high cost and capital intensity of modern industry have resulted from unbalanced development, creating few jobs and an increasing dependence on imports. Yet the high level of domestic savings and investment achieved from 1964-1974 reflects a substantial investible surplus. This surplus has declined recently and, much of it is preempted by a steady growth of regular claimants, so that even when copper prices are reasonably high, little of the surplus remains for new development initiatives. Three groups account for the bulk of these claims: a) Inefficient and/or inappropriate industries which require annual subsidies, often hidden, or tariff protection to remain in operation; b) urban consumers receiving subsidized food and farmers receiving subsidized fertilizer; and c) the "social bureaucracy" -- government and parastatal employees receiving high wages and salaries.

Thus the large investible surplus, which was once thought to have given Zambia high potential for fairly rapid economic development, has not resulted in significant growth and increased productivity and has partially been preempted by the urban, industrial and mostly higher income sections of the Zambian economy, leaving the rural and low income groups to subsist on what remains. Within the rural areas themselves, especially the areas outside the "line of rail", limited resources and inadequate market, transportation and other basic facilities interact to reinforce poverty.

B. Recent Economic Performance

In constant 1970 prices, Gross Domestic Product (GDP) grew by an average of 2.7 per cent annually between 1965 and 1975, but then fell by 1.9 percent a year for the next few years. After rising 3 percent in 1980 the growth rate turned negative again (-1.8%) in 1981. The external terms of trade facing Zambia declined by a staggering 69% between 1970 and 1981. Real Gross Domestic Income (GDY), adjusted for changes in the terms of trade, fell by an average annual rate of 3.8 percent during these last eleven years, to a 1981 level 35 percent below that of 1970. Real GDY per capita has fallen by 60 percent since 1965, and 54 percent during the last eleven years alone.

Net national savings have gone sharply negative as recurrent expenditures created budgetary deficits and the level of private savings has dropped.

Zambia's record in providing productive employment for its labor force has not been good. Real wages have declined in every sector. "Formal" sector employment has dropped from 27 percent of the labor force in 1970 to 21.5 percent in 1981. Today about 78.5 percent of all workers are unemployed or underemployed in the "informal sector" -- mostly subsistence farming, but with rapidly growing numbers in the urban "informal" sector. About 80 percent of the new entrants to the labor force seek work in the urban areas, indicating a failure of the economy to provide sufficient employment opportunities.

In real terms, productivity (value-added) per worker for the whole economy has been dropping at steadily increasing rates since at least 1965 and reached an average rate of decline of -4.2% annually between 1975 and 81.

Except for a temporary improvement in 1979 thanks to higher copper export prices, the Zambian balance on current account has steadily deteriorated since 1974. The deficit rose to U.S.$567 million in 1980 and $686 million in 1981, or 43 and 65 percent of exports, respectively. During this same two-year period the real purchasing power parity of the kwacha foreign exchange rate increased upwards of 20%. While the real value of the Kwacha was being revalued upwards, the Zambia terms of trade declined by another 38 percent, after falling by 50 percent between 1970 and 1979.[4/]

There has been little improvement in export performance, and Zambia still relies almost exclusively on the volatile minerals (especially copper) export market for 95 percent of its earnings of foreign exchange. With the real value of the kwacha increasing, imports are even cheaper than before and lowered kwacha earnings for exportable crops and manufacturing goods (5% of export earnings) discourage new investment in these areas.

Zambia's outstanding foreign debt totalled about US$3 billion in 1981, which was equal to about 94 percent of GDP at the official exchange rate. The ratio of public external debt to GDP has increased rapidly from 17 percent in

4/ National Commission for Development Planning (NCDP), Economic Report 1981, Republic of Zambia, Lusaka, Jan. 1982,p.14.

1965 and 34 percent in 1970 to its present level.[5/]

Debt service payments (capital and interest) have risen rapidly from only 2.5 percent of export earnings in 1965 and 11 percent in 1975 to an estimated 21 percent in 1979[5/] and 40 percent or more in 1982. The high debt service ratio itself seriously reduces the availability of foreign exchange.

Total central government expenditures as a percentage of GDP peaked in 1975 at 51.1%, the year in which a general economic decline began. The average annual GDP growth rate was +2.9% for 1970-74 and -1.0% for 1975-80. Total revenues declined in real terms during this latter period.

Prior to the seventies, large domestic deficits did not characterize the Zambian economy. The total deficit of 26 million Kwacha for the period represented only 0.4% of the average annual GDP during the 1970-74 period.

The 1975-80 deficits totalled 1,100 million kwacha. The five year total gap between expenditures and revenues increased from K26 million to K1.1 billion and rose from 0.4% to 8.3% of the corresponding GDPs.

The increase in the deficit during the latter period was due to the relative decline in revenues while total expenditures remained above 40 percent of GDP.

The drop in world market prices for copper was the consequence of external factors and resulted in a steady decline in mineral revenues: K251 million in 1970; K59 million in 1975; K42 million in 1980; an estimated K2 million in 1981. There has been a substantial Zambian effort to compensate for this loss by raising other taxes. The total non-mineral revenue increase from 14.1% of GDP in 1970 to 25.7% in 1980 reflects a commendable effort on the part of the GRZ to compensate for the losses in mineral revenue.

Large portions of the government's recurrent expenditure are subsidies and grants that cover operating losses of parastatals and cooperatives handling agricultural products, inputs and finances. Estimates from the published data indicate that in 1980 these subsidies represented 91% of the Ministry of Agriculture and Water Development (MAWD)'s actual recurrent expenditures; in 1981 they represented 83%. (MAWD's recurrent expenditures comprised 15% of total government recurrent expenditures in 1980).

The fact that the bulk of the expenditures was for subsidies is largely

5/ World Bank, Zambia Country Economic Memorandum, February 27,1981,pp.103-5.E.2. Major Constraints to Better Performance.

responsible for key positions in the field and MAWD headquarters not being filled and for extension agents and other agricultural officers not being able to travel as much as needed to provide planned assistance to farmers. The basic problems reside in the kinds and distributions of expenditures, not in the overall level.

C. Recent efforts at economic reform

Beginning with 1978 negotiations for an IMF standby loan, Zambia has taken several steps to improve its economic performance and to begin restructuring its economy. Unfortunately, falling copper prices, rising petroleum prices, deteriorating external terms of trade, internal political imperatives and other factors have resulted in setbacks and in some cases ineffective results. Some of the reforms begun such as reduced budget ceilings, increased consumer prices, improved revenue generation, reduced subsidies, reduced domestic credit ceilings and foreign exchange controls have been implemented. Since 1980 the GRZ introduced and maintained incentive producer prices for maize and other food crops to achieve self-sufficiency in food production and to reduce foreign exchange costs for importing food grains. This effort has resulted in significant increases in crop plantings, primarily maize and; given an average rainfall year should produce a surplus crop in 1982-83. The budget subsidies for maize and fertilizer were scheduled to be phased down or out between 1981-83. However, the 1981-82 maize crop was seriously reduced by the worst drought in 30 years resulting in heavy imports. Efforts to reduce subsidies have been successful in increasing maize consumer prices dramatically in 1981-82 and fertilizer by about 30%.

In December 1982, the GRZ announced lifting of all consumer price controls except for maize meal, candles and wheat flour products. In November the GRZ instituted dramatic revisions to its foreign exchange controls. Other recent efforts at improved financial management have resulted in reduction of costs of the Zambia Consolidated Copper Mines and improved performance of the major parastatal holding company INDECO.

These changes have been offset partially by continuing deterioration of Zambia's economy because of continued depressed copper prices and the economic impacts of the world wide recession.

D. Major Constraints to Better Performance

There are several sets of key constraints to better economic performance Some are subject to little if any control by Zambia authorities. The political turmoil in neighboring states has imposed heavy defense costs, disrupted trade routes to the sea, and reduced exports to southern neighbors; the recent scarcity of foreign exchange available to finance imported materials needed in domestic production activities; the drastic decline in Zambia's foreign terms of trade including the precipitous decline in real world market prices for copper exports and higher prices for most imports, and; the recessionary world market demand of recent years, have certainly been beyond Zambia's control.

Other constraints are more controllable through appropriate policy changes or programmed activities, the more important of which are summarized below.

1. Inappropriate Pricing Policies

Factor and commodity pricing policies since Independence have resulted in a number of distortions in the allocation of productive resources that have a) increased the capital intensity of production and reduced the rate of employment generation, b) increased the import dependence of domestic industry and discouraged production of domestic inputs, c) discouraged agricultural production, d) resulted in high-cost manufacturing production, e) discouraged production for export, f) resulted in a suboptimal mix of commodity production within agriculture, and g) perpetuated a highly skewed distribution of income that results in higher demand for imported products than for lower quality domestic goods.

Producer prices for major agricultural commodities, with few exceptions, have until recently been held significantly below world market price equivalents,[6/] as viewed through the official exchange rate. This has reduced incentives to increase farm production and its effect on reducing farmer incomes has reduced farmer demand for farm implements, supplies and rural consumer goods, many of which can be produced locally. The main exception to this price policy has been for maize (corn), the Zambian staple crop. Corn production has grown rapidly in response to recent increases in producer prices and subsidized fertilizer. (Producer price changes for other food crops which have been announced for the 1982-83 crop year should improve this situation.)

Since the early 1970's the GRZ followed a policy of uniform pricing throughout

6/ See World Bank, Zambia Country Economic Memorandum, Report No.3007-ZA, Feb.27, 1981, pp.22-3. The weighted average producer price for ten major crops was 25% below import/export parity prices from 1965/6-1974/5 and 16% below from 1975/6-1978/9.

the country, for farm inputs like fertilizer and gasoline as well as for the farmer's crop output, ignoring sometimes large differential costs in transport and handling. This has the effect of subsidizing most heavily those crops with the lowest value per ton and discouraging the production of crops with higher net social value as well as production for local markets within the more remote regions.

The overvalued foreign exchange rate and protective tariff regime serve to dampen domestic investment and production further by artificially skewing prices in favor of final manufactured products relative to agricultural products, and by lowering imported capital intermediate input prices relative to the cost of using more domestic labor and domestic sources of input supply. This artificially reduces the rural/urban terms of trade and further discourages investment in agricultural production in favor of often high-cost manufacturing products. It also reduces incentives to produce for export trade, encourages imports and discourages demand for locally produced inputs that could generate more domestic employment and raise the domestic value-added portion of the final goods produced.

Interest rates represent the price of capital. By maintaining ceilings on savings deposit interest rates below the rate of general price inflation, the banking system is discouraging higher rates of savings that could be mobilized for investment purposes. By also maintaining low ceilings on loan interest rates, the authorities have created a situation where the demand for credit far exceeds its supply. This results in credit rationing to favored clients to whom the credit provided is heavily subsidized, thereby encouraging the purchase of more capital intensive equipment and other inputs.

