Africa's Experience with Structural Adjustment

Proceedings of the Harare Seminar,
May 23–24, 1994

Edited by
Kapil Kapoor
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In recent years, structural adjustment programs in Africa have come under very close scrutiny and there has been a lively debate about the effectiveness of these programs in fostering economic growth and reducing poverty. While the proponents of these programs regard them as a necessary, although not sufficient, condition for economic development, opponents contend that the pace of these reforms and the austerity imposed by them have worsened poverty in Africa.

In order to assess the extent to which policy reforms have been implemented in Africa and the results of these reforms, the World Bank conducted a study in 1994 entitled Adjustment in Africa: Reforms, Results, and the Road Ahead. The study concluded that, while overall progress had been mixed, countries which had come furthest in implementing good policies, both macroeconomic and otherwise, had enjoyed a resurgence of economic growth. However, even among the countries which had adjusted the most, levels of per capita income were still below what was needed for rapid poverty reduction.

In order to widely disseminate the findings of the report, the World Bank conducted a series of seminars throughout Africa and invited representatives of the Government and the private sector to engage in an honest and open exchange of ideas on structural adjustment. This report summarizes the proceedings of the seminar which was held in Harare in May, 1994 and includes various papers presented by senior Government officials and private sector representatives from Southern African countries. The proceedings of the seminar indicate that while there appears to be general agreement about the need for structural adjustment, there are very genuine concerns about the pace and sequencing of reforms; the capacity of African bureaucracies to effectively implement and monitor the programs; the emphasis on exports without adequate attention to the development of export infrastructure and the development of an "export culture"; the need to increase the effectiveness of expenditures in the social sectors and to address issues relating to access to services; and the division of responsibility between the Government and the private sector. The conclusions of the Harare seminar therefore suggest that, in order to build a strong domestic constituency for the reforms and in order to derive maximum benefit from the policy changes, careful consideration needs to be given to the areas discussed in this report as countries go about designing and implementing structural adjustment programs.

Katherine Marshall
Director
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Abstract

This paper summarizes the proceedings of a seminar on structural adjustment in Africa, which was held in Harare, Zimbabwe, on May 23-24, 1994 and also includes papers presented by some of the participants. While generally agreeing with the need for structural adjustment, several participants expressed concern about the speed with which these reforms are being implemented in Africa, particularly since most of the adjusting economies have poorly developed institutions and therefore have limited implementation capacity. Representatives of the private sector pointed out that the accelerated pace of trade liberalization had rapidly exposed African economies to international competition without giving domestic industries adequate time to adjust, resulting in de-industrialization and poor employment creation. It was noted that although adjustment programs talked of levelling the playing field, the international trading arena was highly uneven, GATT and the Uruguay round notwithstanding, and there appeared to be a double standard with African economies being required to open up at a time when the economies of Western Europe, U.S.A, and Japan still retained their protectionist stance. In addition, South Africa, which is a major trading partner of Eastern and Southern African economies, was also protecting its domestic manufacturers behind extremely high tariff barriers and was promoting its exports through direct export subsidies. Concern was also expressed about the social impact of adjustment programs and the declines in real per capita expenditures in health and education presently being experienced in Africa.
Overview of the Seminar
Kapil Kapoor
WORLD BANK

Introduction

In a bid to arrest and reverse the prolonged period of economic decline which had afflicted a large part of the African continent, numerous African countries committed themselves to a process of structural adjustment in the mid-1980s. It was expected that the adoption of adjustment policies would catapult these economies onto a higher growth trajectory and enable them to make a visible dent on poverty. Now, after years of adjustment, Africa’s economic climate remains unclear and uncertain, while the overall results have proved to be modest, relative to original expectations. Although some countries have enjoyed a resurgence of growth, the economic performance of the region as a whole has been disappointing, raising serious questions about the extent and efficacy of policy reform efforts.

To assess the extent to which adjustment policies have, in fact, been implemented by the countries themselves and to relate these policy changes to subsequent economic performance, the World Bank commissioned a study which examined, in depth, how much policy reform has taken place in Africa, how successful it has been, and how much more remains to be done. A key question asked by the study is whether it is the failure of adjustment policies that has resulted in such disappointing results for Africa or whether it is the failure to adjust.

Comparing the policies and performance of 29 Sub-Saharan African countries during two periods, from 1981 to 1986, when most African countries were in economic crises, and from 1987 to 1991, when these countries adopted -structural adjustment programs, the study concluded that for those countries that had undertaken and sustained major policy reforms, adjustment was working. While policy reforms remained incomplete and implementation had been uneven across sectors and across countries, policies were getting better and were more conducive for restoring economic growth and reducing poverty. African countries had been generally more successful in improving their trade and agricultural policies but less so with regards to their public and financial sector policies. Consequently, no African country had achieved a sound overall macro-economic policy stance, as defined in terms of a very low budget deficit, a competitive exchange rate, and an inflation rate of under 10 percent. While most countries that had improved their policies had returned to positive rates of GDP per capita growth, in a third of the countries macro-economic policies had actually deteriorated over the decade.

Drawing on successful experiences elsewhere, the study suggested that it is imperative that African countries continue with the current strategy of avoiding overvalued exchange rates and keeping inflation and budget deficits low. In agriculture, although most adjusting countries are taxing their farmers less, the scope for continuing reforms in this sector is still large; liberalizing pricing and marketing of export and food crops has not made headway in several countries. Since most African

economies have limited domestic markets and because exports are beneficial for growth, countries should adopt an "exporters first" rule and provide them with automatic access to foreign exchange and facilitate access to intermediate inputs and capital goods. However, countries should abandon the practice of trying to pick "winners" since they have consistently made poor choices in the past. With regards to public enterprise reform, efforts to privatize state corporations and improve their performance need to be intensified since such efforts have yielded meager results so far. African Governments have resisted privatization even though international experience demonstrates that alternatives, such as imposing hard budget constraints, granting the enterprises greater autonomy, and putting them on a commercial footing, rarely work. In order to develop the financial system, the study recommended that African countries follow a three-part strategy of reducing financial repression, restoring bank solvency, and improving financial infrastructure.

In conclusion, the study pointed out that adjusting policies, by themselves, could not put countries on a sustained, poverty-reducing growth path. In addition to better economic policies, this necessitated higher investment in human capital, infrastructure, and institution building, along with better governance. However, by embarking upon structural adjustment, African countries had taken the "first crucial step in creating a favorable economic environment for sustainable growth and development".

The Harare Seminar

In an effort to discuss the findings of the Adjustment study, particularly with respect to structural adjustment in Southern Africa, the World Bank conducted a seminar in Harare on May 23-24, 1994, and invited participants from Mozambique, Malawi, South Africa, Zambia, and Zimbabwe (see Annex I for a list of participants). In addition to submitting papers reviewing the actual experience of their countries with structural adjustment the participants, who consisted of representatives of both Government and the private sector, were encouraged to engage in a true "give and take" dialogue about the impact of reforms and constructive ways to make adjustment more successful, in terms of growth, equity, and poverty alleviation. It was further stressed that while a transcript of the proceeding would be prepared, this would serve only to provide a general flavor of the discussions and, in a bid to encourage an honest exchange of ideas, would not attribute statements to any specific participant.

While not exhaustive, the eight areas listed below account for a very large part of the two-day discussions. In listing these areas, the objective has been to try and briefly summarize the principal concerns expressed by the participants and not necessarily to respond to the criticisms or to present a defence of structural adjustment, which goes beyond the scope of this paper.

Methodological Issues

Several participants questioned the methodology underlying the study; the choice of the reference period, i.e. between 1981-86 and 1987-91; and, in particular, the criteria used in choosing the six countries with the best macro-economic performance, i.e. Burkina Faso, Ghana, The Gambia, Nigeria, Tanzania and Zimbabwe. For example, it was noted that of this sample, two countries had actually experienced negative rates of economic growth during the reference period (The Gambia and Burkina Faso), one economy had not grown at all (Zimbabwe), and strong growth was experienced in
only the remaining three countries. Even in the latter, the process of adjustment had not proved to be sustainable in the case of Nigeria, as more recent developments have revealed. Furthermore, participants noted that in a similar study conducted by the International Monetary Fund, the choice of a different set of economic indicators had resulted in some of the countries identified as successes by the Bank being classified as failures by the Fund and vice versa, thereby undermining the conclusions of both reports.

The Need and Capacity to Adjust

One of the main themes to emerge from the seminar discussions was the degree of agreement among the participants about the need for adjustment. Most of the participants agreed that it was imperative to "get the prices right" and that generally appropriate macro-economic policies were a necessary, although not sufficient, condition for economic growth and development. However, while there was broad agreement that macro adjustment is important, there were questions whether it was defensible to separate structural adjustment from general development issues, as the Adjustment study tries to do. In particular, it was felt that successful adjustment depended upon the capacity to effectively implement the adjustment agenda and capacity is inherently a long-term development issue.

While there are some reforms which can be carried out at the stroke of a pen, such as exchange rate reform, price de-control, etc., many others such as parastatal reform and financial sector reform require much more difficult and time-consuming follow through which, in turn, demands a great deal of local capacity; thus both the speed and the likely impact of adjustment would depend upon the level of development. Given the weak implementation capacity in African economies, several speakers noted that structural adjustment programs, in general, have unrealistic expectations about how fast adjustment can occur; consequently, the political costs of speedier implementation are also often underestimated.

Several participants pointed out that it was also often the case that the donor community and the NGOs actually contributed to undermining local capacity through their wage and employment policies. Given the distortions in the African labor market with respect to high level manpower, i.e. inelastic supply and large demand, external agencies were usually very successful in hiring all the talent away from Government agencies and other local institutions by offering inflated salaries (often 15 to 20 times more than offered by the civil service). Moreover, the demand generally came from organizations which were non-profit maximizing and therefore could not be said to reflect economic efficiency. Under these circumstances, there was need not only to rethink domestic labor market policies but for the donor community to re-examine their local recruitment policies.

The Emphasis on Exports

Some participants noted that Africa's recovery prospects had suffered as a result of the excessive emphasis placed by structural adjustment programs on export-led growth. The resulting expansion in the production of primary commodities had resulted in a slump in international commodity prices, thereby contributing to an increase in poverty. However, it was pointed out that it was a historical fact that countries which were pessimistic about exporting had grown more slowly than outward oriented economies. For example, while both India and China had started out with roughly equal export volumes in 1975 at approximately US$9 billion, by 1992 India's exports were about US$20 billion while China's exports had increased to US$85 billion, resulting in a much higher rate of economic growth. Furthermore, even in Africa, the so called adding up problem, whereby
international prices decline as a result of increased production, was a serious issue only for the growers of cocoa, tea and coffee. Even in the case of these crops, long-term profitability would depend upon the future cost of production and the likely response of other countries in the world.

With regards to manufactured exports, several representatives of the private sector pointed out that while adjustment programs emphasized the need to "level the playing field" within African economies, the international trading arena was still far from level, notwithstanding the current efforts being made under the new GATT agreement. Consequently, even as African economies were bringing down tariff barriers and doing away with export subsidies, they were encountering substantial problems in penetrating the international market on account of a variety of tariff and non-tariff barriers. While the concept of a free trade regime had started to gain acceptance, there were still too many countries directly subsidizing exporters, and/or providing subsidized inputs, making it difficult to compete.

Finally, it was contended that not enough attention had been paid to export development, despite all the rhetoric about the importance of exports. Several years of adjustment had not resulted in a structural change within the economy and the export base of most African economies still remained narrow. In this context, it was important for the Government, the international organizations and the donor community to realize that export development in Africa would need more than simply "getting the prices right". Increasing the competitiveness of local exporters would require, among other things, the upgrading of export infrastructure, the provision of export finance, and the development of market intelligence.

Stabilization and De-industrialization

Several participants noted that most African economies found it extremely difficult to control their fiscal deficits and eliminate parastatal losses, resulting in a situation whereby tight monetary policy was not being supported by appropriate fiscal reform in a bid to maintain macro-economic stability. Consequently, the private sector was being crowded out both by the unavailability of credit and punitively high real interest rates. The result was an environment in which it was often more profitable to park resources in the money market or to engage in trading and speculation, rather than manufacturing, resulting in a destruction, over time, of the productive sectors in the economy. The process of de-industrialization was also being aggravated by the process of trade liberalization, which often resulted in cheap imports, e.g. from the Far East, flooding the domestic economy.

Participants were in general agreement that, under the circumstances, appropriate sequencing of reforms was critical. In particular, if there is evidence that an adjusting country is experiencing difficulty in bringing its fiscal house in order, the pace of trade liberalization and that of the liberalization of the financial sector should be restrained.

Poverty and Adjustment

There was skepticism among some participants about the claim made by the Adjustment Study that the process of structural adjustment was conducive to poverty reduction in Africa. In particular, commentators noted that highly aggregated macro-economic indicators such as Gross Domestic Product, were often used in supporting these claims whereas micro level data in rural communities generally revealed a very different picture. While there was agreement that economic growth was a
necessary condition for poverty reduction, there was a feeling among the participants that the Study, and indeed adjustment programs in general, were more concerned with overall macro-economic growth, did not pay enough attention to income distribution issues, and seemed to rely too heavily upon a "trickle down" approach to poverty reduction. While welcoming the emphasis placed by the World Bank on the need for redistributing expenditures in favor of the social sectors, participants cited examples of declines in real per capita expenditures in health and education in several adjusting countries in Africa. It was noted that in economies where Government expenditures were declining as a share of GDP, preserving the share of the social sectors in total expenditures was not adequate and usually implied decreasing real resources being allocated to these critical sectors. Furthermore, it was pointed out that most adjustment programs focused only on social sector expenditures and did not address the basic issue of access to services. In this context, the introduction of user-fees was proving very damaging, particularly with respect to the access by the poor to health services. Even in instances where the core poor were exempt from paying these fees, the system of exemptions was excessively bureaucratic and, generally, poorly administered.

The Role of the State

A fair amount of time was spent discussing the appropriate role for the state in African economies. Participants alluded to the East Asian Miracle Study ² and suggested that the World Bank undervalued the role of Government in Africa, particularly since the Miracle Study had shown that Government intervention in industrial policy may be necessary to promote industrial growth. In fact, rather than trusting the vagaries of a narrowly defined free market, the Governments in these economies had skillfully guided the market by offering incentives to those productive sectors which promised the greatest returns. It was pointed out that there had been a large amount of state intervention in Africa with disastrous consequences; while state intervention in most East Asian economies had been performance based, in Africa such intervention was usually politically motivated, resulting in economic rents accruing to the people making the intervention. Africa lacked the essential ingredients identified by the Miracle study for successful state intervention, i.e. a technically competent civil service which is politically insulated so that it can carry out its functions independently; and strong institutional capacity which enables Government to co-ordinate decision-making activity.

However, participants felt that, given the Bank’s ideological disposition, there was not enough effort made to subject the market to the same level of scrutiny as that received by the state. Because the poor lacked access to productive inputs, marketing infrastructure, information and capital, they are severely disadvantaged in the market. In particular, there was a need to ensure appropriate sequencing of agricultural marketing liberalization. Several adjustment programs had encouraged the dismantling of agricultural parastatals, which had served as buyers of last resort, without ensuring that alternative, private sector based, marketing channels were given the necessary time to develop. As a result, a lot of the rural poor had been deprived of adequate marketing channels, contributing to food insecurity and increased poverty. Examples were also cited by participants of instances whereby monopolistic or monopsonistic trading practices had repeatedly distorted domestic markets and adversely affected the rural poor.

There was general agreement among the participants that the urban poor had been hardest hit by the adjustment process. Falling real incomes, price decontrol, reduction or elimination of consumer subsidies and the reduction in Government expenditures on a variety of "urban maintenance" expenditures had all contributed to a substantial erosion of living standards and an increase in urban poverty. The Social Dimensions of Adjustment funds, which had been put in place in several countries were very inadequate and, at best, a "band aid".

The Role of South Africa

The future role of South Africa was also the subject of some discussion, particularly with respect to trade relations with neighboring countries. The major question on the minds of the participants was whether the new South Africa is going to be a threat or an opportunity to the rest of the region. Interestingly enough, each side tended to see the other as a threat with the South Africans expressing concern about low wage imports coming in from neighboring countries while the smaller countries around South Africa expressing worry about their industrial sectors being swamped by South African exports. It was pointed out that South Africa was a potential source of investment and that there existed several complementarities between South Africa and its regional trading partners which could be exploited for the mutual benefit of all countries. Given its technological advantage, South Africa had the potential of playing a similar catalytic role similar to the one played by the Japanese economy with respect to the economies of East Asia.

The Sustainability of Adjustment Programs

Several participants observed that without the commitment of the Government and the population at large to the program, particularly given the transitional costs involved, the adjustment process would not be sustainable. In a number of countries the programs were being implemented half-heartedly because there was a general perception that the programs were being imposed upon the populous by external forces, in particular the IMF and the World Bank. Not enough was being done by these Governments to build internal consensus and to explain the rationale for adjustment to its citizens, further undermining the objectives of adjustment.

More effort was also necessary on the part of policy makers, and the donors, involved in designing and implementing adjustment programs to thoroughly analyze the likely impact of the reforms prior to announcing a change in policy. Hastily designed programs, which did not take local conditions into account, would not achieve the intended economic impact and would be detrimental to the well-being of the population at large.
Adjustment in Africa:  
Reforms, Results, and the Road Ahead  
Miguel Kiguel and Christine Jones  
WORLD BANK

Introduction

Thank you very much for giving me an opportunity to share the results of this World Bank policy research report with you. Before I introduce the report’s main findings, I’d like to say a few words about the purpose of the study. As you know very well, growth rates in Sub-Saharan Africa have been disappointingly low despite -- or, some people allege, because of -- a decade of structural adjustment. It is sobering to recall that Sub-Saharan Africa’s Gross Domestic Product per capita peaked in 1977. Assuming current growth rates, per capita GDP would not even return to the 1977 level until the year 2037. This troubling performance raises a simple but crucial question: do the very low growth rates in Africa represent a failure of adjustment or a failure to adjust?

To find out, the World Bank researchers evaluated the extent of economic policy reform between the early 1980s, when most countries were hit by economic crisis, and 1987-91, when many countries had begun to implement reform. They then compared these policy rankings with GDP growth per capita to discover what impact economic reform had on growth.

What the Study Does Not Cover

Before proceeding to their findings, I’d like to clarify the scope of the report. The study focuses on the matrix of economic policy issues that have come to be known as structural adjustment; specifically, on fiscal deficits, monetary policy, exchange rate policy, trade and agriculture policy, public enterprises and the financial sector. These are only one part of Africa’s development agenda. Reform in these areas is not intended to substitute for improvements in health and education, for construction of physical infrastructure, for stronger institutions, better public sector management, or for good governance. Rather, as the study shows in great detail, improved economic policies are a necessary foundation upon which development efforts can build.

Main Findings

The researchers found wide diversity of policies across countries, and across economic sectors. In general, however, their findings concerning reforms, results, and the road ahead can be summarized as follows. I’ll state each point briefly, then return to it later in greater detail: (Transparency 1).

First, concerning reforms...

Policies have improved in some countries. But progress has been uneven, and in some countries policies are worse. Furthermore, no country in Africa has established what are
internationally regarded as good macro-economic policies -- most importantly, low inflation, very low budget deficits, and realistic exchange rates. Second, concerning results...

In general, countries that improved their policies had improved growth, while those with deteriorating policies suffered further declines in growth. Even so, overall growth for the region remains very small and even the best reformers are not yet growing fast enough to reduce poverty.

What does this mean for the road ahead?

The authors found reasonable progress in macro-economic policy, agricultural policy and trade policy, and urge that governments continue their efforts in this direction. They found substantially less progress in public enterprise reform, financial sector reform and improvement of public sector management. Here they urge governments and donors to seek new ways of furthering the reform agenda.

Finally, they note that even with good policies, Africa will continue to need foreign assistance, and, in the case of countries with a particularly heavy debt burden, additional debt relief. But they note that aid and debt relief can only be effective if they are accompanied by effective policy reform, and their urge that aid be designed to speed rather than impede reform.

Africa Lagged Other Developing Regions

Let's turn now to look at some of these findings in greater detail.

For more than 20 years, the per capita Gross Domestic Product of Sub-Saharan Africa have stagnated while other that of developing countries in other regions has steadily improved (Transparency 2). As you can see, the region has lagged not only East Asia and the Pacific, where some countries have had remarkably high growth rates, but also developing countries in all other regions. In fact, Sub-Saharan Africa's GDP per capita peaked in 1977 and declined thereafter. Assuming current growth rates, the region would again reach the 1977 GDP level in 2037.

Why Terms of Trade Losses Weren't the Major Factor

The study found that poor policies were largely responsible for poor growth between 1975-1985 (Transparency 3). Terms of trade losses -- the decline in the world price of African exports -- were significant, but as the transparency shows, with the exception of Nigeria, where losses were especially steep due to the decline in world oil prices, terms of trade losses in the rest of Sub-Saharan Africa were about the same as those for other developing countries that had a much better growth performance.

Policies Were Decisive

Within Africa (Transparency 4), the link between policy reform and improved growth is clear. Of the 26 countries that were able to provide macro-economic data, more than half improved their policies to some degree. As we shall see, the six countries that improved their policies the most had the largest average improvement in growth. These six are Ghana, Tanzania, The Gambia, Burkina
Faso, Nigeria and Zimbabwe. Nine countries had a smaller improvement in policies and a smaller improvement in growth.

Lastly, eleven countries suffered a deterioration in policies. As a group, these also had the poorest growth record. Among these are Cote d’Ivoire, Cameroon, Congo, Mozambique, Sierra Leone, and Zambia.

If we look at the performance of these three groups of countries sector by sector, (Transparency 5) we see that the group that improved its macro-economic policies the most fared best not only in terms of GDP per capita, but also in terms of real export growth and industrial growth.

Policies, Government Intervention and Growth

We should not forget, however, that these improvements in policy were insufficient to establish what would be recognized internationally as good macro-economic policies -- low inflation, very low deficits, and realistic exchange rates -- in any of the countries (Transparency 6). This transparency ranks the policy stance of countries in 1990-91. In many cases, macro-economic policies prior to reform were so poor that even substantial improvements merely brought countries from poor to fair policy regimes. Only Ghana ranks as adequate -- a bit better than fair but still short of a good policy regime. As a result, economic growth continues to be weak, even in the best reformers.

