

PROGRAM ASSISTANCE
APPROVAL DOCUMENT
(PAAD)

Official File Copy

2. Country	ZAMBIA
5. Category	Commodity Financing Standard Procedure
4. Date	August 27, 1985
6. OYB Change Number	N/A
8. OYB Increase	N/A
To be taken from:	ESF Account -- FY85
10. Appropriation Budget Plan Code	GESA-85-31611-KG32
13. Estimated Delivery Period	Oct. 1985-Sept. 1988
14. Transaction Eligibility Date	Grant Obligation

3. To
M: Peter McPherson
Administrator

7. From
Mark L. Edelman
Mark L. Edelman
Assistant Administrator for Africa

9. Approval Requested for Commitment of
\$ 25,000,000

11. Type Funding
 Loan Grant

12. Local Currency Arrangement
 Informal Formal None

13. Commodities Financed

Commodities eligible under the AID Commodity Eligibility Listing

6. Permitted Source	17. Estimated Source
U.S. only \$25,000,000	U.S. \$25,000,000 Code 000
Limited F.W.	Industrialized Countries
Free World	Local
Cash	Other

8. Summary Description

This program will provide \$25 million in addition to the planned FY85 program for Zambia in support of GRZ measures to liberalize marketing of maize and fertilizer. The funds will be released in four separate tranches, each of which will be conditioned upon one of the following four policy reforms. Except as AID may otherwise agree in writing, funds would be disbursed only upon presentation of evidence, in form and substance satisfactory to AID, that:

(i) for the initial tranche, the GRZ has announced selling prices for maize and fertilizer which are sufficient to cover the full cost of maize and fertilizer procurement plus one-third of NAMBoard's and the PCUs' operating costs;

(ii) for a subsequent tranche, the GRZ has announced NAMBoard selling prices for maize and fertilizer for the subsequent crop cycle which are sufficient to cover the full cost of maize and fertilizer procurement plus two-thirds of NAMBoard's and the PCUs' operating costs and taken satisfactory steps to permit participating of private traders in maize and fertilizer marketing;

(iii) for a subsequent tranche, the GRZ has established and implemented a multi-channel marketing system which provides for prices to fluctuate within a satisfactory band, and for full and independent

19. Clearances	20. Action
AFR/SA: RCarlson <i>RC</i> 9-3-85 Date	<input checked="" type="checkbox"/> APPROVED <input type="checkbox"/> DISAPPROVED Authorized Signature: <i>Marshall Swon</i> Date: <i>Sept 13, 1985</i> Title: Administrator
REG/DP: HJohnson <i>HJ</i> 9-3-85	
REG/GC: Hery <i>Hery</i> 9/10/85	
AA/PPC: RDerham <i>RDerham</i> 9/12/85	
M/FM: ESowens <i>ESowens</i> 9/13/85	
SER/COM: WSchmeisser <i>WSchmeisser</i> 9-13-85	
AFR/PD: LHausman <i>LHausman</i> 9-8-85	
DAA/AFR: LSaiers <i>LSaiers</i>	
AFR/GC: TBork <i>TBork</i>	

participation of private producers, processors, or traders, who may buy from or sell to any willing seller or buyer;

(iv) and for a subsequent tranche, the GRZ has implemented measures which limit NAMBoard's role in the marketing system to buyer and seller of last resort, including the elimination of all subsidies paid to NAMBoard and the PCUs except those that are required to fund its market interventions at the floor and trigger-selling prices.

In addition, the Grantee shall covenant that, except as AID may otherwise agree in writing, it will complete the steps set out as conditions precedent within three years from the date of the agreement.

Authority to approve any substantive changes in the conditions precedent or the covenant is delegated to AA/AFR.

The program will be administered as a Commodity Import Program (CIP). The authorized geographic code is 000 (US only), except as AID may otherwise agree in writing. It is anticipated that the commodities imported will be trucks and truck spare parts, tires, agricultural processing machinery, lubricants, and locomotive spare parts.

Except as AID may otherwise agree in writing, all commodities imported under this program will be allocated to the private sector, with the exception of the locomotive spare parts which will be allocated to the parastatal railroad company, Zambia Railways.

Local currency generated under the program would be allocated to high priority uses as agreed jointly between AID and the GRZ, including: (i) credit to private traders and cooperatives; (ii) road maintenance; (iii) construction of storage; (iv) budgetary support for policy analysis related to the program; (v) targetted consumer subsidies for the groups most vulnerable to increased food prices; and (vi) establishment of a grain reserve for food security.