Other, less-favored loan applicants may have less collateral and tend to be smaller firms, farmers or businessmen who normally pursue more employment-oriented activities and require less capital per job created. Thus, artificially low interest rates such as those found in Zambia distort savings and investment incentives, reducing both the output efficiency of investment and the amount of employment generated.[7/]

The use of capital equipment instead of more labor intensive methods is also encouraged by fiscal incentives such as tax deductions, depreciation allowances and duty-free privileges on imports, which lower the cost of capital-intensive technology relative to production processes that would employ more labor.

The price of labor is the prevailing wage rate(s). The wage level, compared with the relative costs of other factors of production helps determine the relative attractiveness of more labor-intensive production activities and technology and thus

7/ Prof. Michael J. Applegate has provided a good discussion of the social inefficiencies and misallocation of resources caused by current Zambian interest rate policies in "Restructuring of Interest Rates in the Republic of Zambia: Some Policy Proposals," USAID/Zambia, September 1982.

affects the rate of growth of paid employment. In Zambia wages are artificially maintained at too high a level and this has resulted in reduced employment growth in the modern sectors.

The skewed distribution of income in Zambia, with urban and skilled workers earning much more than the majority of people, also contributes to the import-intensive bias of production, as those with higher incomes tend to demand goods with a higher import component.

2. Production Inefficiencies

Because of their importance in the Zambian economy, the efficiency with which the parastatals are run significantly affects the rate of growth of GDP. The parastatals employed 43 percent of the "formal" sector of the economy (although only 8.0 percent of the entire labor force) in 1979.[8/] Their efficiency is low due to the scarcity of experienced management (which is discussed in more detail below), to poor project choices, to lack of timely investment funds for improvement (often due to official pricing policies) and to under-capitalization together with weak debt management capacity. In addition, their dependency on imported inputs and capital-intensive technology has limited their linkages with the rest of the economy and reduced their overall production efficiency, especially when faced with severe shortages of foreign exchange and the consequent import restrictions.

The high levels of effective tariffs together with quantitative import controls on final goods have protected inefficient, high-cost production industries, since their costs are easily passed on to consumers.

Some progress has been made recently in improving the productive technology of commercial agriculture. In general agricultural productivity per hectare remains very low, based on the opinion of informed observors, particularly the subsistence agricultural sector, for which applied research and extension efforts have just begun. The informal urban sector has also been neglected and probably suffers from inefficient technology, lack of credit, lack of management and technical skills, and from a public policy bias favoring larger firms and the "formal" sector.

3. Public and Private Sector Management Constraints

One of the key problems facing all sectors is the scarcity of technical and management expertise. While the country has been beset with serious changes in the world economy and costly political difficulties among its neighbors, it is also suffering from a set of economic policies that, while imposed to achieve legitimate

8/ Republic of Zambia, Economic Report 1981, Jan. 1982, pp.56-57 social and political goals of equity and industrial development, have resulted in significantly undesirable and unwanted side effects. Zambia could substantially improve its overall economic performance with a better designed and better integrated set of polities to achieve its stated objectives.

Although many expatriate managers and supervisors have remained on the job or have been recruited since independence, many others have left the country. The shortage of such expertise seriously hampers the efficiency with which the country's major industrial activities are run. Especially acute is the lack of Zambian supervisory and managerial talent, as well as other entrepreneurial skills required for rapid development of the more labor intensive small and medium-scale industries all over the country.

4. Rapid Population Growth

Underlying the urgency of achieving faster economic growth and employment generation is the high rate of population increase in Zambia, which averaged 3.1 per cent annually between the census years of 1969 and 1980. As the denominator of per capita income and the engine behind the ever-increasing need for more productive jobs, the high rate of population growth makes economic growth increasingly more difficult. The provision of basic food, clothing and shelter requirements, requires ever more investment and productive effort, leaving less and less available for per capita income growth and improved social services. Rapid population growth intensifies economic failure and itself becomes a serious constraint to better performance.

5. Marketing constraints

Lack of storage, inadequate transportation and communication facilities (especially in the rural, subsistence agricultural areas) poor product quality, design and packaging, and other marketing deficiencies contribute to the poor employment and productivity performance record.

6. Constraints to Better Fiscal Performance

The major weaknesses in Zambia's overall fiscal performance lie in the kinds and composition of expenditures. The revenue effort is satisfactory. The excess of certain kinds of expenditures are wasteful not only in that they are not available for more productive purposes, but also in that they have a depressing effect on Zambian growth and employment.

Many of Zambia's fiscal problems are indistinguishable from the problems of growth, employment and external balance, dealt with in previous sections. Were the funds that are used to cover losses of inefficient capital-intensive parastatals otherwise employed, they would be making greater contributions to income and employment.

Similarly, the chronic failure to balance external accounts leads to new external debts, an increasing debt service burden, and the consequent loss of resources for productive investment. In sum, most of the macroeconomic policies that work against growth, employment and an adeuate balance of payments have fiscal symptoms, if not origins.

The key constraints to better macroeconomic and fiscal performance fall into three main groups: (1) informational constraints; (2) institutional and procedural constraints; and (3) vested interests in the major ongoing misallocations of resources.

In Zambia the complexities and difficulties of reconciling and balancing capital and recurrent expenditure items is compounded by an institutional arrangement under which the two budgeting functions are rather sharply divided between two Ministries.

The general paucity of detailed data and insufficient analysis of the implication of the available data for policy are additional serious constraints to improved Zambian macro-economic and fiscal performance.

E. Priority GRZ Measures Required to Improve Performance

1. Economic Pricing

Probably the most important measure the government could undertake to improve the performance of the economy would be to adjust commodity, exchange rate and factor prices to more accurately reflect their true value to the society. Price signals to producers and consumers are most important determinants of the levels of both production and final demand for each commodity and also, with respect to factor prices (such as wages, interest rates and the kwacha cost of imported capital goods) of the labor-, import- or capital-intensity of the production function chosen. More market-oriented price mechanisms are easier to administer than current price controls and can achieve significant gains in economic efficiency from better allocation of resources.

Based on their relative impact on investment incentives and achieving more efficient resource allocation in the economy, foreign exchange and tariff reforms are the most important for Zambia today, accompanied by a firm wage policy to make them continue to be appropriate. The urgency of export promotion and competitive import substitution in order to earn and save scarce foreign exchange also increases the priority of these reforms.

The second order of priority would be to continue to move domestic commodity prices toward more economic levels, reducing and gradually eliminating consumer and producer subsidies. This should include differential pricing of both consumer and producer goods by region and location to account for transportation, storage and marketing costs and to stimulate more cost-effective local production. Controls should be eliminated on all but a few key commodities.

The elimination of interest rate ceilings, while important to stimulate more labor-intensive investment in the future and probably easier to undertake politically than the first two, is placed in third priority since its effects will take more time to unfold.

2. Production Efficiency

While more market-oriented pricing policies and reduced subsidies will point incentives in the right direction, improved management and the technical efficiency of production will take more long-term effort. Within this second major category of development priorities attention should first be given to agriculture: research, extension, improved management, marketing and transportation facilities. The potential for productive increases in Zambian agriculture are high, and this sector not only employs a majority of the labor, it also contains good possibilities for export growth.

Next in order of importance is the so-called informal, non-agricultural sector, both rural and urban, which employs more workers than the entire "formal" sector, albeit at a low level of productivity. The potential for productive improvements in this sector is also high, if there are improvements in access to technical information and assistance in management, financing and marketing. There is such a dearth of information about this sector, however, that the first order of business is simply to find out more about it.

Finally, the formal sector will need technical, managerial and financial assistance to adjust to a more competitive, efficient mode of production. Assistance should be provided only to those selected industries deemed viable under a reformed price structure.

3. Management Improvement

Listed as a third general priority, but really underlying success in achieving the first two, is the need for better management in both the public and private sectors, including better analytical and research skills, better and more timely information systems, more appropriate training programs and the development of entrepreneurial skills among the general population.

Short term management priorities, which may require the hiring of outside consultants to assist the overextended GRZ staff, include, in a suggested order of importance: 1) wage management, 2) commodity price management, 3) export management and promotion, 4) management of the tariff structure, and 5) domestic and external debt management.

In the longer-term, Zambian economic management capabilities should be improved by building a better national economic research, analysis and data collection system and improving the domestic academic capability for teaching economic and business management subjects.

4. Population/Family Planning

A fourth priority, placed behind the others because of the long period of time before its effects can be felt, not necessarily because it is considered of lesser overall importance, is a reduction in the population growth rate. Much delay in this area could seriously impair the success of future development efforts, however, by increasing the burden placed on the economy in the future to provide basic human needs. To the extent possible, therefore, the GRZ should enunciate an informed population policy and lay the groundworks for effective programs and informational systems in the future.

II. Examination of the Poor

A. Levels and Distribution of Income

Zambia is relatively unusual in Africa because of its high degree of urbanization, its high average 1980 GDP per capita income ($521) and the low extent to which agricultural production contributes to the national economy (approximately 18 percent of total GDP in 1978). Its similarities to many African nations include widespread and increasing poverty among a large segment of its population, a high, steadily increasing population growth rate (average annual percentage increase 1969-1980 was 3.1), and a variety of different tribal groups speaking perhaps as many as 70 different Bantu languages and dialects.

The ILO study of Basic Human Needs published in 1977 and the follow-up 'Basic Needs in An Economy Under Pressure' of 1980,[9/] estimated that 60 percent of the households in the country were below the basic minimum income level in 1980. This level was a yearly per capita income of K105, or household income of K480. Similarly, the ILO study finds one-half the population falling below the bare minimum nutrition level (especially calorie intake) established for Zambia.

Other statistics further elaborate the poverty of much of the Zambian population. As of 1979, literacy was about 39 percent, life expectancy 44 years, and infant mortality by age one is 140 per thousand; housing falls below the minimum standard set for 70 percent of the total households; potable water is available to only 36 percent of all households and sanitation levels are inadequate in 47 percent of all households.

With respect to income, the extent to which distribution of wealth in the form of incomes derived from cash or other sources (e.g., subsistence crops) is highly skewed in urban, semi-urban and rural areas. In percentage

9/ All estimates and statistics in this section are from the two ILO studies terms, the top 10 percent of urban dwellers claimed over 12 percent of the total urban income while the bottom 60 percent received a mere 25 percent. The top 10 percent of the rural households shared 35 percent of the rural income, and the bottom 60 percent claimed 32 percent. There are no conclusive data by which we might compare the range or income distribution since 1973. An important observation, however, of the 1980 ILO report is that the last five years have put considerable strains on virtually all of the Zambian population.[10/] The rural population, however, has suffered worse than the urban population, particularly poor and vulnerable households and virtually all households living in the remoter rural areas.

