PD-ABD-932

76335

ZAMBIA

FY 1979 Commodity Import

Loan Paper

611-K-004

ACTION MEMORANDUM FOR THE ASSISTANT ADMINISTRATOR FOR AFRICA

FROM: AFR/DR, John W. Koehring

Problem: Your signature is requested for the Initial Environmental Examination and the attached Action Memorandum to the Administrator recommending authorization of the 20 million dollar Commodity Import Loan to the Government of the Republic of Zambia.

Discussion: The approval of the Administrator or his designee is required for a PAAD authorizing funds in excess of $10,000,000 and requested waiver in excess of $500,000.

Recommendation: That you sign the Initial Environmental Examination, indicating a negative determination, and the Action Memorandum to the Administrator recommending approval of the PAAD and the requested transport services waiver.

Attachments:
1. Action Memorandum to the Administrator
2. PAAD

Clearances:

AFR/DR:NCohen______________
AFR/SA:RStacy______________
AFR/DP:CWard______________
GC/AFR:JAPatterson__________

AFR/DR/SA:JPGuedet:bks:12/22/78:X29200

FEB 9 1979

ACTION MEMORANDUM FOR THE ADMINISTRATOR

THRU: ES

THRU: AA/PPC, Alexander Shakow

FROM: AA/AFR, Goler T. Butcher

SUBJECT: FY 1979 Zambia Commodity Import Loan

Problem: Your approval is required to execute a 20 million dollar Commodity Import Program Loan from the Southern Africa Program of the Economic Support Fund to the Government of the Republic of Zambia (GRZ).

Discussion: The proposed loan will, in conjunction with the efforts of other donors, mitigate Zambia's current balance of payments problem and will generate counterpart funds to be used for development activities that will help correct the imbalance between the modern and subsistence sectors of the economy. The foreign exchange provided under the loan will be used to import essential agricultural commodities. Both public and private sector use of loan proceeds is anticipated. Although all commodities in the AID Commodity Eligibility Listing will be eligible for financing under the loan, it is expected that the funds will be used primarily for fertilizer; agricultural equipment, accessories, and spare parts; and agricultural raw materials, excluding pesticides, for local industries.

The loan will be funded from the Southern Africa Program of the Economic Support Fund and, therefore, requires a Presidential Waiver as Congress has prohibited the use of this fund for Angola, Mozambique, Tanzania and Zambia unless it is determined that such assistance would further the foreign policy interests of the United States. Since the loan will contribute to the existence of a more stable economic environment, for a peaceful transition to majority rule in southern Africa, a waiver is considered justified and is attached to this memorandum.

In recommending this loan for your approval, the following two items were considered:

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1. <u>Economic</u>

Beginning in 1969, Zambia's balance of payments position and its capability to finance national budget expenditures began to deteriorate as a consequence of reduced profitability from copper mining operations and the financial costs of economic sanctions against Rhodesia. Reduced copper mining profitability is attributed to a decline in world copper prices and rising production costs which affect both the unit value and volume of production. Copper has historically accounted for around 90 percent of Zambia's exports and taxes on mining operations have been a significant source of government revenues. For 1978, it is estimated that Zambia's current account deficit will be approximately $300 million, and the forecast for 1979 indicates that the deficit will continue to grow. On the domestic side, government revenues from mining operations have precipitously declined from a high of $517 million in 1974 to near zero in 1977.

2. <u>Transport</u>

Since 1973, Zambia has been faced with severe problems in moving exports and imports. In January, 1973, Zambia closed the border with Rhodesia in support of the United Nations economic sanctions. As a result of this decision, Zambia relied principally on the Benguela Railway and the Tazara (Tanzanian-Zambian) Railway. In mid-1975, due to internal political problems in Angola, the Benguela Railway, which links northern Zambia to the deep-water port of Lobito, Angola, ceased to operate on a regular schedule. At that time Zambia was exporting about 50 percent of its copper on this route. From 1976 to October, 1978, Zambia's only major lifeline to an ocean port was the Tazara Railway--an inefficient railway because of operating problems and congested port conditions at Dar es Salaam. As of early November, approximately 100,000 tons of Zambian copper ingots were awaiting shipment to world markets.

Zambia's critically needed imports have also been subject to delays, aggravating an already serious economic situation. Delays in receiving production inputs, such as replacement parts for the mining sector and fertilizer for the impending planting season, have adversely affected the Zambian economy. Some relief has been gained by discharging fertilizer shipments at Maputo, Mozambique, and transshipping this commodity through South Africa and Botswana to Zambia. This action has slightly improved, but has not completely alleviated the situation. As a result of this crisis, Zambia decided,

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in October, 1978, to reopen the railway line with Rhodesia. Subsequently, Angolan officials are attempting to resume normal rail service on the Benguela line between Zambia's copper area and Lobito.

Although these recent events are encouraging, there is no assurance that the Rhodesia and Benguela Railways will remain open to efficiently service Zambia's transport requirements. During the next couple of years, inland transportation problems may continue to be the major constraint to supplying imports to Zambia. All reliable inland transport routes from east and southern Africa ocean ports to Zambia should be utilized to efficiently implement the proposed commodity import program. Consequently, a Code 935 Waiver is necessary to facilitate the inland shipment of goods to Zambia. Annex C to the Loan Paper provides the justification for a Code 935 Waiver for transportation services.

The proceeds of the loan will assist the GRZ in decreasing its 1979 balance of payments deficit and, through the generation of counterpart funds, will provide assistance to the national budget. Additionally, it will provide some financial assistance as the GRZ continues to diversify its economy. Recently, the GRZ has increased agricultural producer prices to encourage farmers to increase crop production. Furthermore, the GRZ has reduced imports, increased income taxes and reduced internal borrowing from commercial banks.

In addition to the United States, other donors are actively assisting the GRZ in bringing about an economic recovery. Gross financial assistance flowing to Zambia during 1977 and 1978 were on the order of $200 million annually. Although much of the assistance is intended to support specific projects, a number of donors provided balance of payments loans and grants totalling approximately $42 million in 1977 and 1978. In addition, the International Monetary Fund has approved approximately $300 million through its stand-by agreement with the GRZ. Attachment three presents the recent Department of State assessment of the performance of the GRZ in meeting the conditions of the IMF stand-by agreement.

Implementation: Drawdowns of AID Commodity Import Loans have been timely and a similar record is expected for this loan. The 1977 loan is 93 percent disbursed and the 1978 loan is 58 percent disbursed, only nine months after the loan agreement was signed. Under the FY 1977 and FY 1978 loans, a procurement plan was required which significantly facilitated implementation of these loans. A similar plan and AID standard commodity financing procedures, as set forth in AID Regulation I, will apply for commodities and selected services procured

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under this loan. Procurement will be source and origin Code 000 except for inland transport services from east and southern Africa ocean ports to Zambia. It is estimated that the loan will be fully disbursed within 18 months from the date of the loan agreement.

Loan Terms: In view of the purpose of this loan and Zambia's present economic situation, the loan is being made on standard AID concessional terms--40 year amortization including a 10 year grace period, with an interest rate of two percent during the grace period and three percent thereafter.

The loan committee reviewed and recommended approval of this loan on December 21, 1978. The Commodity Import Loan was included in the FY 1979 Congressional Presentation, therefore a Congressional Notification is not required. There are no outstanding issues regarding GAO or AID audits, internal or external evaluations or congressional inquiries. Zambia's human rights record is good and the GRZ has constitutional guarantees of human rights.

The responsible AID officers in the field will be John Hicks, American Embassy/Lusaka and John Lewis, REDSO/EA and the AID/W officer will be J. Paul Guedet, AFR/DR/SA. The Zambian Ministry of Economic and Technical Cooperation will be responsible for overall loan implementation.

Recommendation: That you sign the attached PAAD, thereby authorizing both the proposed loan and requested waiver.

Attachments:
1. PAAD
2. Presidential Waiver
3. Asst. Sec. of State for African Affairs Moose letter to Gov. Gilligan

Clearances:
DAA/AFR:WHNorth ______
GC:MBall ______
SER/COM:PHagan ______
PPC/PDPR:RCMalley ______
HA/HR:MBova (substance)

AFR/DR/SA:JPGuedet:cks:12/22/78:X29200

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ACTION MEMORANDUM FOR THE ADMINISTRATOR

THRU: ES

FROM: AA/AFR, Goler T. Butcher

SUBJECT: Proposed $20 Million Program Loan to Zambia - Southern Africa Program, Economic Support Fund

Problem: To waive the provisions of FAA Section 533(b) which prohibits the use of funds from the Southern Africa Program of the Economic Support Fund for Zambia unless a determination is made that such assistance would further the foreign policy interests of the United States.

Discussion: The Bureau for Africa is proposing an A.I.D. commodity import program loan to the Government of Zambia in the amount of $20 million from funds of Southern Africa Program of the Economic Support Fund on standard concessional A.I.D. terms. The primary purpose of the loan is to provide balance of payments assistance by financing high-priority imports of fertilizer, agricultural inputs, excluding pesticides; agricultural equipment including spare parts; and raw materials for local industries intended to increase food production.

Funding for the loan will be drawn from the $45 million of the Southern African Program (Section 533). With respect to these funds, there is a prohibition against their use for Zambia unless it is determined that such assistance would further the foreign policy interests of the United States.

Specifically FAA Section 533(b) provides as follows:

> "(b) No assistance may be furnished under this section to Mozambique, Angola, Tanzania, or Zambia, except that the President may waive this prohibition with respect to any such country if he determines, and so reports to the Congress, that furnishing such assistance to such country would further the foreign policy interests of the United States."

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In justification of the waiver we set forth the following points. Zambia occupies a key geographic and political position in Southern Africa. As a frontline state, Zambia has a major role in efforts aimed at a peaceful solution to majority rule in Southern Rhodesia (Zimbabwe) and Namibia. Zambia has experienced severe economic problems by adhering to UN sanctions imposed against Southern Rhodesia. These have been compounded by a sharp and continuing decline in world copper prices, Zambia's main export. The significant economic dislocations have created a substantial need for increased capital and development assistance for Zambia.

United States foreign policy in Southern Africa is to support self-determination, majority rule, equal rights and human dignity for all people of the region. It is United States policy that the region have an opportunity to establish the foundations for economic growth and to become a full-fledged participant in the evolving international economic system.

The economic stability of Zambia is extremely important in contributing to the economic stability of Southern Africa, which reflects the basic United States concerns and objectives. The proposed loan for FY 1979 will have a direct bearing on helping the country meet its critical economic needs and move toward implementing its plans for increasing agricultural production and rural development.

There has been some concern caused by press reports (The Washington Post, Monday November 27, 1978 - Tab A) about Zambia's announced plans to increase military expenditures in response to recent Rhodesian raids into its territory. Specifically, the concern relates to Zambia's actions with regard to section 620(s) of the FAA, one purpose of which is to "ensure that resources intended for economic development are not diverted to military purposes."