The same pattern can be seen if we look at the degree of government intervention in selected economic sectors (Transparency 7). While the reform process has greatly reduced the number of governments intervening heavily in markets, the vast majority of governments continue to intervene to a considerable extent.

How do these two rankings -- macro-economic policy stance and the degree of government intervention -- relate to growth (Transparency 8)? As the transparency shows, countries that have fair or adequate policy rankings managed very modest but positive growth in GDP per capita. In contrast, countries that were ranked as having poor or very poor policies averaged negative growth rates in excess of 2 percent. Similarly, governments that intervened the least in markets had the best growth rates, while those with medium and heavy degrees of intervention suffered sharp declines in GDP per capita.

Flexible Exchange Rate Regimes Performed Better

The pattern is similar for fixed versus flexible exchange rates. Although the study was completed before the steep devaluation in the CFA Franc, its lesson for members of the CFA franc zone now adjusting to devaluation are encouraging. While devaluation doesn’t in itself guarantee improved growth, the study found that overvalued currencies were a major barrier to growth. Removing this barrier therefore presents an opportunity for improved growth.

This transparency (Transparency 9) compares the economic performance of countries with fixed exchange rates -- essentially the CFA Franc Zone members -- and those with flexible exchange rates. As you can see, the fixed exchange rate countries suffered sharp declines in GDP growth per capita and stagnant real export growth, compared to a dramatic positive turnaround in GDP growth per capita and a doubling of real export growth for the flexible exchange rate countries.
Lower Taxes & Higher Producer Prices Helped Agriculture

I would like to turn now to agriculture, a key concern in the region, since the vast majority of the population -- and of the poor -- are farmers or agricultural laborers. African farmers are among the most heavily taxed in the world. These taxes come in three forms. Only the first of these -- export taxes -- are deliberately collected by the government as revenue. In addition, African farmers have often been subject to *de facto* taxes due to overvalued exchange rates that reduce their income by making imported farm goods cheap and domestic crops uncompetitive as exports. Finally, marketing boards that in theory help to ensure producers an adequate price have often been so inefficient that producers actually receive less than they would if market forces operated freely. Each of these three forms of taxation reduce the producers' share of border price, that is, the price of an exportable crop received when it is shipped out of the country.

Because these taxes reduce farm incomes and discourage agricultural production, one of the main goals of reform has been to lighten this heavy burden. How effective have these reforms been (Transparency 10)? To discover this, the authors compared percentage change in the producers' share of the border price; thus an increase in the producer's share means a decrease in taxation. By this measure, about two-thirds of the countries taxed their farmers less -- while the remainder taxed their farmers more.

These reforms paid off (Transparency 11). Agricultural value added increased by 2 percent in the countries that reduced taxation substantially, and decreased by 1.6 percentage points in the countries that increased overall taxation of export crop farmers.

Trade Reform Has Far to Go

In discussing trade reform, the study grouped countries according to four phases (Transparency 12), ranging from Phase IV, a state of severe macro-economic disequilibrium in which there are overlapping controls on foreign exchange and on imports to Phase I, a situation of virtual free trade.

The study found that virtually all the flexible exchange rate countries started in Phase IV. Most have substantially reduced foreign exchange rationing and import controls that were imposed to deal with serious balance of payments crises. For example, open general license schemes have gradually expanded the range of goods that could be freely imported. But most of these countries still maintain quantitative restrictions designed to protect certain industries and still have relatively high tariff rates. Only Ghana was assessed as being solidly in Phase II, relying on a moderate to low level of tariff based protection.

The situation is different for the fixed exchange rate countries, the members of the CFA franc zone: they began in Phase III, not in Phase IV, since they never resorted to foreign exchange rationing. Despite the recent devaluation, most are still in Phase III, with some important restrictions on imports and fairly high level of tariffs, though some countries have reduced the number of quantitative restrictions and reduced their tariff levels.

The conclusion of this section is that trade liberalizations has involved a reduction in the import controls driven by short-run balance of payments problems. Trade reform is now only
beginning to make inroads into the longer-term protectionist-oriented import restrictions and to bring
down tariff rates to low levels. And countries have not had much success in implementing some form
of duty-drawback scheme to protect their exporters.

More Rapid Divestiture Needed in Public Enterprise Reform

Much effort has been expended on public enterprise reform. The results are difficult to assess,
but the available data suggest there is a great need for more accelerated divestiture (Transparency 13).

The data show about 20 percent of public enterprises have been privatized or liquidated. But
this figure overstates the importance of divestitures, since governments often sell only part of their
assets and many of the enterprises they do sell are small. There is little evidence in any country of a
major reduction in the value of government asset holding. Over half the countries have not undertaken
significant divestiture activities.

Audits of public enterprises are very spotty. It is difficult to tell whether there has been
progress in establishing a hard budget constraint and in reducing subsidies to public enterprises. While
explicit budgetary subsidies or transfers from government to the public enterprises may have declined,
there are all sorts of ways of implicitly subsidizing public enterprises: nonpayment of taxes by the
enterprises, non reimbursement of counterpart funds, "loans" from the banking sector, etc. In
Burundi, it was estimated that implicit and explicit subsidies from the government budget on a gross
basis amounted to 25 percent of total expenditure in 1989, or one and a half times the education
budget. In Ghana, preliminary data suggest that subsidies also represent a large share of the
government budget.

Performance contracts have not met with resounding success. Efforts to put parastatals on a
commercial footing under public sector management are not a widespread success. More promising
are efforts at non-asset divestiture for the public utilities being tried in several countries, such as Cote
d'Ivoire and Guinea.

Many parastatals monopolies have been eliminated. But the remaining ones can be costly. There is
heavy parastatal involvement in the procurement and distribution of petroleum products. A rational
system of petroleum product procurement and distribution could save about US$1.4 billion per year,
more than the World Bank's annual disbursements of policy adjustment loans in Sub Saharan Africa.

More Fundamental Reform Needed in the Financial Sector

Africa has a lower level of financial development than other regions, and financial systems
have grown little in real terms over the last decade due to negative real interest rates, political
interference in the banking system, and the resulting a lack of public confidence in the banking system.
While some progress has been made, the report says that restructuring and recapitalization efforts
cannot have a lasting impact without more fundamental reform. The progress can be seen in two areas
(Transparency 14). First, many countries that had unacceptably high negative real interest rates have
brought interest rates into an acceptable range. They have done this by moving to more market-
determined systems of setting interest rates and by bringing down inflation. However, some countries
still have unacceptably high negative rates, while others have unacceptably high positive rates. Second,
many countries have improved the regulatory framework and some problem development banks have
been liquidated. There has been progress in privatizing a number of banks and in increasing competition where there was none.

Still, because these changes have yet to result in a fundamentally sounder banking system, the report suggests that current restructuring and recapitalization of banks cannot be sustained. Transfer of bad loans from commercial or development banks to the central bank or the government will not resolve the problems without major changes in bank ownership, a reduction in the extent of political interference in lending decisions, and overall improvement in health of the public enterprise sector.

Adjustment Has Not Worsened Poverty

The study found insufficient data on poverty and environmental conditions in Africa to permit rigorous cross-country analysis. The authors therefore, draw on research on poverty in other regions, and on available information from Africa, to show that economic reform generally helps the poor, while the failure to reform and the resulting declines in growth result in increased poverty.

For example, when Cote d'Ivoire abandoned its adjustment program in the second half of the 1980s, the economy tumbled. As a result, the incidence of poverty increased by more than 50 percent between 1985 and 1988. The increase in poverty was not a result of redistribution of income from the poor to the rich, but a drop in income that affected all sectors and income groups.

Outside of Africa, countries that have been most successful in attacking poverty have encouraged development that makes efficient use of the poor's labour -- primarily agricultural development and labor-intensive exports -- while at the same time investing to improve human capital. Many reforms increase the returns to the labor of the rural poor, who vastly outnumber the urban poor in Africa.

Reducing taxation of export crops benefits the poor growing those crops or selling their labor to other export crop farmers. Reforms such as fertilizer liberalization, or the elimination of consumer food subsidies did little to hurt the poor, because they weren't benefitting very much in the pre-adjustment period. These reforms may have helped them to the extent that the reforms enabled the poor to get access to fertilizer hitherto unavailable and increased low producer food crop prices. But some poor households that were net purchasers of subsidized foods may have been hurt. There is, however, little evidence of widespread substantial increases in real food prices compared to parallel market prices. And in some cases such as Tanzania, real food producers on the open market have decreased as supplies have increased. Public sector retrenchments have moved some from the non-poor into the poor category, but survey evidence shows that many of those who were retrenched have been able to find other sources of income, albeit with some hardship.

As for public expenditure in the social sectors, contrary to popular perceptions, strong adjustment programs have not been associated with an appreciable decline in social expenditures (Transparency 15). The data, which are limited, suggest that in countries that made improvements in macroeconomic policies, health and education expenditures of a share of GDP have reminded roughly constant. In contrast in the group of countries in which macroeconomic policies declined, there was a noticeable decrease in spending.
Thus, strong adjustment programs have not meant large cuts in social spending. But there is no room for complacency, because improving the access of the poor to basic education and health services is an important element of any poverty reduction strategy. Major misallocations within the health and education sectors remain. For example, the study found that African countries spend about 20 percent of their education budget on universities, compared to half that in Korea, Thailand or Indonesia.

African literacy and school enrollment remain low, while child mortality is high. Policy reform is part of the answer, but investment in human capital and improved institutions are also essential.

The Road Ahead

The report's findings have several implications for the next stage in economic reform. First, in areas where reform is essentially on track, further efforts are nonetheless needed. Getting the macro-economic policy fundamentals right is essential for accelerating growth, encouraging investment and raising savings rates, keeping budget deficits and inflation low, and increasing public sector savings.

For agriculture, countries should further liberalize marketing systems and restructure marketing boards to reduce the taxation of farmers. They should also ensure that the regulatory framework is conducive to private sector marketing activity.

For trade policy, the next steps are to eliminate administrative controls over foreign exchange, to replace nontariff barriers with tariffs, and to give more emphasis to supporting exporters. Achieving a low uniform tariff is a long-term objective.

Second, for the sectors where there has been even less progress, the study suggests some mid-course policy corrections. These include:

For the public enterprises: Continuing on the same path of rehabilitating the major enterprises or the strategic enterprises as they are sometimes called -- the public utilities, agricultural and transportation parastatals -- does not appear to have high payoffs. There is little evidence that this strategy has reduced the drain on the budget or the banking system or improved the quality of vital services. More emphasis on privatization, including non-asset divesture for the natural monopolies, is called for. These reforms are essential for maintaining macro-economic stability, improving the health of the financial system, improving the climate for the private sector, and increasing the resources that can be spent on providing basic services to the poor.

For the financial sector: Recapitalizing banks when their major clients have not been restructured -- and when banks do not have strong incentives to avoid the accumulation of new bad loans -- will most likely create new portfolio problems, adding to the budget deficit and reducing the incentives for financial discipline. Downsizing publicly owned banks, privatizing them where possible, encouraging new entrants, and improving the financial infrastructure are more promising avenues to follow.
Improving public sector management capacity is critical. The state has important functions to fulfill — such as providing a sound macro-economic framework and ensuring widespread provision of social services — but in many cases its capacity to fulfill those functions is limited. Policy reforms per se can only accomplish so much; capacity building is a major long-term development challenge. But adjustment programs can help to improve the quality of public expenditure, thus providing an essential element in a poverty alleviation strategy.

Adjustment Is Necessary, But Not Sufficient

The report recognizes that adjustment is not a substitute for strong public investment programs, capacity building, and improvements in governance. But where there are substantial distortions that contribute to inefficient resource allocation and inhibit the development of markets, adjustment is a necessary— but not sufficient— first step. Adjustment is neither finished, nor has it failed. It is not time to abandon adjustment efforts. What the report shows is that adjustment has not failed, but some countries have failed to adjust. Where there has been progress on improving the policy framework, growth has been renewed. Adjustment can work in Africa— and it does work in Africa— but it does not and should not be expected to work miracles.
REGARDING POLICIES:

♦ Policies have improved in some countries during adjustment

♦ But progress has been uneven and in some countries, policies are worse

♦ No country has reached the policy frontier

REGARDING OUTCOMES:

♦ Countries that improved policies enjoyed a turnaround in growth

♦ But GDP per capita growth is still low
Transparency : 2

GDP PER Capita

Constant 1987 dollars

1,000

840

820

800

500

520

580

360

320

200


Adjustment period

Thirty-five other developing countries

Sub-Saharan Africa

East Asia and the Pacific

African economies stagnated while others improved steadily.

Source: World Bank data.

Transparency : 3

Barter Terms of Trade

Index: 1970-73 = 100

140

130

120

110

100

90

80

70

60

50

40


Adjustment period

Sub-Saharan Africa

Sub-Saharan Africa excluding Nigeria

Twenty-four other developing countries

Setting aside Nigeria, Africa's terms-of-trade losses resembled those in other developing countries.

Note: Data are means weighted by 1980 GDP in U.S. dollars.
Source: World Bank data.
Change in Macroeconomic Policies, 1981-86 to 1987-91

Ghana
Tanzania
The Gambia
Burkina Faso
Nigeria
Zimbabwe

Madagascar
Malawi
Burundi
Kenya
Mali
Mauritania
Senegal
Niger
Uganda

Benin
Central African Republic
Rwanda
Sierra Leone
Togo
Zambia
Mozambique
Congo
Côte d'Ivoire
Cameroon
Gabon

Large Improvement

Small Improvement

Deterioration

Index scores

Note: Chad, Guinea, and Guinea-Bissau are excluded because of insufficient data.

Change in GDP per Capita Growth

Change in Real Export Growth

Change in Industrial Growth

Change in Agricultural Growth

Note: See source tables for a listing of countries in each group.


Policy reforms paid off in higher growth rates in income, exports, industry, and agriculture.
More than half of the countries improved their macroeconomic policies.

Countries Ranked by Overall Macroeconomic Policy Stance, 1990-91.

<table>
<thead>
<tr>
<th>Adequate</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Ghana</td>
<td>****</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Fair</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>2 Burundi</td>
<td>***</td>
</tr>
<tr>
<td>3 The Gambia</td>
<td>***</td>
</tr>
<tr>
<td>4 Madagascar</td>
<td>***</td>
</tr>
<tr>
<td>5 Malawi</td>
<td>***</td>
</tr>
<tr>
<td>6 Burkina Faso</td>
<td>***</td>
</tr>
<tr>
<td>7 Kenya</td>
<td>***</td>
</tr>
<tr>
<td>8 Gabon</td>
<td>***</td>
</tr>
<tr>
<td>9 Mauritania</td>
<td>***</td>
</tr>
<tr>
<td>10 Nigeria</td>
<td>***</td>
</tr>
<tr>
<td>11 Senegal</td>
<td>***</td>
</tr>
<tr>
<td>12 Togo</td>
<td>***</td>
</tr>
<tr>
<td>13 Mali</td>
<td>***</td>
</tr>
<tr>
<td>14 Uganda</td>
<td>***</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Poor</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>15 Central African Republic</td>
<td>**</td>
</tr>
<tr>
<td>16 Niger</td>
<td>**</td>
</tr>
<tr>
<td>17 Benin</td>
<td>**</td>
</tr>
<tr>
<td>18 Rwanda</td>
<td>**</td>
</tr>
<tr>
<td>19 Tanzania</td>
<td>**</td>
</tr>
<tr>
<td>20 Zimbabwe</td>
<td>**</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Very poor</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>21 Côte d’Ivoire</td>
<td>*</td>
</tr>
<tr>
<td>22 Cameroon</td>
<td>*</td>
</tr>
<tr>
<td>23 Congo</td>
<td>*</td>
</tr>
<tr>
<td>24 Mozambique</td>
<td>*</td>
</tr>
<tr>
<td>25 Sierra Leone</td>
<td>*</td>
</tr>
<tr>
<td>26 Zambia</td>
<td>*</td>
</tr>
</tbody>
</table>

Note: Countries are ranked by the overall scores reported in appendix table B.5, which reflect their fiscal, monetary, and exchange rate policy stances. Chad, Guinea, and Guinea-Bissau are excluded because of insufficient data.

Government Intervention in Selected Sectors

<table>
<thead>
<tr>
<th>Country</th>
<th>Before reforms</th>
<th>Late 1992</th>
</tr>
</thead>
<tbody>
<tr>
<td>Benin</td>
<td>●</td>
<td>○</td>
</tr>
<tr>
<td>Burkina Faso</td>
<td>●</td>
<td>○</td>
</tr>
<tr>
<td>Burundi</td>
<td>●</td>
<td>○</td>
</tr>
<tr>
<td>Cameroon</td>
<td>●</td>
<td>○</td>
</tr>
<tr>
<td>Central African Republic</td>
<td>●</td>
<td>○</td>
</tr>
<tr>
<td>Chad</td>
<td>○</td>
<td>○</td>
</tr>
<tr>
<td>Congo</td>
<td>●</td>
<td>○</td>
</tr>
<tr>
<td>Côte d’Ivoire</td>
<td>●</td>
<td>○</td>
</tr>
<tr>
<td>Gabon</td>
<td>●</td>
<td>○</td>
</tr>
<tr>
<td>The Gambia</td>
<td>●</td>
<td>○</td>
</tr>
<tr>
<td>Ghana</td>
<td>●</td>
<td>○</td>
</tr>
<tr>
<td>Guinea</td>
<td>●</td>
<td>○</td>
</tr>
<tr>
<td>Guinea-Bissau</td>
<td>●</td>
<td>○</td>
</tr>
<tr>
<td>Kenya</td>
<td>●</td>
<td>○</td>
</tr>
<tr>
<td>Madagascar</td>
<td>●</td>
<td>○</td>
</tr>
<tr>
<td>Malawi</td>
<td>●</td>
<td>○</td>
</tr>
<tr>
<td>Mali</td>
<td>●</td>
<td>○</td>
</tr>
<tr>
<td>Mauritania</td>
<td>●</td>
<td>○</td>
</tr>
<tr>
<td>Mozambique</td>
<td>●</td>
<td>○</td>
</tr>
<tr>
<td>Niger</td>
<td>●</td>
<td>○</td>
</tr>
<tr>
<td>Nigeria</td>
<td>●</td>
<td>○</td>
</tr>
<tr>
<td>Rwanda</td>
<td>○</td>
<td>●</td>
</tr>
<tr>
<td>Senegal</td>
<td>●</td>
<td>○</td>
</tr>
<tr>
<td>Sierra Leone</td>
<td>●</td>
<td>○</td>
</tr>
<tr>
<td>Tanzania</td>
<td>●</td>
<td>○</td>
</tr>
<tr>
<td>Togo</td>
<td>●</td>
<td>○</td>
</tr>
<tr>
<td>Uganda</td>
<td>○</td>
<td>●</td>
</tr>
<tr>
<td>Zambia</td>
<td>●</td>
<td>○</td>
</tr>
<tr>
<td>Zimbabwe</td>
<td>●</td>
<td>○</td>
</tr>
</tbody>
</table>

○ Heavy intervention (government control over producer prices of agricultural exports, private sector competition restricted in key sectors, and fairly extensive price controls).
● Medium intervention (some government involvement in producer price setting, government monopolies in one or more key sectors, and some price controls).
○ Little intervention (no government involvement in producer price setting, private sector competition allowed in key sectors, and liberalized pricing of all goods other than petroleum products).

Note: Sectors include petroleum importing and wholesale supply, retail distribution of refined petroleum products, fertilizer importing and/or distribution, wheat and/or rice importing, and domestic food-crop marketing.

Sources: Appendix tables A.12 and A.13.

Countries with better policy stances had faster GDP per capita growth.

Policy Stance and Median GDP per Capita Growth in Adjusting African Countries

Macroeconomic Policies and Growth

Market Intervention Policies and Growth

Note: See source tables for a listing of countries in each group.


<table>
<thead>
<tr>
<th>Good or adequate</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>None</td>
<td>****</td>
</tr>
<tr>
<td>Fair</td>
<td></td>
</tr>
<tr>
<td>Niger</td>
<td>***</td>
</tr>
<tr>
<td>Poor</td>
<td></td>
</tr>
<tr>
<td>Benin</td>
<td>**</td>
</tr>
<tr>
<td>Burkina Faso</td>
<td>**</td>
</tr>
<tr>
<td>Central African Rep.</td>
<td>**</td>
</tr>
<tr>
<td>Gabon</td>
<td>**</td>
</tr>
<tr>
<td>Mali</td>
<td>**</td>
</tr>
<tr>
<td>Togo</td>
<td>**</td>
</tr>
<tr>
<td>Very poor</td>
<td></td>
</tr>
<tr>
<td>Cameroon</td>
<td>*</td>
</tr>
<tr>
<td>Congo</td>
<td>*</td>
</tr>
<tr>
<td>Côte d’Ivoire</td>
<td>*</td>
</tr>
<tr>
<td>Senegal</td>
<td>*</td>
</tr>
</tbody>
</table>

*Note:* A “good or adequate” rating indicates a depreciation in the real effective exchange rate of more than 40 percent between 1980 and 1990-91 (non-African countries averaged 60 percent). A “fair” rating indicates a depreciation of 21-40 percent; “poor,” a depreciation of 6-20 percent; and “very poor,” a depreciation of 0-5 percent or an appreciation. Chad is excluded because of insufficient data.

Change in Overall Taxation of the Agricultural Sector, 1981–83 to 1989–91

Note: Mauritania was excluded because it has no major export crops.

a. See appendix C for further discussion of the real protection coefficient as a measure of overall taxation.

Changes in Agricultural Taxation and Agricultural Growth.