B. Rural Households

Three types of rural households or farmers have been identified in Zambia: commercial farmers, emergent farmers, and traditional farmers. The commercial farmers have been predominantly white Zambian and expatriate farmers who numbered over 1,000 at Independence. The number of commercial farmers is currently down to some 600. Of this remaining group, perhaps a fourth are African Zambians. This group is in the top 5 percent or so of all income earners in the country.

The emergent farmers have been defined as those who farm less than 20 hectares and sell over 50 percent of what they produce. They are comparatively successful cash crop farmers. They tend to use improved farm technology (ploughs and oxen, fertilizer, insecticides, hybrid seeds) and they have received more government support than the traditional farmers. The emergent farmers have been gradually developing the high potential land on the East, Southern and Central Plateaus. Much of this land has been made available by the departure of the expatriate commercial farmers who

10/Per capita real gross domestic income has been reduced 54% between 1970-1981.

began leaving Zambia after Independence. Estimates of the size of the emergent farmer group vary from 60,000 to 120,000.

It is estimated that there are approximately 600,000 traditional, basically subsistence, farmers -- those using a farm technology based on the hoe or axe (chitemene cultivation) relying on traditional institutions (e.g., not the Ministry of Agriculture) and consuming most of the produce grown, fish caught, livestock raised, etc. According to the 1980 ILO report 25 percent of the traditional farmer households are headed by women; and household size averaged 4.0 persons in 1978. In 1974, subsistence farmers farmed more than 75 percent of all cropland with hand methods. Of the traditional farmers, about three-fourths farmed less than one hectare.

Traditional farm families have very poor living conditions, as seen from standards of housing, water and sanitation. According to the 1969 census, inadequate housing was widespread in the rural areas: 80 percent of all homes lacked good thatched roofs; 64 percent lacked adequate sun-dried brick or better quality walls. Regarding adequate water supplies, 13 percent of rural households in 1974 used tap water; 43 percent were able to use water from a borehole or well, 38 percent had to seek water from a river or stream, and 6 percent found water from some other presumably inadequate source. Sanitation levels are also an indication of low standard of living: 38 percent of rural households in 1974 had a pit latrine or a more elaborate sewage disposal system; 62 percent did not have an adequate system.

The loss of population from the rural areas has had severe effects. Many villages have been deprived of their most able-bodied manpower. A 1975 study in seven Zambian provinces showed that the sex ratio of working age adults in rural households was closely related to the general economic conditions of those households. Approximately 20% of the poorest households did not have adult males. Outmigration of working age men from rural areas has given rise to a very uneven distribution of wealth among rural households. Unlike most developing countries the average size of the rural household is lower than in urban areas, due at least in part to the outmigration.

C. Urban Poor

According to 1972 data there were an estimated 245,000 households in urban low cost and squatter areas and 50,000 families living in high cost urban areas. Average urban household size was estimated to be 4.7 -- slightly larger than in rural areas.

The rural-to-urban migration and the inadequate supply of urban housing have raised the level of congestion of peri-urban settlements and the standard of living among the poorer households in the urban areas may be declining. Average occupancy per dwelling unit, for example, is believed to have risen in recent years from 4.7 to 6.8 persons per dwelling. There is a shortfall of over 225,000 rooms in urban areas, 18.5 percent of urban households lacked adequate access to potable water in 1974, and similarly 11 percent lacked an adequate sewage disposal system. As a result of the increased stress on the urban areas caused by steady rural-urban migration, the quality of urban life and the opportunities for adequate employment are apparently both diminishing. Unquestionably, unemployment is the biggest problem of the urban poor.

III. The Agriculture Sector

A. Introduction

This part of the CDSS assesses the problems and constraints of the agricultural sector and identifies needed reforms. The macro-economic assessment indicates the need for a variety of monetary, fiscal, tariff and macro structural reforms as well as reforms in the manufacturing sector; and the need for improved performance in the urban/rural informal sector. It is clear however that major structural change and improved allocation of resources is required in the agricultural sector. Attention also needs to be given to macro-economic policies which impact on agriculture (many of which are discussed in the macro-assessment).

The small farm sector in Zambia, which is almost wholly dependent upon agriculture for employment and income, constitute the bulk of the poor majority in Zambia. Efforts to substantially improve the condition of the rural poor majority must be concentrated on improving and increasing agricultural growth and income from agriculture. Such a direction of resources will not only provide major benefits for the rural poor, but build a sound agricultural structure from which additional surplus investment sources can be tapped to generate overall growth in the rest of the economy. This should also generate increased growth in demand from a large part of the rural population which is now almost excluded from the modern economy. The potential impact of growth in the agricultural sector to overall growth and development is an important key to achieving a more balanced economy.

For the above reasons it is felt that additional analysis in other sectors of the economy would not lead to the identification of significant opportunities for AID. In addition, AID's strategy since 1979 has been to concentrate resources in the most optimum way to influence reforms especially in the agricultural sector. On that basis, the agricultural sector was selected; it continues to be the most appropriate sector to accomplish AID's development objectives.

B. Structural Characteristics

1. Land Use

Roughly one-third of Zambia's surface area is well suited to agriculture.[11/] The other two-thirds of the country is either infested

11/ "Development Needs and Opportunities for Cooperation in Southern Africa: Zambia." USAID (March 1979) with tsetse fly, devoted to forests or game reserves, permanently under water, or excessively rocky. Of the roughly 25 million hectares presently suited to agriculture, 12 million hectares are cropped intermittently and 2 million hectares continuously. Overall, land use relative to potential remains low; only 8 percent of the land presently suited for agriculture is continuously cultivated.

In large part, this reflects the production technologies presently available, the skills of most of the rural producers, and the Government's policies with respect to agriculture.

Zambia, as a whole, has above average water resources when compared to similar regions elsewhere. Lack of availability of water on a year-round basis is often a serious problem. Zambia's soils have a generally low inherent fertility. However, soils that have high potential for crop production require fertilizer.[12/]

Zambia, as a whole, has suitable to very suitable conditions (the highest FAO rating) for rainfed production of millet, sorghum, maize, beans, sweet potato, and cottom, placing it among the most agriculturally favored countries in Africa.[13/]

2. Labor

There are about 600,000 widely dispersed small-holder subsistence farm families in Zambia. They practice traditional farming methods using hand tools to produce such staples as maize, millet, sorghum, cassava, beans and peanuts; in tsetse-free areas they also raise open range cattle. About three-fourths of these farm families probably farm less than one hectare at any one time and only 40 percent sold or bartered any part of their produce in the early 1970s. Probably less than half produced any surplus, the cash value of which was estimated to be between K60-70 a year per farm (US$66-77). This group farms about 75-80% of the total cultivated land and account for the majority of total production; however, they supply little to the official marketing channels. Information about this group is spotty.

There are also 600-800 capital intensive commercial farmers including about 100-200 non-Zambians. They use high technology to farm

12/ J.K.McPhillips, "Fertilizer Recommendations and Crop Yields in Zambia," MAWD (undated, written in the late 1970s).

13/ "Report on the Agro-ecological Zones Project, Volume I, FAO" (Rome, 1978).

roughly 5% of the total cultivated land, producing maize, wheat, soyabeans, rice, and in some areas cattle. Gross annual sales from commercial farms average about K25,000-30,000 a year per farm. In terms of the volume of officially marketed production, this group supplies upwards of 60% of the total. Annually, they produce 30-40% of the country's preferred staple - maize.

Between the subsistence and commercial farmer groups is a small but growing group of "emergent" farmers (60,000-120,000) who are using improved seeds, oxen or tractors to produce the same range of crops as commercial farmers, in addition to cotton, which remains a small-holder crop in Zambia. Gross annual sales from this group varies widely but typically ranges from K1,000 to K3,000 per year. They farm roughly 15% of the total cultivated area.

During the 1960s, the annual growth rate of the rural labor force was about 0.5%, while it increased to just over 1% during the 1970s and early 1980s. This reflects the relative attractiveness which urban areas have and has resulted in a relative scarcity of young males who have migrated to urban centers. The negative effects of migration on the supply of labor for agriculture is judged to be critical in some places at certain times of the year. There is no evidence of labor migration between rural areas.

On the whole, there is a great need for additional information concerning the rural labor supply, not only because it is the source of the majority of the country's food, but also because it constitutes the majority of the population in Zambia.

3. Marketing Systems

Zambia's rural markets operate on two tiers. The first is the collection and distribution of commodities (primarily agricultural) by parastatal organizations. The second is the private marketing system about which little is known. However, it is generally accepted that the latter has been adversely affected by monopolistic marketing policies favoring parastatals and by the uniform price structure for many commodities which makes no allowance for differing distribution costs. Many observers point towards a decreasing availability of essential goods such as salt, oil, soap, etc. in the rural areas as evidence of the impact that this policy has had on the private marketing system.

Working through parastatals and cooperatives the GRZ establishes uniform prices and dominates the marketing of major crops, particularly maize. The marketing and pricing of vegetables is largely left to the private sector, including cooperatives.

Although there are official producer prices for sorghum, millet and beans they have until recently been below the prevailing prices in rural markets, and are therefore largely traded by the private sector. Hence, the official marketing agencies were buyers of last resort for these crops. Even though this arrangement allows some room for the small private traders to operate, the environment is not very supportive of their activities.

4. Location

A significant characteristic of Zambian agriculture is its concentration in the Central, Southern and Eastern Provinces. This area accounts for over 50% of officially marketed production, only 16% of the land, 29% of the rural population, most of the urban population and jobs, and contains the majority of the major transportation arteries.

The distribution of the majority of the rural population (about half of the total population remains outside the major transportation and modernized areas) has implications for development prospects. The transportation costs will be significant for any development program which tries to generate substantial growth of rural areas without transportation links with the center of Zambia's economic activity.

C. Agricultural Sector's Performance

Accurate data about total agricultural activity in Zambia is not available. However, the available estimates are believed to be sufficiently accurate to indicate trends. Comprehensive analyses of the sector remain suspect unless improvements are made in the quality of data and information.[14/] The sector's performance is compared against two goals: increased agricultural production and increased agricultural incomes. These GRZ goals are very much related to the AID/Zambia goals of increasing food production and small-farm income.

14/ A recent (1982) WFP food assessment team reported that the quality of agricultural crop forecasts were inadequate to reasonably determine the food deficit situation in the country. (See Lusaka 3708).

1. Increased Agricultural Production

Total output in the agricultural sector has increased since 1979 by 3.4% and 9.8% in 1980 and 1981, respectively. This is a turn around from the 3.2% average annual decline experienced during the 1976-1979 period.

The major source of change in total agricultural output is the commercial farmer group. During 1976-79, their output fell by nearly 11% per year. The rebound since 1979 was led by this group whose output grew by 9.8% and 28.6% in 1980 and 1981, respectively.

The traditional or subsistence farmer group's annual changes in output average around 1-2% per year. However, their contribution still accounts for 65-70% of total agricultural output.