Section 620(s) is implemented by the President's taking into account (a function delegated to the Administrator AID) and so reporting to the Congress the following: the percentage of recipients' budgets devoted to military purposes; the degree to which recipients use foreign exchange resources to acquire military equipment; and the amount recipients spend for the purchase of sophisticated weapons systems.

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In the report submitted to the Congress on August 11, 1978 Zambia was not singled out as a country for concern or for detailed discussion. The two tables below show Zambia's defense expenditures over the last seven years.

Zambia

Defense Expenditures as a Percent of Gross National Product

Year	1972	1973	1974	1975	1976	1977	1978
Percentage	5.3	3.2	3.1	3.0	3.2	?	?

Defense Expenditures as a Percent of Central Government Expenditures

Year	1972	1973	1974	1975	1976	1977	1978
Percentage	13.9	10.3	11.1	6.8	8.2	12-15*	?

Figures for calendar year 1977 are estimated and those for 1978 are not yet available. However, reference to the above two tables shows that Zambia has not spent an inordinate amount on defense or military expenditures. In fact, we estimate that Zambia ranks eleventh (11) out of thirty-seven (37) of African countries in defense expenditures as a percentage of Gross National Product and twenty-third (23) out of 37 in defense expenditures as a percentage of total central government expenditures.

Our records show that no AID funds have been diverted to military purposes and we believe that Government of Zambia statements regarding the diversion of funds from developmental to defense purposes is attributable in part to election propaganda.

The authority to make the determination and issue a waiver pursuant to FAA Section 533(b) is vested in the Administrator by virtue of Executive Order 10973 and Department of State Delegation of Authority No. 104. Your determination and waiver will be forwarded to the Congress as required by Section 533(b), and published in the Federal Register pursuant to FAA Section 654.

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*These figures are estimates recently reported from the Mission in Lusaka.

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Recommendations:

(1) That you determine that assistance to Zambia financed from the Economic Support Fund would further the foreign policy interests of the United States and that you waive the provisions of FAA Section 533(b) by signing the attached determination and waiver (Tab B); and (2) that you sign the attached transmittal letters to the Congress (Tab C).

Approved: ____

Disapproved: ____

Date: 2-8-79

Clearances:
- AF:RMoose (draft)
- DAA/AFR:WHNorth
- AA/LEG:JLewis (Draft)
- AA/PPC:AShakow (Draft)
- PPC/RC:MJHeyl (Draft)
- AF/EPS:CCundiff (Draft)
- AFR/SA:RStacy
- AFR/DP:CWard
- GC:MBall

GC/AFR:JPatterson:my:12/21/78

December 26, 1978

MEMORANDUM FOR THE FILE

Subject: 620(s) of the FAA and Zambia

Pages two and three of the Action Memorandum for the Administrator from AA/AFR sets forth the issues and facts relating to Zambia's defense expenditures and 620(s). To this information should be added the fact that no report, to our knowledge, has been made that Zambia is inappropriately depleting its foreign exchange resources for military expenditures or inappropriately purchasing sophisticated weapons systems.

Based on the foregoing, we find no reason to recommend amendment to the August 11, 1978 report to Congress on 620(s).

Jerome Patterson
GC/AFR

a

DEPARTMENT OF STATE

AGENCY FOR INTERNATIONAL DEVELOPMENT

WASHINGTON

THE ADMINISTRATOR

Determination and Waiver Pursuant to Section 533(b) of the Foreign Assistance Act of 1961, as amended, Relating to Zambia

The Agency for International Development has proposed a commodity import program loan to Zambia in the amount of $20 million from the Economic Support Fund on standard concessional A.I.D. terms. The primary purpose of the loan is to provide balance of payments assistance by financing high-priority imports of fertilizer; agricultural inputs, excluding pesticides; equipment including spare parts; and raw materials for local industries intended to increase food production. Funding for the loan will be drawn from the Southern African Program of the Economic Support Fund (FAA Section 533).

FAA Section 533(b) prohibits the utilization of the Southern Africa program funds for Zambia unless it is determined that such assistance would further the foreign policy interests of the United States.

Zambia occupies a key geographic and political position in Southern Africa. Zambia has a major role in efforts aimed at a peaceful solution to majority rule in Southern Rhodesia (Zimbabwe) and Namibia. Zambia has experienced severe economic problems by adhering strictly to UN sanctions imposed by the UN against Southern Rhodesia. These have been compounded by a sharp and continuing decline in world copper prices, Zambia's main export. The significant economic dislocations have created a substantial need for increased capital and development assistance to Zambia.

United States foreign policy in Southern Africa is to support self-determination, majority rule, equal rights and human dignity for all people of the region. It is United States policy that the region have an

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opportunity to establish the foundations for economic growth and to become a full-fledged participant in the evolving international economic system.

The economic stability of Zambia is extremely important in contributing to the economic stability of Southern Africa, which reflects the basic United States concerns and objectives. The proposed A.I.D. loan will have a direct bearing on helping the country meet its critical economic needs and move toward implementing its plans for increasing agricultural production and rural development.

Pursuant to the authority set forth in Section 533(b) of the Foreign Assistance Act of 1961, as amended, and delegated to me by Executive Order 10973 and Department of State Delegation of Authority 104, and for the reasons stated above, I hereby determine that it would further the foreign policy interests of the United States to provide assistance to Zambia from the Economic Support Fund and hereby waive the prohibition set forth in the above cited provision of law with respect to Zambia.

This determination and waiver shall be reported to the Congress and shall be published in the Federal Register.

Date: February 8, 1979

John J. Gilligan

ASSISTANT SECRETARY OF STATE
WASHINGTON, D.C. 20520

The Honorable
John J. Gilligan
Administrator
Agency for International Development

Dear Governor Gilligan:

I refer to the House Conference Report on Fiscal Year 1979 Foreign Assistance Appropriations and to the opinion given therein by the conferees that funds appropriated for Zambia from the Economic Support Fund should be made available to Zambia only after the State Department is assured that Zambia is meeting the conditions of its stand-by arrangement with the International Monetary Fund.

As you are aware, on April 26, 1978, the Executive Board approved a two year stand-by arrangement for Zambia in the amount of SDR 250 million; so far, Zambia has purchased SDR 100 million under this arrangement.

Zambia's compliance with the conditions of the arrangement is monitored by the IMF on a quarterly basis. We understand that Zambia's compliance through the third quarter of 1978 has already been determined and that meetings between IMF and Government of Zambia representatives are to begin shortly in Washington to determine Zambia's compliance for the fourth quarter as well as to reach understandings on the performance criteria to be used for the period January 1 to December 31, 1979.

Following these meetings, the Department will seek assurances of Zambia's current compliance.

Sincerely,

Richard M. Moose

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DEPARTMENT OF STATE

AGENCY FOR INTERNATIONAL DEVELOPMENT

WASHINGTON

FEB 8 1979

THE ADMINISTRATOR

Honorable Walter F. Mondale
President of the Senate
Washington, D.C. 20510

Dear Mr. President:

There is transmitted herewith, pursuant to the provision of Section 533(b) of the Foreign Assistance Act of 1961, as amended, a determination that it would further the foreign policy interests of the United States to provide a $20 million commodity import program loan to Zambia from funds of the Southern Africa Program of the Economic Support Fund; included in the determination is a waiver of the prohibition set forth in the above-cited provision of law with respect to Zambia.

The determination and waiver will be published in the Federal Register pursuant to the provisions of Section 654 of the Foreign Assistance Act of 1961, as amended.

Sincerely,

John J. Gilligan

John J. Gilligan

Enclosure:
Determination
and Waiver

DEPARTMENT OF STATE

AGENCY FOR INTERNATIONAL DEVELOPMENT

WASHINGTON

THE ADMINISTRATOR

FEB 8 1979

Honorable Clement J. Zablocki
Chairman, Committee on International
Relations
House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

There is transmitted herewith, pursuant to the provision of Section 533(b) of the Foreign Assistance Act of 1961, as amended, a determination that it would further the foreign policy interests of the United States to provide a $20 million commodity import program loan to Zambia from funds of the Southern Africa Program of the Economic Support Fund; included in the determination is a waiver of the prohibition set forth in the above-cited provision of law with respect to Zambia.

The determination and waiver will be published in the Federal Register pursuant to the provisions of Section 654 of the Foreign Assistance Act of 1961, as amended.

Sincerely,

John J Gilligan

John J. Gilligan

Enclosure:
Determination
and Waiver

DEPARTMENT OF STATE

AGENCY FOR INTERNATIONAL DEVELOPMENT

WASHINGTON

THE ADMINISTRATOR

FEB 8 1979

Honorable Thomas P. O'Neill
Speaker of the House
of Representatives
Washington, D.C. 20515

Dear Mr. Speaker:

There is transmitted herewith, pursuant to the provision of Section 533(b) of the Foreign Assistance Act of 1961, as amended, a determination that it would further the foreign policy interests of the United States to provide a $20 million commodity import program loan to Zambia from funds of the Southern Africa Program of the Economic Support Fund; included in the determination is a waiver of the prohibition set forth in the above-cited provision of law with respect to Zambia.

The determination and waiver will be published in the Federal Register pursuant to the provisions of Section 654 of the Foreign Assistance Act of 1961, as amended.

Sincerely,

John J. Gilligan

John J. Gilligan

Enclosure:
Determination
and Waiver

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DEPARTMENT OF STATE

AGENCY FOR INTERNATIONAL DEVELOPMENT

WASHINGTON

THE ADMINISTRATOR

FEB 8 1979

Honorable Frank Church
Chairman, Committee on Foreign
Relations
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

There is transmitted herewith, pursuant to the provision of Section 533(b) of the Foreign Assistance Act of 1961, as amended, a determination that it would further the foreign policy interests of the United States to provide a $20 million commodity import program loan to Zambia from funds of the Southern Africa Program of the Economic Support Fund; included in the determination is a waiver of the prohibition set forth in the above-cited provision of law with respect to Zambia.

The determination and waiver will be published in the Federal Register pursuant to the provisions of Section 654 of the Foreign Assistance Act of 1961, as amended.

Sincerely,

John J. Gilligan

Enclosure:
Determination
and Waiver

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CLASSIFICATION:

AID 1120-1 (8-66)

PAAD

DEPARTMENT OF STATE
AGENCY FOR
INTERNATIONAL DEVELOPMENT

PROGRAM ASSISTANCE APPROVAL DOCUMENT

1. PAAD NO.: AFR 79-01
2. COUNTRY: Zambia — Loan # 611-K-004
3. CATEGORY: Commodity Financing
4. DATE: December 22, 1978
5. TO: John J. Gilligan, Administrator, AID
6. OYB CHANGE NO.: Not applicable
7. FROM: Goler T. Butcher, Assistant Administrator, Africa
8. OYB INCREASE: none
TO BE TAKEN FROM: not applicable
9. APPROVAL REQUESTED FOR COMMITMENT OF: $ 20,000,000
10. APPROPRIATION – ALLOTMENT: 72-1191037 937-61-698-00-57-91

11. TYPE FUNDING	12. LOCAL CURRENCY ARRANGEMENT	13. ESTIMATED DELIVERY PERIOD	14. TRANSACTION ELIGIBILITY DATE
[X] LOAN [ ] GRANT	[X] INFORMAL [ ] FORMAL [ ] NONE	Jan. 1979 to June 1980	Loan Authorization Date

15. COMMODITIES FINANCED

Commodities for the agricultural sector, such as agricultural equipment and supplies, fertilizer and raw materials, excluding pesticides, for agricultural inputs, will be approved for AID financing.