<table>
<thead>
<tr>
<th>Country</th>
<th>Change in the real protection coefficient, 1981-83 to 1989-91 (percent)</th>
<th>Difference in average annual agricultural growth rate between 1981-83 and 1987-91 (percentage points)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Large decrease in overall taxation of export crop producers</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ghana</td>
<td>341.0</td>
<td>2.2</td>
</tr>
<tr>
<td>Guinea</td>
<td>325.8</td>
<td>-</td>
</tr>
<tr>
<td>Madagascar</td>
<td>117.1</td>
<td>0.9</td>
</tr>
<tr>
<td>Malawi</td>
<td>78.3</td>
<td>2.3</td>
</tr>
<tr>
<td>Uganda</td>
<td>33.9</td>
<td>6.4</td>
</tr>
<tr>
<td>Central African Republic</td>
<td>31.5</td>
<td>-2.9</td>
</tr>
<tr>
<td>Tanzania</td>
<td>30.6</td>
<td>1.9</td>
</tr>
<tr>
<td>Mean</td>
<td>136.9</td>
<td>1.8</td>
</tr>
<tr>
<td>Median</td>
<td>78.3</td>
<td>2.0</td>
</tr>
<tr>
<td>Small decrease in overall taxation</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Burkina Faso</td>
<td>17.9</td>
<td>-2.3</td>
</tr>
<tr>
<td>Rwanda</td>
<td>15.2</td>
<td>-0.1</td>
</tr>
<tr>
<td>Burundi</td>
<td>15.0</td>
<td>-1.6</td>
</tr>
<tr>
<td>Togo</td>
<td>10.9</td>
<td>-1.8</td>
</tr>
<tr>
<td>Gabon</td>
<td>10.7</td>
<td>1.5</td>
</tr>
<tr>
<td>Mali</td>
<td>9.4</td>
<td>2.5</td>
</tr>
<tr>
<td>Kenya</td>
<td>8.9</td>
<td>-0.3</td>
</tr>
<tr>
<td>Congo</td>
<td>4.5</td>
<td>1.9</td>
</tr>
<tr>
<td>Nigeria</td>
<td>1.3</td>
<td>2.7</td>
</tr>
<tr>
<td>Niger</td>
<td>1.1</td>
<td>-</td>
</tr>
<tr>
<td>Mean</td>
<td>9.5</td>
<td>0.3</td>
</tr>
<tr>
<td>Median</td>
<td>10.0</td>
<td>-0.1</td>
</tr>
<tr>
<td>Increase in overall taxation</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mozambique</td>
<td>-2.0</td>
<td>5.2</td>
</tr>
<tr>
<td>Zimbabwe</td>
<td>-3.1</td>
<td>-4.7</td>
</tr>
<tr>
<td>The Gambia</td>
<td>-10.3</td>
<td>-10.0</td>
</tr>
<tr>
<td>Côte d'Ivoire</td>
<td>-23.2</td>
<td>8.2</td>
</tr>
<tr>
<td>Chad</td>
<td>-27.4</td>
<td>6.9</td>
</tr>
<tr>
<td>Benin</td>
<td>-27.6</td>
<td>-0.1</td>
</tr>
<tr>
<td>Senegal</td>
<td>-28.3</td>
<td>-2.2</td>
</tr>
<tr>
<td>Sierra Leone</td>
<td>-33.4</td>
<td>1.4</td>
</tr>
<tr>
<td>Cameroon</td>
<td>-34.7</td>
<td>-4.7</td>
</tr>
<tr>
<td>Guinea-Bissau</td>
<td>-70.3</td>
<td>-5.0</td>
</tr>
<tr>
<td>Zambia</td>
<td>-76.0</td>
<td>-1.6</td>
</tr>
<tr>
<td>Mean</td>
<td>-30.6</td>
<td>-0.6</td>
</tr>
<tr>
<td>Median</td>
<td>-27.6</td>
<td>-1.6</td>
</tr>
</tbody>
</table>

Note: Mauritania is excluded because it has no major export crops.

1. An increase in the real protection coefficient constitutes a decrease in agricultural taxation.

Evolution of Trade Policy in Selected Countries during the Adjustment Period.

Despite much progress, many countries have not firmly committed to low or moderate tariffs.

Source: World Bank staff.
PUBLIC ENTERPRISE REFORM

♦ SUBSIDIES REMAIN HIGH

♦ 20% OF ENTERPRISES DIVESTED, BUT GOVERNMENT OWNERSHIP STILL HIGH

♦ SUCCESS OF REHABILITATION NOT CLEAR; NON-ASSET DIVESTITURE MORE PROMISING

♦ PROGRESS ON REDUCING MONOPOLIES, BUT MONOPOLIES STILL COSTLY

FINANCIAL SECTOR REFORM

♦ PROGRESS ON INTEREST RATE REFORM

♦ GREATER PRIVATE SECTOR OWNERSHIP IN BANKING SECTOR

♦ LONG-TERM SUSTAINABILITY OF RESTRUCTURING/ RECAPITALIZATION IN DOUBT
Public Expenditures - Health

(percentage of GDP)

- Deterioration in macroeconomic policies
- Large & small improvement in macroeconomic policies

Public Expenditures - Education

(percentage of GDP)

- Deterioration in macroeconomic policies
- Large & small improvement in macroeconomic policies

Public Expenditures - Health & Education

(percentage of GDP)

Source: World Bank Staff
FOR THE ROAD AHEAD:

▲ STAY THE COURSE ON:

- MACROECONOMICS
- AGRICULTURE
- TRADE POLICY

▲ MID-COURSE CORRECTION IN:

- PUBLIC ENTERPRISE REFORM
- FINANCIAL SECTOR REFORM
- PUBLIC SECTOR MANAGEMENT

▲ MORE NEEDS TO BE DONE ON:

- EXTERNAL DEBT
I will divide my presentation in four parts. First of all, I will pick up just for a moment where Christine Jones had left off. One of the questions that came up from a Malawian delegate asking "why this message remains the same and why nothing different is happening". Second, and this will be the core of my remarks, I will supplement the presentation made this morning by sharing the results of seven case studies. Third, I will briefly speculate on the prospects of the sustainability of these programs. Finally, I will share my concerns about adjustment in Africa.

On the first point, I would like to show you how complex and difficult is this whole strategy of poverty reduction that the Bank is trying to pursue, and how the policy reforms, which we are discussing, are only one small component of this entire strategy. In the first chart (Transparency 1), which is called "The Conceptual Design of Poverty Reduction Strategy", you can see that there are three parts. The first one is economic growth, the second is targeted interventions, and the third is transfers to vulnerable groups. These three things together lead to poverty reduction. Under economic growth, there are four different elements which impinge upon the rate of growth itself. One is external environment, which is debt, commodity prices and the world growth. The other is the institutional capacity, which is civil service and administrative capacity, political stability and the governance. The third one is the accumulation of human resources, capital, transfer of technology and infrastructure; and only then do the policy reforms come in, which is the subject we are discussing today.

My submission to you is that we should not have very high expectations just from one of these four components that contributes to growth. Policy reforms are necessary for economic growth, but they are not sufficient. Economic growth is necessary for poverty reduction, but it is not sufficient. So, unless you have policy reforms with a favorable external environment, institutional capacity, investment in human resources, physical infrastructure and technology, you will not have economic growth; even if there is economic growth, that in itself will not lead to poverty reduction. In addition to economic growth you need targeted interventions, which are labor intensive employment, food security and credit, and access to services like primary education, basic health services, safe water and nutrition. And even the combination of economic growth and targeted interventions will leave some vulnerable groups outside the poverty reduction strategy; and there you need transfers to vulnerable groups like the pensioners, the handicapped people, the landless labor and the people who do not have assets.

I just wanted to influence the discussion this morning by providing this framework in which we should start thinking. Do not expect that, just because we have done all what is required in the area of policy reforms, we will have, all of sudden, a spurt in economic growth. I think that it is a fallacious argument that just by doing this subset of policy reforms you should be able to see reduction in poverty, or have rapid economic growth. That is not what is happening, and is unlikely to happen. You need the complementarity of all these factors, moving in the same direction, before rapid economic growth is achieved, and that, in itself, is not a sure shot for poverty reduction, unless you also make the targeted interventions and make transfers to the vulnerable groups. Let me respond to the Governor from Mozambique. What we see in Asia is not so much a lack of an external influence—I
mean the World Bank has been doing the structural adjustment in Thailand and Indonesia and most of the Asian countries—or much of a cultural effect, but it is the effect of the head start they had in some of the elements that contribute to rapid growth, whereas Africa, as you said, is 20 years behind. Unless you make progress on those fronts—human capital, strong institutional capacity, strong leadership—Africa will continue to lag behind Asia. So, I just wanted to set this framework in order to have more focused discussions during the next two days, and to suggest that we are looking this morning at only one subset, i.e., the policy reforms which are part of a much larger mosaic.

Now, I do not want to repeat what Miguel and Christine presented this morning. We did seven case studies of African countries undertaking adjustment. Unfortunately, we did not include one of the cases on Southern Africa for various reasons, but we took into account many factors in selecting these countries, i.e., whether they have a socialistic, Marxian or capitalistic economy; heritage; the initial conditions in these countries, i.e., whether they were severely indebted or moderately indebted or whether they were all primary commodity exporters or diversified exporters. There were a whole set of criteria and we, therefore, selected seven countries—Nigeria, Ghana, Ivory Coast and Senegal in the West; Burundi, Kenya and Tanzania in the East. And this morning, I would like to share with you the results of the following five questions which aim at supplementing the main study, but also to provide some deeper insights by looking at the initial conditions, the evolution of the external environment as it impacts upon these countries, the capacity of implementing these reforms and evaluating the outcome. The book, which is already available to you, goes into each one of them, both the design and outcome, and what I want to do is concentrate on the following five questions:

a) What was the result as far as the economic indicators were concerned?

b) How fast, or how adequate, was the supply response?

c) What was the behavior of investment and domestic savings?

d) What role external resource flows played in getting economic growth going in these countries?

e) Finally, what was the impact of adjustment on poverty reduction?

I think these are the five questions which are on everybody's mind, and I would like to go through each one of them.

Results of Adjustment

Growth Performance:

The second transparency (Transparency 2) looks at the real GDP growth, and here the periods are very carefully chosen. I have already circulated to you the table which gives the pre-reform period and the reform period, and these are not the same reform periods as Miguel and Christine have, because what we have decided to do in the case studies is to specify the exact period in which the reforms were taking place, and not to take a single, uniform period. When you do cross-section analysis, you have to impose a uniform, standard demarcation, but, in this case study, we have the luxury of doing this in a more eclectic way. If you look at real GDP growth before reforms and after reforms, you will find that, except for Cote d'Ivoire, Burundi and Senegal, the other four countries,
Ghana, Kenya, Nigeria and Tanzania show resumption of growth—4 to 5% per annum. These are not changes but the real growth rate during the period after reforms. The reason why Cote d'Ivoire and Senegal have not been able to have such high rates of growth is that, if you look back at the record of their macro-economic policies, both of them had inadequate policy reforms, and the exchange rate issue was very much a constraining factor. But the four countries, which had really done a great deal in improving the macro-economic policy performance and the exchange rate regime, were able to show positive growth rate after the reforms.

Supply Response:

In the third transparency (Transparency 3), I want to look at what happens to agricultural growth rates; and let me say that there are a lot of problems with the estimates and data on agricultural growth. In these case studies we had to construct a consistent picture because the data on agriculture growth is awful. I have used the agriculture production growth rate from the FAO, the data on agriculture value-added from the National Accounts, the food price data in the main consuming centers, the food imports and the food aid data to construct the picture as far as the supply response in agriculture is concerned. Again, except for the same three countries—Burundi, Cote d'Ivoire and Senegal—you have a faster growth rate in agriculture in the remaining four countries. Now, in Tanzania, the data presented here is inconsistent as far as the FAO production data is concerned. But we have tested this with the other criteria and found that the picture derived in this case study is robust. So, in Ghana, Kenya and Tanzania we have remarkable rates of agriculture growth. I would like to show you, from my own experience in Nigeria, that this country of 100 million people, used to import food worth about US$2 or 2.5 billion every year before 1986, and from 1986 to 1991 the food imports have actually declined to US$400-500 million. This is a fantastic transfer of resources from the import sector that was primarily dominated by a small group of rent-seekers who collected huge profits, to the domestic agriculture sector that consists of millions of smallholders and contains most of the poor. This has not only made Nigerians self-sufficient as far as the food is concerned but also redistributed incomes from the well-to-do rentier class to a large segment of the poor.

The next slide (Transparency 4) just shows you the agriculture value-added story. If you look at the numbers on agriculture value-added, you find that in all seven countries there is an improvement as far as the agriculture value-added rate is concerned. I just wanted to show you that these rates differ from those of the agriculture production growth rate, but the direction is the same. The point that I want to make is that most of the countries in the case study samples have registered positive growth rates as far as agriculture is concerned.

Food:

The next slide (Transparency 5) is on the food production. One of the criticisms against the adjustment program is that it tries to improve the incentives for export commodities at the expense of food production. And we made great efforts to construct a series in order to find out what was happening to the food production—in per capita terms—that is after taking account of population growth rate which averages 3% for most of the countries. You can see that per capita food production has increased in Nigeria, Senegal, Kenya, Ghana and Cote d'Ivoire in the 1986-91 period. In Tanzania, the food production data from the FAO shows a decline, but if you use the national data, the food production per capita index is also higher. This result is credible because food imports in Tanzania have declined, food aid is much lower today than in the pre-1986 period and the prices of food staples
in Dar-es-Salaam have declined (Transparency 6). Therefore, if you look at the supporting data, you will find that the picture in Tanzania is different from what we have taken from the FAO production data. And I want to stress that this is one of the important findings of this study--there is no conflict between export production and the food production. I will show you now what happened to the food imports. While population has grown at a rate of 3% per year, food imports have declined in almost every country in this sample, except in Cote d'Ivoire. This is the complete story of supply response in so far as agriculture is concerned.

I believe that Africa will not be able to take off unless its agriculture sector takes off. If you look at Malaysia, Indonesia and Thailand, which are more comparable to Africa as they had identical economic structures to begin with, i.e., heavy reliance on the agriculture sector in 1970, they took off because there was a transfer of purchasing power to the majority of the population and that led to the demand for consumer goods, then to domestic industrialization through forward linkages, and then to export industrial growth. So, I think this important linkage between agriculture growth, the domestic purchasing power expansion, and the demand for industrial goods in the country should not be understated.

Exports:

I look at the export growth rates in the next slide (Transparency 7). There has been a large decline in terms of trade for the major commodities of these seven countries during the period of adjustment. Thus, the idea was to look at the export volume growth. In case of Cote d'Ivoire, Ghana, Kenya, Nigeria and Tanzania, there is an increase in export volume. Negative growth rates were recorded in Ghana, Nigeria and Tanzania in the pre-reform period and these have turned significantly positive. In Cote d'Ivoire, there was a slight increase, although the exchange rate has become overvalued since 1986. But the country had a very diversified base, and thus there were relative shifts in the composition of its exports with an overall favorable outcome. Burundi, on the other hand, depends heavily on coffee and, because the world coffee prices declined, the producer prices dropped too. The volume of coffee production therefore declined. Exports have been revived in most of the seven countries, except in Burundi and Senegal, and that, I think, is another factor contributing towards the supply response.

Investment and Savings:

The third question, asked this morning by the Malawi delegate, is: how robust is this growth rate--how much of this growth is underpinned by increased domestic investment and higher domestic savings? I want to share with you this particular chart (Transparency 8) which shows that there has been an increase in investment only in two countries--Ghana and Tanzania--but they started with a very low base. There is also a slight increase in Senegal and Kenya but investment has declined in Nigeria, Cote d'Ivoire and Burundi. It is a source of major concern. I want to emphasize, however, that the efficiency of investment has improved. The 20% investment ratio for the seven countries was generating 1% growth rate in the period before reforms. This ratio is down to 15-16% now but the growth rate for these countries has increased to 5%, mainly due to a more efficient use of existing resources. But this situation is not clearly sustainable, that is just better capacity utilization and improvement in the efficiency of investment are not enough. Again, I would like to emphasize that we
all share the same concern—that new investment is still not taking place, especially private investment in Sub-Saharan Africa.

The next slide (Transparency 9) shows what is happening to the domestic savings. Now, let me warn you that the data on domestic savings is even worse than any other series we have seen, because this is derived as a residual after accounting for all other variables. There are a lot of problems with domestic saving data and you should be aware of it. But you can see that, except in Burundi and Cote d'Ivoire, the domestic savings rates have revived in Ghana, Kenya, Nigeria, Senegal and Tanzania. When people look at the general picture of Africa and say that the domestic savings have declined, they do not make a distinction between the countries which are improving the domestic savings rates and the countries which are either stagnant or have a declining savings rates. If you look at Zaire, Sudan, Liberia, Somalia or Angola, and mix them up with those countries which are doing well, the aggregate domestic savings rates appear to be declining. So, I want to reinforce the point that we have to look at a disaggregated level rather than at Sub-Saharan Africa as a whole. This, however, does not imply that the domestic saving rates are adequate in countries which have shown some improvement. These are still much lower than warranted by the investment and growth requirements and need to be stepped up.

External Transfers:

Finally, I would like to look at the fourth question about the role of external transfers. There are a number of people who are saying that there has been a tremendous inflow of foreign aid to adjusting countries, because the World Bank and IMF want to demonstrate that these episodes of adjustment have been successful. According to them, an increase in external inflows has a multiplier effect through increased imports, which in turn leads to higher growth. We look at the data on net external transfers (Transparency 10). The only odd case where there has been a great increase is Tanzania. Both net external transfers, unadjusted for terms of trade, and after the terms of trade adjustment show positive increase in the case of Tanzania. The most significant case which has been quoted widely is that of Ghana; everybody says Ghana is a successful story because too much money has been poured in it, and, naturally, this will translate into a higher growth rate. If you look at the period between 1989 to 1992, you will see that Ghana suffered severe terms of trade losses and, although the net aid flows were positive, the net aid flows after adjusting for terms of trade losses, have actually turned negative. In other words, Ghana has been using its domestic savings in order to repay part of its debt service and finance its imports. The level of exports in Ghana has actually gone up from 400 million dollars to US$1 billion during this period. Ghana has also been servicing its debt fully since 1983. Ghana has not defaulted or accumulated arrears, which is not the case with many other countries. So, if we take the terms of trade loss into account and the fact that it is servicing its debt fully, the net external transfers to Ghana are actually negative. I have a paper responding to Professor Hellenier in the December 1993 issue of World Development, where I compare Zambia during the period it was not adjusting and Ghana during the period it was adjusting. Zambia, because the copper prices had gone up—and it was servicing its debt—was getting $35/capita of the net external transfers, while Ghana was getting $15/capita in the same period. Zambia had a declining per capita income growth rate while Ghana has a positive 2% growth rate. I, therefore, wanted to take some time to explore this particular issue because there is a popular perception that all what Ghana is doing is taking too much money from the foreigners and then trying to use it for financing imports, hence, a multiplier effect.
Sustainability of the Programs

This is a summary of the work we have done in looking at the five questions. I did not spend time on the poverty alleviation question because there is a whole session tomorrow where we will discuss that issue.

Let me now try to bring the picture which I have sketched above up-to-date in light of the subsequent developments. The picture in Burundi is very unclear and there are serious doubts that adjustment efforts will be sustained in Burundi under tense political conditions. Since the January 1994 devaluation, I would tend to put Cote d'Ivoire in a different category where the prospects of sustainability of reforms have improved tremendously because it had a good track record in the past, relatively good infrastructure and, therefore, the economy is going to rebound. In Ghana, I think we all have serious concerns about private investment, but, at least, the pace of the reform has not slowed down and there has not been any backslide or reversal. In Kenya, things have actually improved since the Adjustment report was done, because the economy has been liberalized further and, if you look at Kenya's macro-economic policy stance, it is pretty good. Let me tell you that this is one country in Africa where the domestic savings rates have been historically in the order of 18-20%, and the dependence on foreign aid has not been as great as in Tanzania, Uganda or Zambia. This is a country which can really take care of itself. Nigeria has all the potential and has, in fact, demonstrated that it is capable of doing much better; it has gone through a period where it was growing at 5%; but the new government has reversed the policy stance, so it is not a sustainable situation at least under the present circumstances. In Senegal, because of the recent devaluation, things are going to improve. Tanzania has been following a pace of its own, and I want to emphasize that point because there is a lot of criticisms among the donors concerning the slow pace of the Tanzanian reforms. But the donors also realize that if the success is to be assured in Tanzania, we have to recognize the ownership and the commitment of the Tanzanians to this particular pace. So, to sum up, Tanzania, Senegal, Kenya, Ghana and Cote d'Ivoire are five out of seven countries where, I believe, the prospects for sustainability look reasonably good if unforeseen exogenous shocks do not create any adversity.

Concerns with Adjustment Programs

In the end, let me just share my concerns about adjustment programs in Africa. I have five concerns. First of all, economic recovery is still fragile and growth rates extremely low to be able to make any dent on poverty reduction. Africa would need 7-8% growth rates to achieve any meaningful reduction in the incidence and depth of poverty, and only Botswana and Mauritius have been able to reach that goal. The rest of the countries are far from that growth path.

Second, the policy credibility and macro-stability are not yet firmly established or have taken firm roots. Political liberalization, which is taking place simultaneously, has further complicated matters and led to slowing down, reversals or slippages in economic reform implementation in several countries. In the long run, political liberalization is going to help.

Third, and related to the credibility issue, is the sluggish response of private sector in even successful adjusting counties to undertake new investment. Unless the level of investment is raised significantly, the gains from adjustment are likely to dissipate.
Fourth, despite the evidence I presented for these seven countries, dependence on official development assistance is relatively high. This dependence circumscribes the autonomy of economic decision making of the African countries and distorts the priorities in public expenditures.

Finally, I am worried that the composition of essential social expenditure and the access to social services by the poor still remains unsatisfactory. Unless African governments reallocate and improve the efficiency of delivery of these services to the poor, there will hardly be any impact on poverty reduction.
Transparency 2:

Real GDP Growth Rate

Source: Africa Adjustment Case Studies.

Transparency 3:

Agricultural Growth Rate

Source: Africa Adjustment Case Studies.
Transparency 4:

Agricultural Value Added (average annual percentage change)

Source: Africa Adjustment Case Studies.

Transparency 5:

Food Production Per Capita (index average 1979-81 = 100)

Source: Africa Adjustment Case Studies.
Transparency 6:

**FOOD IMPORTS (thousand tons, average)**

Source: Africa Adjustment Case Studies.

Transparency 7:

**Export Annual Growth Rate (Volume)**

Source: Africa Adjustment Case Studies.
**Transparency 8:**

Investment/GDP

![Bar Chart]

Source: Africa Adjustment Case Studies.