The increase in officially marketed maize during 1979/80 is important since in any given year it accounts for at least 90% of the total agricultural crops volume marketed through official channels. Officially marketed production of maize in 1979-80 was 336,000 MT or roughly 62% of the 1972/73-1979/80 production trend. In 1980/81 and 1981/82, it increased to 70% (383,000 MT), and 128% (693,000 MT based on provisional data) of trend for 1981/82 respectively.

The difference between total marketed production and officially marketed production for the various crops is not known and opinions vary significantly. For example, the estimates of the quantity of maize illegally exported to Zaire each year ranges between 45,000-90,000 MT. This is roughly 10-30% of total quantity marketed officially, depending on the year chosen for comparison. For other crops, such as rice, groundnuts, sorghum, millet, and cassava, even less is known. Most observers would agree the quantities of these crops marketed outside the official channels are significant, particularly for sorghum, millet and cassava, which are an important part of the diet in many parts of the country.[15/]

Between 1964 and 1981 the productivity per worker in the agricultural sector had declined about 9.1%, although for the economy as a whole, it had declined by 29%. Beginning in 1980, however, productivity per worker in agriculture rose 2.6% and another 7.6% in 1981.

15/ See Dutch Food Strategy Study

These gains mostly came from the commercial farm sector where productivity grew 15.5% and 22.6% in 1980 and 1981.

The real value of output per worker in the commercial farm sector has been above the average for the economy since around 1970. In 1981 it stood at K1,842 per worker, while it is K111 in the traditional sector, and K737 for the entire economy. These figures understate the true productivity of the commercial farms since a number of "emergent" farmers are now included in the commercial farmer category.

2. Increased Agricultural Incomes

Since 1979, total real income in the agricultural sector once again started rising relative to the rest of the economy. Increased income came from two sources: increased production and increased prices for that proportion of value added by the sector (e.g. increased unit prices for that proportion of value added to the product by the agricultural sector).

The 1980 and 1981 GRZ producer price increases resulted in an increase of the per unit value of production in the sector which was greater than in the economy as a whole. For these years, agriculture's average value added price increases were 12.3% and 11.4% while the economy's average increases were 11.5% and 2.0% respectively. Partially as a result of these real increases, total agricultural production rose, thus further increasing total income in the sector.

Most of the increased income has gone to the commercial farm sector. In 1980 and 1981, the price for that proportion of agricultural value added by the commercial sector increased by 21.4% and 15.4%, while it rose by only 8.1% and 9.8% in the traditional farm sector. The major reasons for the unequal distribution of the price gains are: (a) not all the country's farmers are able to capitalize equally on the higher producer prices because of differences in access to markets (e.g., most commercial farmers have better access than traditional farmers); (b) not all the price increases are for crops that the traditional farmer can grow (e.g., wheat and rice); and (c) there were not large price increases for traditional crops (e.g., millet, cassava, sorghum).

When coupled with the fact that productivity in the commercial farm sector rose by 2.6% in 1979-80 and 7.6% in 1980-81, while the traditional sector's productivity remained stagnant, the conclusion that most of the increased agricultural income went to the commercial sector becomes even clearer. Even though the traditional sector's income did not increase as much as the commercial sector's, it did do better than the economy as a whole in 1981.

3. Zambian Government's Role

The Sector's performance since 1979 has clearly improved over its performance during the previous several years when agricultural production and incomes fell. Agricultural policy adjustments by the GRZ have played a major role in bringing about this turn around.

Real producer price increases for many crops, particularly maize, contributed significantly to the sector's improved performance. Although the GRZ has been actively using price increases as a tool for increasing production since 1974/75, it was not until 1980/81 that the price increases represented increases in real terms. If inflation does not rise significantly over projected levels (12%),[*/] the price increases announced up through the 1983/84 crop season will amount to real increases for most crops.

The real price of maize has increased 8.8% per year during 1979/80-1981/82 and is projected to increase another 3.4% per year during 1981/1982-1983/84. This compares to the real decline of 4.4% per year experienced during 1973/74 - 1979/80. On average, the real producer price increases announced for the other crops have not been as large as those for maize.

With respect to inputs, the GRZ imported and produced sufficient quantities of fertilizer to allow sales to increase by a compound rate of 7.3% per year since 1972-73. The preliminary results of one analysis reveals that fertilizer sales are a major factor in explaining the increased level of officially marketed maize.[16/]

The GRZ has also continued its fertilizer subsidy. The effect is to increase the real price of the crop on which the fertilizer is used. Fertilizer in Zambia tends to be used primarily on maize. Given that the fertilizer subsidy has averaged between 28% and 50% of the total cost, the impact of the subsidy on the profitability of maize production is significant. The subsidized prices have helped increase

16/ D. Dijkerman. "Major Factors Explaining the Level of Officially Marketed Maize in Zambia," (forthcoming 1982)

*/ Analysis utilizes implicit GDP deflator obtained from IMF, "International Financial Statistics", for Zambia.

agricultural production and incomes of those farmers who can obtain fertilizer. Various sources estimate that between 50% and 75% of all fertilizer is used on large commercial farms. Although the GRZ reduced fertilizer subsidies in 1982, a substantial level remains (an estimated 28% for 1983).

To improve the efficiency of the official marketing system, the GRZ began a major reorganization of its largest agricultural marketing parastatal, Namboard, in 1980. Since January 1981, the provincial cooperative unions have been assigned the responsibility of becoming the official purchasers of maize and other crops at the provincial level while Namboard retained its national level responsibilities. The cooperatives are not permitted to charge a fee for marketing and handling costs but must rely upon government transfer payments to cover expenses. The benefits of this change were that Namboard was able to reduce its work force by several thousand, and the responsibility of marketing was partially decentralized to the cooperatives. Unfortunately, not all the cooperative unions are ready for this responsibility. Furthermore, the GRZ has been slow in reimbursing the cooperatives for their expenses which has led to severe cash-flow problems. Whether or not this change has been beneficial remains to be seen. However, those cooperatives who have been able to assume their expanded role seem to be pleased with having a greater say in the management of their affairs.

The GRZ has also legislated a wide range of reforms to make investment in agriculture more attractive including (a) maize producer bonus in foreign exchange of US$0.50 for each bag over the first 5,000 delivered to an official marketing agency depot; (b) tax laws adjusted to be more favorable toward farmers; and (c) liberalization of depreciation allowances and write-offs on agricultural investments.

D. Constraints to Improving Performance

Until recently the attempts to implement Zambia's humanist political philosophy has resulted in policies which suppressed agricultural production and incomes below what they could be. These policies have favored maize production (due to the relatively high producer price) and favored maize consumption (due to the relatively low consumer price) and have reduced the profitability of producing other crops. They also have resulted in the country becoming more of a mono-culture crop (maize) economy.

1. Uneconomic Pricing

(a) Uniform National Pricing

Zambia's uniform prices are based on the estimated cost of production on large commercial farms. The transport and distribution costs are all absorbed by the GRZ. These high prices for crops, primarily maize, relative to other food crops, leads to inefficient crop production allocations. Small holders now receive a greater incentive for the production of those crops favored by GRZ price increases. That in itself is not necessarily bad, however because transportation and distribution costs do not have to be considered by the farmer in making his decisions on how much to produce. The small holder in isolated areas far from any markets has about the same incentive to produce maize as a farmer along a major transportation artery. Thus, the economics of comparative advantage is ignored. This is significant in light of the present distribution of Zambia's producers. The GRZ maize handling and transportation subsidy has become substantial as a result of this policy. In 1976, this subsidy to Namboard was about K25 per metric ton, while by 1981 the subsidy was over K95 per metric ton. In comparison, the price of maize was K130 per metric ton.

Not accounting for the transportation costs of various crops favors low value high bulk crops. For example, on a per metric ton basis, maize has a lower value than wheat, rice, soyabeans, groundnuts, or cotton.

(b) Uneconomic Relative Crop Pricing

Maize prices have increased in absolute and relative terms faster than any other crop in Zambia. The average annual decline of other crops against maize prices was 8.2% per year during 1967/69-1979/80 and the loss increased to 9% per annum during 1979/80-1981/82.

This pricing policy provides additional incentives for maize production at the expense of other crops. If the availability of labor is an important constraint to increasing production, then these policies would tend to reduce the acreages of other crops as producers shift into maize production to achieve the same level of cash income.

During the late 1970s. domestic prices were below import parity prices for most crops, the exceptions being wheat and rice (two crops for which Zambia has limited agro-ecological potential).

During 1980/81-1981/82, Zambian producer prices were above import parity for most crops except sorghum and seed cotton (two crops for which Zambia has a significant agro-ecological potential). The domestic maize price has improved steadily against the import parity prices,* rising from an average of 59% of import parity during 1973-1976/77 to 118% during 1980/81-1981/82.

(c) Subsidized Inputs

The GRZ also subsidizes some agricultural inputs, primarily fertilizer. In 1972, the fertilizer price and handling subsidy to Namboard for 112,800 MT of fertilizer sold was K3.7 million. By 1980 the subsidy increased to K50.0 million for 196,361 MT sold, almost a 14-fold increase for only a 74% increase in sales. In 1981, the subsidy declined by K12 million. However, with the opening of the fertilizer facility in Kafue, the estimated subsidy cost could start increasing again, unless the GRZ continues to reduce per unit fertilizer subsidies. Since most of the fertilizer is believed to be used for maize production, the subsidy becomes another incentive for maize production.

(d) Uneconomic Relative Pricing for Consumption

The GRZ subsidizes maize consumption in order to maintain low urban prices for its major foodstuff. The total subsidy costs per bag of maize handled by the GRZ are substantial. For the 1980/81 crop season total official maize purchases and imports were valued roughly at K104 million (US$120.0 million) which is equivalent to 9.5 million bags of maize. Total subsidy outlays were K94.0 million (US$110 million) or equivalent to 90% of total GRZ outlays for maize purchases. Based on past trends, roughly 40% of the subsidy is for fertilizer, another 50% is for maize handling and distribution and the remainder for other input subsidies (i.e., seeds). Given the size of this subsidy to the consumer,

* An important assumption of this comparison is that the present exchange rate properly reflects the value of the Kwacha. There is considerable evidence that that is not the case. In essence, the effect would be to reduce the gain the GRZ has made on import parity prices. For example, if the actual "shadow" exchange rate was equivalent to a 30% devaluation of the Kwacha, then maize price including the fertilizer subsidy would be only 17% above the import parity price in 1981/82, down from unadjusted level of 51%.

it can be readily understood why maize consumption has been stimulated relative to the other staple food crops.