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UNITED STATES INTERNATIONAL DEVELOPMENT COOPERATION AGENCY
AGENCY FOR INTERNATIONAL DEVELOPMENT
WASHINGTON, D.C. 20523

ASSISTANT ADMINISTRATOR SEP 13 4 50 PM '85

SEP 9 1985

ACTION MEMORANDUM FOR THE ADMINISTRATOR

THRU: AA/PPC, Richard A. Derham *for*
FROM: AA/AFR, Mark L. Edelman *ml*
SUBJECT: FY 85 EPRP for Zambia (ZAMCAM Program)

Problem: You are requested to authorize a \$25 million non-project assistance grant for Zambia, to be funded from the special FY85 ESF allocation for the Economic Policy Reform Program (EPRP) in Africa.

Background: Faced with a declining mineral resource base, deteriorating terms of trade and, as a consequence, falling incomes and growing unemployment, Zambia is confronted with an urgent need to diversify its economy. In response, the Government of Zambia (GRZ) must embark on a comprehensive package of policy reforms in order to restructure its economy. Macro-economic adjustments are needed to encourage a shift away from capital intensive modes of production, high levels of consumer imports, and a reliance on copper for the country's export earnings, and to encourage increased private and public sector saving. In addition, steps must be taken to develop the agricultural sector which, despite its potential, has made only a limited contribution to the country's growth.

Against this background, Zambia has been selected as one of five countries to be eligible for additional FY 85 funding under the Africa Bureau's EPRP. The GRZ has already demonstrated its commitment to reform by undertaking a number of measures needed to increase incentives in agriculture. Since 1983, the government has increased producer prices, reduced tax rates, permitted partial retention of foreign exchange earnings by exporters, and increased customs duty exemptions for farm machinery. AID has played a role in obtaining these reforms through leverage provided by ongoing Commodity Import and PL480 programs and technical assistance in policy analysis under its Zambia Agricultural Training, Planning, and Institutional Development (ZATPID) Project. 514065

A central issue remains, however, in liberalizing the marketing of maize and fertilizer. At present, prices for these products are fixed by the GRZ and their marketing is handled by the parastatal marketing agency, the National Agricultural Marketing Board (NAMBoard), and by Provincial Cooperative Unions (PCUs) which serve as its agents in the rural areas. This marketing system results in considerable inefficiencies: the pricing mechanism does not encourage increased production, nor does it permit an efficient level of input use; NAMBoard itself cannot efficiently manage the logistical support or financial resources needed to distribute these products on a timely basis to where they are needed; and the

subsidies being provided to NAMBoard to operate this system are eating up an increasing share of the GRZ budget.

The proposed ZAMCAM Program addresses these pending issues, and builds on AID's program experience in and focus on the agricultural sector.

Program Description: The proposed program would provide the GRZ an additional \$25 million in FY85 funds in support of a program to liberalize marketing of maize and fertilizer. The funds would be disbursed in four tranches, with release of each tranche subject to specified conditions precedent relating to the overall program objectives. In summary, these conditions precedent require that the GRZ progressively reduce subsidy payments to NAMBoard and the PCUs, and eventually restrict their role to buyer and seller of last resort; open trade in maize and fertilizer to private traders; and allow prices to fluctuate in response to market forces, within a band dictated by appropriate border prices.

The program would be administered as a Commodity Import Program (CIP), with funds being used to import trucks and truck spare parts (\$11 million), tires (\$3 million), agricultural processing machinery (\$3 million), lubricants (\$3 million), and locomotive spare parts (\$5 million). All of these commodities would be of US source and origin, with the possible exception of certain lubricants, which may not be available in the U.S. This will not be known until the specifications are developed, and any necessary waivers will be requested at that time. No other waivers are included or anticipated in the PAAD. All but the locomotive spare parts would be allocated to the private sector; the locomotive spares would be allocated to Zambia Railways, the parastatal railroad company.

Local currency generated under the program would be allocated to high priority uses as agreed jointly between AID and the GRZ. At present, these uses are expected to include: credit to private traders and cooperatives to procure needed equipment and materials to enter the maize and fertilizer trade; road maintenance to improve farm-to-market access; construction of storage facilities, as needed; budgetary support for policy analysis related to market liberalization; targetted consumer subsidies for the groups most vulnerable to substantial increases in staple food prices; and the establishment of a grain reserve for food security.