**Transparency 9:**

Domestic Saving/GDP

![Bar Chart]

Source: Africa Adjustment Case Studies.
Table 1

IMPACT AND SUSTAINABILITY OF REFORMS

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Source: Adjustment in Africa & Case Studies.
Introduction

The reform program envisaged an average economic growth rate of 5% per annum in real terms over a five year period to 1995. Most of this growth was targeted to emanate from the industrial sector, growing by 5.8% per annum, while the agricultural and service sectors were to grow by 3.2%. To achieve these sectoral levels of growth, the economic reform program currently underway has been focusing on the following key areas: investment promotion, monetary and financial sector reform, fiscal reform, trade liberalization and domestic deregulation. At the outset, government recognized that the adjustment program would, in the short term, impose costs on the vulnerable segments of the population. In view of this, government introduced a Social Dimensions Fund which is aimed at partially shielding disadvantaged or vulnerable groups from declines in welfare arising from the restructuring or stabilization measures.

Investment Promotion

The successful implementation of the economic structural adjustment program crucially depends on a sustained increase in investment levels in order to increase the productive capacity of the economy and to create the much needed employment. The drive to stimulate investment entailed institutional changes geared at curtailing the red tape that prospective investors had to contend with previously. In this respect, in 1990, government set up the "one stop" Zimbabwe Investment Centre (ZIC) to expedite the investment sanctioning process. In line with the liberalization of the economy, the procedures and criteria used by the Centre for sanctioning new and expansion projects have been progressively streamlined and simplified. To lure foreign direct investment into the economy, more liberal provisions governing dividend remittances and the repatriation of capital in respect of new investments by foreign-owned companies or joint ventures have been introduced.

Efforts to encourage the inflow of foreign capital into the economy have also witnessed the opening up of the Zimbabwe Stock Exchange in June, 1993 to foreign investors who can now purchase shares in companies listed on the Exchange through an injection of foreign currency. The opening up of the Exchange has already begun to bear fruit as reflected by a significant rise in both the industrial and mining indices from just above 850 points and 180 points at the end of 1992 to 3 771 points and 955 points by the middle of May 1994, respectively. To date, over $300 million in foreign exchange has been injected into the Stock Exchange and indications are that foreign investment on the Stock Exchange will continue to rise.

Government efforts to encourage investment have also centered on the promotion of the small scale sector. This has been in recognition of the fact that, small-scale enterprises maximize possibilities of local participation, employment creation, the development of appropriate low cost technologies and the re-distribution of income. Initiatives to foster the development of the small scale sector have seen the introduction of a number of facilities aimed at providing funds to this sector.
Monetary Policy and Financial Sector Reform

The thrust of monetary policy from late 1989 shifted from direct controls to market based instruments of monetary control. In this regard, direct controls on credit and most interest rates have been removed with the only interest rates currently administered being in respect of the Post Office Savings Bank and the building societies. In place of direct controls, open market operations and the active use of the rediscount window have become the primary instruments for money market intervention to regulate monetary aggregates and interest rates.

A major challenge for monetary policy under the economic reform program has been the unprecedented rise in inflation emanating from the wage and price increases, the removal of subsidies on basic commodities, major exchange rate adjustments and high fiscal deficits largely financed from the banking sector. These factors were exacerbated by the effects of the severe 1992 drought. Reflecting the upsurge in inflationary pressures, the rate of inflation rose from 17% in 1990 to 30% in 1992 and peaked at 50% in August 1993.

Against this background of rising inflation, the active use of monetary policy has been characterized by a restrictive monetary stance which saw nominal interest rates rise to levels of over 40% at the end of 1992 and in the first half of 1993. In an environment where economic reform focused on promoting investment and increased production, the high interest rates, coupled with exchange rate adjustments in 1991, greatly increased the cost of capital for both domestic and foreign investment, negatively affecting returns on capital and forcing the postponement and cancellation of numerous investment projects. The high nominal interest rates also adversely impacted on the operations of long-term lending institutions as investors, attracted by higher rates of return on the short-term money market, switched portfolios to the higher-yielding money market instruments. As a result, the Stock Exchange, the building societies and finance houses experienced reduced inflows of funds to the extent that the societies' suspended mortgage lending activities in the second half of 1992 while activity on the Stock Exchange declined drastically.

To cushion the various sectors of economy against the adverse effects of the high interest rates, government put in place various alleviating measures. These included the introduction of pre- and post-shipment offshore finance facilities for the export sectors to enable them to benefit from lower interest rates ruling on international capital markets and that way enhance their competitiveness on world markets. The alleviating measures also focused on assistance to the small scale sector as well as those starting up with no built up reserves of their own. In this regard, government made available to the small scale sector Z$100 million at concessionary rates in 1992, with the latest facility being the Z$400 million introduced this year, also for the benefit of small-to medium-scale entrepreneurs. Government also assisted the farming community to recover from the drought by providing $400 million at subsidized interest rates which enabled farmers to take advantage of the return of good weather conditions in the 1992/93 season.

The tight monetary policy, however, succeeded in containing inflationary pressures such that by the third quarter of 1993, inflation had come down to around 24%. The weakening inflationary pressures allowed the Reserve Bank to gradually ease monetary policy, beginning in December 1992, by a progressive reduction in its overnight accommodation to banks from 39% to 28.5% by September 1993. The decline in money market rates also enabled funds to flow into long-term lending institutions. This allowed building societies resume mortgage lending in the second half of 1993.
Furthermore, the decline in money market interest rates, coupled with the opening up of the Stock Exchange to foreign investors, resulted in a turnaround on the Exchange with the industrial index rising from levels of below 900 points in January 1993 to the current level of over 3 700 points as at mid-May 1994.

The financial sector is also being deregulated and opened up to both domestic and foreign competition. This has so far witnessed the entrance of a third discount house, a fourth building society and a fifth merchant bank. The legislation governing the operations of financial institutions is being revised to raise the level of competition across previously segmented markets.

Fiscal Reform

Fiscal reforms under the program have been designed to achieve a reduction in the budget deficit from an average of 10% in the 1980s to below 5% of GDP by 1994/95. This reflects the need to release resources to support the trade liberalization program and the aforementioned investment program. Given that the tax ratio at the end of the decade to 1990 was already high at 35% of GDP, the program envisaged the reduction of the budget mainly through the containment in recurrent expenditures coupled with increased cost recovery in order to increase non-tax revenues. At the same time, the reduction in recurrent expenditures was envisaged to be accompanied by a shift in public expenditures towards more capital expenditures and fiscal incentives to support the productive sectors such as the small scale enterprises and the exporting sectors.

To reduce recurrent expenditures, the program envisaged a 25% reduction in the civil service (excluding the education sector) by 26 000 workers from a total figure of approximately 189 000 workers and a reduction in public enterprise deficits. The progress under the civil service reform program has been slow with a reduction of only 11 000 posts through retrenchment and the abolition of vacant posts by the end of 1993. The performance of the major public enterprises has continued to be cause for concern. With the exception of a few parastatals, the majority of parastatals in particular problem parastatals such as the GMB and ZISCO have continued to record huge deficits.

As a result of the lack of progress on the rationalization of the civil service and parastatal reform, government expenditures have remained high. This has therefore meant that progress in addressing the question of the high budget deficit, even taking into account the impact of the drought has been less than hoped for. In the current fiscal year domestic financing has amounted to almost Z$2 billion, which is significantly higher than the budgeted Z$490 million for the whole fiscal year. The impact of this financing not only continues to fuel inflationary pressures and result in interest rates being maintained at relatively high levels, but also results in productive sector crowding-out, thereby further undermining the recovery of domestic economic activity. For the economy to achieve the targeted growth of about 4-5% in 1994, efforts to reduce inflation and hence, interest rates, need to be intensified.

Trade and Exchange Liberalization

The liberalization of trade was initially programmed to operate principally through the progressive expansion of the Open General Import Licensing system, with all items to be imported through OGIL by 1995. Fairly early in the program, however, the emphasis was switched away from an expansion in the OGIL system to expanding the Export Retention entitlements. This was aimed at
liberalizing imports while stimulating export growth. By early 1993 the premium on ERS entitlements had risen to 50% and the entitlements had become tradeable. Further liberalization saw, individuals allowed to open FCAs with effect from June 1993. This was followed by the transformation, on January 1, 1994, of the various foreign exchange allocation schemes which include the export retention entitlement system, direct local market allocations and OGIL into single market based system of foreign currency accounts (FCAs). At the same time, the level of retention was increased to 60% while exporters were allowed to sell their share of foreign exchange at market determined rates. With the introduction of corporate FCAs, all private sector and public enterprises current account transactions, except for a few items on the negative list, were transferred to the interbank market. Central governments imports, fuel and debt service commitments have, however, continued to be funded by the Reserve Bank from its 40% share of the country's export earnings.

Experience with trade liberalization shows that the program has provided impetus to companies to reduce costs and to innovate in order to become more competitive. At the same time, the removal of most restrictions on current account transactions has led the country's foreign exchange reserves to rise to current levels of four months import cover.

The introduction of FCAs led to the emergence of a two-tier foreign exchange rate system comprising the Reserve Bank rate and the interbank exchange rate, which is determined by the demand and supply of foreign exchange. To reduce the gap between the Reserve Bank official rate and the perceived market exchange rate as reflected by the ERS premium and also to enhance export competitiveness, the Zimbabwe dollar was depreciated by 17% with effect from January 1, 1994. To date, the system of two exchange rates has performed well with the gap between the two rates narrowing from 5% during the initial days of trading period to the current level of less than 1%. In fact, at times in recent weeks, the market rate for the Zimbabwe dollar has been stronger than the Reserve Bank rate. The ultimate objective is to unify the two rate in order to achieve full convertibility of the Zimbabwe dollar for current account transactions. Once unification is achieved, the role of the Reserve Bank will be limited to open market operations to ensure stability in the system through the selling and buying of foreign currency. Stability in the system will also, of course, depend on supportive monetary and fiscal policies to create a stable macro-economic environment and balance of payments sustainability.

Domestic Deregulation

Cognizant of the fact that the full benefits of trade liberalization cannot be fully exploited in a highly regulated environment, the liberalization of the economy has been accompanied by various domestic deregulation measures designed to increase domestic competition. Deregulation is also aimed at providing entrepreneurs with the necessary freedom to respond to emerging market opportunities and pressures. Under the program, government moved fast to dismantle controls on prices, with strict controls remaining only on a few compounds of fertilizer and a few commodities controlled on a mark up basis. The decontrolling of prices, however, has not been without its problems. The removal of price controls was done at a time when the level of competition in the economy had not significantly increased and, in the absence of a monopolies commission to monitor the activities of monopoly producers, companies which enjoyed market power increased prices indiscriminately, contributing to the surge in inflation at the beginning of the program.
Domestic deregulation has also seen the abolition of direct intervention in wage setting by government and its replacement with collective bargaining to provide greater flexibility in wage negotiations. Strict labour market regulations pertaining to hiring and firing and retrenchment which, in the past, have undermined the ability of companies to adjust to changing market conditions, have also been dismantled and streamlined. A major objective of the deregulation of the economy has also been to open up various sectors of the economy to competition from the small scale sector.

Social Aspects of Adjustment

In recognition of the fact that there will be transitional negative social effects of adjustment on some vulnerable segments of society - i.e., the poor, the disabled, the unskilled and unemployed - government set up a Social Dimensions Fund to perform a number of functions. These include the training of those temporarily unemployed through retrenchments and to provide financial support for social services such as educational fees, hospital fees, feeding schemes and subsidized mortgage interest rates for the low income groups. In addition, people earning less than Z$400 per month are entitled to free medical services at government clinics and hospitals. The Fund also provides funding for micro-projects, especially for those entrepreneurs who have undergone training under the SDF program and wish to start their own businesses.

Conclusion

The implementation of the economic reform program has brought immense opportunities for the productive sectors to engage in business with the movement to a market based foreign exchange allocation system making it easier for the business community to access foreign exchange for importing vital investment equipment and raw materials. In this regard, business decisions on new investments can now be implemented timeously. At the same time, the decontrol of prices coupled with the opening of the economy to increased competition has forced Zimbabwean industry to adapt production structures and the quality of products to the needs of the consumer. Businesses can now plan ahead on returns they expect to reap by studying market behavior without having to go into time consuming protracted price negotiations with government officials. The opening up of the economy to competition has also forced industry to address quality, marketing and competitive pricing considerations which has also left the consumer a wider range of goods to choose from while the regular shortages of basic consumer items which were prevalent before the program have now been overcome through increased production and supply. The removal of import tax and surtax on capital equipment imports by companies has also effectively reduced costs for industrialists while the progressive reductions to the levels of individual income tax over the last three years have, to some extent, raised disposable incomes. The reduction in the cost of doing business in Zimbabwe is contributing to the recovery of investment in the economy.

While investor response to government's efforts to increase investment has been encouraging, much more investment, however, will have to be undertaken in the productive sectors before employment creation can rise to levels required to seriously address the unemployment problem. In view of this, the need for government to put in place stimulative fiscal investment measures cannot be over-emphasized. In this regard, the major outstanding aspects of reform which continue to pose constraints in a number of sectors have largely pertained to reform of the public enterprises, reduction of government expenditures and some aspects of the regulatory requirements.
Much more still needs to be done to overcome the formidable constraints which the small scale sector continues to face and enable it to take advantage of new opportunities being offered by the improving flow of credit. Lack of title deeds which can be offered as collateral to obtain finance capital is one such major constraint to the development of the small sector. Strict licensing requirements, building codes and restrictive zoning regulations have also impeded small scale enterprise development. These are areas which need to be deregulated if the potential of the small scale enterprises create employment is to be realized.

To the extent that government has not significantly addressed the problems of the small scale sector by deregulating the licensing inhibitions to their operations and, therefore, undermining the full realization of this sector’s potential in employment creation and overall development of the economy, the benefits of the program to the wider community are, therefore, perceived as being limited. The lack of affordable land and factory space still remains a problem. In this connection, the designation and erection of industrial parks and the complementary provision of adequate infrastructure and services such as water, electricity and telecommunications will go a long way towards overcoming the constraints faced by this sector.

High government and parastatal borrowing from the domestic market has contributed to maintaining interest rates at high levels with the result that the competition for domestic resources by the public sector has marginalized the productive sectors. While corporate tax levels have been reduced, the current levels still remain high especially when compared to competing countries in the region. A reduction of government expenditures through rationalization of the civil service and other expenditure restraints as well as limiting expenditure demands to loss-making public enterprises by reforming these institutions speedily, should be addressed as a matter of urgency if the program is to remain on target. Failure to do this would perpetuate the current high inflation and high nominal interest rates.

Although significant progress has been made in the battle against inflation and high interest rates, the transition from a highly regulated to a market based economy has, posed various problems to business enterprises. This is especially so for manufacturing companies which used to depend on protection over the domestic market. Domestic companies are facing increased competition not only over the regional export markets but also over the domestic market as historical import controls are liberalized. The same is true for the previously protected public enterprises, such as the marketing boards, which are facing stiff competition from the private sector. Despite these transitional problems of adjustment, government’s commitment to the overall reform program has remained firm and the period ahead should see an acceleration in those aspects of the program which have lagged behind.

Having said that, however, the question still remains - is the adjustment program achieving the desired results? We have indicated that the key weakness in the reform program has been slower progress in the public sector which has forced monetary policy to play a bigger role than desired. This in turn has kept interest rates high which has impacted negatively on investment, growth and employment. Assuming, however, that progress is made in these areas, what will be the results?

Clearly the jury is still out on the success of the reform program. Investment has started to pick up but still remains relatively weak, export growth remains very slow, growth and employment, while positive, are still low, with growth in 1994 not expected to exceed 4%. My view is, however, that even this performance is vastly better than would have been achieved without the economic
reforms. I am further confident that with further progress on fiscal and parastatal reform, which will bring with it lower inflation and interest rates, investment and growth will strengthen. It will not be easy - the international market place is highly competitive - and it may take longer than expected to achieve, but I believe that these reforms will at the end of the day deliver rising real per capita incomes and rising employment which is really the ultimate objective.
Lessons of Adjustment from Zimbabwe
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Lessons

African economies are driven by exogenous influences that are beyond their control. In the short-run, economic policy can do little more than cushion the blows of adverse exogenous shocks, but in the longer run, policy reform improves economic efficiency resulting in a more broadly-based, diversified, competitive and flexible economy, better able to ride the punches of adverse fortune.

The adjustment report tries to play down the exogenous shocks and bad luck aspects of economic performance, stressing instead the role of policy in driving performance. In my view it goes over the top on this score, the more so when one reads recent OECD research on the extent to which exogenous shocks have influenced industrial economy performance. Let me illustrate my point from a Zimbabwean perspective. This economy is driven by four main factors:

* Climatic conditions
* World commodity prices, especially for tobacco, gold and base minerals (ferrochrome, nickel, asbestos)
* Regional geopolitical and economic factors, and
* Domestic economic policy

Except for the sanctions/war period (1975-1979), there is a very close correlation between rainfall and the rate of economic growth in the subsequent year. Because exogenous shocks loom so large, there is little to be gained in trying to read anything from output numbers of recent economic performance in Zimbabwe.

Whatever the report on adjustment in Africa may say, economic reform in Zimbabwe did not take off until 1991. The subsequent growth performance of the economy has been poor, but this is the result primarily of climatic considerations, exacerbated by regional political and economic uncertainties and depressed commodity prices in global markets. Structural adjustment is not to blame, though clearly, the - as yet unsuccessful - search for macro-economic stability, continues to militate against a stronger growth performance.

Given the numbers, however, its hard to convince the man in the street that reform is working to his advantage. In 1993, GDP per head was at its lowest point for 14 years - lower indeed, than in 1970; unemployment, estimated at around 30%, has doubled in the last decade, and average real wages (outside agriculture) are at a 20-year low. It will take to the turn of the century to regain pre-adjustment living standards. In the meantime, a wage explosion waits in the wings.

Inflation and nominal interest rates remain far too high, while, as a result, the currency is under persistent downward pressure on purchasing power parity considerations. Until macro-economic stability is achieved, ESAP is not going to secure the required supply response in investment, output, jobs and exports.
Sadly macro-economic stability is elusive as ever, which leads into my second lesson - namely that because the supply response is significantly dependent on macro-economic stability, public sector reform must be tackled far more vigorously than hitherto. There is nothing to be gained from delaying public sector reform on the grounds that it is politically unpalatable and difficult to implement. It is public sector performance that lies at the heart of Zimbabwe's macro-economic problems; money supply growth averaged 39% in the first quarter, inflation which fell sharply in the latter half of 1993, is back on an upward track. The public sector deficit, we are told, will remain at double digit levels in 1993/4. The lessons are the obvious and familiar ones:

* structural adjustment does not - cannot - work unless public sector reform is placed at the top of the agenda;

* a loose fiscal and a tight monetary policy is a worst of all worlds situation, giving rise to inflation, a depreciating currency, the specter of a future debt trap problem, and the crowding out of private sector investment both by excessive levels of public sector borrowing and high nominal - and real - interest rates. The central bank is seeking to sterilize monetary growth by the compulsory issue of bills, which has the effect of pushing up interest rates and deterring investment.

All over Africa, public sector reform has inhibited structural adjustment and lesson number two is: don't go slow on public sector reform, as Zimbabwe has done.

A third, related, lesson concerns institutional decay. The best policies are not going to work without the institutional capacity to implement them. The Adjustment in Africa report cites the National Railways of Zimbabwe as a model that might be followed in commercializing African parastatals. Yet in February, the NRZ revealed that 48% of its locomotives were out of service and earlier this month we were again told it cannot move traffic on offer, despite the fact that volumes are running well below the levels of 1990/91. The telecommunications system is a deterrent to investment; the public service is demoralized and demotivated. Senior posts remain unfilled for protracted periods - there has been no Minister of Commerce for four months and so on.

The police, the health system and education all face serious underfunding. One brief, sad, case study brings several of these strands together - the decline in institutional capacity, the impact of under funding and the absence of strategic coherence in government policy.

At a meeting of the University of Zimbabwe Council on Saturday the following four pieces of information were set before us:

(i) The University has been ordered by Cabinet to double its annual intake of medical students from 80 to 160;

(ii) That the University 's budgetary grant from Govt will be cut in 1994/95 by almost a quarter or about Z$100m;

(iii) That the vacancy rate at the institution is now 31% (34% in medicine); and
(iv) That UZ may not increase its fees by more than 20% - so that for the fifth successive year at least, the rate of fee increase will fall substantially behind inflation. This is a classic case of a government making policy decisions that simply cannot be implemented. The most simple and basic requirement of matching needs with resources is ignored.

The fourth lesson is the need for accelerated implementation. Achieving this against the background of the institutional capacity constraints, already identified, is a major problem. The fact remains, however, that this economy has been living with policy uncertainty for as long as anyone can remember. Uncertainties associated with the transition to majority rule in 1980, exacerbated by the repeatedly-trumpeted - and undelivered - promises of socialist transformation that would radically restructure the economy. From the late 1980s, a new uncertainty arose in the form of the promise of a home-grown indigenous reform program, followed in 1991 - not 1987 as the Adjustment Report claims - by a World Bank/IMF style structural reform program. That in turn has been followed by a new commitment to indigenize the economy.

Uncertainty is perpetuated and deepened by uneven implementation. Where for instance is the promised tariff commission, and the threatened monopolies commission? The establishment of such institutions is bound to influence private sector decision-making. Where is the new banking act; where is the Securities and Exchange Commission? What has happened to the frequently promised export processing zones. The delay in establishing these institutions cannot be attributed to the ravages of drought, but is the distressing reflection of a failure to implement identified measures and policies. If the political will is there, the institutional capacity very obviously isn't.

Where too is the government headed on privatization? What is the point in transforming a parastatal into a 100% state-owned private company? It could be that this will turn out to be privatization by stages, but where there are profitable enterprises such as the Dairy Marketing Board, why not privatize immediately? Here again Government is perpetuating uncertainty, sending signals that suggest that its commitment to reform is less than whole-hearted, with adverse ramifications for private sector investment.

A fifth lesson is public service reform. The arbitrary decision to retrench 25% of the civil service - excluding teachers and nurses - is a meaningless exercise. The civil service - and the parastatals - need root-and-branch reform, not just number shedding. It means starting by asking what services do we want and what resources are needed to satisfy them. Then - and only then - can we say how many public servants are needed in each department. Cutting numbers is not the problem. It is a culture problem, an attitude problem - a matter of getting people to understand that they are there to provide a service, not to obscure and obstruct. Its a qualitative issue, not a quantitative one.

A similar comment applies to the parastatals. Much of the so-called commercialization we have seen has been little more than cost-plus pricing run amok. There is precious little evidence of improved service, improved productivity and of reduced government intervention. Board autonomy remains a mirage.