The low food prices have not guaranteed sufficient supply of staple foods at official prices. Parallel markets have risen in these and other "controlled" food commodities [17/] although they are thought to be relatively small due to the reduced importance of private traders in agriculture. In rural areas sorghum, beans, and millets are often more expensive than the controlled price for maize. Even though these other staples can be grown more cheaply than maize in many areas, it is difficult to compete with the GRZ's relatively high producer prices and relatively low consumer prices for maize.[18/]

2. Uneconomic Markets

(a) Inefficient Marketing Parastatals

Virtually all of Zambia's marketing parastatals receive subsidies annually. Namboard, even after the reorganization, still gets the largest share of all the subsidies passed out annually. A large part of Namboard's problems, which is also the case for other parastatals, is having to operate within the GRZ's legislated price structure. This system does not allow Namboard to make a profit. Until recently maize purchased was sold to millers at the same price paid to farmers. Thus, to operate, Namboard has had to rely on GRZ budget transfers to cover its handling and distribution costs. (This was an "improvement" because prior to 1981, maize was sold to millers at prices below what the farmers received). Since losses are covered by the GRZ, there is little incentive for parastatals to be efficient.

The other major problem of this marketing system is the lack of managerial talent not only at the top but at middle and lower levels. As noted in virtually all reports on Zambia, lack of trained manpower is clearly a major constraint throughout the Government.

17/ See recent Food Strategy Study (1982) for more details.

18/ This conclusion is also supported by Alan Marter, "Cassava or Maize: A Comparative Study of the Economics of Production and Market Potential of Cassava and Maize in Zambia, Rural Development Studies Bureau, University of Zambia, 1978" and Doris Dodge, "Zambian Agricultural Pricing and Marketing Policy," (July 1979).

The reliance on budgetary transfers to cover operating expenses has caused serious cash-flow problems for the parastatals because the GRZ has been increasingly slow in approving the transfers. As a result, parastatals have been forced to enter the commercial credit market where they have soaked up credit which might otherwise have gone to productive activities (i.e., private sector investment).

The GRZ has publically stated that it wants the cooperatives to play a major role in agriculture. However, the present situation will require that cooperatives receive more support to survive and grow.

(b) Constrained Marketing System

The result of the GRZ's uneconomic pricing structure for essential goods such as salt, soap, oils, as well as other goods has reduced the size and importance of the rural private marketing system. To make no allowance for distribution costs in rural Zambia where the population density is low by most standards, has created shortages of most consumer goods. Without much to purchase, the rural traditional farmer cannot be expected to grow more. (However, as of December 27, 1982, the GRZ has eliminated price controls on all previously controlled commodities except for maize meal, candles and wheat flour products.)

3. Other Constraints

Other constraints on agricultural performance are the lack of credit, agricultural information, appropriate agricultural research and extension, and restrictive land tenure laws. The two most important macro policies that impact negatively on the sector are the overvalued exchange rate and low interest rate policies which are discussed in the macroeconomic section.

E. Measures to Improve Performance

The GRZ can alleviate the sector constraints which are largely a result of inappropriate GRZ policies and create an environment conducive to improving the sector's performance.

1. Regionally Differentiated Producer Pricing

By allowing regional producer price variations based on transportation and handling costs the GRZ will present farmers with a more accurate picture of what the value of their production is to the country and the real comparative advantage of different crops for different farmers. It will also reduce transport and handling subsidies to Namboard and the Cooperative Unions.

The preferred way to implement this policy would be to let the producer prices for most crops such as sorghum, millet, beans, cassava, etc. be determined in the market place. In essence, this would legitimize the unofficial markets, hence the private sector, and allow it to play a greater role. Because of the sensitivities regarding maize, the GRZ might retain control of the pricing of this crop, but would allow for adding the costs of transport and handling.

2. Reduce Incentives for Consumption of Subsidized Foods

By reducing consumer subsidies, particularly on maize, the incentives to consume will decline and the demand for substitutes will increase, thus altering consumer preference.

Although this means an alteration in the consumption patterns for those Zambians living in areas where subsidies are important, this is not an unfamiliar event. Rural and urban Zambians often experience shortages of commodities such as cooking oil, sugar, salt, soap, food crops, etc. at official prices. These commodities are only sometimes obtainable at higher prices on the parallel market. In many areas alternatives to maize, wheat and rice, such as sorghum and millet already are a major element in their diet. 19/

This altering of consumer preference (based on price) would be occurring at the same time that producers would be responding to altered product pricing (i.e.,relatively lower maize prices and relatively higher prices for other crops) to varying degrees throughout the country. In the face of such changes, the country's marketing system would have to adapt.

3. Alter the Function of Parastatals and Increase the Role of Private Traders and Cooperatives

In order to enable the present marketing system to adapt to the changing situation which would result from the different production and consumption patterns, the GRZ will have to allow official marketing agencies (Namboard and the cooperatives) and private traders to pay market prices for crops such as sorghum, millet, beans and cassava. The effect of this decision will be to immediately expand the size of the marketing system which could respond to the expected increased supply and demand for alternative food crops. The cooperatives and the remaining few Namboard depots would be responsible for

19/ Food Strategy Study, Ibid.

making the decisions regarding how much to pay producers for a particular crop in their respective regions. The marketing units working in a particular area can respond more quickly and accurately to market conditions than can the present centralized pricing system.

By allowing official marketing agencies to freely interact in the marketplace the competition (demand) to purchase these commodities will increase. It is expected that most cooperatives will enter the market because in most regions, particularly in the northern and western parts of the country, the market determined prices have been observed to be above the official prices for sorghum, millet, beans, rice and cassava.

The GRZ also would phase out subsidies to the cooperatives. Thus, the cooperatives would have to assure that these added operations cover their costs and provide a return to the cooperative shareholders -- the local farmers. This would provide the necessary incentives to cooperative managers to maintain and improve the efficiency of their operations.

4. Deregulate Prices of Non-Agricultural Commodities

By allowing the prices of essential production such as soap, oil, salt, etc. to reflect the cost of transport and handling, marketing organizations will once again have an incentive to deliver the goods to rural areas and, the farmers will have something to spend their cash on.

5. Account for Relative Price Differences

The preferred method of implementing this policy measure would be to set the wholesale price of maize (before adjusting for internal transport and handling costs) at levels consistent with long term trends in world markets (e.g., world border price equivalents). This would do several things. First, it would protect Zambian farmers from sharp fluctuations in the international markets. Second, it would provide a proxy of the value of maize to the country, because if there was a domestic shortfall the price at which maize was imported would probably not be that significantly different from the domestic producer price. Finally, the market place would determine the relative crop price relationships, thus relieving the GRZ of another major burden.

6. Reduce Subsidies on Inputs

By reducing subsidies on agricultural inputs, the GRZ would present the farmers with a more accurate picture of the cost of using that input. It might reduce, for example, fertilizer consumption, but the resulting allocation of resources would be more efficient for the country. The impact of reducing fertilizer subsidies on fertilizer sales, hence production would not be significant according to one study.[20] Reduced subsidy outlays by the GRZ also would mean more resources are made available for potentially productive purposes.

7. Expected Effects

Measurable impacts are expected as a result of the above measures. First, production and income in the rural areas would increase. Second, GRZ per unit budgetary subsidy outlays for commodities (agricultural inputs and food crops) would decline as the GRZ reduces such payments to organizations. Third, these changes would increase the production (supply) and sales (demand) of other crops, particularly sorghum, millet, beans and other crops which are important and viable alternatives to maize. A fourth effect would be increased regional food self-sufficiency by reducing interregional food transfers. The production of alternative crops would increase most where the maize price decreases would be the largest -- the northern and western parts of the country. These regions, which have been deficit maize producers, would become less dependent on food imported into the region from surplus production regions. A fifth result would be the expected decline of the maize monoculture since maize would no longer receive the relatively high production and consumption incentives.

It is important to note that the extent to which these changes would actually occur would be influenced by the other needed changes in the GRZ's macro-policies (e.g., interest rates, exchange rate, etc.) If these changes are made, one could, for example, expect an increase of agricultural exports.

20/ Dodge, Ibid.

Copper Mines and improved fiscal management of the Zambia Industrial Mining Corporation. The Ministry of Finance has in the past two years increased its revenue to compensate for losses of revenue from the mines. Other less dramatic but important actions such as increased incentives to farmers in the form of bonuses, reduced taxes and access to foreign exchange have improved the climate for increased farm production. Decentralization of marketing services from the parastatal Namboard to the provincial cooperative unions could auger well for a reorganized private marketing system.

The 1983 GRZ Budget released in January indicates real reductions in government expenditure and deficits. Consumer subsidies have been reduced over the actual amounts for 1982 and the recurrent budget for the Ministry of Agriculture and Water Development was increased by 40%. If maintained, the announced budget is indicative of policy commitment to financial discipline and to increased reliance on agriculture for future growth. (See Confidential telegram Lusaka 00454).

Although important macro reforms have been taken by the GRZ much needs to be done to implement and manage its restructuring effort and to revise other policies. Nevertheless, in less difficult times, Zambia would receive considerable recognition for its recent performance in economic reform.

IV. The GRZ Commitment to Economic Reform

The significant reforms described below recently undertaken at substantial political risk by the GRZ to stabilize the economy were those called for in the 1979-80 period by the IMF, IBRD, AID and others. Unfortunately the economic situation, primarily external prices for copper, cobalt and petroleum as well as dramatic decreases in Zambia's terms of trade have overshadowed these reforms. One result is that unless the world economy and copper prices improve dramatically and rapidly, the impact of the Zambian reform package will take longer to bring about substantial improvement in economic performance and Zambia will have to face a longer period and perhaps more difficult readjustment of its consumption and investment patterns. In spite of reasonably good long term prospects for economic growth, the current economic crisis in Zambia and the dramatic actions taken to stabilize the situation, the confidence of the world banking system in Zambia has not improved.

Over the past two years, Zambia's efforts at economic reform have been significant. The GRZ has brought producer prices for maize to near import parity thus stimulating substantial increases in maize plantings which should achieve maize self sufficiency in the near term. Producer prices for other food crops have also been raised to incentive levels. Consumer prices for many food items and prices for fertilizer have also been substantially increased. The GRZ was committed to a program to eliminate government subsidies on maize and fertilizer which, if not for imports of maize in 1982 to compensate for a drought, would have been phased out in 1983 or 1984. In early December 1982 the GRZ lifted price controls on all consumer goods except maize meal, candles and wheat flour products. The GRZ also announced a 20% devaluation effective January 10, 1983. Efforts by the GRZ to improve operation of the parastatals have resulted in large cost savings to the Zambia Consolidated

V. Goals for AID during the CDSS Period

A. Current AID Strategy

AID's overall development objectives have been to assist in increasing food production and small farmer incomes.

The short term objective (1-3 years) has been to assist the GRZ in achieving economic stability, primarily through reduction of food imports and increasing food production. AID has assisted in meeting some of the country's foreign exchange needs through CIP and PL 480 resources, utilizing them to encourage the Government to revise its policies. In particular AID has emphasized pricing policy for foodstuffs to provide sufficient incentives for farmers to expand production and to decrease government consumer subsidies for maize and for fertilizer. AID is providing assistance through the Agricultural Training, Planning and Institutional Development Project (611-0075) to expand and improve the analytical basis for some of the short-term policy shifts toward increased food production, particularly producer price incentives.