The program was reviewed by the Africa Bureau's ECPR on June 21, 1985. The program was approved with some adjustments to the proposed conditions, and subject to other minor modifications in the proposed allocation of local currencies, as detailed below.

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The ECPR concurred in the proposed allocation of local currencies, with the following provisions: that priority in credit allocations be given to private traders over cooperatives; that any support for a strategic grain reserve be accompanied by a plan for making such a grain reserve largely self-financing; and that any allocations to a targetted consumer subsidy program be deferred until such time as the GRZ removes all subsidies to NAMBoard.

Prior to disbursement of each of four tranches of AID funds, the GRZ will be required to satisfy specific conditions for the reduction of subsidies to NAMBoard and to encourage the participation of private traders in maize and fertilizer marketing. After the condition precedent to initial disbursement is met, the remaining conditions may be met in any sequence. (These conditions are detailed in the attached facesheet.) It is understood that the reduction in subsidies to NAMBoard and the PCUs will mean a compensating increase in both NAMBoard's prices and consumer prices of maize and fertilizer and ultimately, a substantial reduction in NAMBoard's role and size. These consequences are obviously of concern to the GRZ.

The impact on prices is likely to be the most serious in the short term. Assuming that initially these price increases are fully passed on to consumers, we have estimated that the consumer price of maize flour would increase by 17% as a result of meeting the first condition precedent to disbursement of AID funds. If the Zambian currency is devalued, the price increase would be greater. Although the GRZ is in general agreement with the need to reduce subsidies to NAMBoard and the PCUs, they are very concerned about passing the commensurate costs on to consumers. Because this is such a difficult and sensitive issue, we will need to be flexible on the proposed timeframe for meeting the conditions precedent.

In addition, the ECPR recommended that, to facilitate the negotiating process, the AA/AFR be delegated authority by you to approve substantive changes in the conditions precedent should that prove necessary as negotiations proceed. While we are committed to the essential objectives of the program, we may need to agree to an alternative timetable or modified language. We are requesting the delegation as part of this package. We have instructed the Mission that prior to making any substantive changes in the conditions precedent, the Director is required to consult with AA/AFR.

Finally, the ECPR discussed whether the CIP mechanism, as proposed for this program, will be workable in the context of the foreign exchange auction system expected to be put in place in Zambia very shortly. Lacking specific details on how such a system would operate, the ECPR recommended proceeding with the program as proposed, while recognizing that AID would have to work closely with the GRZ to agree on how to implement the CIP once the auction system is in place.

The project review committee has determined from its review of the Program Assistance Approval Document (PAAD) that:

1. The program grant approach is technically and economically sound;
2. The timing and funding of program activities are appropriately scheduled;
3. Sufficient planning is underway for the implementation, monitoring, and evaluation of progress under this activity; and
4. All statutory criteria have been met.

Status of Pre-Authorization Actions: The Bureau's Environmental Officer has reviewed the Initial Environmental Examination and has concurred in a categorical exclusion for this program.

An Advice of Program Change was forwarded to Congress on July 8, 1985. The waiting period expired on July 23, 1985, permitting obligation as of that date.

There are currently no human rights issues in Zambia.

The USAID/Zambia Mission Director, John Patterson, will be the AID officer responsible for negotiating and implementing this program. The Mission's direct-hire economist will be responsible for program management which includes closely monitoring progress in the policy reform areas targetted by the program. The program backstop officer in AID/W will be Ms. Karen Nurick, AFR/PD/SAP.

Recommendation: That you approve the proposed ZAMCAM Program in an amount of \$25 million by signing the attached PAAD facesheet (Tab A). The facesheet includes a provision by which you redelegate authority to AA/AFR to approve changes in the program conditions which may arise in the course of negotiations, provided such changes do not undermine overall program objectives.

Drafted by: AFR/PD/SAP:WStickel:ds

Cleared by: DAA, LSaiers

AFR/PD, LHausman

AFR/DP, HJohnson JWolgin(draft)

AFR/SA, RCarlson LPempa(draft)

GC/AFR, TBork MAKleinjan

EA K.KAUFFMAN
PPC/PDPR, ARosenberg

GC, HFry

^{KSW Per}
aid/afr/pd:wstickel:corrected 8/22/85:ah:doc no. 0059L

Attachments:

PAAD Facesheet
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