16. PERMITTED SOURCE		17. ESTIMATED SOURCE	
U.S. only:	$19,000,000 (Code 000)	U.S.:	$19,000,000
Limited F.W.:		Industrialized Countries:	
Free World:	1,000,000 (Code 935)	Local:	1,000,000 (Code 935)
Cash:		Other:	

18. SUMMARY DESCRIPTION

This loan will provide U.S. assistance to the Government of the Republic of Zambia (GRZ) to help the GRZ to improve an adverse balance of payments situation.

This loan will make available foreign exchange for critically needed public and private sector agricultural imports and related services to be agreed upon by the GRZ and AID.

1. The GRZ shall repay the loan to AID in United States Dollars within forty (40) years from the date of the first disbursement under the loan including a grace period of not to exceed ten (10) years from such date. GRZ shall pay to AID in United States Dollars interest at the rate of two percent (2%) per annum during the grace period and three percent (3%) per annum thereafter on the outstanding disbursed balance of the loan and on due and unpaid interest.
2. Procurement will be restricted to AID Geographic Code 000 except for procurement of inland transport services from east and southern Africa ocean ports to Zambia.
3. Such other terms and conditions as AID may deem advisable.

LOAN COMMITTEE:

Chairman: J. Paul Guedet, AFR/DR/SA
Desk Officer: Leonard Pompa, AFR/SA
Commodity Mgt.: Peter Hagan, SER/COM
Devel. Plang.: Dwight Wilson, AFR/DP
Legal Advisor: Jerome A. Patterson, ~~AC~~ GC/AFR

19. CLEARANCES	DATE
AFR/DR:JWKoehring	12/26/78
AFR/DP:CWard	[illegible]
AFR/SA:LPompa	[illegible]
GC/AFR:JPatterson	12-26-78
AA/PPC:AShakow	2/2/79
PPC/PDPR: R.Malley	2/2/79
SER/COM:PHagan	12/ [illegible]
FM:MDStafford (phone, DBaker)	[illegible]

20. ACTION

[X] APPROVED [ ] DISAPPROVED

John J. Gilligan — AUTHORIZED SIGNATURE — DATE: 2-8-79

Administrator, A.I.D. — TITLE

ZAMBIA

COMMODITY IMPORT LOAN

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ANNEXES:

I. Initial Environmental Examination

II. Checklist of Statutory Criteria

III. Justification for Procurement Services Waiver

PROJECT COMMITTEE:

Chairman: J. Paul Guedet, AFR/DR/SA
Desk Officer: Leonard Pompa, AFR/SA
Legal Advisor: Jerry Patterson, GC/AFR
Commodity Mgt: Peter Hagan, SER/COM
Devel. Plang: Dwight Wilson, AFR/DP

RECENT EXCHANGE RATES FOR THE ZAMBIAN KWACHA

January - June 1976	Kwacha=$1.55
July 1976	Kwacha=$1.25
March 1978	Kwacha=$1.17
December 1978	Kwacha-$1.30

ZAMBIA COMMODITY IMPORT LOAN

BACKGROUND

The political situation in southern Africa has changed drastically over the last four years. Following the decision by the Portuguese (after the overthrow of the Caetano regime in 1974) to withdraw from Portugal's African colonies, including Angola and Mozambique, the future of white minority regimes no longer gave the appearance of being secure. Angola gained independence in November 1975 in the midst of a three-cornered struggle between competing political groups which brought about armed Cuban intervention on behalf of the victorious faction. Mozambique became independent in June, 1975. The existence in Angola and Mozambique of independent governments greatly increased the pressure for military solutions to the problems of white minority rule in Rhodesia and Namibia (South West Africa). It has become increasingly clear with each passing month that unless a solution can be found quickly, both Rhodesia and Namibia will be plunged deeper into guerrilla warfare, leading possibly to further outside intervention and perhaps to racial warfare in South Africa.

The U.S. has consistently encouraged a peaceful transition to majority rule in southern Africa. In response to the increased urgency of negotiated settlements, Secretary of State Kissinger in 1976 made a major effort to resolve the questions of majority rule in Rhodesia. This led to the abortive Geneva Conference on Rhodesia. On taking office, the Carter Administration made clear its commitment to peaceful change towards majority rule in Southern Africa. Strong U.S. support was given to a five power initiative designed to bring about an internationally acceptable Namibian solution. The Carter Administration also lent its weight to a British initiative designed to bring about majority rule, peace, and independence to Rhodesia by 1978, through negotiations. By repeal of the Bryd Amendment, the new Administration brought the U.S. into full compliance with the 1968 Security Council call for sanctions against Rhodesia.

The U.S. is assisting countries bordering Rhodesia which are sustaining economic losses by enforcing these same sanctions against the Rhodesian regime. One of these states is Zambia, which borders Rhodesia along the Zambezi River and was previously joined with Rhodesia and Malawi, then Nyasaland, in the Central African Federation. Although Zambia has had to bear an extremely heavy financial burden to maintain sanctions since Rhodesia's Unilateral Declaration of Independence (UDI) in 1965, Zambia's President, Kenneth Kaunda, has consistently supported a political solution in Rhodesia and has provided moderate leadership for African efforts to bring about a negotiated settlement. However, there have been recent indications that he is becoming disillusioned with negotiations, and is now leaning towards the armed struggle as the way to bring about majority rule.

President Kaunda's continued ability to play a constructive and moderating role in the Rhodesian situation has in part been undermined by Zambia's worst economic crisis since independence. The crisis is primarily attributable to the continued heavy cost of sanctions against Rhodesia and to the rapid decline in copper prices since mid-1974. Zambia has introduced a series of austerity measures, beginning in early 1975 and including the 20 percent devaluation of the Zambian Kwacha in July 1976 and a 10 percent devaluation in March 1978. Although the austerity measures have been effective in restraining imports and improving budget performance, low copper prices and the continued conflict in Rhodesia have worked strongly against the government's stabilization efforts. Consequently, the expectation that the economic crisis could be largely resolved by the end of 1977 has had to be revised, and it may now be 1980 before Zambia's balance of payments situation improves significantly.

Zambia has been relatively successful in mobilizing stabilization assistance from multilateral and bilateral sources. In addition to IMF drawings, Zambia has received stabilization assistance in the form of non-project loans and grants from the IBRD, EEC, the U.K., Canada, Germany, the Netherlands, and the Scandinavian countries. The U.S. has provided three previous commodity import loans--$5 million in FY 1973, $20 million in FY 1977, and $30 million in FY 1978. The proposed FY 1979 Economic Support Fund loan will complement other donor efforts and provide additional support for the GRZ in overcoming the current economic crisis and building a firm base for long-term development programs.

II. Loan Analysis

A. The Zambian Economy

(1) Structural Development

Prior to attaining its independence in 1964, Zambia (then Northern Rhodesia) was the northernmost extension of white-ruled Southern Africa. The development that had taken place has been oriented to the needs of the white settlers and the mining industry, and, under the Federation of the Rhodesias and Nyasaland (1953-1963), much of the government revenue generated by Northern Rhodesia's mines was used to develop Southern Rhodesia. This left Zambia at the time of independence with an infrastructure system geared to the needs of mining and European agriculture and oriented southwards; an acute scarcity of skilled Zambian technical and administrative personnel; a commercial agricultural sector almost wholly dependent upon expatriate farmers; and a highly dualistic economy in which a high-wage, capital-intensive modern sector coexisted with a traditional subsistence sector. Moreover, the economy was heavily dependent on copper, an export subject to wide price swings on the international market.

The major objective of government economic policy since independence has been to reorient the economy to serve Zambian development needs and to provide the basis for sustained and balanced growth. Thus the government has emphasized establishment of physical infrastructure reducing Zambia's dependence on the south, development of Zambian technical and administrative personnel, reduction of the gaps between the modern and traditional sectors, and diversification of the economy to make it less dependent on copper.

The government has been generally successful in moving towards its infrastructure development and personnel development objectives. Because of neglect of African education by colonial authorities, the country had fewer than 100 Zambian university graduates at the time of independence, and less than one percent of the population has completed primary school. Zambians with university or secondary school qualifications comprised only 40 percent of the personnel required to fill high-level and middle-level positions in the public and private sectors. Consequently, very high priority was given to the

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expansion of education at all levels. As a result, during the decade after independence, enrollments increased threefold in vocational schools, fourfold in secondary schools, and sevenfold in university education. Zambianization has proceeded steadily in all fields, although the mining industry is still heavily dependent on expatriate personnel in skilled technical and administrative positions. According to recent projections prepared by the World Bank, the planned output of the Zambian educational system should permit the replacement by the mid-1980s of all but about 20 percent of the 30,000 expatriates now employed.

Zambia has made similarly impressive progress in the physical infrastructure field. Following Southern Rhodesia's Unilaterial Declaration of Independence (UDI) in 1965, Zambia began to phase down its use of Rhodesian transport routes which initially accounted for over 90 percent of Zambian imports and exports. This process had not been completed when Rhodesia closed the border in 1973 and halted all rail traffic between the two countries until late 1978, when rail operations resumed after meetings between Rhodesian and Zambian officials. By 1975 Zambia had secure routes to the sea through Tanzania via pipeline, road and rail. The development of these facilities has been expensive, however, and has preempted funds and attention which could otherwise have been devoted to more productive investment elsewhere in the economy. Zambia was also heavily dependent on Rhodesia for power, which is critical to the mining industry. Although the Zambia power system is still interconnected with the grid serving Rhodesia and the Zaire/Zambia Copperbelt, power projects initiated since 1966 have made Zambia a net exporter of power and have eliminated reliance on power stations located in Rhodesia.

Despite impressive achievements in certain sectors, Zambia still provides a classic example of a dualistic economy. At one end of the economic spectrum is a sophisticated, high technology economy centered around the copper mining industry, a rapidly growing manufacturing sector, a commercial agricultural sector, and a relatively large services sector. Juxtaposed against these modern sectors is a low technology, rural subsistence sector comprising approximately 62 percent of the total population.