AID's longer-term objective is to assist the Government to restructure the agriculture and non-agriculture productive sectors in the rural areas in order to increase the incomes of the rural poor. The primary target will be the 600,000 small-farm families including the 60,000-120,000 emergent farmers; initial emphasis will be on their contribution to food production.

The first element of AID's strategy has been to provide assistance to the GRZ to design an effective long-term strategy for increasing the production and income of the small farmer by attacking the following generally perceived constraints: agricultural and consumer pricing policy; agricultural production technologies; farm inputs supply, including materials and credit; labor utilizing methods; management knowledge; marketing and market services; and other farm related productive and support services, e.g., maintenance/ repair services, implement production and agro industry/processing services.

The two main vehicles for carrying out this element of the strategy are the Agricultural Training, Planning and Institutional Development Project (611-0075) and the Agriculture Development: Research and Extension Project (611-0201).

A second component of AID's strategy has been to attack the major Zambian policy and planning constraints. Centralized decisions and planning have a profound impact on the national economic balance and the agricultural economy as well as the ability of small farmers to increase their incomes. AID has begun to assist the GRZ to improve this system to assure that the alternatives to and consequences of such decisions on important social and national planning goals are incorporated in the decision-making process. AID's immediate tasks in this regard are to assist the GRZ to rationalize and structure the planning and decision-making system with respect to agriculture/growth and development; to establish an analytical capability within this system; to assure that appropriate alternatives and consequences of decisions are considered; to assure that decision-making is supported by adequate data;and, to focus attention on resource allocation to agriculture and on developing realistic rural development strategies.

Based on this current AID strategy, the following chart indicates the ways in which AID has used its resources in taking action to bring about needed policy reforms, to assist in improving institutional and manpower capabilities in national and agricultural sector policy and planning, and in agricultural technology development and diffusion.

APPLICATION OF AID RESOURCES TO GRZ CONSTRAINTS

GRZ CONSTRAINTS	Policy Dialogue 1/	Resource Transfer		Technical Assistance		Other Projects	
		CIP	PL 480	Planning Project 2/	Research and Extension Project 3/	Kafue-Chirundu Road 4/	Africare OPG
Foreign Exchange		X	X			X	
Food and Ag. Commodity Imports		X	X				
Producer/Consumer Food Prices - Fertilizer Prices	X	X[5]	X[5]	X			
Ag. Planning and Policy Development Capability	X	X	X	X			
Ag. Technology and Management Capability				X	X		X
MAWD Recurrent Budget		X[5]	X[5]	X	X		
Agricultural Manpower Development				X	X		

1. Policy Dialogue - is shown to indicate the focus of AID/Z efforts at policy reform which is also closely linked to and reinforced by the major resource transfer programs and technical assistance projects.
2. AID/Zambia Project 611-0075 Zambia Agricultural Training, Planning and Institutional Development.
3. AID/Zambia Project 611-0201 Zambia Agricultural Development: Research and Extension
4. Regional Project - 611-K-008 - to rebuild the Kafue-Chirundu section of the road between Lusaka and Harare, Zimbabwe.
5. Local currency generations

B. Zambia's Achievements in Agricultural Reform

AID/Zambia in parallel with the World Bank and the IMF has since 1979, encouraged the GRZ to introduce incentive producer prices for food crops, primarily maize, which should have the dual effect of increasing production and farm income. Since the 1981 crop year the GRZ has established maize producer prices which have been at or near import parity.[21/] The response of farmers to these incentive prices has resulted in total estimated increases in maize plantings of 20% in 1980-81, 16% in 1981-82 and 17% in 1982-83.[22/] Statistics on income improvements to small farmers as a result of these price increases are not available. However, approximate estimates indicate gross income increases.[23/]

Current estimates are that even with an early December/January drought a yield of only 70% in the Southern Province maize producer belt will not undercut maize self-sufficiency at the time of the next harvest.

Zambia also announced for the first time near import parity producer prices for sorghum and millet for the 1982-83 crop year. This should result in increased production of alternative food crops and help to

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21. In 1982 it was 17% above import parity based on an adjustment of 30% for exchange over-valuation of the kwacha.

22. 1982 Annual Plan, National Commission for Development Planning; Ministry of Agriculture and Water Development Planning Division preliminary estimates; estimates of the Commercial Farmers Bureau. See also Accelerated Development in Zambia: Agenda for Action. World Bank, April 1982,pp16.

23. Marketed maize purchases by Namboard in 1982 totaled 560,000 tons. Approximately 60% was produced by small farmers and 40% by commercial farmers. The Commercial Farmers Bureau estimates that commercial farmers cost of production per 90 kg bag of maize was K10 and was sold for K16. Commercial farmers utilize higher capital intensive technology with higher input costs than do emergent and small farmers. By induction it has been assumed that a greater cash income per bag of maize was achieved by small farmers over previous years.

rationalize the former maize mono-culture production patterns.

Other recent incentives for farmers which have contributed to an improved agricultural outlook and earnings were income tax reductions for farmers, production and early delivery bonuses and improved access to foreign exchange.

Fortunately until the recent balance of payments crisis, macro-economic constraints, in particular distorted foreign exchange, tariff and other pricing signals have not constrained growth in agricultural production and the disintegration of the agricultural production base which was observed in the late 1970s has (according to recent observers) been reversed.

Current efforts by the GRZ in agriculture policy reform, together with continued attention to related macro-economic aspects such as food and other consumer price distortions can, up to a point, result in increased growth in agriculture.

C. Problems in Executing AID's Strategy

Previous sections of this CDSS relate to major constraints and the need for GRZ reform in macro-economic policy, improved resource allocation and changes in the agricultural sector. Priorities for AID action in those areas have been identified. However, in proposing a balanced strategy it is important to consider what is the AID and US comparative advantage in delivering assistance and the practical, local limitations to utilizing these strengths.

Analysis has led to the conclusion that the US comparative advantage with respect to assisting Zambia falls primarily in three areas:

1. Policy analysis and planning
2. Technology development, particularly agriculture research
3. Economic and agricultural management

The history of AID programs throughout the world, as well as private sector experience, indicates that the U.S. has the highest level of competence, trained manpower, research facilities and institutional support in these areas. However, AID's use of its comparative advantage can only be considered in the context of country related factors.

AID strategy selection must take into account AID staff capacity and the GRZ view of AID's presence in Zambia. At the time of our program expansion in 1977 and continuing today is the agreement that AID support to Zambia would be carried out without a large visible presence of either AID personnel or technical assistance projects. Added to this is the fact that from June 1981 to June 1982, as a result of the expulsion of U.S. Embassy officials, the AID presence was viewed with suspicion by the GRZ. Although U.S./Zambian relations have improved, AID should not consider a major expansion of personnel or technical assistance projects in the near future.

A second constraint is the total resources available. Any efforts to bring about significant policy reform in the macro-economic area are limited by the relative level of AID funds provided Zambia ($27 million in 1982), when compared with the total external resource flows (approximately $250-$300 million per year). Although in the past AID has been able to achieve policy reforms, particularly in the agricultural sector, prospects for achieving significant policy reform in the macroeconomic arena must be viewed with realism.

The third limitation is the instruments by which AID resources are transferred, i.e. commodity import loans, PL 480 programs and technical assistance grants. Because each of these instruments provides resources to different sectors of the economy, they must be negotiated with different elements of the Government. (For example, loans are negotiated with the Ministry of Finance and grants with the National Commission for Development Planning). Since each instrument has its own peculiar method of implementation and requirements, the overall impact of the total AID resource package as well as the opportunities for policy dialogue is often diffused.

Another area of concern is AID's access to policy-makers. In Zambia, to a great extent, the system through which policy decisions are made is obscure, and does not follow any set organizational or procedural lines. The major policy decisions probably take place in a series of consultations involving State House, Cabinet and the Central Committee. American aid, because it is on a government to government basis, deals almost exclusively with the executive Ministries and through them to the Cabinet. Policies for the GRZ largely emanate from or through the Central Committee. However, because the Central Committee is an instrument of the political party, AID's access is not only formally limited but politically risky because of the sensitivity of the policy issues being addressed. Although this has hindered AID/Zambia in the past, the U.S. Mission expects to develop a new line of action in gaining access to a wider spectrum of key policy makers with regard to AID's proposed strategy. (See section on Tactics for Implementing the AID strategy).

The last area which limits effective use of AID's comparative advantage relates to other donors in Zambia. AID's ability to deliver U.S. assistance resources in the most effective way is limited by the substantial number of donors who are providing a very wide array of assistance to all areas of the economy. Most donors have not concentrated their resources in the same way as AID, and a substantial number of them approach the Government with offers of short term, ad hoc assistance. In some cases, for example in agriculture, this type of assistance can be counter-productive and can inhibit long term institutional development. Competition to provide assistance to solve short term problems and the wide array of donors to choose from leads to a hodge podge of limited efforts by a large number of advisors from different donors and does not result in a comprehensive or sustained development program. One additional result is that AID's ability to negotiate with the GRZ for necessary institutional and policy reforms as a condition for long term assistance becomes more difficult when the GRZ can turn to other donors for assistance on their own terms.

D. Proposed AID Strategy

AID's current strategy which was developed in 1980 and 1981, has concentrated on the agricultural sector as the means for short term action concerning some of Zambia's economic problems, e.g., high food imports, depressed agricultural production and consumer subsidies. It was recognized that stabilization actions were also required by the GRZ in macroeconomic policies such as reduction of total imports,and restructuring manufacturing away from capital and import intensive industries. There was some expectation that world economic conditions, as well as copper prices, would improve[24/] and that Zambia would, with the help of the IMF 800 million SDR Extended Fund Facility, be able to re-establish its credit and begin to restructure the economy without drastic and abrupt reduction in consumption and domestic production. Consideration

24/ World Bank - Zambia Economic Memorandum 1981 was given in the AID/Zambia sectoral strategy to the impacts and constraints of the balance of payments problem and other distortions in the economy affecting potential growth in agriculture, i.e., the constraints critical to the attainment of sectoral goals.

The 1980, 1981 and 1982 increased maize plantings and increased contribution of agriculture to GDP seemed to support the conclusion that the macro-economic constraints were not critical to sectoral growth and in particular the import component needed for increased agricultural production would not pose a serious drain on foreign exchange reserves.[25/]

The conclusion that sectoral growth was possible also took into consideration that the agricultural sector from 1976 to 1979 was not utilizing its full available productive capability, therefore little new investment and only incremental increases in foreign exchange were needed to achieve food self sufficiency and growth in the sector over the short term.