Above all, there is the conflict to which my University of Zimbabwe example bears witness. The World Bank claims that it is possible to maintain - indeed build - institutional capacity, while simultaneously cutting costs, retrenching and (unavoidably) demoralizing staff is unconvincing. The
Bank’s own record both in Washington and here in Harare where the Joint-Venture Africa Capacity Building Foundation is a manifest failure - is evidence enough that the physical must heal himself first.

The next lesson relates to information and indeed disinformation. Reliable economic information is a precious and scarce commodity in Africa; where it can be produced it greases the wheels of private sector investment. The World Bank and IMF have access to more and better information than many in the private sector whose investment response they seek to encourage. Yet sadly, this information is either withheld or positively distorted as part of broader strategy, such as securing donor support or hoodwinking the local electorate. Last year in Zimbabwe, until after midyear the Bank insisted that the economy was growing at 7%. No one in the private sector believed this and yet this disinformation continued to be drummed out to anyone foolish enough to listen.

The actual figure was below 2%. The result was an unnecessary, self-inflicted wound - the Bank shooting itself, and the private sector, in the foot, undermining its credibility in the process. Few in the private sector now take World Bank projections seriously.

Africa’s aid dependence has grown dramatically in recent years. In Zimbabwe our aid dependence ratio boosted of course, by drought relief in 1992 - increased form 5.4% in the 1986/7 to 9.3% in 1991/2. Our external debt/GDP ratio has virtually doubled since the program started. At least 30% of export earnings are siphoned into debt service. As if this were not enough, there is the added drawback that aid dependence intensifies institutional weakness. So long as we believe that there is a donor just waiting to pay for the project or to provide technical assistance to keep the hospitals running or whatever, we will never achieve self reliance and self-sufficiency.

Funding is fungible; donors, including the Bank, cannot provide funding and simultaneously disclaim responsibility for the pattern of public spending. If less aid were available, African governments, including this one, would spend more wisely. That surely is simple economics - the marginal efficiency of investment and all that!

In the specific context of Zimbabwe, ESAP lacks a coherent growth strategy; prior to the 1992 slump, manufacturing accounted for a quarter of GDP. The original ESAP document projects manufacturing growing faster than the rest of the economy, so that Zimbabwe’s manufacturing sector would move towards 28% or even 30% of GDP. This is way out of line in terms of the country’s per capita income and is the kind of level one would find only in a country that either has a huge domestic market, which we don’t, or exports manufactures very substantially, which is also not the case in Zimbabwe. My point is - and the more so after the momentous political changes in South Africa - that manufacturing is unlikely to be the lead sector over the next decade. We lack market size, technology, skills and we are not integrated globally. Our US$4 billion market pales into insignificance alongside South Africa’s US$112 billion. We will find it increasingly difficult to industrialize within her shadow, and growth is much more likely to be led by agriculture, mining and tourism than manufacturing - certainly not the type of manufacturing investment that many in this country believe we can - and should - seek to encourage.

Related to this is the requirement for realism in strategy. It is possible though I believe unlikely, that dozens of African countries can simultaneously enjoy exported-led growth. What is surely inconceivable, is a situation in which dozens of African countries simultaneously increase their market share of the global economy. Take the Zimbabwe example. According to the World Bank’s own
numbers, Zimbabwe's export market grew at 4.1% annually during the 1980s, yet the original ESAP document projects merchandise export growth of almost 9% annually. The Bank's most recent projections I have seen has export growing at over 10% a year, when world trade is forecast to grow at around 6% annually.

Such targets can be achieved only by increasing market share, whereas in the 1980s, the obverse occurred with Zimbabwe's exports growing at 2% so that market share was lost. It's worth remembering that market share is a zero sum game. If African countries are going to gain market share, then whom, I wonder is going to lose?

A further lesson to be taken on board is that even when the supply response is achieved, it is not going to solve Africa's single most important problem - unemployment. In Zimbabwe, investment of some US$800 million in the last two and a half years - to be sure, an inadequate response - has generated less than 35,000 new jobs. With an annual net addition of around 200,000 school-leavers to the labour market, the frightening implication is that the country needs to invest nearly US$5 billion annually - 20% more than its GDP - merely to peg unemployment at its present level of around 30% of the workforce. Clearly, that isn't going to happen, implying a combination of higher levels of unemployment and enhanced reliance on informal sector job generation.

My final lesson concerns time frames. There is just no way that - given institutional decline, not to mention infrastructural decay in most African countries, - that a three- or five-year time horizon for structural reform makes any sense. Building, rebuilding, institutional capacity is going to take decades rather than years. There has to be culture change and that is not achieved in five years. Structural adjustment is going to take far longer than electorates around the continent have been led to believe. As the Nigerian experience illustrates so vividly, - though unfortunately, this is ignored in the Adjustment report - promising results in an impossible short time is bound to backfire politically, which is precisely what has happened in Nigeria. There can be no arbitrarily-determined starting and stopping dates for adjustment - it's an ongoing process and the World Bank, the IMF, the donors and participating governments would do better to come clean and tell electorates the truth.

Conclusion

None of this detracts from the need for adjustment which is inevitable. Structural adjustment is a necessary - but not a sufficient - condition for self-sustaining economic growth. Some of the policies are open to criticism, but for the most part it is implementation that is at fault. This goes back to one central, crucial missing component - namely institutional capacity. Until we get that part right - which is a long-run challenge - structural adjustment is not going to work as well as it could and must - if a horrendous socio-political crisis is to be avoided in Sub-Saharan Africa.
Introduction

Zambia became an independent nation with a copper spoon in her mouth which generated substantial amounts of export revenue. It did not take long before the risk of depending on a single export commodity materialized when copper prices fell in 1975. Since then, annual copper production has also been falling from as high as 750,000 metric tons around 1975 to about 400,000 tons now.

Economic policy since the mid 1980s has aimed at bringing about fundamental structural changes to the economy. Structural adjustment is needed to reduce dependence on copper and to remove deep rooted distortions that have arisen over the years due to past policies. By 1991 when a new government came to power for the first time in almost 30 years, it was perceived that only quick drastic action would reverse the declining economic conditions. The new government therefore introduced harsh measures such as removal of subsidies, general decontrol of prices, decontrolling the exchange rates and interest rates, removal of exchange controls, opening up the domestic markets to imported goods, and tight monetary and fiscal policy.

This paper describes the major elements of the structural reform process so as to provide an update to developments in Zambia. An attempt is also made to outline the consequences of the reform program on the private sector. The conclusion drawn to date is that the policies seem to begin to work especially in respect of price stability. However, these harsh measures have not been without pains.

Background to Structural Adjustment in Zambia

The Main Characteristics of Macro-Economic Instability. The major failure of economic policy in Zambia has been the inability to diversify the export base of the country from copper to other commodities. When copper prices therefore plummeted in 1975, it resulted not only in lower export revenues but also to substantial losses in public revenue and in general output.

The policy responses to this crisis were inadequate. In the face of lower foreign exchange availability, the government borrowed heavily from abroad in the belief that the crisis was temporary. Since Zambia was in the medium income group category then, it borrowed from the multilateral institutions such as the World Bank and the IMF at non-concessionary terms. This is how the country came to find itself as one of the most indebted in the world, owing about $6.3 billion or $741 on per capita basis. This is about 2 times the size of the GDP. Since about half of her debt is to the multilateral institutions whose terms are not renegotiable, Zambia has found itself in a tight corner.

Another inadequate response to the balance of payments problems was in the foreign exchange rate management area. In the 1970s and 1980s, many developing countries did not accept the exchange rate as a potent instrument for balance of payments policy. This was due to the belief that devaluing a
currency merely increased inflation without substantially improving the balance of payments situation. This view was also held in Zambia.

With a fixed exchange rate and rising domestic inflation, it was not long before the currency became overvalued. This, combined with the industrial policy then that encouraged import substituting industries, quickly led to the mushrooming of industries that were capital intensive and dependent on imported raw materials. In turn, this deepened the foreign exchange crisis further. Rationing of foreign exchange was made even harder and probably more subjective as well. Firms complained that they were operating at very low capacity due to limited foreign exchange availability. Others threatened that they would lay off workers.

In the midst of this, economic growth was mostly negligible and when it occurred, it was not sustainable. The black market in both foreign currencies and commodities flourished. This economic environment worked to the benefit of rent seekers rather than producers, thereby intensifying the distortions against production. By 1985, the authorities came to the conclusion that the system had become moribund and that it required drastic action to reform it. This is how the reform program of 1985 to 1987 came into being.
Outline of the Pre-1991 Structural Adjustment Effort

Structural Adjustment between 1985 and 1987. The reform program of 1985 was intended to provide a greater role for market forces in influencing economic decisions. Policy reform in Zambia had begun as early as 1982 when prices of many consumer goods like beef which had hitherto been controlled by the government were freed.

The 1985 reforms which begun in September were more comprehensive. All prices with the sole exception of the staple mealie meal were decontrolled. Interest rates were decontrolled in September and in October, the foreign exchange rate was also decontrolled. Henceforth, a new system of foreign exchange allocation through an auctioning mechanism in which all importers would be free to bid was introduced. The power to allocate foreign exchange was therefore no longer with Bank of Zambia but with the market.

Another important change which came was the opening of the domestic market to foreign goods to compete with local goods. This was a major change for a country whose producers had been protected from external competition for a long time. Other reform measures which were introduced included an attempt to reduce subsidies on consumer items especially the staple maize and a declaration by government to liberalize maize marketing so as to break the parastatal monopoly.

At first, the reform program seemed to proceed well. As had been anticipated, the Kwacha's exchange rate fell at the first auction from about K2.2 to the dollar to K5. This was about the level at which it was trading in the black market. Thereafter, the exchange rate displayed stability for quite some time as did the interest rates. As the program proceeded however, problems arose. The Kwacha's exchange rate began to depreciate more rapidly. The money supply accelerated and inflation followed.

The 1987 to 1988 Growth from Own Resources

By May, 1987, the Kwacha's exchange rate had depreciated to K21 to the dollar before it appreciated back to K15. All the same, the depreciation had already raised heated debate in the country as to whether the auction system for determining the exchange rate was appropriate. For some people, the Kwacha's value would continue to depreciate as long as its value was determined by market forces. This in turn led to continuing inflation.

Since the arguments against continuing the auctioning system won the day in the political circles, the system was finally abolished in May, 1987. The Kwacha was revalued back to K8 per dollar, controls on interest rates were re-established and prices of many commodities deemed to be essential were once again brought under state control. Allocation of foreign exchange was to be done administratively through the Foreign Exchange Management Committee (FEMAC) which comprised members from the Bank of Zambia, Government, the business community and farmers. Preference for allocating foreign exchange was to be given to the productive sectors. As a way of encouraging the use of local materials in manufacturing as opposed to imported ones, firms which were deemed to have the capacity to use some local raw materials but deliberately chose not to were denied foreign exchange.
The government claimed that the new policies were a success. Growth in the first year amounted to 6 percent. Although most of this was accounted for by agriculture following a good rainy season, the manufacturing sector also registered some growth. The setbacks experienced during the program were firstly, the inflation rate remained stubbornly high at 60 percent. The second setback experienced during the program was the re-emergence of the black market after it had disappeared during the 1985 - 1987 program.

A serious problem which the New Economic Recovery Program suffered from was absence of donor support. At the outset, Zambia had as part of its economic measures announced that she would unilaterally reduce to 10 percent the share of her export revenue after payments for critical imports like oil which would be used for debt servicing. This move was not received well by the major creditors which are the multilateral lending institutions and some of the bilateral donor countries. Many of them made it a condition that new aid would only be forthcoming if the outstanding debts were paid. Further, a number of them expressed reservations at the return to controls in economic management. In the course of implementing this restricted debt servicing program, Zambia accumulated a lot of arrears to the multilateral institutions like the International Monetary Fund (IMF) and the World Bank which automatically precluded her from utilizing their soft window lending facilities.

Table 1. Government Budget Deficit, Growth in Money Supply and Inflation Rates

<table>
<thead>
<tr>
<th>YEAR</th>
<th>GOVT BUDGET DEFICIT/GDP</th>
<th>MONEY SUPPLY GROWTH RATES</th>
<th>INFLATION</th>
</tr>
</thead>
<tbody>
<tr>
<td>1985</td>
<td>-7.3</td>
<td>23.5</td>
<td>58.7</td>
</tr>
<tr>
<td>1986</td>
<td>-15.9</td>
<td>93.1</td>
<td>35.2</td>
</tr>
<tr>
<td>1987</td>
<td>-8.9</td>
<td>54.3</td>
<td>48.0</td>
</tr>
<tr>
<td>1988</td>
<td>-8.7</td>
<td>61.6</td>
<td>57.2</td>
</tr>
<tr>
<td>1989</td>
<td>-3.9</td>
<td>65.2</td>
<td>158.0</td>
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<tr>
<td>1990</td>
<td>-6.7</td>
<td>45.5</td>
<td>106.8</td>
</tr>
<tr>
<td>1991</td>
<td>-16.1</td>
<td>95.0</td>
<td>111.1</td>
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<tr>
<td>1992</td>
<td>-3.5</td>
<td>98.0</td>
<td>191.2</td>
</tr>
<tr>
<td>1993</td>
<td>-2.5</td>
<td>107.2</td>
<td>138.3</td>
</tr>
</tbody>
</table>

Source: Government Authorities.

Return to Liberalization: 1988 to 1993

By 1988, the actions of the government seemed to indicate that they were reconsidering increasing the role of market forces in economic management. The exchange rate, although still controlled, was adjusted more frequently for its purchasing power parity. Exporters of non-copper commodities (non-traditional exports) were allowed to retain 50 percent of their export receipts in foreign exchange
which they could utilize for their own imports or to sell to other importers of approved goods at a mutually agreed exchange rate. This helped to make their non-traditional exports more profitable, apart from the convenience the facility provided to them. The prices of most commodities except maize meal were liberalized.

A major area that remained untackled in the period up to the end of 1991 was government subsidies for maize, the staple food for Zambia. For a long time, government provided subsidies on maize production through fertilizers, agricultural credit, and marketing. There was also a huge subsidy on consumption. The intention was to prevent the market price of mealie meal, the final product from maize, from rising to high levels because of the fear of a political backlash from the highly urbanized Zambian society (about 50 percent urbanization). The scheme became increasingly expensive so that by October, 1991, the government was reportedly spending about K25 million per day.

Since the government was unable to raise money from tax to finance its huge expenditures including subsidies, it resorted to heavy borrowing from the central bank, which in turn led to high monetary growth and high inflation. In general terms, one of the key missing links in the previous reform programs which also contributed significantly to their failures was lack of fiscal stringency. In its absence, corrections to the exchange rate quickly reflected themselves in inflation.

Background

Towards the end of October, 1991, Zambia experienced a major political change that saw the defeat at polls of the long reigning government of UNIP by the Movement for Multiparty Democracy (MMD). The new government said their main objective was to resuscitate the economy by liberalizing markets beyond what the former government had done. All prices, including the exchange rates and the interest rates were to be freed. Fiscal rationalization to end the age old problem of government having to print money was to be instituted. In pursuance of this goal, subsidies on maize at both the production and consumption levels were to be eliminated. Government was also to withdraw from commercial activities like maize marketing so as to encourage the private sector to take over.

This section is devoted to a detailed description of the measures that government introduced so as to deal with the deteriorating economic situation.

Fiscal Policy

In its first year in office the government managed to reduce the fiscal deficit from about 16.1 percent of the GDP in the previous year to 3.5 percent. This was achieved, as outlined above, by the massive reduction of agricultural subsidies. Unfortunately, this also happened to be the year when a severe drought engulfed Southern Africa with the consequence that large amounts of maize had to be imported and distributed, some at sub market prices as relief food. Combined with salary awards to civil servants amounting to 150 percent across the board that were not fully funded by new revenue measures, this lead to monetary expansion of nearly 100 percent against the programmed growth of 65 percent with velocity increasing sharply. Inflation for the year amounted to nearly 200 percent.

By the end of 1992, inflation was categorized as the main economic problem the country faced. As long as it remained at that high level, the country would continue to be seen as not being conducive for
long term investment. The government therefore decided to adopt a cash budget whereby expenditures would only be incurred if the revenue came in first. This is the system that has been in operation since the beginning of 1993. The cash budget has operated as follows:

(a) All domestic expenditures on recurrent and capital expenses are met from domestic revenue

(b) External debt servicing is met from donor balance of payments assistance. Under the program, Zambia was usually expected to receive donor assistance in excess of her debt servicing obligations.

(c) In the event that donor assistance fell short of the programmed levels (this has been so for most of the time) then any external debt servicing must come from domestic revenues. This means that domestic expenditures are reduced by the magnitude of debt servicing.

(d) At the beginning of 1993 when the cash budget was introduced, the government had an outstanding domestic debt of K44 billion, almost all in treasury bills. It was decided that if maturing bills were to be charged to ordinary revenues, then little money would remain for other domestic expenditures. The solution that was agreed upon, therefore, was to finance the maturities of treasury bills by sales of fresh ones to the members of the public.

The cash budget has now been in operation for almost 16 months. The major experience of this operation can be summarized as follows. Firstly, shortfalls on external assistance has resulted in the utilization of some domestic revenue for debt servicing. Secondly, the government has to large extent managed to finance its maturing domestic debt obligations by rolling them over.

The financing of the treasury bills maturities through roll overs instead of charging the expenditures to government revenues has had the effect of increasing the outstanding stock of this debt from K44 billion at the beginning of the year to about K130 billion as of May, 1994. While this remains a tolerable 5 percent of GDP, it still represents a potential danger of a severe debt burden for the future. The outstanding stock of treasury bills could in fact have been higher had it not been for the fact that when monetary policy got very tight in June and July 1993, some commercial banks ran down their treasury bills stocks to finance their liquidity needs. There are other implications of the cash budget operation which will be addressed in this paper in the section that assesses the effects of fiscal and monetary policy on the private sector.

Monetary Policy

Monetary policy management since 1993 has aimed at complementing the government's effort to reduce inflation. There are a number of key principles which guide monetary policy. Firstly, the Bank of Zambia ensures that it manages government accounts in such a way that the cash budget principle is adhered to. To this end, government accounts are monitored daily by the Bank of Zambia and the Ministry of Finance.
Secondly, the Bank of Zambia has withdrawn from commercial and semi-commercial activities and it has encouraged its former partners in these arrangements to deal with commercial banks instead. In the past, the bank got involved in activities such as financing crop purchasing, giving credit in Kwacha or foreign exchange to large parastatal utilities and so on. This practice often compromised the central bank’s ability to control primary liquidity and the money supply.

Thirdly, the Bank has started to pay special attention to the liquidity effects of its activities in the foreign exchange markets. By this is meant accumulating foreign exchange at the expense of increasing liquidity in the economy. Given the dominant position of the Zambia Consolidated Copper Mines in the export sector of Zambia, the potential for foreign exchange induced excess liquidity in the country is enormous. Unless there is a corresponding surplus on the budget, accumulation of foreign exchange leads to increased primary liquidity and money supply which can lead to inflation. In the absence of government surplus, the only solution to foreign exchange induced liquidity was to sell it back to the rest of the economy, thereby giving up control over the exchange rate.

As part of the new operating strategy in the foreign exchange market, the central bank ended the old practice of reserving foreign exchange for anyone. Previously, what were considered preferential users of foreign exchange (mainly large utility parastatal companies) were reserved foreign exchange and this meant available foreign exchange could not be sold to anyone else who might have had sufficient local currency cover. Once it became accepted that the main policy objective was to reduce liquidity expansion it became imperative that foreign exchange had to be offered to whoever could pay for it soonest. This works very well at present under a dealing system where commercial banks submit foreign exchange bids or offers to the Bank of Zambia three times per week for dealing. Apart from its desirable monetary policy consequences, this also helped to instill discipline in the companies that required foreign exchange.

At this point, it is useful to reflect on the role of treasury bills in the current practice of monetary policy in Zambia. Many local commentators have said that the Treasury bill tenders have been utilized to siphon out money from the economy. This is not correct. As explained earlier on, the quantity of bills on offer in any week is tailored to meet the need to pay maturing bills the following week. Treasury bills could therefore only siphon money out of the economy if the quantity of bills sold were perpetually in excess of the amount of money required to pay off the maturing bills the following week. Although this has been done, the occasions have been few and were mainly in the early part of 1993 when the money supply accelerated out of control.

In practice, the BOZ has on most occasions aimed at just being able to meet the maturities rather than using the tender to mop out liquidity from the economy. This was done in recognition of the fact that money is expensive. In addition, liquidity influences from the budget and foreign exchange transactions were under control, thereby making it unnecessary to have open market operations using Treasury bills.

Figure 2 shows the withdrawals (below the X axis) and injections (above the X axis) of funds in the economy by Treasury bills from January to December, 1993. Over this period, the picture that emerges is that it was only on a few occasions when the accepted bids exceeded the amounts
required for maturities. On many other occasions, the proceeds from the Treasury bills sales were less than was required to meet maturities. On such occasions ordinary budget revenues or counterpart to donor balance of payments support, when the agreement permitted, had to be used to pay off the maturities. If this was not done, the result would be liquidity expansion in the economy.

The foregoing implies that Bank of Zambia did not really have many instruments for use in monetary policy. It relied on the cash budget to eliminate the possibility of government being a net source of liquidity creation over the year. To the extent that liquidity rose to intolerable levels either because the government was spending its accumulated cash balances at the Bank or because the Bank was accumulating foreign exchange, then the statutory reserve ratio and or the liquidity ratios were utilized to neutralize the effects. The Bank is working towards introducing open market operations so that it can intervene in the markets to control liquidity without resorting to draconian instruments like statutory reserves and liquidity ratios.

Financial Liberalization

Another important ingredient of the current structural adjustment program has been the extensive liberalization of the financial sector. The areas affected are interest rates, exchange rates and foreign exchange. Liberalization has been undertaken because it was felt that it would be additional stimulant to make the economy operate more efficiently. The details of the liberalization now follow.
Interest Rates

According to the government’s Policy Framework Paper of 1992, interest rates were to be freed to enable them to reach positive real levels. This was intended to stimulate savings and discourage unproductive investments. Accordingly, interest rates were liberalized in September 1992. Before then only time deposits at commercial banks were uncontrolled. Savings deposit rates as well as lending rates were all controlled. As a result of the decontrols on interest rates, commercial banks adjusted their rates but not significantly.