Within the modern sector, copper mining is predominant and has been the mainstay of the Zambian economy since independence. The degree of dependence on copper mining is evident by the following statistics:

(a) in 1975 the value of copper's share of merchandise exports was 93 percent of the total, and preliminary 1977 figures show a decline to only 91 percent;

(b) value added to GDP by copper has accounted for 25-33 percent of GDF over the past decade;

(c) the government is highly dependent on the mining sector tax base--in years of high copper prices, revenues from mining accounted for as much as 50 percent of total revenue.

The Zambian economy has been so dependent on copper production that vacillations in world copper prices, copper production, and production costs permeate the entire economic system. Activity in the manufacturing sector is dependent upon developments in the mining sector. For example, since a large segment of manufacturing industries produce inputs for the mining sector, output is quickly responsive to mining conditions. Additionally, local manufacturing industries rely heavily on imported capital goods creating a serious susceptability to falling foreign exchange earnings in periods of depressed copper prices and/or production. The construction sector is similarly dependent on the performance of the mining sector. While the agriculture sector is not so directly affected by mining activity, there is an interrelationship of a different kind. Economic resources have been predominantly channeled into the mining sector leaving the basically subsistence oriented agriculture sector in a state of stagnation. Government policies to promote low food prices for urban consumers led to very unfavorable domesitc terms of trade for farmers, thus discouraging the production of key foodstuffs. This phenomenon led, in turn, to the importation of food and the concommitant requirement for additional foreign exchange for merchandise purchases and transportation services.

(2) Current Situation

Over the past decade, copper output has become static and production costs have risen because of greater depths in mining, declining ore grades, and rising inventory needs emanating from the previously mentioned transportation problems. The mining sector's contribution to real GNP declined to 20 percent in 1975, recovered slightly to 23 percent in 1976, and fell again to 21 percent in 1977. As a result of falling copper prices and higher production costs, revenue from mineral taxation declined from K339 million in 1974 to K59 million in 1975, K12 million in 1976, and to near zero in 1977. Despite GRZ efforts

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to retrench on recurrent expenditures, cuts in capital expenditures, and increases in non-mineral taxes, the decline in mineral revenue has necessitated deficit financing. The deficits have been financed primarily through Central Bank borrowings which, in combination with depressed domestic production and restricted import volumes, has fueled inflationary pressures. In addition, the events previously discussed have eroded mining company profits, and losses incurred during the past years have led to large-scale borrowing from domestic monetory institutions, thus contributing to the rapid growth in the money supply.

As a result of the steep decline in copper prices, Zambia is incurring serious balance of payments deficits. Exports fell from K898 million in 1974 to K704 million in 1977, while merchandise imports increased from K509 million to K593 million during the same period. Although the net factor and nonfactor services account and the net unrequited transfers account have shown deficits historically, the trade balance surpluses were large enough to ensure a solid current account position. This situation changed drastically with the 1975 fall in copper prices when Zambia realized the first trade deficit in the country's history; the deficit on current account in 1975 was K393 million. An improvement in copper prices coupled with import restrictions reduced the deficit to K41 million in 1976 but the trend reversed in 1977. The current account deficit rose to K219 million in 1977; projected deficits for 1978 and 1979 are K231 million and K455 million, respectively.

Since the net capital inflows during the period 1975-77 were short of the needed amounts to cover current account deficits, the deficits were partially covered by an accumulation in payments arrears for imports and a reduction in gross official foreign reserve holdings. At the end of 1977, payments arrears were K363 million; gross official holdings of international reserves fell from K132 million in 1974 to K56 million (equivalent of one month of imports, c.i.f.) by the end of 1977.

The foreign exchange shortage has severely affected Zambia's ability to import essential raw materials, spare parts, and intermediate goods. The shortage of these goods has, in turn, created idle capacity in many sectors and has been a prime factor in the 2 percent decline in real GDP experienced between 1975 and 1977. The sectors most seriously affected over the three year period were manufacturing (11% decline), construction (13.8% decline), transport and storage (25.8% decline), and wholesale and retail trade (11.6% decline).

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TABLE 1

CURRENT ACCOUNT BALANCE, 1974-79

(Kwacha-Millions)

	1974	1975	1976	1977
Exports (F.O.B.)	898.2	523.1	751.9	704.3
Imports (F.O.B.)	508.6	599.6	468.6	592.8
Trade Balance	398.6	-76.5	283.3	111.8
Invisibles (Net)	-341.1	-316.0	-324.0	-330.3
Current Account Balance	48.5	-392.5	- 40.7	-218.5

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TABLE 2

Estimates of Current Account Balances and Financing Requirements for 1978-79*

(Kwacha-Millions)

	1978	1979
Exports (F.O.B.)	736	913
(Copper)	(672)	(817)
Imports (c.i.f.)	747	1123
Trade Balance	-11	-210
Invisibles (Net)	-220	-245
Current Account Balance	-231	-455
Financing From Known Sources	200	23
IMF	(+175)	(+102)
Flows from Loans Committed by end 1977	(-21)	(-83)
Flows from Loans Negotiated after end 1977	(+46)	(+4)
Financial Shortfall	31	432

*GRZ Estimates
Includes accumulation of arrears=K363 million at end of 1977

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TABLE 3

The GRZ Budget, 1975-78

(Kwacha-Millions)

	1975	1976	1977 (prelim.)	1978 (budget)
Recurrent Expenditures	547.0	562.6	593.6	580.8
of which: Subsidies	(82.8)	(59.8)	(66.2)	(44.2)
Capital Expenditures	131.0	122.9	92.3	92.1
Net Lending (incl. short-term)	124.9	46.6	84.2	38.0
Total Expenditures	802.9	732.1	770.1	710.9
Total Revenues	462.2	461.9	510.7	550.7
of which:				
Mining Revenue	59.4	11.6	0.1	0.0
Income Taxes (excl. mining)	142.6	159.1	198.6	199.7
Customs, Sales & Excise Taxes	188.4	212.1	241.0	271.9
Other Revenue (incl. grants)	71.8	79.1	71.0	79.1
Overall Deficit (-)	-340.7	-270.2	-259.4	-160.2
Financing (net)	+340.7	+270.2	+259.4	+160.2
External Borrowing (net)	58.9	30.1	19.0	54.3
Domestic long-term borrowing (net)	20.7	34.8	13.4	15.9
Short-term financing	261.1	205.3	227.0	90.0

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TABLE 4

Zambia's Terms of Trade for 1968-1976 (1965=100)*

1968	140.5	1973	134.8
1969	181.8	1974	120.8
1970	143.4	1975	59.1
1971	110.6	1976	53.9
1972	107.6		

*Source IBRD

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TABLE 5

Government Debt Service Ratio, 1966-1976*

1966	2.2%	1971	10.2%
1967	2.4	1972	10.4
1968	2.7	1973	28.8**
1969	2.2	1974	5.3
1970	5.7	1975	8.6
		1976	9.1

*Source IBRD
**Abnormally high debt service because of GRZ's decision to prepay ZIMCO Bonds which had been issued in payment for the takeover of the mining companies.

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(3) Stabilization Program and Response to the Current Economic Crisis

Over the past three years the government has introduced a series of policy measures to overcome the current economic crisis and to diversify the economy. Prime objectives are the lessening of Zambia's dependence on copper revenues, a reduction in imports, increased incentives for agricultural and locally based industrial production, and to encourage the use of more appropriate production techniques. Policies designed to promote these objectives are discussed below.

The Government Budget. The government has made commendable efforts to mobilize additional revenue in the light of precipitously declining mining revenues. This tax base diversification was accomplished in a relatively short time frame and prevented the copper crisis from crippling the public sector. The increased revenues have been obtained through higher personal and business income taxes, customs duties, excise taxes, and taxes on expatriate wages. Between 1975 and 1977, income tax revenue has grown by 39% while revenues from customs and exise taxes rose by 28%.

On the expenditure side, the government has, by necessity, curtailed capital investment and slowed the growth rate in recurrent expenditures. While the measures taken to control recurrent expenses (e.g. freeze on government salaries and a reduction in subsidies) have been somewhat successful. Recurrent expenditures will continue to expand due to higher debt service payments, increased prices, and higher defense outlays. Government expenditures have increased at a slower pace than prices and the resulting decrease in real expenditures has cut into some important social services such as health and education as well as road maintenance, agricultural extension, and other productive services.

Despite the GRZ's efforts to restrain expenditures while increasing other revenue, the decline in mineral revenues could not be totally offset; budget deficits remained large but did decline steadily from K341 million in 1975 to K259 million in 1977. Furthermore, the 1978 budget indicates that recurrent expenditures will fall by K12 million (mostly due to a K22 million reduction in subsidies) and that the total deficit will be reduced to K160 million.

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The GRZ realizes that such measures as wage freezes, restrictive import licensing, and cutting capital and social service expenditures are short-term, crisis-oriented measures and will do little in solving Zambia's basic problem, an over dependence on copper production. The need to improve the efficiency and output in other sectors in an effort to diminish the economy's reliance on copper is recognized as paramount in the government's development program. For example, the need to maintain adequate incentives for farmers has been emphasized through increased producer prices; since the 1974/75 growing season, the price of maize has risen by 36%, cotton 15%, groundnuts 68%, wheat 67%, and soy beans 63%. These measures have induced increased agricultural production as evidenced by the sectors share of value added to GDP which grew by 7% in 1975 and 6% in 1976. The GRZ announced producer price increases ranging from 8 to 26% for the latest growing season (1977/78) but, for the most part, reflect a necessary adjustment for rising imported input costs.

The success noted alone has led to plans for continued use of producer price policies as a means of encouraging agricultural output and the improvement in the domestic terms of trade of farmers. At present, producer prices in Zambia are in line with those in neighboring countries, a situation that did not exist only a few years ago.

The GRZ's 1978 budget is a stringent one, involving a cut in total expenditures and an increase in non-mineral revenues (principally customs, excise, and sales taxes). The resulting reduction in the overall budget deficit will reduce the government's borrowings from the central and commercial banks and should reduce inflationary pressures somewhat. The Minister of Finance announced the following actions as integral components of the 1978 budget:

(a) reduction of government subsidies;

(b) moratorium on the creation of government posts in 1978 and a freeze on vacant professional and administrative positions (except in the case of vital need);

(c) undertaking new projects only if directly productive, with emphasis on agriculture;

(d) increased duties on capital and luxury goods imports;

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(e) higher excise and sales taxes; and

(f) higher expatriate income taxes.

<u>The Third National Development Plan</u>. In addition to the short- and long-term stabilization measures included in the 1978 budget, other policies have been implemented or are anticipated during the Third National Development Plan (TNDP). In the industrial sector, the Industrial Development Act of 1977 gives foreign capital immunity against nationalization and assurances concerning remittances. The Act also gives tax incentives to manufacturing firms which export, use domestic raw materials, provide sizeable employment opportunities, promote the development of employee industrial skills, or locate in rural areas. The Act should stimulate manufactured exports, the processing of local raw materials, and more labor-intensive production.