The economic/financial crisis of 1982 during which Zambia faced collapse of external credit required a reassessment of the ability of Zambian agriculture to continue to grow. The financing of agriculture in 1982 faced serious problems and crisis actions by the GRZ to make credit available for inputs, purchase of imported fertilizer, imports of food to offset the serious reduction in maize production caused by the drought, etc. The availability of domestic credit and GRZ resources for capital investment needed to generate new growth in agriculture were cast in serious doubt by the overall macroeconomic crisis.

AID/Zambia concluded that the Agency's sectoral strategy would have increasingly reduced impact if attention were not paid to the macroeconomic problems, in particular pricing distortions throughout the economy and unrealistic interest rates; and, that distortion in foreign exchange valuation of the kwacha would have an inhibiting effect on potential future growth in agricultural exports.

25/See Applegate, M. "An Evaluation of USAID Strategy in the Republic of Zambia", January 1983.

Although it is not possible to predict with any certainty when growth in agriculture will be absolutely constrained by such macro-economic distortions, the history of growth of production in agriculture over the past three years would suggest that its limit has not yet been reached.

AID's proposed strategy incorporates consideration of what macro-economic reforms would need to be made by the GRZ to achieve stabilization of the economy and assure continued viability of AID's growth strategy in agriculture. Obviously a frontal attack on these macro-economic reforms would change dramatically the USG approach to development in Zambia and as described below could create some risks for our geopolitical strategy in Zambia.

1. Policy Reform

The package of macro-economic reforms which we believe is necessary for the GRZ to institute in order to stabilize the economy and provide the basis for future growth and which could be the U.S. Mission's first line of attack follows. These reforms are not unique since they have been identified repeatedly by economic analysts since Independence and have been the subject of negotiations with the GRZ by both the IMF and IBRD. As indicated elsewhere, the GRZ has in December 1982 and January 1983 instituted some of these policies.

As a result of the recently instituted GRZ reforms, it is believed that the GRZ will be able to negotiate successfully the long awaited IMF stand-by arrangement. However, the "stand-by" is expected to be short term and in an amount which will not make a significant difference in the balance of payments deficit.[26/] It is also expected that the GRZ will soon begin to negotiate re-scheduling with some of its creditors and a Paris Club is possible.

An IMF agreement will not solve Zambia's short or long term problems. The fiscal and monetary reforms which are required by the IMF will need constant attention, discipline and resolve by the GRZ. Additional actions on future

26/ The standby arrangement with the fund is estimated at SDR 211.5 million.

devaluations, maintenance and further implementation for the new pricing policies, careful control of debt ceilings and budget expenditures, revisions of the tariff and tax structure will be essential not only to maintain the thrust of the current reforms but to establish the pre-conditions for a possible World Bank restructuring loan. It is AID/Zambia's view that the additional reforms noted below should, taking the political and economic costs into account, warrant support by the USG. AID could play a critical role in supporting the needed strategic actions by the GRZ beyond the IMF Agreement.

Needed reforms proposed are:

1. Exchange rate to be correctly valued in 24 months
2. All consumer price controls lifted except for minimum essential food commodities. Prices and subsidies on the latter would be eliminated in 24 months after a safety net system is installed for the poor.
3. Revise the tariff structure to eliminate preferential treatment for imported raw materials, intermediate inputs and capital goods and to assist in restructuring the industrial sector toward domestic sources of supply and labor.
4. Negotiation of wage restraint with the Unions and the development of a realistic formula for wage increases based on productivity increases.
5. Change in agriculture producer prices to floor prices for food crops
6. Elimination of restrictions on competitive trade in agricultural products.
7. Establishment of incentive pricing for high value, export agricultural produce and import substitution crops.

Given the short term impacts on the domestic economy of the above reforms and the limited prospects for a significant increase in external foreign exchange resources, AID/Zambia believes that the USG should only consider approaching the GRZ with such a proposed package if the size of the increase in USG assistance is of sufficient magnitude and duration to help to bridge the difficult near term period. AID/Zambia believes that our action to support and reinforce the necessary GRZ resolve to institute the entire package, manage the implementation and take other follow-on actions will require USG commitments to be increased substantially.

The U.S. role in offering substantial marginal resources to help stabilize the Zambian economy could be sufficient to encourage the GRZ to agree to take action on the total reform package. In addition, such action by the GRZ could generate more confidence in Zambia's prospects by International Financial Institutions and other banks. Both the recent GRZ actions and current negotiations with the IMF and IBRD could set the stage for the complete package of overall reforms noted above.

It is recognized that these reforms, while highly desirable and necessary for long run economic stability and equitable growth, will require some difficult economic and possibly political adjustments in the short run. Although there is good reason to believe the economic and political costs of inaction may actually be greater than the temporary costs of reform especially in the medium to long-term if not the short-term, the Zambian authorities are understandably concerned with the political implications of the short-term adjustment costs arising from higher prices of tradeable goods (imports and exports). The U.S. Government can help Zambia deal with this legitimate concern by joining World Bank and the IMF in offering a substantial amount of financial assistance to ease the economic burdens imposed by the adjustment process.

There is, of course, the risk that certain Zambian elements will misinterpret any action by the USG to support its reform effort as an attempt to meddle in the country's internal affairs, rather than as a sincere effort to be helpful in a constructive way at a time of severe economic tension and crisis. For this reason, great care must be taken in presenting any potential American offer of increased assistance as a positive gesture at a time of need, to help Zambia get through an admittedly difficult period of adjustment that the country has decided to pursue.

Finally AID/Zambia believes that such reforms and an increased AID policy involvement, if accepted, would have several other beneficial effects.

1. It would illustrate in a material way the beginning of a new period of the US/Zambian cooperation which was signalled by Vice President Bush's visit in November of 1982;
2. It would reinforce the U.S. role of providing support for economically troubled African countries;
3. The Zambian actions could provide another example for other African countries who are in similar straits, yet hesitant to proceed with necessary economic reform.

It is AID/Zambia's view that in order to obtain sufficient high level attention to the policy proposals, funding of approximately $60-$75 million and PL 480 Title I/III of about $15-$25 million will be needed for each of the next three years.

The AID/Zambia program would see a continuation of the two technical assistance projects in agriculture research and extension and planning and training; continued use of CIP for agricultural products, e.g., fertilizer and agricultural materials and PL 480 imports of wheat, rice and vegetable oil. However, the policy reforms may require expansion of both projects. In addition, local currency could be utilized to more directly impact on building an agricultural marketing system and to improve and expand the cooperatives.

If for political reasons, and/or the lack of resources, Washington is unable to support such an initiative in macroeconomic policy reform then AID/Zambia proposes to continue to pursue its strategy in the agricultural sector (see 2. below). Obviously AID/Zambia will continue to press for macroeconomic policy change as the opportunities appear and continue informal support for the IMF and IBRD.

A third or low option must also be discussed, if it is decided that Washington political/funding imperatives are such that a Zambia program is not of sufficient priority to maintain current levels. Under this option, AID/Zambia proposes the maintenance of the two current technical assistance projects; reasonable phase out of CIP levels and; maintenance of PL 480 levels at about $5 million per year in order to sustain U.S. market penetration for wheat, rice and vegetable oil.

The consequences of implementing this last option are difficult to predict and may be affected by other events beyond U.S. control, e.g., IMF and IBRD negotiations, Zambia labor union response to the deteriorating economy, the perceptions of the U.S. action by westernized Zambians as well as U.S. businessmen in Zambia. However, unless resource levels are gradually phased out, there would be a lowering of confidence by the world commercial banks; the reasonably good access of U.S. to Zambia's political leadership on subjects ranging from Namibia to regional security would certainly be affected; U.S. leverage on economic policy and agricultural policy issues and access to GRZ officials would certainly be lessened if not eliminated; Zambia's Western critics and particularly those critical of the U.S. would be strengthened if not vindicated, and last but not least, the impact of what could be characterized as a U.S. withdrawal could be interpreted as a signal to other friendly or non-aligned African countries in similar economic straits.

Since, as the latter option indicates, regardless of efforts to manage well a withdrawal of economic support to Zambia, USG actions result in a negative signal to the region, it is imperative that the potential consequences affecting U.S. regional security objectives be carefully assessed. AID's actions in Zambia are not only directed at influencing Zambia's behaviour toward the U.S. and acceptance of U.S. objectives in Zambia, but also the favorable behaviour of Zambia within the Southern African region.

2. Agricultural Sector Reform

AID can make its greatest contribution in improving Zambia management by continuing to assist the GRZ to improve its own capabilities in economic and agricultural planning and policy formulation leaving assistance in other priority fields to other donors. AID activity would include the short term priorities of agricultural commodity price management and the management and promotion of agricultural exports, as well as building better long-term capabilities in national economic and agricultural research, analysis and data collection and in academic instruction in the economic and agricultural management fields. (See Section III.E.)

a. Pricing and Marketing Reform

The GRZ cannot afford to continue its present pricing and marketing policies which are sending signals to the economy that have resulted in misallocation of resources. As a result, AID/Zambia's major program thrust will continue to be to assist the GRZ in developing an agricultural development strategy and policy environment commensurate with the sector's potential and the GRZ's resources. AID/Zambia will actively support policy reforms which (1) continue to reduce both consumer and producer subsidies; (2) improve the flow of financial and credit resources to agriculture; (3) improve regional food production and consumption patterns; (4) improve the marketing system; and (5) improve access of the rural population to essential consumer goods. Information gathering, analysis, and training are major components of all the above.

For the continued reduction of subsidies, AID/Zambia will focus on consumer subsidy reductions for food products, primarily maize and wheat. On the producer side, AID/Zambia will support further reductions in fertilizer subsidies.

To improve the allocation of financial and credit resources to agriculture, AID/Zambia will support the elimination of ceilings on savings and credit interest rates to productive farmers and agro industries.

To improve regional food production and consumption patterns, AID/Zambia will support efforts to establish producer production incentives for each major crop based on import parity prices. The price established would be equivalent to a national wholesale price which would then be adjusted for each major marketing center by accounting for transport and handling costs. By the same token, consumer prices should include the cost of transport, processing and distribution. Farmers would also be offered prices by traders and Namboard for their produce which would take into account transport and handling costs.

To improve the marketing system AID will support efforts already underway to decentralize national marketing functions to Provincial Cooperative Unions including the improvement of the management, and physical operation of the Cooperatives (storage, grain handling and transportation) and farm to market roads.

Finally, to improve the rural population's access to essential consumer goods, AID/Zambia will support efforts to eliminate fixed prices on essential goods to liberate the marketing system and let it respond to needs and demands.

b. Production Efficiency

AID has a comparative advantage in providing technical assistance in agriculture and should continue to focus much of its program in the high priority area of improving agricultural productivity, especially in the small farm sector. This would include agricultural research, farm management, market management and transportation.