Interest rates only begun to respond more significantly when the treasury bills tender started on the 15th of January, 1993. Before then, treasury bills were sold on tap mainly to commercial banks. At that time, the discount rate and hence the yield rate were controlled at the levels of 47 percent and 52.3 percent respectively. By controlling the price, the central bank had to make available whatever quantities of treasury bills the market demanded. The major drawback for this system was that there was no systematic way of controlling the quantity of bills on issue. And commercial banks took advantage of this to buy and rediscount bills to suit their portfolio requirements. This made liquidity management by the central bank difficult.

Under the treasury bill tender system, the quantity of bills sold corresponded with what was required to meet the maturities for the following week. Since the quantity was now set by the authorities, they had to let go off the price or the interest rates. The response of the interest rate changes due to the tender process can be seen from Table 2. Commercial banks’ deposit and lending rates rose in response to the rising rates on Treasury bills. This was inevitable since the treasury bills became commercial banks' competitor for money from the public. Due to the high inflation rate that prevailed in the first half of the year, interest rates remained negative in real terms although they were quite high in nominal terms. As the inflation rate tapered off, however, the interest rates became very high in real terms and they have remained so since then even though they have declined.

Before March, 1993 only the 91 days treasury bills were available. Since then, the 28 days and the 182 days bills have also been introduced in order to deepen the market. Of the three instruments, the 28 days bills proved to be the most popular. The authorities have now moved in to put a ceiling on how much 28 days Treasury bills can be sold which has resulted in a rise in the demand for 91 days bills.

Exchange Rates

Zambia has, for most of the time, followed a fixed exchange rate regime except for the period between 1985 and 1987 when the exchange rate was determined by an auctioning mechanism. The current structural adjustment period (since 1991) begun with a fixed exchange rate which was however adjusted weekly on the basis of the Kwacha’s purchasing power parity. Since there was also a retention market exchange rate (in which the exchange rates were determined by market forces) co-existing with the official rate, there was in effect a dual exchange rate regime.

The exchange rate regime changed drastically in October 1992 when the bureaux de change became operational. After 3 months of their establishment, the government decided to merge the official exchange rate, which all along had been controlled, with the bureaux de change cum retention market exchange rate. The daily official rate was henceforth to be determined by the weighted average of the bureaux de change rates. The rates were merged because the government believed there should be a single market determined
exchange rate. Also, the major foreign exchange earner - Zambia Consolidated Copper Mines - which also happens to be the major consumer of imports, felt that it was being treated unfairly because its Kwacha receipts were at the less cheaper official rate and yet its suppliers priced their goods at the bureaux cum retention market exchange rates which were more expensive.

The Kwacha depreciated quickly to reach around K560 per US dollar in May, 1993 from K359 at the end of December, 1992. From the middle of 1993 the Kwacha made a remarkable recovery from its earlier depreciation, reaching about K350 to the US dollar by the beginning of October. This turn about was largely attributed to the tight liquidity situation that existed, with reserve money growing much slower from June to September compared to the first half of the year. Another indication of the tight liquidity has been the lower growth rate of the money supply from an average of about 8 percent per month between January and May to only 2.1 up to October. Finally, the high real interest rates have also led to less borrowing from the banks which in turn has reduced the demand for foreign exchange, thereby contributing to the kwacha’s appreciation.

Foreign Exchange Liberalization

Another key area of reform has been foreign exchange liberalization to the extent of full convertibility. As explained earlier on, Zambia has for most time been faced with acute foreign exchange shortages which resulted in industries operating below capacity and in rampant shortages of many essential goods. The abandonment of the 1985 program in which an auction system allocated foreign exchange the new Foreign Exchange Management Committee that was established rationed
foreign exchange among the competing needs. The preference for allocating foreign exchange was given to manufacturing firms, especially those using local raw materials, and to farming.

Table 2: Treasury Bill Rates(%)  

<table>
<thead>
<tr>
<th>Period</th>
<th>Annualized Nominal Interest Rates</th>
<th>Annualized Compound Interest Rates</th>
<th>Inflation Rate</th>
<th>Real Interest Rates</th>
</tr>
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<tbody>
<tr>
<td>Perio</td>
<td>28 days</td>
<td>91 days</td>
<td>182 days</td>
<td>28 days</td>
</tr>
<tr>
<td>1993</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Q1</td>
<td>107.7</td>
<td>127.8</td>
<td>181.5</td>
<td>203.3</td>
</tr>
<tr>
<td>JAN</td>
<td>84.6</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>FEB</td>
<td>109.2</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>MAR</td>
<td>107.7</td>
<td>150.3</td>
<td>181.5</td>
<td>258.4</td>
</tr>
<tr>
<td>Q2</td>
<td>131.0</td>
<td>165.2</td>
<td>248.3</td>
<td>298.9</td>
</tr>
<tr>
<td>APR</td>
<td>108.3</td>
<td>160.6</td>
<td>183.1</td>
<td>286.0</td>
</tr>
<tr>
<td>MAY</td>
<td>118.7</td>
<td>161.2</td>
<td>211.5</td>
<td>287.7</td>
</tr>
<tr>
<td>JUN</td>
<td>153.0</td>
<td>173.2</td>
<td>324.8</td>
<td>440.6</td>
</tr>
<tr>
<td>Q3</td>
<td>180.4</td>
<td>150.8</td>
<td>148.1</td>
<td>441.7</td>
</tr>
<tr>
<td>JUL</td>
<td>208.5</td>
<td>181.7</td>
<td>591.3</td>
<td>347.5</td>
</tr>
<tr>
<td>AUG</td>
<td>187.2</td>
<td>157.6</td>
<td>169.3</td>
<td>475.2</td>
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<tr>
<td>SEP</td>
<td>165.8</td>
<td>130.6</td>
<td>145.5</td>
<td>376.2</td>
</tr>
<tr>
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<td>144.7</td>
<td>82.7</td>
<td>111.3</td>
<td>200.1</td>
</tr>
<tr>
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<td>151.2</td>
<td>109.7</td>
<td>125.3</td>
<td>318.1</td>
</tr>
<tr>
<td>NOV</td>
<td>99.9</td>
<td>80.8</td>
<td>99.7</td>
<td>159.9</td>
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<tr>
<td>DEC</td>
<td>102.5</td>
<td>77.8</td>
<td>112.3</td>
<td>179.5</td>
</tr>
<tr>
<td>1994</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Q1</td>
<td>140.9</td>
<td>93.7</td>
<td>109.9</td>
<td>281.1</td>
</tr>
<tr>
<td>JAN</td>
<td>148.0</td>
<td>90.6</td>
<td>115.5</td>
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<tr>
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<td>146.3</td>
<td>101.4</td>
<td>111.0</td>
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<tr>
<td>MAR</td>
<td>132.3</td>
<td>81.4</td>
<td>108.2</td>
<td>252.4</td>
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</tbody>
</table>

Source: Government Authorities.

* Monthly average.

* Derived through the following formula: \(1+i=(1+i)/(1+p)\), where \(i\) and \(p\) are the annualized interest and inflation rates, respectively.

Nevertheless, complaints were often made about unfair treatment. It was partly as a result of this that an Open General License Import System was introduced in 1990. This system initially operated on the basis of a positive list whereby an item included on the list committed the central bank to providing foreign exchange to each importer for its procurement. The number of items on the list was continuously increased until, in 1992, it was finally decided to drop the positive list and, instead, have a negative list of only 11 items which would not qualify for importation under the OGL arrangements. All other items qualify.

Although foreign exchange allocation under the OGL system worked better than it did under the foreign exchange management committee, it was far from being perfect because the exchange rate was still controlled. This, on a number of occasions, resulted in pipelines of foreign exchange approvals which could not be timely funded. Exporters of non-traditional commodities and importers who were willing to buy foreign exchange from them under the foreign retention market facility, however, were able, most of the time, to access foreign exchange quickly.
In October 1992, bureaux de change opened. Exporters of goods and services were free to sell their export proceeds at the bureaux. Importers of goods and services were also allowed to buy their foreign exchange from the bureaux, just as they were free to do so from commercial banks. As a result, exchange control on current account transactions were virtually removed save for those on a small number of restricted items like arms and ammunition. In theory there still existed quantitative restrictions on how much foreign exchange could be bought per transaction in addition to restrictions on capital transactions. In practice however, it was impossible to police the restrictions.

The supply of foreign exchange improved substantially after the merger of the retention, bureaux de change and the official exchange rates in December 1992 especially after June when the monetary conditions tightened up. It was this mark of confidence later towards the end of 1993, apart from the confidence that the exchange rate was likely to remain stable in future that encouraged the authorities to finally eliminate exchange control in January, 1994.

Other Reforms

The last key area of reform that the Zambian government has embarked upon is privatization. Since the nationalization of the early 1970s, the state sector has dominated economic activity in Zambia to the extent, by some estimates, of 75 percent. The state involvement extended to areas as diverse as manufacturing, agriculture, mining, banking and finance, retail trade and tourism. The MMD
government declared that it was going to privatize the state enterprises so as to improve performance. The necessary legislation was passed by Parliament which also established a Zambia Privatization agency to oversee the sales of the enterprises.

Indications to date are that privatization has not made as much progress as had been anticipated. Among the serious obstacles to faster privatization include the slow procedures which in many cases are the consequences of following the guidelines stipulated in the law. Apart from Chilanga Cement and Zambia Sugar Company, no other important state enterprises have been sold. This short coming is going to be one source of slow supply response in a liberalized economic environment in which it had been expected that one major source of the supply response was going to be improved efficiency in production.

Effects of Fiscal and Monetary Policy on the Macro-Economic Environment

Exchange Rates, Inflation, and Interest Rates. The harsh measures introduced especially in 1992 and more intensively after 1993 seem to be bearing fruit now with some key macro-economic parameters like the rate of inflation and the exchange rates showing signs of stability or moving in the desired direction. Interest rates, which were for the most time negative in real terms have became very positive since August, 1993.

After the merger of the official and the bureaux de change rate in December 1992, the exchange rate initially appreciated only to start depreciating very badly as liquidity expanded rapidly in the economy. Later, from the middle of the year, when liquidity conditions tightened the exchange rate not only stabilized but also appreciated very strongly back to around K350 from around K600 to the dollar. As the Kwacha appreciated, the inflation rate also quickly dropped to low monthly rates.

Bringing stability to the economy has however not been without pain. Most of the measures to drastically slow down growth in reserve money was done by the Bank of Zambia avoiding being a net buyer of foreign exchange. This meant selling back most of the foreign exchange it bought from ZCCM. With the government fiscal operations already having a neutral effect on liquidity in the economy due to the cash budget, the foreign exchange sales tightened liquidity drastically. As the exchange rate appreciated in response to the tight liquidity, exporters, including the Zambia Consolidated Copper Mines were threatened with bankruptcy. In turn many big corporations (who depend on ZCCM for business) were unable to pay taxes which put pressure on government finances.

Under the circumstances the authorities towards the end of 1993 permitted a faster increase in reserve money than before. Combined with the general perception in the market that the Kwacha had become overvalued, demand for foreign exchange surged and the exchange rate quickly got back to its middle of 1993 level in the K600 range. The monthly inflation rates which had declined to as low as 0.1 and -1.6 in October and November, 1993 respectively climbed slightly higher to 4.1 in December, 6.1 in January and to 4.9 percent in February before falling back to 1.9 percent in March and 2.9 percent in April. A significant part of the price increases in November, December and January were due to seasonality factors as fresh fruits and vegetables become scarce at that time of the year. Nevertheless, the exchange rate depreciation also played a part.

The exchange rate has remained relatively stable in the K650-K730 range since the end of 1993 to the present in spite of the total removal of exchange controls. Consequently, the parallel market
premiums on the exchange rates have declined sharply. Interest rates, on the other hand, have only slowly declined from 140 percent on the 28 days Treasury bills at the end of 1993 to about 105 percent at the time of writing. With the inflation rate much lower, these interest rates are highly positive.

Many people express concern at the fact that government borrows very expensive money through the Treasury bill tender and they wonder how it will pay back. If the private sector says it finds bank credit unaffordable, how is it that the government can borrow this expensive money?

The 1993 Budget estimated that domestic interest would be K27 billion. This cost was to be covered by sale of new Treasury Bills during the first half of the year (i.e. new Treasury bill issues would finance both principal and interest). During the second half of the year, a net surplus of non-project foreign financing would be available to the government which it would use to pay back to the banking system thereby reduce the stock of Treasury bills outstanding. Unfortunately, the excess external financing failed to materialize.

The failure to reduce inflation early in 1993 which resulted in interest rates remaining high led to the Treasury bill interest cost being higher than expected from the estimated K27 billion to K71 billion. As a result, the outstanding stock of Treasury bills increased from K44 billion to K95 billion. The growth occurred because the interest was not paid in cash but by issuing further Treasury bills.

It is this which has led to the criticism that because interest rates are so high and since the cost is rolled over, the Treasury Bill tender is causing Government debt to mushroom out of control thereby posing a heavy debt service burden for future generations. But this happened because of the high inflation which, by the way, also pushed up nominal GDP at roughly the same rate. In real terms, and in proportion to the size of the economy, domestic debt has remained relatively low at 4 percent of the GDP, and this ratio fell slightly last year.

It must be pointed out that the growth in the Treasury bills stock in 1993 is lower than what it could have been. The liquidity squeeze which became effective from the middle of last year in order to bring money supply growth under control meant that the roll-over did not succeed in fully financing this interest cost. The combined effect was to create an unplanned draw-down of Treasury bill balances.

With liquidity tight and many investors particularly the banks being unwilling to roll over their bills, the involuntary draw down on Treasury bills holding had to be financed through ordinary revenues. This led some people to conclude that the Treasury bills operation was diverting government revenue from legitimate expenditures. The reality is that interest and principal on Treasury bills are also legitimate expenditure items. If it so happened that revenue was not applied to them earlier when liquidity conditions permitted government to borrow from the public it does not mean that the government should ignore to pay them using its revenue when borrowing from the markets is less easy.

Interest payment on Treasury bills in 1994 is treated "above the line" unlike in 1993 when it was a below the line item. Accordingly, there is budgetary provision in 1994 for interest payments on monthly basis. It is therefore expected that the stock of Treasury bills should grow at a much reduced rate although, in fact, the program foresees a draw down if there will be net excess external financing which can be utilized to reduce the government's indebtedness to the banking system. In all, it is
desirable that the budget in 1994 should perform as closely as possible to program so that the interest payments provisions materialize thereby making it unnecessary for the Treasury bills stock to rise significantly higher from its current level.

Foreign Exchange Availability

It had been mentioned earlier that one of the key principles underlying monetary policy is to avoid being an excessive net buyer of foreign exchange so as to limit excessive injection of reserve money into the economy. In other countries, the central banks accumulate foreign reserves without losing control over the growth in the reserve money because the government will at the same time run a budget surplus. In the absence of a government budget surplus, Bank of Zambia has had to sell some of the foreign exchange it buys from Zambia Consolidated Copper Mines just to avoid adverse reserve money consequences. This aside, foreign exchange availability has improved substantially in Zambia due to the introduction of the bureaux de change combined with tight monetary policy.

Donor support has been critical for the improved availability of foreign exchange. Without it most of the foreign exchange earned by ZCCM would have had to be utilized for its own imports and more importantly, to pay the country’s huge foreign debts. However, the large magnitude of the external debts in local currency terms meant that the government would have no capacity to raise the necessary revenue through taxes to pay the loans. Inevitably, the Bank would have had to print money for the government. By providing Zambia with balance of payments support, most of which was used to pay external debts, the supply of foreign exchange was improved since ZCCM money became available for the domestic markets. Three hundred and five million dollars were received in 1993 against debt payments amounting to $364 million. The donor support made it possible to pay the large foreign debts without inflationary consequences.

The single most threat to future availability of foreign exchange is the huge debt overhang that Zambia faces. As indicated earlier on, debt servicing also has serious repercussions on the ability of the national budget to meet other expenditures without the central bank having to print money. Because of these two important considerations, Zambia will continue to require external financial support for quite some long time to come. Since the current practice among donors is to give assistance to those countries undertaking a program with the multilateral institutions, it follows that on this account alone Zambia will continue to need a program. Table 3 shows the projected grim debt service obligations for Zambia to the year 2000 which are not very much lower than the projected export earnings even under the best possible scenario.

Foreign exchange availability has helped to improve management objectives in companies. When foreign exchange was scarce, companies executives spent a lot of time at the central bank lobbying for allocations. Consequently, they did not spend as much time on other important issues such as product development, rationalization, and so on. Under the current foreign exchange management system, company executives cannot blame lack of foreign exchange for their failure to manage their enterprises well.

Other Economic Conditions

The stabilization effort has no doubt been quite hard on many people and institutions in the country. For example, one of the harsh realities of operating the cash budget has been government’s
inability to provide as much money to some departments as might otherwise have been desirable. This has brought problems in many sectors of the economy, the worst hit being maize farming. Since the

<table>
<thead>
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<th>Table 3: External Assistance to Zambia 1992-2000</th>
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<tbody>
<tr>
<td>US$ millions</td>
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<tr>
<td>Exports</td>
</tr>
<tr>
<td>Foreign Aid</td>
</tr>
<tr>
<td>Debt Relief</td>
</tr>
<tr>
<td>Foreign Financing</td>
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<tr>
<td>Debt Service</td>
</tr>
</tbody>
</table>


pre-independence days, government or its agencies bought all the marketable maize produce, transported it and kept it in safe storage. As maize production expanded all over the vast country side, the cost of marketing became huge. In the 1993 season, the cost was estimated at K80 billion or about 40 percent of the estimated budgetary expenditure.

Given the cash budget constraint and the need to spend money in other areas, the government put a budgetary ceiling of K20 billion on maize buying, and urged the private sector to get into maize marketing. Being the first year of its operation (and due to the high positive interest rates) the private sector's response was lower than required and a substantial amount of the maize remained unbought. This caused a lot of hardships for many farmers who desperately needed cash to redeem their expensive loans and to prepare for the next planting season. The government was therefore forced to issue promissory notes to farmers later during the marketing season which were only redeemed in February, 1994.

The cash budget has also reportedly led to many companies being owed large sums of money by government departments, who had committed themselves with suppliers or contractors, in the expectation that all the money allocated to them in the budget would be disbursed. At operational levels also many government departments were reportedly unable to provide full service to the public due to cash shortages.

It is also important to mention that real wages have significantly collapsed during the recent restructuring of the economy. Worst hit are public service salaries which, under the cash budget constraint, could not be increased to the full extent of the inflation as was the practice in the past. Government has for long recognized the negative impact of low public service salaries on their output. It therefore, planned to carry out public service reforms under which, among other things, its size would be reduced by retaining a smaller number of qualified staff who would be paid living wages at a more affordable cost. Unfortunately this exercise has not moved far and it remains as one of those areas that still requires attention. Nevertheless, real earnings in the non-public sector have also fallen as companies discovered that the previous option of increasing wages through price increases were no
longer always feasible due to consumer resistance and the availability of cheaper alternatives (sometimes smuggled) from outside the country.

Overall, the cash budget has had a visibly positive effect of helping to stabilize the Zambian economy which was just on the verge of experiencing hyper inflation. Some of its negative side effects just mentioned are not quite surprising, being the first time that government is exercising fiscal restraint. Once this discipline sets root and the public accept it as a matter of fact, problems such as over-committing government will slowly disappear. Besides, it is not entirely unexpected that a number of enterprises had to go bankrupt during the disinflationary process as international experience shows that this is often hard to avoid. In the case of Zambia, many companies that were established during economic controls such as motor assembly plants can never stand completion in a liberalized economy. In other sectors especially agriculture, some of their problems, apart from the droughts, are a result of having been highly over-borrowed. When interest rates were negative in real terms, many farmers found it attractive to finance most of their operations out of debt than equity. When interest rates became positive, they were found it difficult to unwind themselves out of the debt.

Credit Distribution

As price stability came, the interest rates suddenly became very high in real terms because the nominal interest rates declined at a slower rate than the consumer prices (see Table 4.0). This made the cost of borrowing in real terms rise substantially and, as pointed out above, it is one of the reasons why private borrowing for maize trading remained at a low level. Firms in other sectors were reportedly reluctant to borrow money and those that had borrowed large amounts found themselves with rapidly growing debt.

When the rate of inflation was still high, high nominal interest rates did not matter much because the rates were negative in real terms. Therefore, borrowers did not find them prohibitive since they could count on increasing prices to finance the interest cost. As inflation came down the cost of borrowing increased in real terms.

While it is true that high interest rates have led to cash flow problems for some companies, it is also true that many companies' problems have emanated from other sources such as stiff competition from imported goods, negative rates of protection in some cases, import dependency and, lastly but importantly, the initial gearing condition of the company etc. With the cost of capital in the past having been negative in real terms, few people failed to realize that it was more preferable to borrow than to use equity finance. This is no longer the case.

According to the BOZ Quarterly Business Opinion Survey for the period ended December 1993, the majority (33.3 percent) of respondent firms from a sample of 120, identified lack of demand as their major constraint in business, compared to 14.2 percent who identified high interest costs. Of the 48 respondents from the manufacturing sector, forty-eight percent said that the lack of demand was their most limiting constraint compared to two percent who identified high interest rates. Although this sample was small and it did not include agriculture, its results suggest that the problems facing industries in Zambia under the structural adjustment program, are more complex than is often casually considered.
Another frequent criticism of the high interest rates is that capital is being directed away from productive uses into Treasury bills where the rates of return are very high and the risk very low. Available evidence does not support this view. In 1993, commercial banks' holdings of Treasury bills rose by 87 percent from K38 billion to K71 billion. Over the same period, loans and advances increased by a higher percentage (122 percent) from K41 billion to K91 billion. In real terms, both loans and advances and Treasury bill holdings of commercial banks declined but the decline was sharper for Treasury bills.

The complaints against high interest rates can, however, not be dismissed too simply. What is required is a detailed empirical study on the effects. In other countries where interest rates were allowed to rise sharply in real terms there have been some negative effects such as widespread bankruptcies, rapid increase in non-performing bank loans which in certain cases threatened the viability of many financial institutions and, ironically, even led to government printing of money in an attempt to rescue many ailing industries.