The TNDP places emphasis on the diversification of economic activity with increased attention being devoted to the agricultural sector. The significant increase in agricultural producer prices, increased capacity of the Ministry of Lands and Agriculture to identify and implement projects, and the growing proportion of government investment in agriculture, all reflect a commitment to agriculture as the vehicle for the government's diversification strategy. The Plan proposes an annual review and revision of producer prices in light of domestic production costs and world prices. However, price incentives must be complemented by efforts to further improve the planning and implementation capacity of the Ministry of Lands and Agriculture, improved extension services, and a strengthened agricultural research program. These measures will be crucial to the achievement of the TNDP goal of increasing agriculture's share of the development budget from under 20 to over 30%.

The objectives of the TNDP can be summarized as follows:

(a) to improve the overall growth performance of the economy to achieve an average GDP growth rate of 4.8%;

(b) to diversify the economic structure in order to reduce the economy's dependence on copper;

(c) to ensure a broader distribution of the benefits of growth through emphasis on rural development, concentrating on the lowest income groups in the rural areas;

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(d) to reduce import dependence of the economy by developing industries based on local resources;

(e) to reduce the capital intensity of production and to generate increased employment through the adoption of more appropriate, labor intensive technology;

(f) to increase the export orientation of non-mining sectors; and

(g) to accelerate the pace of Zambianization in the key sectors.

Zambia's prior experience points vividly to the fact that high GDP growth centered around a few predominant, capital intensive economic activities does not necessarily lead to increases in total employment and may have a detrimental impact on the rural sector. The current crisis is characterized by balance of payments deficits, budgetary deficits, inflationary pressures, idle capacity and unemployment in the formal wage sectors. These are actually ramifications, however, of Zambia's basic problem, a severely imbalanced economy that has, in the past, neglected the problems of low productivity and underemployment affecting large numbers of the population in rural areas. The TNDP, therefore, gives high priority to the objective of providing fuller and more productive employment by making agriculture more rewarding for small farmers, by increasing productivity and incomes in the informal sector, and by creation of employment through small-scale, locally based industries.

The goals of the TNDP will be attained through a variety of government policies, including:

(a) pricing policies to remove the present bias in favor of capital-intensive production techniques;

(b) interest rate policies to promote and mobilize private savings;

(c) tariff and tax policies to reduce dependence on certain imported goods while increasing exports of the non-mining sectors; and

(d) incentive policies to attract and direct foreign capital into desired sectors.

While the Plan calls for maintaining the level of gross investment of approximately 30% of GDP, the mix of investment expenditures will shift from mining, transport, and social infrastructure to more labor intensive projects in agriculture and small-scale industry.

It is anticipated that approximately one-half of total investment during the TNDP will be government investment. To protect the government's development program from fluctuations resulting from changes in copper prices, the Plan proposes the establishment of a Budget Stabilization Fund. The purpose of the fund will be to provide buffer resources to reduce the need for expenditure cuts in the event of depressed copper prices and/or output. Accordingly, the appropriate rate of expansion of Government recurrent and capital expenditures will be based on long-term forecasts of mineral and non-mineral revenues in conjunction with net flows of foreign and domestic borrowing. The Fund will be a countercyclical device responding to changes in copper revenues.

In summary, the TNDP proposes measures that will clearly help diversify Zambia's economy and decrease the role played by copper. Some of the austerity measures proposed in the 1978 budget will have negative effects on important social services as well as the government's ability to implement the Plan. In an expanding economy, diversification would be easier; there would be sufficient Government revenues and foreign exchange earnings to support development projects in the rural areas. In a stagnant economy such as Zambia's, the problem becomes much more complex; regardless of the desire to diversify, the linkages of almost every sector to copper mining performance signifies that improved performance in this sector will continue to play an integral role in the development process. Given the outlook for copper prices (IBRD predicts little improvement until after 1980), the next 3 years will be difficult ones for Zambia.

B. Other Donor Assistance

Gross assistance flows to Zambia during 1977 and 1978 were on the order of $200 million annually. Although much of the assistance is intended to support specific projects, a number of donors provided balance of payments loans and grants totalling approximately $42 million in 1977 and 1978. In addition, Zambia made a compensatory financing drawing of $22 million from the IMF in early 1977 and flows from the IMF standby, Compensatory Financial Facility, and the Trust Fund will provide approximately $218 million in 1978 and $127 million in 1979. The U.K.

announced soft loans totalling $42 million for 1978 and a project loan for $22.5 million was negotiated by the IBRD.

C. International Monetary Fund's Standby Agreement

In April, 1978, the IMF approved a two-year standby arrangement in the amount of Special Drawing Rights (SDR) 250 million and approved an additional drawing of approximately SDR 49 million under the compensatory financing facility. These stand-by arrangements are based on the GRZ's stabilization program designed to achieve four main objectives: (1) to move progressively from the current balance of payments deficit to equilibrium by 1980; (2) to limit the fall of real income in 1978 and to facilitate a resumption of growth in 1979; (3) to reduce demand pressures in 1978 and the overall rate of price increases in 1979; and (4) to set the basis for a diversification of the economy through an improved allocation of resources between investment and consumption as well as among different sectors of the economy. The policy measures formulated to achieve these objectives are summarized below.

The stabilization plan calls for a gradual reduction in the balance of payments deficit to be achieved through a higher value of exports and a decline in real imports. The achievement of this goal is obviously dependent upon world market prices for copper, but will also be integrally linked to the GRZ's diversification program which will promote exports other than copper and will support import substitution activities.

The program contains several measures to improve recent production performance and set the basis for economic growth in 1979. To improve the profitability of mining operations, Kwacha was depreciated by 10% in March, 1978, and operating costs were retrenched through cutbacks in social services, suspension of operations in certain high-cost mining sites, and the procurement of supplies from cheaper sources in neighboring countries.

The GRZ's economic diversification program will center around efforts to adjust the rural/urban terms of trade by increasing agricultural producer prices and strengthening policies for economic pricing by parastatals through the reduction in government subsidies. The program also calls for a reduction in real domestic demand of 5 to 7% in 1978. Over the medium term, both fiscal and monetary policies will be formulated to increase savings and shift the demand structure in favor of investment.

Although it is still too early to estimate the progress of the program, it is obvious that the program will be difficult to implement. Actions are being taken during the adjustment process that are undesirable (e.g., reduction in some social services), but that seem unavoidable given past policies and the resulting imbalance in the Zambian economy. Preliminary evaluations indicate that IMF appears satisfied with GRZ efforts to adhere to the IMF standby agreement.

During Zambia's planned economic diversification program, assistance will be needed to maintain imports at levels consistent with growth level objectives. The projected import volume for 1978 is about one-half of that of 1969, and even if copper prices improve as anticipated, imports will grow very little in real terms in 1979. The continuing shortage of vital imported intermediate goods will profoundly affect Zambia's growth prospects and the level of economic activity. Therefore, it is imperative that the GRZ's planned economic adjustment efforts be supported by external assistance on concessional terms.

D. Rationale for Proposed Commodity Import Loan

While the international donors, the IMF standby agreement and other IMF facilities will supply a large flow of resources over the next two years, Zambia's need for balance of payment support will remain acute. In 1979, it is projected that the financing gap will reach K432 million, over and above IMF and other known capital flows. If imports are allowed to increase to levels necessary to support normal capacity utilization in 1979 and 1980, the gap could rise to over K1 billion over the period 1978-80; a build-up of appropriate reserve holdings and a reduction in payments arrears indicate a gap ranging as high as K1.8 billion for this period. The above figures indicate the magnitude of Zambia's need as well as the justification for assistance on a concessional basis.

E. Debt Service Prospects

Zambia's debt service ratio has been relatively low historically, but rose to around 9% in 1975 and 1976. Available information indicates that the ratio in 1977 may have reached 30%, primarily a consequence of heavy Eurodollar borrowing between 1973 and 1975. During the meeting of the Consultative Group for the GRZ in June, 1978, the IBRD emphasized that, given the magnitudes of project financing gaps, it is essential that a major portion of foreign assistance be made available on concessional terms if debt servicing problems are to be avoided. Since a large proportion of the GRZ's loans will be coming due for repayment in 1980, short-term loans should be avoided in favor of longer-maturity loans with longer grace periods. During the 1980's, higher projected copper prices, coupled with lower service payments on existing debts, should lead to an improvement in Zambia's ability to service debt. The IBRD projects that if the required resources can be raised in the proportion of three-quarters on concessional terms and one-quarter on commercial terms, Zambia's debt service ratio should remain around 20% during the 1980's. If copper prices do not increase as expected, or if production falls below anticipated levels, capital requirements and the debt service ratio could be higher. While the GRZ should have no difficulty in servicing the proposed A.I.D. loan, the uncertainty of the country's debt service prospects highlights the importance of providing the $20 million on concessional terms.

III. LOAN ADMINISTRATION

A. Status of Existing Commodity Import Loans

The Loan Agreement for the FY 1977 $20 million Commodity Import Loan was signed on December 3, 1976. The first L/Com was opened in March, 1977, and the first shipment took place in May, 1977. As of October 31, 1978, the loan was fully committed with $18.8 million disbursed. It is anticipated that there will be no problem in disbursing the remaining amount of the loan by June, 1979. Among the commodities purchased under the loan are fertilizer, animal feed, land clearing equipment, and coal mining equipment/spare parts.

The Loan Agreement for the FY 1978 $30 million Commodity Import Loan was signed on March 30, 1978. In only eight months over $20 million of the loan has been committed with disbursements totalling approximately $18 million. The primary commodities to be purchased under the loan are fertilizer, agricultural equipment, construction equipment, industrial equipment, chemicals, and raw materials for local industries. The GRZ has recently requested, however, that a portion of the loan be used to finance spare parts for General Electric locomotives, some of which were purchased under a $5 million loan made by A.I.D. in FY 1973. Given the seriousness of the transportation bottleneck caused by the border closings with Angola and Rhodesia, A.I.D. has agreed to the request to procure spare parts totalling approximately $2.3 million. The procurement plan being followed by the GRZ should result in the loan being completely disbursed prior to the March 30, 1980 terminal disbursement date.

The GRZ's performance under the two above-mentioned loans is highly commendable, especially when compared to the FY 1973 loan which was characterized by slow disbursement over a $2\frac{1}{2}$ year period. The improved performance may, in part, be attributable to a Condition Precedent (CP) included in the FY 1977/78 loans requiring a detailed procurement plan. This CP has enhanced loan implementation by requiring the GRZ to identify commodity needs at an early stage. A similar CP will be included in the proposed FY 1979 loan. Finally, the rapid disbursements under the FY 1978 loan provides cogent evidence of Zambia's critical foreign exchange needs.

B. Loan Implementation

1. Procurement Procedures

A.I.D.'s Standard Commodity Financing Procedures, as set forth in A.I.D. Regulation 1, will be followed for this loan. All procurement by the Public Sector will be carried out under the formal competitive bid procedures, except in certain cases where negotiated procurement would be more appropriate and justifiable. For purposes of implementing the loan, any parastatal organization which is more than 50 percent owned by the GRZ will be considered a public sector entity. Procurement by the private sector will be carried out in accordance with the negotiated procurement procedures as set forth in Section 201.23 of A.I.D. Regulation 1.