Secondly, in view of its importance and its relative neglect by the GRZ and other donors, AID should help the GRZ sponsor some survey and analytical research work of the informal sector, both rural and urban. The Government needs to understand better how this sector works and how it might be encouraged to improve its productivity and increase employment. At a later date, AID should consider how it might be able to assist in the development of the rural informal sector, as an activity complementary to its efforts in agriculture.

3. Population/Family Planning

In view of the importance of reduced population growth for long-run development success, and AID's expertise and experience in the field of population, AID should consider increasing its effort in this area. AID/Zambia should lay the groundwork for expanding its current limited program in the direction of improved awareness of population issues and the need for an explicit GRZ policy in population. To implement this aspect of the strategy, AID/Zambia should begin informal conversations with donors and selected GRZ officials to explore issues and opportunities in the population policy arena. On the whole, however, AID/Zambia believes that for political reasons and because of staffing constraints, other donors and intermediary institutions such as IPPF, FPIA and Pathfinder should provide whatever Family Planning programs that result from these efforts. AID/Zambia should not be directly involved financially or programmatically.

E. Relationship to AID Priorities

1. Policy Reform

Zambia's current economic crisis and its underlying structural imbalances have made it imperative that the country undertake the dramatic reforms recently announced. However, the actions taken to reduce consumption and eliminate pricing distortions such as devaluation and tariff restructuring will have a substantial and immediate impact on consumers. The political realities seem to dictate that the GRZ leadership will need substantial resolve and political will to implement any additional needed reforms as noted earlier.

AID/Zambia's proposed first line of attack is highly focussed on the major macro-reforms needed to be taken by the GRZ. AID's current strategy which is similarly focussed on and integrated around policy reforms, primarily in agriculture, is in direct compliance with AID's policy emphasis.

The second line of attack which is almost wholly directed to the agricultural sector is similarly in tune with AID's policy reform priority.

2. Private Sector

All AID policy reforms are directed at reducing government involvement and management of the economy and allowing free market forces to operate. Although about 60% of the economy is dominated by parastatals, the farm sector is in private hands. The National Marketing Board (Namboard), however, is a parastatal which has dominated the marketing functions in the agricultural sector. In 1980, Namboard began to decentralize its regional grain buying, selling, and transport function to the Provincial Cooperative Unions. As this effort continues the Cooperative Unions will continue to receive subsidies and financial assistance from the GRZ to carry out this transition. There has been some concern that the GRZ would try to dominate the Cooperative Unions, but with the development of the Zambian Cooperative Federation there is strong and growing resistance to such action.

AID's strategy in agriculture will help to improve the climate for more open operation of the pricing and marketing system for private farmers and for supporting the primary cooperatives and cooperative unions to expand their operations and services with a profit oriented operational management. AID resources will continue to be used to influence such policy shifts and the resources themselves will be used in the private sector. For example, CIP financed fertilizer, agricultural machinery and equipment, spare parts and other commodities for agriculture will be utilized to support the private farm sector and in some cases such as tractor spare parts, flow through private distributors; and PL480 food commodities will be sold through the marketing system. CIP and PL480 currency attributions will be used increasingly to assist in developing a strong, private cooperative movement, improving farm to market roads and to improve access to farm inputs and credit.

The AID/Zambia program gives high priority to building a strong private farm sector, providing more free pricing and marketing systems and providing the basis for strong growth of this important segment of the economy.

3. Institutional Development, Technology Transfer and Research

AID's strategy is to build strong institutions in the areas of agricultural planning and policy, agricultural technology development and dissemination through the two existing technical assistance projects. These important areas which are inherent functions of the government are critical to successful growth of agriculture. A third area which the GRZ until now has received most of its support from the Swedish International Development Agency is the development of the cooperative movement. It is an area which AID/Zambia believes should be targeted directly by AID/Zambia for institutional support since it is the most important institution for growth of the private farm sector.

With the right kind of resources and reduction of government controls, the cooperatives could act as a driving force for substantial agricultural growth; take on more service functions not done well or at all by the GRZ; and, themselves become a strong market force in the private sector. This will be a subject for negotiations with the GRZ during the CDSS period.

4. Participant Training

Lack of human resources is a major constraint to development in Zambia. This follows the important qualitative constraint of inappropriate and poorly conceived and implemented policies. The latter is in many respects a manifestation of the human resources problem. Although higher level trained resources are wanting in all areas, there is a thin line of very good competence available. Unfortunately, in many instances personnel are transferred to meet ad hoc emergency needs or are drained off into the mining sector. There is an uneven distribution of this kind of competence, with the GRZ making poor distribution and allocation decisions. AID/Zambia believes that the greatest lack of trained manpower is at the middle management and supervisory levels.

Participant training represents a substantial portion and major priority of AID's institution building and technical assistance efforts. The two projects, Zambia Agricultural Training, Planning and Institutional Development (611-0075) and Zambia Agricultural Development: Research and Extension (611-0201), are providing grant funding for 69 degree programs and 57 non-degree programs representing approximately $3 million. There are nine trainees continuing in the Southern Africa Academic Skills Training program, two graduate trainees under AMDP II for FY 82 and AID/Zambia has requested $290,000 for AMDP II in FY 83 to supplement project training in the agricultural sector.

Within agriculture the problem AID/Zambia faces is that there is insufficient qualified manpower to enter training programs. AID will continue to emphasize higher levels of technical training in agricultural planning and research. AID/Zambia will also press the GRZ for improvements in the incentives, staffing and assignments system to provide for increased continuity and improved distribution and utilization of highly trained manpower. AID will also look for opportunities to exploit in-country short-term training programs and to build up short term training capacity of indigenous institutions such as the University of Zambia and the Cooperative College to improve the training of middle managers.

5. PL 480

AID/Zambia's PL 480 program has been used to achieve policy reform in agricultural prices and subsidies. It is utilized in an integrated fashion with CIP and technical assistance activity to address policies in the agricultural sector, and most local currency resources have been used to support producer price increases and decreased subsidies. Recently local currency has also been utilized to provide support to the Ministry of Agriculture and Water Development recurrent and capital expenses budget

Consideration is being given to a Title III program to effect changes in uniform producer/consumer prices and moving toward a regional pricing system. Local currency would be used for improving marketing, storage and transportation functions of the primary and provincial cooperative unions.

F. Tactics for Implementing AID Strategy

If the appropriate level of resources is made available for AID to embark on its effort to bring about significant macro-policy reforms such as devaluation and tariff reform, AID/Zambia will, in concert with the Embassy, begin its negotiations with State House and the Ministry of Finance. Assuming acceptance of the reforms by the GRZ, AID/Zambia would seek to coordinate with other resources available from the World Bank to assist in implementing the reforms, although some technical assistance would be provided from AID's Planning Project (611-0075) or from PMR resources.

In addition to the above, or if the proposed first line of action is not approved, AID/Zambia would seek broader policy level involvement in its agricultural reform strategy by proposing to the GRZ an annual review and programming meeting with the Ministry of Agriculture and Water Development, Finance and the National Commission for Development Planning.[27/] Subject always, of course, to the availability of funds, individual loans and grants would be programmed and negotiated at appropriate times, reinforcing the reform package agreed to in the annual programming meeting. Increased efforts will be made by AID/Zambia to find other means such as informal seminars to raise and discuss policy issues in order to heighten awareness of AID's concerns and improve access to policy makers on specific issues and problems.

The Ambassador has also agreed to develop a program of specific economic and development issues which he will raise in meetings with GRZ officials as well as Ambassadors of other embassies interested or involved in development activities.

27/ Sufficient time has passed since the political "freeze" of the June 1981 to June 1982 period to make such an activity feasible.

VI. AID/Zambia Resource Plans

A. Financial Resources

AID/Zambia proposes a significant initiative in macro-economic reform as the first line of action in carrying out AID's strategy. In order for the U.S. to follow this course of action higher assistance levels are critical both from the point of view of a U.S. negotiating stance, but also because Zambia will need substantial external assistance to implement the desired economic reforms.

An alternative AID/Zambia strategy, which constitutes continued support for policy and other reforms in the agriculture sector, while being supportive of macro-economic reforms, will require continuity and maintenance of current real levels of funding. U.S. political objectives in Zambia as currently viewed seem to preclude a reduction of resources at least over the next three years. Embassy reporting has been extensive on this subject.

However, if Washington concludes that funding levels should be reduced to a minimum, then only the two technical assistance projects should be continued together with PL 480 programs to sustain U.S. market penetration for wheat, rice and vegetable oil.

The following table reflects a high option, continuing support option, and a minimum program level.

Proposed Assistance Planning Level

U.S. $ Millions

	FY 85 L	FY 85 G	FY 86 L	FY 86 G	FY 87 L	FY 87 G	FY 88 L	FY 88 G	FY 89 L	FY 89 G	Total L	Total G
HIGH OPTION												
a. Commodity Import Program	70		65		50		50		50		285	
b. Technical Assistance Projects		5		10		5		5		5		30
c. PL 480 Title I/III	25		25		20		20		20		110	
Totals	95	5	90	10	70	5	70	5	70	5	395	30
CONTINUING SUPPORT OPTION												
a. Commodity Import Program	22		25		27		30		33		137	
b. Technical Assistance Projects		4		5		4		5		5		23
c. PL 480	9		11		13		15		17		65	
Totals	31	4	36	5	40	4	45	5	50	5	202	23
MINIMUM LEVEL												
Technical Assistance Projects		5		5		5		5		5		25
PL 480	5		5		5		5		5		25	
Totals	5	5	5	5	5	5	5	5	5	5	25	25

B. Staffing

AID/Zambia staffing is predicated on certain assumptions such as: continued support from REDSO/ESA; continuation of single commodity or simply administered CIP programs; no expansion of projects or technical assistance workload; continuation of JAO support arrangements.

Under the high option the addition of a Commodity Manager would be required; for the continuing support option no increased staffing is required as long as the proposed staffing mix is of sufficient quality and flexibility to continue current effective management and maintenance of a high dollar to staff ratio.

	FY 85	FY 86	FY 87	FY 88	FY 89
High Option					
AID Representative	X	X	X	X	X
General Development Officer	X	X	X	X	X
Agriculture Development Officer	X	X	X	X	X
Economist	X	X	X	X	X
Management Officer	X	X	X	X	X
Regional Engineer	(Regional Road Project Completed)				
Commodity Manager	X	X	X	X	X
Total	6	6	6	6	6
Continuing Support Option					
AID Representative	X	X	X	X	X
General Development Officer	X	X	X	X	X
Agriculture Development Officer	X	X	X	X	X
Management Officer	X	X	X	X	X
Regional Engineer					
Total	4[1]	4[1]	4[1]	4[1]	4[1]

1 - May require PSC economist

	FY 85	FY 86	FY 87	FY 88	FY 89
Minimum Option					
AID Representative	X	X	X	X	X
General Development Officer					
Agriculture Development Officer	X	X	X	X	X
Management Officer	X				
Regional Engineer					
Total	3	2	2	2	2