A related problem is on the distribution of credit in the economy - data indicate that net claims on the private sector rose from K42.8 billion in January, 1993 to K84 billion in August. From this information, it is quite tempting to conclude that the private sector did obtain adequate credit over the period. This is not so in reality because bank lending data is distorted by the practice by commercial banks of adding unpaid interest to the principle amount owing thereby making it appear as if lending is increasing. With the high interest rates in the country, the effect of this exaggeration is quite substantial. Further, lending to the private sector in real terms declined a lot in 1993 due to the high inflation that prevailed earlier in the year.

<table>
<thead>
<tr>
<th>Date</th>
<th>Loans &amp; Advances Nominal Values</th>
<th>Index Nos. Cpi (1975 weights)</th>
<th>Treasury Bills Held by Comm Banks</th>
<th>Loans &amp; Advances Deflated Values</th>
<th>Treasury Bills held by comm banks Deflated Values</th>
</tr>
</thead>
<tbody>
<tr>
<td>31/12/90</td>
<td>13,251,150,355</td>
<td>2,341.6</td>
<td>4,068,179,626</td>
<td>565,901,535.5</td>
<td>172,735,037.0</td>
</tr>
<tr>
<td>31/03/91</td>
<td>15,437,490,111</td>
<td>2,660.6</td>
<td>7,673,367,104</td>
<td>580,225,893.1</td>
<td>288,407,395.2</td>
</tr>
<tr>
<td>31/07/91</td>
<td>18,376,412,365</td>
<td>3,137.2</td>
<td>9,487,351,733</td>
<td>585,758,394.9</td>
<td>302,414,628.7</td>
</tr>
<tr>
<td>30/09/91</td>
<td>18,764,383,221</td>
<td>3,358.9</td>
<td>7,692,227,593</td>
<td>558,646,676.6</td>
<td>229,010,318.6</td>
</tr>
<tr>
<td>30/12/91</td>
<td>21,728,466,240</td>
<td>4,941.6</td>
<td>13,862,878,067</td>
<td>439,705,080.1</td>
<td>280,534,200.8</td>
</tr>
<tr>
<td>31/03/92</td>
<td>23,901,116,826</td>
<td>7,429.4</td>
<td>20,436,122,447</td>
<td>321,709,920.4</td>
<td>275,070,967.3</td>
</tr>
<tr>
<td>30/06/92</td>
<td>25,087,522,885</td>
<td>8,968.3</td>
<td>21,422,008,888</td>
<td>290,885,930.3</td>
<td>238,863,651.8</td>
</tr>
<tr>
<td>30/09/92</td>
<td>31,209,832,227</td>
<td>10,923.7</td>
<td>38,838,330,572</td>
<td>285,707,518.8</td>
<td>355,541,900.4</td>
</tr>
<tr>
<td>31/12/92</td>
<td>40,583,988,000</td>
<td>14,388.2</td>
<td>38,086,926,000</td>
<td>282,064,386.1</td>
<td>264,709,456.4</td>
</tr>
<tr>
<td>31/03/93</td>
<td>49,790,785,000</td>
<td>19,487.9</td>
<td>56,324,481,000</td>
<td>255,495,897.4</td>
<td>289,022,834.7</td>
</tr>
<tr>
<td>30/06/93</td>
<td>68,225,927,000</td>
<td>27,937.1</td>
<td>45,865,550,000</td>
<td>244,212,631.2</td>
<td>164,174,341.6</td>
</tr>
<tr>
<td>30/09/93</td>
<td>90,516,550,000</td>
<td>33,449.3</td>
<td>53,762,370,000</td>
<td>270,608,204.0</td>
<td>160,727,937.5</td>
</tr>
<tr>
<td>31/12/93</td>
<td>91,323,672,000</td>
<td>34,284.4</td>
<td>70,765,421,000</td>
<td>266,370,920.9</td>
<td>206,407,056.8</td>
</tr>
</tbody>
</table>

Source: Government Authorities.

Overall, it cannot be denied that the private sector has been crowded out of the credit markets during 1993. There are two main reasons for this. Firstly, the government's need to borrow to finance the treasury bill maturities plus interest has resulted in a rising stock of government domestic debt. Secondly, the demand for credit by the private sector has gone down. This is partly a
consequence of the high real interest rates, combined with a slump in demand for goods, resulting in firms being reluctant to borrow. The other aspect to this is that some commercial banks are now taking the view that buying treasury bills is safer than lending to companies because the high interest rates makes defaulting by companies very probable.

Social Sector Developments

A strong criticism that has frequently been made on the reform program in Zambia is that it has happened at a great cost to the quality of human life. The removal of subsidies on basic food stuffs and other essential goods and services, the introduction of fees for education and health services are said to have affected the vulnerable groups very adversely. Available statistics indeed suggests that the

Table 5: Select Social Indicators for Zambia

<table>
<thead>
<tr>
<th></th>
<th>Low Birth Weight (percentage less than 2500g)</th>
<th>1986: 10.2</th>
<th>1988: 11.9</th>
</tr>
</thead>
<tbody>
<tr>
<td>2</td>
<td>Weight for Age (percent underweight)</td>
<td>1985: 13.6</td>
<td>1990: 23.0</td>
</tr>
<tr>
<td></td>
<td>Immunization (percent Infants Immunized)</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Measles</td>
<td>1987: 80.0</td>
<td>1992: 69.0</td>
</tr>
<tr>
<td></td>
<td>Polio</td>
<td>1987: 81.0</td>
<td>1992: 68.0</td>
</tr>
<tr>
<td></td>
<td>BCG</td>
<td>1986: 92.0</td>
<td>1992: 90.0</td>
</tr>
<tr>
<td></td>
<td>DPT1987:</td>
<td>83.0</td>
<td>1992: 67.0</td>
</tr>
<tr>
<td>4</td>
<td>MCH coverage by trained personnel of pregnant women (percent antenatal)</td>
<td>1985: 84.1</td>
<td>1990: 80.0</td>
</tr>
<tr>
<td>5</td>
<td>Access to safe water (percent population)</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Urban</td>
<td>1985: 70.0</td>
<td>1991: 66.0</td>
</tr>
<tr>
<td></td>
<td>Rural</td>
<td>1985: 41.0</td>
<td>1991: 30.0</td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td>1985: 54.0</td>
<td>1991: 48.0</td>
</tr>
<tr>
<td>6</td>
<td>Access to sanitation (percent population)</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Urban</td>
<td>1985: 76.0</td>
<td>1991: 43.0</td>
</tr>
<tr>
<td></td>
<td>Rural</td>
<td>1985: 34.0</td>
<td>1991: 25.0</td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td>1985: 52.0</td>
<td>1991: 34.0</td>
</tr>
<tr>
<td>7</td>
<td>Daily calorie intake per capita</td>
<td>1980: 2227.0</td>
<td>1991: 1881.0</td>
</tr>
<tr>
<td>8</td>
<td>Per capita public expenditure on education (1985 dollars)</td>
<td>1982: 25.6</td>
<td>1990: 8.2</td>
</tr>
<tr>
<td>9</td>
<td>Primary School enrolment: (as percentage of 7-13 year-old population)</td>
<td>1990: 88.0</td>
<td></td>
</tr>
<tr>
<td>10</td>
<td>Girls as percentage of school enrolment</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Grade 1</td>
<td>1989: 50.0</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Grade 7</td>
<td>1989: 45.0</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Grade 12</td>
<td>1989: 34.0</td>
<td></td>
</tr>
<tr>
<td>11</td>
<td>Adult illiteracy (percent)</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td>1990: 27.0</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Female</td>
<td>1990: 35.0</td>
<td></td>
</tr>
</tbody>
</table>

Sources: (i) Seshamani V and Saasa O.S (Study Co-ordinators). ZAMBIA: CONSTRAINTS TO SOCIAL SERVICE DELIVERY, (Lusaka: Study Commissioned by the World Bank), May 1993.
(ii) Department of Water Affairs
(iii) Ministry of Local Government and Housing
(iv) Ministry of Education
quality of life of most people in the country has deteriorated. The question is whether it would have improved in a sustainable manner without the reform program. In all probability it would not have since government expenditure in real terms on social services has consistently declined over the past decade resulting declining quantities and qualities.

Nevertheless, government appreciates the need to spend money to improve the quality of social services. To this end, a Social Sector Rehabilitation and Development Program for 1993-1996 has been drawn up at the National Commission for Development Program. Its implementation has somewhat been delayed though, partly because of the resource constraint imposed by the cash budget which has often resulted in expenditure priorities going to areas which if not funded, created immediate pressure and crisis.

This problem is being addressed now through improved revenue collections through the newly established Revenue Authority which has taken over the functions of the previous tax departments. In addition some donors have made it a condition that disbursement of future aid will depend on progress being made by government to fund social sector activities. Among these is the World Bank which has staked at least $50 million of disbursements through the Economic and Social Recovery Credit (ESAC) be subject to the fulfillment of this conditionality.

Conclusion

After several halfhearted attempts in the past to reform its economy, Zambia has finally undertaken a very comprehensive reform program since 1991. The central feature of this program was to allow greater freedom for market forces to influence economic decisions. Subsidies have been eliminated and fiscal management rationalized through government commitment to avoid printing money as a mode of financing. Interest rates and the exchange rates have been liberalized. The government has moved swiftly to take advantage of the resulting macro-economic stability to liberalize the foreign exchange markets to the extent of removing all exchange controls.

The major achievements so far have been in the area of macro-economic stability. On the other hand, indications are that the productive areas in a number of sectors, especially the manufacturing and agriculture have been adversely affected partly due to the fact that they are not used to stiff competition that arises from a liberalized economy. Nevertheless, the government is fully aware of the need to have investment and production picking up again. This will partly follow from a stable macro-economic environment which, through liberalization, has also been made investor friendly. It is also envisaged that as privatization picks up and as regulations in other areas like land law get changed to reflect the liberalized environment, further attraction to investors will ensue.

A major source of concern regarding the long stability of the reform process in Zambia is its extraordinary high debt service burden for the foreseeable future. This aspect alone, makes it imperative that the country will continue to be dependent on foreign aid.
The Structural Adjustment Program in Zambia: 
Reflections from the Private Sector
Mebelo K. N. Mutukwa
PRICE WATERHOUSE
Oliver S. Saasa
UNIVERSITY OF ZAMBIA

Introduction

This paper begins with a brief presentation of Zambia's adjustment and stabilization policies over the 1983 to 1994 period, highlighting its major components and the government's policy shifts in the attempt to restructure the ailing economy. This is followed by a general commentary, in a form of notes, regarding the emerging issues pertaining to Zambia's adjustment efforts. Practical implications for private sector development are then highlighted by way of revealing the economic regime's impact on the productive and commercial sectors. Lastly, the paper makes a brief examination of the social impact of adjustment in the country.

Adjustment and Stabilization Policies: 1983-94

In order to cope with Zambia's economic difficulties, the government attempted in various ways to stabilize the economy. The different economic regimes the country has gone through over the years could be characterized as follows:

<table>
<thead>
<tr>
<th>PERIOD</th>
<th>ECONOMIC REGIME</th>
</tr>
</thead>
<tbody>
<tr>
<td>Before December 1982</td>
<td>Centralized planning and controlled regime</td>
</tr>
<tr>
<td>December 1982-October 1985</td>
<td>Decontrols and deregulation</td>
</tr>
<tr>
<td>October 1985 - April 1987</td>
<td>Highly liberalized regime</td>
</tr>
<tr>
<td>May 1987 - November 1988</td>
<td>Return to controlled regime</td>
</tr>
<tr>
<td>November 1988-June 1989</td>
<td>Relaxation of some controls</td>
</tr>
<tr>
<td>July 1989 - April 1991</td>
<td>Return to highly flexible regime with movement towards full-scale liberalization</td>
</tr>
<tr>
<td>May 1991 - October 1991</td>
<td>Political transition with both government and the opposition expressing support for economic liberalization</td>
</tr>
<tr>
<td>31 October 1991</td>
<td>New government of President Chiluba took over power from the old government of President Kaunda through democratic elections</td>
</tr>
<tr>
<td>November 1991 - Present</td>
<td>Fully-fledged Structural Adjustment program (SAP) and stabilization policies.</td>
</tr>
</tbody>
</table>

It is noteworthy at the outset that the IMF has had a significant influence in Zambia at the level of economic program design, particularly in the post 1982 period. The country's relationship with the
World Bank dates back to a much earlier period. The first stabilization package agreed upon between the Zambian government and the IMF consisted of the 1973/74 stand-by agreement which was aimed at halting the country's declining external reserves as well as arresting the budget deficit which resulted from the terms of trade deterioration following the decline in copper prices. At this early stage, the IMF conditionality was basically demand management involving a call for a reduction in public spending; borrowing restrictions, and a wage freeze. This program, though observed by the government, did not lead to any noticeable improvement in the country's domestic and external economic situation.

The second IMF stand-by program was effected in 1976/77 and involved a financial injection into the Zambian economy of SDR19 million. The conditionality again focused on demand management and included such measures as a 16% ceiling on domestic credit expansion; a 20% currency devaluation; a wage freeze; and government budget reduction. Under this program, investment outlays were restricted to the support of on-going projects. No positive effects were realized from this program and this was explained largely by external factors which included the closure of the southern route (due to the war of liberation in the then Rhodesia) which was highly disruptive of the country's trade passages.

The third and longer IMF Program, also demand management-focused, was the 1978 to 1980 SDR250 million stand-by facility. The Program performance criteria included domestic credit expansion being limited to 18% only and a 10% devaluation of the Kwacha's nominal value. Despite the country's GDP registering a negative growth rate during the period, the government met all the conditions and the total stand-by facility was disbursed. The decline in the copper price and poor rainfall adversely affected the economic situation soon after the program was completed.

The fourth arrangement with the IMF was the SDR800 million Extended Program which covered a three-year period from 1981-83. The Extended Program was meant to serve as a cushion to the food and transport problems. Whereas the first three IMF Programs above were directed more towards demand management, this fourth one focussed primarily on the supply side policies for the promotion of agriculture, mining and manufacturing. Due to a variety of shocks which included the weather, poor copper and cobalt prices, and declining mineral outputs, the government failed to meet the IMF conditionalities for the program. This led to the cancellation of the Extended Program half way (in 1982) after only SDR300 million were purchased.

It was in the 1983-85 period when a more comprehensive IMF/World Bank Structural Adjustment Program was undertaken. It covered a much wider range of structural policies and involved two stand-by facilities of SDR211.5 million and SDR225 million for the 1983-84 and 1984-85 periods, respectively. These facilities were also complemented by the World Bank Structural Adjustment lending which focussed on the promotion of the supply side of non-traditional exports. The conditionalities of the program included the following:

- export diversification through an active foreign exchange policy. In this regard, a multi-currency crawling system was adopted and a 20% devaluation of the Kwacha was effected in 1983;

- the replacement of the crawling exchange rate system with the auction system in October 1985;
the abolishing of quantitative import restrictions resulting in the liberalization of the import licensing system by allowing businessmen to import any type of goods;

decontrol of prices in order to allow more market-determined prices as well as reduce the budgetary burden of price subsidies;

interest rates liberation aimed at stimulating domestic servings and remove the adverse effect of negative interest rates which encouraged capital intensive projects;

a wage freeze; and

restriction on government expenditure in order to reduce government budget deficit.

The introduction of the auction system was perhaps the most known and felt of the IMF/World Bank-supported structural adjustment measures. Under this system, the price of the Kwacha was determined by the market-clearing bid that exhausted the supply for foreign exchange allocated weekly by the Bank of Zambia. Due to what was seen as unacceptable effects of the reform measures, the government unilaterally abandoned the IMF/World Bank Structural Adjustment Program in May 1987 and introduced its own New Economic Recovery Program (NERP). To implement the new approach, the Interim National Development Plan that ran over the July 1987 to December 1988 period was launched. The NERP included the re-activation of import controls; the decision to limit debt service payments to only 10% of the net export earnings after the foreign exchange required by named strategic sectors had been deducted; re-introduction of price controls; a return to the system of interest rates of commercial banks being fixed by the government; and the re-appearance of the administrative allocation of foreign exchange. The key slogan for the new approach was 'growth from our own resources'.

Upon the abandonment of a liberalized exchange rate market with the intention of reducing the cost of living through a rate appreciation, the Zambian Kwacha was revalued and pegged at the rate of K8 per US dollar. Despite what was seen as a good argument for abandoning the IMF and World Bank-supported SAP and its replacement with the 'home-grown' NERP, Zambia's economic performance continued to worsen and the government U-tumed back to the IMF. However, Kaunda's government could not go far in its renewed commitment to SAP before it was replaced by the present government in October 1991.

When the new government took up the reigns of power, it stated that it seeks to undertake "an unbreakable integrated package" of economic reforms. The World Bank and the IMF have continued to play an instrumental role in the reform process. Although the Policy Framework Paper (PFP), prepared by the previous government, was to cover the period up to 1993, the new political leadership prepared its own document with the assistance of the World Bank and the IMF covering the 1992-94 period. Although in most important aspects, the new government's policy document is similar to the PFP, the major difference has been that of its commitment to a much faster pace of liberalization and stabilization.

In terms of approach, the new government's reform program rests on three main policy planes, namely, the removal of subsidies; economic liberalization and stabilization; and the privatization of the
public sector enterprises. The following quotation, made in the Budget Speech shortly after coming to power, summarizes both the new government's thinking and its reform policy:

Government must concern itself primarily with providing and maintaining public infrastructure and services. [Its] role in the commercial economy will merely provide a conducive framework of incentives and legislation to promote the rapid growth of the private business sector and entrepreneurship.

The "integrated package" of the reforms has several components at both the economic liberalization and stabilization levels. These are briefly outlined below.

**Liberalization Measures**

One of the major liberalization measures taken by the new government entailed the decontrol of prices and the attendant elimination of all subsidies on maize, fertilizer, and fuel. This was effected in December 1991. Similarly, interest rates were liberalized with a view to attaining positive interest rates. Foreign exchange controls were finally abolished in January 1994.

Exchange rate liberalization has also been effected in an effort to attain a market-clearing exchange rate. In October 1992, foreign exchange was devalued to put it at par with the bureau de change rate, hence, marking the unification of the earlier dual exchange rate regime. Related to this, the new government has declared its commitment to the setting up of a diversified system of intermediation. The key instrument of this policy includes the setting up of the stock exchange. The Securities and Exchange Commission was established in November 1993 to work out the mechanics of establishing a stock exchange and the Lusaka Stock Exchange (LUSE) was eventually established in March 1994. Other instruments include the encouragement of private sector competition in insurance services; pensions and building societies; and the creation of other financial intermediaries notably leasing companies; merchant banks; credit unions; and finance houses.

Trade liberalization has also been put in place in the context of SAP. This has been done through, inter alia, the simplification of the government’s import tariff regime by introducing a three-tier harmonized tariff with a minimum duty rate of 20% and a maximum rate of 40%. This has been done in order to expose domestic firms to eternal competition that would arguably stimulate efficiency. Additionally, in January 1993, the new government abolished the import license levy and it is currently reviewing the justification of continuing with the general licensing of imports and exports as all these are perceived to compromise free trade.

Lastly, the policy of privatization of the state enterprises and the complementary enhancement of private sector development constitute the heart of the new government’s liberalization and economic restructuring measures. In simple terms, the privatization exercise in Zambia seeks to achieve basically two things. Firstly, it aims to promote private sector development in order to stimulate competition and greater economic activity in the economy. Secondly, it intends to free the government from the burden of subsidizing loss-making parastatals. With respect to this last point, it is noteworthy that in 1991, subsidies to the ailing parastatal enterprises amounted to K53 billion. The privatization Act was passed in July 1992 and, subsequently, the Zambia privatization Agency was created to take charge of the transfer of state-owned parastatals into private hands. The Act has the exclusive mandate
Table 1: Sectoral Distribution of Proposed Investments

<table>
<thead>
<tr>
<th>SECTOR</th>
<th>LICENSES APPROVED</th>
<th>VALUE OF INVESTMENT</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Number</td>
<td>Percentage</td>
</tr>
<tr>
<td>Agriculture</td>
<td>198</td>
<td>30.46</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>115</td>
<td>17.69</td>
</tr>
<tr>
<td>Mining</td>
<td>43</td>
<td>6.61</td>
</tr>
<tr>
<td>Tourism</td>
<td>60</td>
<td>9.23</td>
</tr>
<tr>
<td>Transport</td>
<td>69</td>
<td>10.61</td>
</tr>
<tr>
<td>Others</td>
<td>22</td>
<td>3.38</td>
</tr>
<tr>
<td>Rejected</td>
<td>143</td>
<td>22.00</td>
</tr>
<tr>
<td>TOTAL</td>
<td>650</td>
<td>100.00</td>
</tr>
</tbody>
</table>

Source: Investment Centre.

to implement the divesture of government from commercial enterprises by way of trade sales; management buy-outs; share flotations; leasing, management contracts; dilution of government share holding; etc.

To further facilitate private sector development, the Investment Centre was created in 1991 by the Investment Act of the same year. In 1993, the Act was extensively amended to fall in line with MMD government interests. The Centre is mandated to appraise project proposals and issue Investment Certificates with Special or General Incentives. Investors in mining, agriculture, agro-processing, non-traditional exports, import substitution, rural enterprises, and tourism are entitled to special incentives which exempt the investor from paying any customs duties or sales taxes on imported machinery and equipment.

The Investment Centre has reported that over 650 applications for licenses were considered in 1993, at a value of approximately US$522 million. Of this amount, 70% comprises proposed investments by existing companies such as Zambia Sugar Company ($40 million) and Swarp Spinning Mills ($10 million). Less than 50% of the projects have actually commenced.

The sectoral distribution of proposed investments is shown in Table 1. Large international mining companies have obtained prospecting licenses and it is hoped that there will be an investment boom in Zambia in future.

Stabilization Measures

In this area of SAP, the new government's first major assignment has been that of eliminating the huge fiscal deficit so as to achieve a balanced budget. Thus, in 1992, the government succeeded in reducing the fiscal deficit from 7.4% of GNP in 1991 to 2.2%. To realize further progress in this area, the government has set itself stringent rules regarding its borrowing. There are two considerations regarding restrictions on government borrowing. The first is the government's declared scheme for exporters of value added products. Withholding taxes on dividends, interest, rent, need to combat inflation which stood at 191% for 1992 and 180% in 1993. This policy, of necessity, involves
drastic reductions in government expenditure. Importantly, the government has attempted to do away with deficit financing from, for example, bank borrowing that has in the past explained the economy's problem of over money supply. Hence, budget deficits are expected to be financed from such supposedly 'non-inflationary' sources as donor funds and the issuing of treasury instruments.