Under the FY 1978 loan, the GRZ allocated a portion of the loan to importers operating in the private sector. The GRZ will be encouraged to make allocations to the private sector under this loan, since these importers can normally complete import transactions efficiently and are somewhat familiar with A.I.D. regulations. This should result in the loan being disbursed more quickly, with a net effect of having a greater impact on the current balance of payments problem facing the country.

2. Administrative Responsibility

The administrative responsibility for the loan, which will include preparation of all reports as well as assuring compliance with all A.I.D. requirements, will rest with the Ministry of Economic and Technical Cooperation. However, the Ministry of Finance will control the disbursement of funds through

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the issuance of Financing Requests to A.I.D. The Ministry of Economic and Technical Cooperation will be responsible for coordinating the issuance of Financing Requests by the Ministry of Finance.

Primary responsibility for managing A.I.D.'s implementation functions under the loan will rest with REDSO/EA in Nairobi, Kenya. The REDSO/EA implementation functions will be closely coordinated with the A.I.D. Officer assigned to Lusaka. Also, AID/W will provide TDY support, if necessary, and will assist the Zambian Embassy to undertake any formal procurements, such as fertilizer.

3. Implementation Schedule

The following is the proposed implementation schedule for the loan:

1. Loan Authorization	December 1978
2. Loan Signing	December 1978
3. CPs Met	February 1979
4. First L/Com Opened	April 1979
5. First Commodity Shipment	June 1979
6. First Disbursement	June 1979
7. Final Disbursement	June 1980

The above schedule appears realistic in view of the rapid disbursement of the FY 1978 Commodity Import Loan.

C. Commodities to be Financed

The authorized source and origin of commodities and related services to be financed under the loan will be A.I.D. Geographic Code 000 (U.S. only), except for inland transportation from east and southern Africa ocean ports of discharge to the final point in Zambia. Because of Zambia's acute shortage of foreign exchange and the difficulties involved in transporting large shipments to a land-locked country, a waiver to permit procurement of inland transportation services from Code 935 countries is requested. The justification for the waiver is presented as Annex C to this paper.

Although all commodities in the A.I.D. Commodity Eligibility Listing are acceptable for A.I.D. financing, only those items to be used for increasing food production in Zambia will be approved for financing under the proposed loan. It is anticipated that the loan funds will be used primarily for the procurement of fertilizer, agricultural supplies and equipment and raw materials, excluding pesticides, for the agricultural sector.

D. Commodity Import Procedures

At present, all imports into Zambia are subject to license control. This involves a process of first applying for a foreign exchange allocation through the GRZ's Technical Committee and, if successful, then applying for an import license through the Ministry of Commerce. Licenses are issued quarterly on the basis of quotas set by a ministerial committee in consultation with the Bank of Zambia and the Ministry of Finance. The actual release of foreign exchange is controlled by the Bank of Zambia; the release need not necessarily be at the time payments are due. However, imports tied to certain foreign loans, such as this one, are handled separately. A ministerial committee will allocate specific amounts for previously agreed upon end uses, and an approved import license will insure the immediate opening of a Letter of Credit against AID-issued Letters of Commitment. Thus, it is anticipated that importers will save a substantial amount of time in getting orders placed and Letters of Credit opened under this modified procedure.

E. Loan Disbursement

The proceeds of the loan are expected to be disbursed within an 18-month period after the time the loan agreement is executed. Therefore, the terminal disbursement date will be set 18 months from the loan agreement date and the terminal date for requesting disbursing authorizations will be set at 12 months from the loan agreement date.

The method of disbursement will be through A.I.D.'s standard Letter of Commitment/Letter of Credit procedure. Direct A.I.D. Letters of Commitment to suppliers will be used for the procurement of fertilizer and/or other selected commodities. The approved applicant for the Letters of Commitment will probably be the National Commercial Bank of Zambia, which is wholly owned by the GRZ, and has been thé approved applicant under the last two program loans.

F. Commodity Arrival and Disposition

Since 1973, the GRZ has been faced with severe problems in moving imports from ocean ports to Zambia. In January, 1973, Zambia closed the border with Rhodesia in support of the four frontline states. As a result of this decision, Zambia relied principally on the Benguela Railway and the Tazara (Tanzanian-Zambian) Railway. In mid-1975, due to internal political problems in Angola, the Benguela Railway, which links northern Zambia to the deep-water port of Lobito, Angola, ceased to operate on a regular schedule. At this time Zambia was exporting about 50 percent of its copper on this route. From 1976 to October, 1978, Zambia's only major lifeline to an ocean port was the Tazara Railway--an inefficient railway because of operating problems and congested port conditions at Dar es Salaam. As of early November, approximately 100,000 tons of Zambian copper ingots were awaiting shipment to world markets.

Obviously, Zambia's critically needed imports have also been subject to delays, aggravating an already serious economic situation. Delays in receiving production inputs, such as replacement parts for the mining sector and fertilizer for the impending planting season, have adversely affected the Zambian economy. Some relief has been gained by discharging fertilizer shipments at Maputo, Mozambique, and transshipping this commodity through South Africa and Botswana to Zambia. This action has slightly improved, but has not completely alleviated the situation. As a result of this crisis Zambia decided, in October, 1978, to reopen the railway line with Rhodesia. Subsequently, Angolan officials are attempting to resume normal rail service on the Benguela line between Zambia's copper area and Lobito.

Although these recent events are encouraging, there is no assurance that the Rhodesia and Benguela Railways will remain open to efficiently service Zambia's transport requirements. During the next couple of years inland transportation problems may continue to be the major constraint to supplying imports to Zambia. It is probably safe to assume that all reliable inland transport routes from east and southern Africa ocean ports to Zambia should be utilized to efficiently implement the proposed commodity import program. Consequently, a Code 935 Waiver is necessary to facilitate the inland shipment of goods through countries in southern Africa to Zambia. Annex C provides the justification for a Code 935 waiver for necessary transportation services.

IV. OTHER CONSIDERATIONS

A. Impact on U.S. Balance of Payments

The short-run impact of this loan on the U.S. Balance of Payments position will be minimal and will depend on the types of commodities imported. In the long-run, U.S. exporters may be able to establish market positions in Zambia, but the transportation cost disadvantage of buying from the U.S. (as opposed to traditional European suppliers) could militate against any lasting inroads. Utilization of the loan for imports by U.S. firms already operating in Zambia could result in some minor substitution for commercial U.S. exports, but any substitution should be minimal given the tight foreign exchange situation. The overall impact of the loan will be favorable since imports by agents of U.S. firms will enable them to maintain the market position of U.S. equipment suppliers. Additionally, U.S. equipment purchased under the loan will result in follow-up orders for U.S. spare parts.

B. Use of U.S. Government Excess Property

Given the nature of the items the Zambians are interested in purchasing, it is unlikely that U.S. government excess property would be appropriate for financing under this loan. However, A.I.D. will review the possibilities for the financing of excess property under the loan.

C. Use of Procurement Consultants

The loan agreement provides that loan proceeds may be used to finance the services of a U.S. firm or firms to assist the GRZ in the preparation and issuance of IFBs, the analysis of awards, the execution of supply contracts, etc. Although the GRZ has no current plans for the utilization of procurement consultants, A.I.D. will encourage the GRZ to do so if appropriate.

D. Relation to Export-Import Bank Credits

The EXIM Bank has traditionally provided substantial financing for mining and transport equipment for Zambia. EXIM Bank has not extended any new credits to Zambia for several years, due primarily to Zambia's financial crisis. Possibilities for financing include U.S. railway signal equipment and U.S. aircraft for Zambia Airways.

The EXIM Bank expressed no objections to the proposed A.I.D. loan. A.I.D. will coordinate closely with EXIM Bank and the U.S. Embassy in Lusaka to assure that the A.I.D. loan does not finance items which EXIM has already agreed to finance.

E. Counterpart Generation

The Kwacha counterpart generated by private and public sector imports under the loan will accrue to the GRZ for allocation to development activities included in the GRZ budget. Use of counterpart for improving rural development and other activities to promote diversification of the economy will be encouraged to the maximum extent possible. Since the GRZ budget is based on the calendar year, and given that most of the counterpart should be generated in 1979, the bulk of the counterpart funds is likely to be utilized to support the 1979 and 1980 budgets.

The GRZ will establish a separate account for the counterpart generated by the loan funds. The counterpart will be deposited by importers upon the foreign exchange from the loan being made available to them. An exception to this procedure may be a case where it would be necessary for an organization to obtain a supplemental budget, which could delay the deposit of the counterpart by two to three months.

F. Loan Terms

The previous program loans for Zambia were extended on standard A.I.D. concessional terms, i.e., 40 year amortization including a 10-year grace period, with interest of 2 percent during the grace period and 3 percent thereafter. Although some current Economic Support Fund loans are being extended on harder terms, the recent deterioration in Zambia's long-term prospects makes application of the harder terms to the proposed A.I.D. loan inappropriate. It is important to note that the World Bank has recently taken note of the relative deterioration in Zambia's prospects by making Zambia eligible for IDA credits as well as IBRD loans.

V. RECOMMENDATIONS

It is recommended that you authorize a $20 million loan to the Government of the Republic of Zambia subject to the following terms:

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(a) Repayment to A.I.D. in U.S. dollars within forty (40) years after the first disbursement, including a grace period not to exceed ten (10) years.

(b) Interest payable to A.I.D. in U.S. dollars at two percent (2%) during the grace period and three percent (3%) thereafter.

(c) Commodities and related services financed under the loan shall have their source and origin in the U.S. (A.I.D. Geographic Code 000) with the exception of inland transport costs from east and southern Africa ocean ports of discharge to Zambia. The latter will be eligible for financing under A.I.D. Geographic Code 935 (U.S. and free world countries).

(d) Such other terms and conditions as A.I.D. may deem advisable.

INITIAL ENVIRONMENTAL EXAMINATION

Project Country: Zambia

Project Title: Zambia Commodity Import Loan

Funding: FY 79 $20,000,000

Period of Project: The terminal date for requesting disbursement authorization is 12 months from the date of the loan agreement. The terminal disbursement date is 18 months from the loan agreement date.

IIE Prepared By: J. Paul Guedet, AFR/DR/SA

Environmental Action Recommended: Negative Determination

Concurrence: AFR/DR/SDP:BBoyd 10/20/78

AFR/SA:RStacy ______

Assistant Administrator Decision:

APPROVED ______

DISAPPROVED ______

DATE 12/26/78

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I. Description of Project

Zambia is currently facing serious balance of payments deficits as a result of overdependence on copper mining. Depressed copper prices plus declining production volumes have eroded Zambia's historically favorable current account position and led to extensive external borrowing, a decline in foreign reserve holdings (to less than one month's imports c.i.f.), and a large accumulation of payments arrears on imports. The GRZ has launched a program, including short-run measures, to ameliorate the current crisis and has developed the Third National Development Plan (TNDP) which focuses on the diversification of the Zambian economy.

The proposed $20,000,000 commodity import loan will provide the GRZ with needed foreign exchange for essential public and private sector imports and will contribute to the GRZ's development program by generating counterpart funds. It is anticipated that commodities financed under the loan will primarily be inputs required by the agricultural sector (excluding pesticides) to increase food production.

II. Recommended Environmental Action

In accordance with AID Reg. 16, paragraph 216-2(f), it has been determined that a negative determination is appropriate regarding the environmental impact of this activity. As the proceeds of the loan will not be used for the purpose of carrying out a specifically identifiable project or projects, an Environmental Assessment or Environmental Impact Statement is not required.

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CHECKLIST OF STATUTORY CRITERIA

COUNTRY CHECKLIST

A. GENERAL CRITERIA FOR COUNTRY

1. FAA Sec. 116. Can it be demonstrated that contemplated assistance will directly benefit the needy? If not, has the Department of State determined that this government has engaged in consistent pattern of gross violations of internationally recognized human rights?	No No
2. FAA Sec. 481. Has it been determined that the government of recipient country has failed to take adequate steps to prevent narcotics drugs and other controlled substances (as defined by the Comprehensive Drug Abuse Prevention and Control Act of 1970) produced or processed, in whole or in part, in such country, or transported through such country, from being sold illegally within the jurisdiction of such country to U.S. Government personnel or their dependents, or from entering the U.S. unlawfully?	No
3. FAA Sec. 620(a). Does recipient country furnish assistance to Cuba or fail to take appropriate steps to prevent ships or aircraft under its flag from carrying cargoes to or from Cuba?	a. No b. Zambia has no ships under its registry. c. The question of Zambian aircraft carrying cargo to or from Cuba has not arisen to our knowledge. However, Zambia has diplomatic relations with Cuba and would be unlikely to enforce sanctions against Cuba at our behest.
4. FAA Sec 620(c). If assistance is to a government, has the Secretary of State determined that it is not controlled by the international Communist movement?	Yes. Secretarial Determination No 77-1 dated 10/28/76.

5. FAA Sec. 620(c). If assistance is to government, is the government liable as debtor or unconditional guarantor on any debt to a U.S. citizen for goods or services furnished or ordered where (a) such citizens has exhausted available legal remedies and (b) debt is not denied or contested by such government?	We are not aware of any such case.
6. FAA Sec. 620(e) (1). If assistance is to a government, has it (including government agencies or subdivisions) taken any action which has the effect of nationalizing, expropriating, or otherwise seizing ownership or control of property of U.S. citizens or entities beneficially owned by them without taking steps to discharge its obligations toward such citizens or entities?	No
7. FAA Sec. 620(f); App.Sec. 108. Is recipient country a Communist country? Will assistance be provided to the Democratic Republic of Vietnam (North Vietnam), South Vietnam, Cambodia or Laos?	No No
8. FAA Sec. 620(i). Is recipient country in any way involved in (a) subversion of, or military aggression against, the United States or any country receiving U.S. assistance, or (b) the planning of such subversion or aggression?	(a) No (b) No
9. FAA Sec. 620(j). Has the country permitted, or failed to take adequate measures to prevent, the damage or destruction, by mob action, of U.S. property?	No
10. FAA Sec. 620(l). If the country has failed to institute the investment guaranty program for the specific risks of expropriation, inconvertibility or confiscation, has the AID Administrator within the past year considered denying assistance to such government for this reason?	No, because no recent effort has been made by the U.S. to undertake an Investment Guaranty Agreement with Zambia. Consideration is provided in the approval process for the annual OYB.

11.	FAA Sec. 620(o); Fishermen's Protective Act, Sec. 5. If country has seized, or imposed any penalty or sanction against, any U.S. fishing activities in international waters, a. has any deduction required by Fishermen's Protective Act been made? b. has complete denial of assistance been considered by AID Administrator?	Not applicable
12.	FAA Sec. 620(q); App.Sec.504. (a) Is the government of the recipient country in default on interest or principal of any AID loan to the country? (b) Is country in default exceeding one year on interest or principal on U.S. loan under program for which App. Act appropriates funds, unless debt was earlier disputed, or appropriate steps taken to cure default?	(a) No (b) No
13.	FAA Sec. 620(s). What percentage of country budget is for military expenditures? How much of foreign exchange resources spent on military equipment? How much spent for the purchase of sophisticated weapons systems? (Consideration of these points is to be coordinated with the Bureau for Program and Policy Coordination, Regional Coordinators and Military Assistance Staff (PPC/RC).)	Under the FY 1976 assessment of defense expenditures as required by Sect. 620(s), it was concluded that there is no impediment to consideration of economic aid to Zambia. In 1976 the GRZ allocated approximately 3.2 percent of its GNP and 8.2 percent of Central Government Expenditures to defense.
14.	FAA Sec. 620(t). Has the country severed diplomatic relations with the United States? If so, have they been resumed and have new bilateral assistance agreements been negotiated and entered into since such resumption?	No
15.	FAA Sec. 620(u). What is the payment status of the country's U.N. obligations? If the country is in arrears, were such arrearages taken into account by the AID Administrator in determining the current AID Operational Year Budget?	Current

16. FAA Sec. 620A. Has the country granted sanctuary from prosecution to any individual or group which has committed an act of international terrorism? — No

17. FAA Sec. 666. Does the country object, on basis of race, religion, national origin or sex, to the presence of any officer or employee of the U.S. there to carry out economic development program under FAA? — No

18. FAA Sec. 669. Has the country delivered or received nuclear reprocessing or enrichment equipment, materials or technology, without specified arrangements on safeguards, etc.? — No

19. FAA Sec. 901. Has the country denied its citizens the right or opportunity to emigrate? — No

B. FUNDING CRITERIA FOR COUNTRY

1. Development Assistance Country Criteria

a. FAA Sec. 102(c), (d). Have criteria been established, and taken into account, to assess commitment and progress of country in effectively involving the poor in development, on such indexes as: (1) small-farm labor intensive agriculture, (2) reduced infant mortality, (3) population growth, (4) equality of income distribution, and (5) unemployment: — Not applicable to this loan; however, Zambia's Third National Development Plan addresses most of these issues.

b. FAA Sec. 201 (b) (5), (7) & (8); Sec. 208; 211(a)(4), (7). Describe extent to which country is:

(1) Making appropriate efforts to increase food production and improve means for food storage and distribution. — Zambia's Third National Development Plan and 1978 Budget Speech emphasizes these items.

(2) Creating a favorable climate for foreign and domestic private enterprise and investment. — Not applicable

(3) Increasing the public's role in the developmental process. — Not applicable

(4) (a) Allocating available budgetary resources to development. — Not applicable

(b) Diverting such resources for unnecessary military expenditure and intervention in affairs of other free and independent nations.

(5) Making economic, social, and political reforms such as tax collection improvements and changes in land tenure arrangements, and making progress toward respect for the rule of law, freedom of expression and of the press, and recognizing the importance of individual freedom, initiative, and private enterprise. — Not applicable

(6) Otherwise responding to the vital economic, political, and social concerns of its people, and demonstrating a clear determination to take effective self-help measures. — Not applicable

c. <u>FAA Sec. 201(b), 211 (a).</u> Is the country among the 20 countries in which development assistance loans may be made in this fiscal year, or among the 40 in which development assistance grants (other than for self-help projects) may be made? — Not applicable

d. <u>FAA Sec. 115</u>. Will country be furnished, in same fiscal year, either security supporting assistance, or Middle East peace funds? If so, is assistance for population programs, humanitarian aid through international organizations, or regional programs? — Not applicable

2. <u>Security Supporting Assistance Country Criteria</u>

a. <u>FAA Sec. 502B</u>. Has the country engaged in a consistent pattern of gross violations of internationally recognized human rights? — No

(Is program in accordance with policy of this Section?) — Yes

b. FAA Sec. 531. Is the Assistance to be furnished to a friendly country, organization, or body eligible to receive assistance?	Yes
c. FAA Sec. 609. If commodities are to be granted so that sale proceeds will accrue to the recipient country, have Special Account (counterpart) arrangements been made?	Not applicable. This assistance is to be a loan.

NONPROJECT CHECKLIST

A. GENERAL CRITERIA FOR NONPROJECT ASSISTANCE

1. App. Unnumbered; FAA Sec. 653(b)	
(a) Describe how Committees on Appropriations of Senate and House have been or will be notified concerning the nonproject assistance;	FY 79 Congressional Notification submitted
(b) is assistance within (Operational Year Budget) country or international organization allocation reported to the Congress (or not more than $1 million over that figure plus 10%)?	Yes
2. FAA Sec. 611(a)(2). If further legislative action is required within recipient country, what is basis for reasonable expectation that such action will be completed in time to permit orderly accomplishment of purpose of the assistance?	No further legislative action is required to implement the program.
3. FAA Sec. 209, 619. Is assistance more efficiently and effectively givem through regional or multilateral organizations? If so why is assistance not so given? Information and conclusion whether assistance will encourage regional development programs. If assistance is for newly independent country, is it furnished through multilateral organizations or in accordance with multilateral plans to the maximum extent appropriate?	Not applicable
4. FAA Sec. 601(a); (and Sec. 201(f) for development loans). Information and conclusions whether assistance will encourage efforts of the country to: (a) increase the flow of international trade; (b) foster private initiative and competition; (c) encourage development and use	(a) Loan will finance import of commodities with long-term objective of increasing Zambia's ability to engage in international trade; (b) under AID Regulation I procedures

of cooperatives, credit unions and savings and loan associations; (d) discourage monopolistic practices; (e) improve technical efficiency of industry, agriculture, and commerce; and (f) strengthen free labor unions.	private initiative and competition will be fostered; (c) no direct impact; (d) no direct impact; (e) Loan will promote efficiency through imports of needed commodities; and (f) no direct impact.
5. FAA Sec. 601(b). Information and conclusion on how assistance will encourage U.S. private trade and investment abroad and encourage private U.S. participation in foreign assistance programs (including use of private trade channels and the services of U.S. private enterprise).	Following Regulation I procedures, assumes there will be maximum private participation in transactions financed under the loan.
6. FAA Sec. 612(b); Sec. 636(h). Describe steps taken to assure that, to the maximum extent possible, the country is contributing local currencies to meet the cost of contractual and other services, and foreign currencies owned by the United States are utilized to meet the cost of contractual and other services.	Not applicable
7. FAA Sec. 612(d). Does the United States own excess foreign currency and, if so, what arrangements have been made for its release?	No. Not Applicable

B. FUNDING CRITERIA FOR NONPROJECT ASSISTANCE

1. Nonproject Criteria for Security Supporting Assistance

a. FAA Sec. 531. How will this assistance support promote economic or political stability? Is the country among the 12 countries in which Supporting Assistance may be provided in this fiscal year?	This loan will assist the GRZ in improving its balance of payments situation. Yes.

2. Nonproject Criteria for Development Assistance

a. FAA Sec. 102(c); Sec. 111; Sec. 281a. Extent to which activity	This loan will finance agricultural inputs to

will (1) effectively involve the poot in development, by extending access to economy at local level, increasing labor-intensive production, spreading investment out from cities to small towns and rural areas; and (2) help develop cooperatives, assist rural and urban poor to help themselves toward better life, and otherwise encourage democratic private and local government institutions?

assist the GRZ in developing rural areas and increasing food production.

b. FAA Sec. 103, 103A, 104, 105, 106, 107. Is assistance being made available: (include only applicable paragraph -- e.g., a, b, etc. -- which corresponds to sources of funds used. If more than one fund source is used for assistance, include relevant paragraph for each fund source.)

(1) [103] for agriculture, rural development or nutrition; if so, extent to which activity is specifically designed to increase productivity and income of rural poor; (103A) if for agricultural research, is full account taken of needs of small farmers;

Not applicable

(2) [104] for population planning of health; if so, extent to which activity extends low-cost, integrated delivery systems to provide health and family planning services, especially to rural areas and poor; extent to which assistance gives attention to interrelationship between (A) population growth and (B) development and overall improvement in living standards in developing countries. Is activity designed to build motivation for small families in programs such as education in and out of school, maternal and child health services, agriculture production, rural development, and assistance to urban poor?

Not applicable

(3) [105] for education, public administration, or human resources development; if so, extent to which activity strengthens nonformal education, makes formal education more relevant, especially for rural families and urban poor, or strengthens management capability of institutions enabling the poor to participate in development;	Not applicable
(4) [106] for technical assistance, energy, research, reconstruction, and selected development problems; if so, extent activity is:	Not applicable
(a) to help alleviate energy problem;	Not applicable
(b) reconstruction after natural or manmade disaster;	Not applicable
(c) for special development problem, and to enable proper utilization of earlier U.S. infrastructure, etc., assistance;	Not applicable
(d) for programs of urban development, especially small labor-intensive enterprises, marketing systems, and financial or other institutions to help urban poor participate in economic and social development.	Not applicable
(5) [107] by grants for coordinated private effort to develop and disseminate intermediate technologies appropriate for developing countries.	Not applicable
c. FAA Sec. 207; Sec. 113. Extent to which assistance reflects appropriate emphasis on: (1) encouraging development of democratic, economic, political, and social institutions; (2) self-help in meeting the country's food needs; (3) improving availability of trained worker-power in the country; (4) programs designed to meet the country's health needs; (5) other important areas of economic, political, and social develop-	Not applicable

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ment, including industry; free labor unions, cooperatives, and Voluntary Agencies; transportation and communication; planning and public administration; urban development, and modernization of existing laws; or (6) integrating women into the recipient country's national economy.

d. FAA Sec. 281(b). Describe extent to which program recognizes the particular needs, desires, and capacities of the people of the country; utilizes the country's intellectual resources to encourage institutional development; and supports civic education and training in skills required for effective participation in governmental and political processes essential to self-government.	Not applicable
e. FAA Sec. 201(b)(2)-(4) and (8); Sec. 201(e); Sec. 211(a)(1)-(3) and (8). Does the activity give reasonable promise of contributing to the development of economic resources, or to the increase of productive capacities and self-sustaining economic growth; or of educational or other institutions directed toward social progress? Is it related to and consistent with other development activities, and will it contribute to realizable long-range objectives?	Not applicable
f. FAA Sec. 201(b)(6); Sec. 211(a)(5), (6). Information and conclusion on possible effects of the assistance on U.S. economy, with special reference to areas of substantial labor surplus, and extent to which U.S. commodities and assistance are furnished in a manner consistent with improving or safeguarding the U.S. balance-of-payments position.	See page 22, Section IV. A of Loan Paper.

3. Nonproject Criteria for Development Assistance (Loans only)

a. FAA Sec. 201(b)(1). Information and conclusion on availability of financing from other free-world sources, including private sources within the United States.	See page 14, Section II. B of Loan Paper
b. FAA Sec. 201(b)(2); 201(d). Information and conclusion on (1) capacity of the country to repay the loan, including reasonableness of repayment prospects, and (2) reasonableness and legality (under laws of country and United States) of lending and relending terms of the loan.	See page 16, Section II. E of Loan Paper
c. FAA Sec. 201(e). If loan is not made pursuant to a multilateral plan, and the amount of the loan exceeds $100,000, has country submitted to AID an application for such funds together with assurances to indicate that funds will be used in an economically and technically sound manner?	Not applicable
d. FAA Sec. 202(a). Total amount of money under loan which is going directly to private enterprise, is going to intermediate credit institutions or other borrowers for use by private enterprise, is being used to finance imports from private sources, or is otherwise being used to finance procurements from private sources?	Not applicable

4. Additional Criteria for Alliance for Progress

[Note: Alliance for Progress assistance should add the following two items to a nonproject checklist.]

a. FAA Sec. 251(b)(1)-(8). Does assistance take into account principles of the Act of Bogota and Charter of Punta del Este; and to what extent will the activity contribute to the economic or political integration of Latin America?	Not applicable

b. FAA Sec. 251(b)(8); 251(h). For loans, has there been taken into account the effort made by recipient nation to repatriate capital invested in other countries by their own citizens? Is loan consistent with the findings and recommendations of the Inter-American Committee for the Alliance for Progress (now "CEPCIES", the Permanent Executive Committee of the OAS) in its annual review of national development activities?	Not applicable

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STANDARD ITEM CHECKLIST

A. PROCUREMENT

1. FAA Sec. 602. Are there arrangements to permit U.S. small business to participate equitably in the furnishing of goods and services financed?	Yes
2. FAA Sec. 604(a). Will all commodity procurement financed be from the United States except as otherwise determined by the President or under delegation from him?	Yes
3. FAA Sec. 604(b). Will all commodities in bulk be purchased at prices no higher than the market price prevailing in the United States at time of purchase?	Yes
4. FAA Sec. 604(c). Will all agricultural commodities available for disposition under the Agricultural Trade Development & Assistance Act of 1954, as amended, be procured in the United States unless they are not available in the United States in sufficient quantities to supply emergency requirements of recipients?	No agricultural commodities are anticipated under this loan.
5. FAA Sec. 604(d). If the cooperating country discriminates against U.S. marine insurance companies, will agreement require that marine insurance be placed in the United States on commodities financed?	Yes
6. FAA Sec. 604(e). If offshore procurement of agricultural commodity or product is to be financed, is there provision against such procurement when the domestic price of such commodity is less than parity?	No agricultural commodities are anticipated under this loan.
7. FAA Sec. 604(f). Are there arrangements whereby a supplier will not receive payment under the commodity import program unless he/she has certified to such information as the Agency by regulation has prescribed?	Yes, thru the use of Letters of Commitment and Letters of Credit.

8.	FAA Sec. 608(a). Will U.S. Government excess property be utilized wherever practicable in lieu of the procurement of new items?	Yes
9.	MMA Sec. 901(b). (a) Compliance with requirement that at least 50 per centum of the gross tonnage of commodities (computed separately for dry bulk carriers, dry cargo liners, and tankers) financed shall be transported on provately owned U.S.-flag commercial vessels to the extent that such vessels are available at fair and reasonable rates.	Yes
10.	International Air Transport. Fair Competitive Practices Act, 1974	
	If air transporation of persons or property is financed on grant basis, will provision be made that U.S.-flag carriers will be utilized to the extent such service is available?	This program is loan financed.

B. OTHER RESTRICTIONS

1.	FAA Sec. 620(h). Do arrangements preclude promoting or assisting the foreign aid projects or activities of Communist-Bloc countries, contrary to the best interests of the United States?	Yes
2.	FAA Sec. 636(i). Is financing prohibited from use, without waiver, for purchase, long-term lease, exchange, or guaranty of sale of motor vehicle manufactured outside the United States?	Yes
3.	Will arrangement preclude use of financing:	
	a. FAA Sec. 114. to pay for performance of abortions or involuntary sterilizations of to motivate or coerce persons to practice abortions? to pay for performance of involuntary sterilizations as method of family planning or to coerce or provide any financial incentive to any person to practice sterilizations?	Yes
	b. FAA Sec. 620(g). to compensate owners for expropriated nationalized property?	Yes

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	c. FAA Sec. 660. to finance police training or other law enforcement assistance, except for narcotics programs?	Yes
	d. FAA Sec. 662. for CIA activities?	Yes
	e. App. Sec. 103. to pay pensions, etc., for military personnel?	Yes
	f. App. Sec. 106. to pay U.N. assessments?	Yes
	g. App. Sec. 107. to carry out provisions of FAA Sections 209(d) and 251(h)? (transfer to multilateral organization for lending).	Yes
4.	FAA Sec. 201(d). If development loan, is interest rate at least 2% per annum during grace period and at least 3% per annum thereafter? Can the country borrower service the loan on harder than standard development loan terms?	Yes, the U.S. and other international donors have determined that the GRZ should service loans on concessional terms.

Justification for Waiver

I. Waiver Required

Procurement source and origin waiver from AID Geographic Code 000 (U.S. only) to Code 935 (U.S. and free world countries) for procurement of inland transport services from ocean ports in east and southern Africa to Zambia.

II. Summary Waiver Information

Cooperating Country:	Zambia
Authorizing Document:	PAAD
Project:	Zambia Commodity Import Loan
Nature of Funding:	Loan, Economic Support Fund
Description:	Inland transport services for commodities from east and southern Africa ocean ports to Zambia.
Approximate Total Value:	$1,000,000
Probable Source:	Tanzania, Mozambique and South Africa

III. Discussion

AID policy requires AID Geographic Code 000 (U.S. only) source and origin procurement for Economic Support Fund (ESF) loans. This applies to the procurement of transport services as well as the commodities financed under the proposed loan. Zambia is a land-locked country and is dependent upon its neighboring countries for inland transportation from ocean ports to Zambia. U.S. transport services are effectively not available because most transport facilities in this area are owned and operated by the public sector or local firms in the region. Therefore, a waiver is requested for Code 935 (U.S. and Free World Countries) procurement for these services.

Payment of inland freight costs with loan funds is further justified by Zambia's chronic balance of payment difficulties as described in the loan paper. Total local costs for inland transportation services should not exceed $1,000,000 for all goods financed under the proposed loan.

IV. Justification

The previously mentioned transport services are not readily available from the authorized source, and these services are essential to the successful implementation of the proposed commodity import loan. Procurement from Code 935 countries is necessary to the attainment of U.S. foreign policy objectives and objectives of the foreign assistance program.