With respect to the tax reforms, the MMD government reduced individual and corporate tax rates to a maximum of 35%, reduced the level of customs duties, increased capital allowances to 50%, lowered tax rates on farming and non-traditional exports to 15%, and introduced a duty draw back management fees, and royalties has been reduced to a uniform rate of 10%. A value added tax is to replace sales tax in July 1995 to counteract existing double taxation difficulties.

On April 1, 1994, the Zambia Revenue Authority (ZRA), a semi autonomous body, was created to improve the efficiency of tax and customs duty collections through incentive schemes, staff monitoring, and the threat of summary dismissal. It is too early to ascertain the success or failure of the ZRA, though it is notable that daily revenues declared to the Bank of Zambia have doubled, from K800 million per day K1.6 billion. This is, however, below target.

Complementary to the above, cash-based budgetary system has been introduced in Zambia during 1993 whereby the government is expected not to incur an expenditure that is not covered by existing revenue. Related to this, the government has adopted a closely monitored tight money policy in an effort to ensure that money supply does not go beyond the set limits (for example, 22% for 1993). Moreover, in an effort to shift a substantial proportion of the cost of social services to the consumers, Zambia's SAP has included the policy of economic pricing of goods and services through the introduction of cost recovery user charges. Additionally, the government introduced the Treasury Bills tender system, occurring each week, and recently added government bonds to the repertoire of debt instruments administered by the Bank of Zambia.

Lastly, the rationalization of the civil service is yet another stabilization policy component. Against the background of a huge and overly-bureaucratic civil service that has tended to fuel excessive government recurrent expenditure, the government has stated that it intends to attain a leaner and efficient civil service. The freezing of new recruitment as well as the on-going retrenchment exercise have, thus, been put in place. Additionally, the Government has declared its intention to drastically reduce its financial obligations to municipal councils which are being called upon to operate autonomously.

What the above presentation demonstrates is that the new government in Zambia has made considerable advance in the country's SAP and within a short period.

Commentary on Reforms

Exchange Controls:

Initial apprehension that the abolition of exchange controls would precipitate capital flight and a run on the Kwacha has proven unfounded. The Kwacha has stabilized and preliminary evidence indicates that there is actually a positive net inflow of privately held foreign currency. The commercial banks report minimal activity in the creation of foreign currency accounts, but this is to be expected while returns generated by Kwacha denominated debt instruments exceed capital gains on currency
speculation. An increasing number of private companies is applying for foreign currency loans which can now be secured against Zambian based assets to refinance extant projects at realistic rates of interest, to finance greenfield or expansion projects. It is not yet known what proportion of the estimated US$500 million illegally externalized by Zambians during the years of strict exchange control regimes has flowed back into the country since financial liberalization commenced.

Privatization:

The divestiture of the State from its business holdings, which account for 80% of GDP, is a critical pre-requisite to the dynamization of the productive sectors of the economy through new private investment and the infusion of business principles and management techniques into dying Parastatals. Sadly, a failure to assemble sufficient technically competent manpower by the ZPA, resistance from interested parties, and persistent legislative and structural impediments, have combined to decelerate the privatization process. The program is well behind schedule, with only 10 Parastatals being sold to date, and the initial consensus on the need for privatization is cracking.

Lusaka Stock Exchange (LUSE):

There are approximately 10 shares traded each week, almost entirely Standard Chartered Bank shares, which have actually lost 60% of their value since they were first listed. With high yields, between 113% and 140% on government debt securities, lending rates of interest averaging 85%, poor liquidity and tradability of shares on the LUSE, poor dividend distribution history of public companies in Zambia, lack of market confidence in Kwacha denominated equity securities, and high transaction costs, have de-activated the LUSE and prevented the Exchange from becoming an attractive, vibrant source of long-term capital and liquidity.

Tax Reform:

The Zambian business community is naturally supportive of tax reforms that reduce the burden of tax on the formal sector, and seals perforations in the system, snaring evaders and avoiders. It is, however, more difficult to comply with tax authorities when the taxpayer is dissatisfied with the use of his tax money by government. Wasteful government spending, extravagance, retention of a bloated civil service, etc dissuade law abiding citizens from incurring the full brunt of tax liabilities.

Investment Centre:

The tax reforms alluded, authorization to export 100% of after tax earnings attributes to foreign shareholders, and the streamlining of paperwork relating to exporting and importing goods, combine to improve Zambia as an investment target within the region. A rational investor over the last two years would compile resources which would otherwise go towards procuring inputs for manufacturing or agriculture and purchase Treasury Bills or currency and earn up to 350% annualized. Moreover, the reality of the present is that there is no domestic development finance, there has been no institutional deepening in the financial sector, and the rates of interest charged on current finance is excessively high and inimical to rational investment decisions.
Fiscal Management:

The introduction of the cash budget system has significantly impacted upon government behavior, compelling revenue-led expenditure patterns. Its introduction, additionally, has compelled a higher level of fiscal discipline within government and the budget deficit has been controlled to a reasonable extent. The difficulties, however, include the following:

Bank Illiquidity:

The Commercial banking community was unable and unwilling to extend credit to the private sector because statutory reserve requirements were raised to a point where K82.50 of every K100.00 had to be withheld to maintain government determined liquidity ratios. The Commercial banks were authorized to channel approximately 35% of statutory reserves in Treasury Bills, which yielded peak annualized rates exceeding 330%. From the perspective of a rational banker, there was no logical reason to extend credit to the private sector at all when the net available resources could also be loaned to government through the Treasury Bills system for returns that the real economy could not offer, and at no risk.

Money Supply:

After some initial transitional problems which led to fiscal leakages and fuelled triple digit inflation, government managed to reduce the rate of growth of money supply and severely tighten liquidity. The velocity of money decelerated significantly and one major culprit was the Zambia Consolidated Copper Mines (ZCCM), which withheld payments to domestic creditors, including government (namely the Department of Customs and Excise) for several months, fomenting capital starvation and a chain reaction of financial truancy in the economy.

Expenditure Switching:

The government has virtually abandoned all capital investment and social service projects and reallocated resources budgeted for such purposes to consumption expenditure.

High Interest Rates:

Government expenditure has not been adequately curbed. Civil service reform has stagnated, thus, the initial objective of reducing the size of the civil service and improving the conditions of the streamlined public service has not been achieved. Instead, salaries for the bloated civil service were increased and extravagant expenditure perpetuated (the number of Ministries was raised as well), thus, creating pressure on the government budget. As a result of high recurrent expenditure, the government has been compelled to offer an average of K15 billion in Treasury Bills each week. The return by investors who inject this amount of cash into government on a weekly basis must be high. This has led to triple digit Treasury Bill yields that are significantly positive in real terms.

The triple digit Treasury Bill (TB) yields present the most attractive and largest investment on a commercial bank portfolio. The commercial banks, which purchase approximately 92% of all TBs issued, are in no way encouraged to reduce their interest rates, which now correlate closely with TB rates instead of inflation (creating positive real interest rates of approximately 50%).
Financial Repression:

Interest rates have become the critical success factor for private business which, for historical reasons, is highly geared. Lending rates of interest peaked at 140% by August 1993 during a period of poor general liquidity, price rigidities, and an influx of imports. Deposit rates of interest, as well as foreign exchange buying rates, were significantly lower than lending rates, and they continued to be significantly negative in real terms.

The price of fuel has risen dramatically, compelling many transport companies to procure their fuel from Zimbabwe rather than in Zambia, and forcing the State to impose punitive customs and excise duties on fuel imports that do not flow through the State owned fuel monopolies.

Practical Implications

This part of the paper attempts to provide, in a very brief manner, the environment in which the Zambian private sector finds itself today. It covers the major fields of economic activity. The table below gives a general picture of output changes in the main sectors of the Zambian economy. Overall, real GDP growth was estimated by government to stand at 4% during 1993.

Agriculture

Potentially the sector to provide the stimulus to economic recovery, the agricultural sector is at a crossroads. After the 1991/2 drought, farmers accessed credit and invested heavily in expanding their hectarage planted for the 1992/3 season. This led to an unprecedented 52.1% growth in real value added agricultural production, though largely a recovery from the previous years drought. Having produced 18 million bags of maize, 71,000 tonnes of wheat, and bumper harvests of rice, soya bean, sunflower and other crops, the Zambian farming community is tottering on the precipice of collapse.

This paradox is the result of several factors which could be illustrated in a brief case study of the maize and wheat crops. As stated above, farmers planted higher hectarages of maize and wheat to achieve strong harvests. Three months after planting, interest rates were fully decontrolled and rates escalated dramatically, stabilizing at well over 110%. The crop was already in the ground and there was no recourse to invest in newly introduced Treasury Bills as interest began to accumulate on commercial loans. Simultaneously, electricity tariffs were raised by up to 700% (further hurting commercial farmers utilizing irrigation), the price of diesel fuel increased by over 100%, the Kwacha depreciated significantly, impacting directly on the price of fertilizers, packaging materials, and pesticides. The announcement of a floor price by government (K5000), ill-advised statements by government officials (including a temporary ban on the export of maize), rapidly escalating interest rates, and tightening bank liquidity nullified private sector involvement in maize marketing. Government appointment agents to purchase maize and deliver to milling companies.

Farmers were introduced to promissory notes which matured six months after the harvest as government was unable to fund them immediately. Large commercial farmers were stuck with their maize, unable to export when the ban was lifted because the Kwacha had appreciated by over 57% and it became uneconomic to export and accumulating interest made it uneconomic to sell at the prevailing price. Wheat producers are still stuck with 51,000 tonnes of the 71,000 tonnes produced
because the wheat milling monopoly found it cheaper to import subsidized French wheat, American flour (via South Africa), and Mauritian flour than to purchase domestically produced wheat.

The result of this fiasco is that maize production has taken a sharp decline this season (the maize milling giant has imported maize from Zimbabwe to meet the shortfall), wheat farmers have vowed never to sell to the wheat milling company, bank provisions for bad debts on agricultural lending portfolios are averaging 50%, many farmers are on the verge of bankruptcy/insolvency, and there is grossly inadequate government concern at this looming crisis.

<table>
<thead>
<tr>
<th>Sector</th>
<th>% change in output (1988/93)</th>
<th>1992/93</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture</td>
<td>(5.8)</td>
<td>52.1</td>
</tr>
<tr>
<td>Mining &amp; Quarrying</td>
<td>(3.3)</td>
<td>(1.1)</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>19.8</td>
<td>5.8</td>
</tr>
<tr>
<td>- Food, Bev, Tobacco</td>
<td>47.9</td>
<td>14.3</td>
</tr>
<tr>
<td>- Textiles and Leather</td>
<td>(33.5)</td>
<td>(22.9)</td>
</tr>
<tr>
<td>- Wood products</td>
<td>22.5</td>
<td>(18.3)</td>
</tr>
<tr>
<td>- Paper products</td>
<td>(16.7)</td>
<td>(9.4)</td>
</tr>
<tr>
<td>- Chemical, rubber</td>
<td>(8.1)</td>
<td>4.0</td>
</tr>
<tr>
<td>- Fabricated metals</td>
<td>23.4</td>
<td>9.5</td>
</tr>
<tr>
<td>- Other manufactures</td>
<td>(4.4)</td>
<td>(4.4)</td>
</tr>
<tr>
<td>Electricity, Gas, Water</td>
<td>(17.9)</td>
<td>(10.2)</td>
</tr>
<tr>
<td>Construction</td>
<td>(15.2)</td>
<td>0.0</td>
</tr>
<tr>
<td>Trading</td>
<td>0.1</td>
<td>11.8</td>
</tr>
<tr>
<td>Restaurants &amp; Hotels</td>
<td>60.2</td>
<td>(0.9)</td>
</tr>
<tr>
<td>Transport, Storage &amp; Communications</td>
<td>(18.4)</td>
<td>8.5</td>
</tr>
<tr>
<td>Financial Institutions</td>
<td>(10.2)</td>
<td>0.0</td>
</tr>
<tr>
<td>Real Estate and Business Services</td>
<td>(19.9)</td>
<td>3.0</td>
</tr>
<tr>
<td>Social Services</td>
<td>3.8</td>
<td>(2.6)</td>
</tr>
<tr>
<td>Import Duties</td>
<td>4.2</td>
<td>15.2</td>
</tr>
<tr>
<td><strong>Total GDP</strong></td>
<td>1.8</td>
<td>9.2</td>
</tr>
</tbody>
</table>


The impending maize marketing disaster of the 1993/94 season is worth noting. Due to persistently high interest rates and poor bank liquidity, as well as because of more attractive alternative investment opportunities, namely TBs, the private sector cannot take the lead in maize marketing. There is still a recognized need for government to provide about K60 billion for maize and fertilizer marketing to be administered by the private sector under a revolving fund managed by a commercial bank.

The season is about to commence yet only K1 billion of the required K60 billion is in the fund and the balance will not be provided because this will hinder government from achieving World Bank conditionality targets. A cost-benefit analysis must be done on such matters.
Manufacturing

For the last seven consecutive years, the manufacturing sector has been in decline. This situation is worsening rather than improving. A survey by the Zambia Association of Manufacturers (ZAM) revealed that in 1993, 17% of its members ceased operations and 24% are likely to collapse in 1994 if current trends continue. The implications for employment (each employed Zambian has an average of seven dependents) and production can become socially explosive.

The decline in manufacturing must be conceptualized with the following information fully understood. The post independence manufacturing concerns were mostly funded through loans by the Development Bank of Zambia (BDZ). This was because multinational corporations and high net worth foreign investors would not invest in Zambia during an era of nationalizations and Socialist economic policies.

Recipients of DBZ loans obtained up to 75% finance for projects from the bank (there was no wealthy indigenous class of entrepreneurs shortly after independence so there was little equity to finance projects) and funded working capital requirements using overdraft facilities. During the period of an overvalued exchange rate and suppressed interest rates, the sector boomed.

The factors that have proved injurious to the manufacturing and agricultural sectors are, generally, applicable to this sector, which has also declined despite the fact that non-traditional exports are expected to be a major growth area. Zambian non-traditional exports became less competitive in 1993 for the following reasons, and are not likely to rebound rapidly:

- there has been no government effort to pressurize countries engaging in unfair trade practices to open their own markets, which Zambian exporters are struggling to penetrate;
- exporters suffer double taxation by paying sales tax on utilities and services, duties and sales taxes on inputs, and final taxes on their export products. The introduction of value added tax and a workable duty drawback system is likely to improve the station in future;
- transport costs are high and escalating, as are fuel, electricity, and other costs that must be incorporated into the sale price;
- finance charges now constitute the largest single cost centre on the profit and loss accounts of many exporters, and they cannot sustain activities competitively against international competition that has accessed credit at 4 - 10% in dollars;
- the rapid, and unanticipated, appreciation of the Kwacha against convertible currencies created massive dislocation in this sector as it became unprofitable to export for cheap dollars while facing a ratchet effect on Kwacha costs.

Financial liberalization increased obligations denominated in hard currency by up to 7,000%. Kwacha linked liabilities attracted rates of interest which peaked at 140%. Furthermore:

- liquidity in the market contracted severely;
- trade restrictions were withdrawn, leading to an important boom;
production costs, such as electricity, fuel, telecommunications, wages, all multiplied due to price decontrol across the board, making local manufacturers uncompetitive against foreign competition, much of which was smuggled in;

- the manufacturing community has protested strongly to government on the fact that countries engaging in unfair trade practices are not being penalized by the domestic tax regime, and the level of smuggling is very high, negating the impact of existing duties and taxes. Furthermore, the uneven rates of implementation of PTA tariff rates have weakened the position of Zambian manufacturers vis-a-vis regional competitors who continue to enjoy a protected environment characterized by incentive schemes and subsidies.

Non-Traditional Exports

The prognosis for this sector is not entirely negative. There have been notable successes in horticultural and floricultural exports, and it is anticipated that there will be growth in these sectors, which now operate on a dollar basis, if access to foreign currency loans, at interest rates below 10%, is achievable.

Parastatals

Acknowledged by the government as a major catastrophe, the Parastatal sector has deteriorated further during the liberalization period, suffering the same difficulties as manufacturers and farmers, but further debilitated by staff demotivation, "spontaneous privatization", "cannibalism", and short sightedness arising from the impending threat of privatization, which they have been expecting for the past two years. Recent reports indicate that even previously profitable Parastatals are now suffering negative net cash flows, ranging from ZCCM, which suffered a K48 billion loss in the quarter ending 31 December 1994 to Zambia Breweries, Supa Baking Company (probably the only loss making bakery in Zambia) and all the state trading companies.

The slow pace of privatization is exacerbating the problem by leaving the companies in administrative limbo, without access to fresh capital or medium to long-term strategic planning because of uncertainty.

Two years into the privatization program, revisionists, dubbed the "Kremlin boys", who are opposed to privatization, are gaining support as they question the utility of privatization, highlight the current state of Parastatals awaiting sale, warning about possible retrenchments, neo-colonialism by Multi National Corporations, and, no doubt, reminding those who can benefit from contracts with Parastatals to recognize that those arrangements could be lost if the companies are sold to the public. Moreover, there is no domestic finance available to finance private sector acquisitions of parastatals, interest rates are too high, alternative short term instruments are too attractive, the process is too slow, and the dilapidated state of the parastatals requires heavy new investment capital which is also not available at present. As long as this situation prevails, privatization will falter, the state of the economy will decline in line with parastatal deterioration, and the Privatization concept will earn greater disfavor and skepticism.
Tourism

Despite the acknowledged failure by government to allocate budgeted resources for infrastructural rehabilitation and development, there has been an increase in the number of tourist licenses issued, 58 were granted in 1993, up from 38 in 1992, and a total projected investment in tourism of K2.8 billion was expected. International tourist arrivals increased by 2.4% in 1993, according to the Zambia National Tourist Board (ZNTB). There is no policy on tourism to date and investors are forced to endure up to two years of bureaucracy and paperwork before they can obtain all necessary documentation to commence their project, unless they win favor with key decision makers in the system early on.

The poor infrastructure, high cost of facilities, little international marketing, and stiff competition from better organized tourism industries in Zimbabwe, Kenya South Africa and others has ensured that Zambia’s tourism boom remains a pipe dream.

Financial Services

One of the success stories of structural adjustment, the Zambian financial services sector, is expanding rapidly and prospering. With the notable exception of the Zambia National Commercial Bank (ZNBC), the State owned banking giant, commercial banks in Zambia have registered record profits in the 1993/94 financial year. There has been an estimated net transfer of capital from the agricultural sector to the banking sector of K9 billion in 1992 (no figures are available for 1993) and the high bank profits reflect a strong capital outflow from other sectors, namely government (through Treasury Bills), the productive sectors (through interest on loans and overdrafts as well as margins obtained by banks on interest rate differentials), and the general populace, (through 20% margins earned on foreign exchange trading and deposit/loan rate differentials). Financial deepening occurred in the financial services sector with the introduction of Merchant Banks, public investment funds, the Lusaka Stock Exchange, and the registration of an additional 10 banking institutions (most of which are accumulating operating capital through rolling Treasury Bills stocks). There is a strong possibility that externally funded venture capital funds will be established in the near future to supplement wholly inadequate domestic financing sources.

The Development Bank of Zambia has taken on the attributes of a commercial bank, disbursing credit in dollars at 12 - 14%, requiring hard currency borrowers to bear the full brunt of exchange losses, charging interest rates averaging 112% on Kwacha denominated loans, in effect compelling the borrower to repay the amount borrowed twice before an average industrial project has been fully commissioned and operationalized.

Mining

As alluded to above, the main mining activity, that of copper mining by ZCCM is in a significant loss position. The options for privatizing or not privatizing ZCCM are currently being studied by government. Gemstone mining is generally a very profitable endeavor, except again for Kagem, the state owned emerald mining company that, inexplicably, is unable to cover staff costs. Liberalization of foreign exchange regulations, particularly the introduction of an export retention scheme, has encouraged gemstone exporters to enter the formal economy. It is estimated that up to US$400 million
in Zambian gemstones is exported annually, of which a small percentage is officially recognized. Little effort has been made to absorb illegal miners or smugglers into the formal tax system.

Trading

The trading sectors, with the exception of the State owned chains, enjoyed significant growth over the past two years. Merchandise imports have increased by over US$500 million (as exports declined) and the system has been streamlined to make obtaining foreign exchange, an important license, and trading license, very easy. To illustrate the above points, imports as a proportion of GDP rose from 26.87% in 1988 to 41.41% in 1993, and exports increased from 34.20% to 40.19% of GDP during the same period.

The Social Impact of Adjustment

The idea of developing some form of short-term action program aimed at addressing the problems of the poor and vulnerable groups is justified in recognition of the reality that, in the short-term at least, adjustment creates difficulties for two basic reasons. First, since economic restructuring of an economy with deep-rooted structural rigidities is usually sluggish and uneven, it is normal that some forms of compensatory mechanisms (e.g. transfers) and related ‘safety nets’ ought to be put in place to cushion the vulnerable groups. After all, under structural adjustment, firms and labour markets do not adjust immediately while the country experiences higher un-and under-employment and labour incomes decline.

Second, in the adjustment effort’s attempt to reduce demand, the average citizen’s consumption is hurt. As the 1990 World Development Report that focused on poverty noted, "the need for cuts in public spending can lead to a particularly sharp short-run conflict with... essential parts of the strategy... [of] delivering social services and providing transfers and safety nets" [p.103].

The above realities have been evident in Zambia’s structural adjustment efforts. Overall, the inevitable economic contraction that results from stabilization and adjustment policies has ignited unprecedented high levels of transitional unemployment that, in turn, has had a telling effect on, inter alia, household food security. Complimentary to this are declining income levels. For example, real national weighted average annual basic pay for workers over the 1983-91 period (at 1983 constant prices) declined by 58.3%. For the majority of employees in Zambia, wage levels have reached a stage where they are no longer able to meet their basic needs. Food price increases over the years have been phenomenal. For example, between October 1991 and October 1992, the average price of maize meal (the staple foodstuff) had gone up by 437.5% although, on the other hand, nominal wages for the low and medium income groups increased by about 100%. All indications suggest that there is a strong correlation, at least in the short-term, between household food insecurity and the government’s combined policy of subsidy elimination; price liberalization and wage restraint especially when these measures are put in place without a corresponding effort in the development of compensatory measures targeted at vulnerable groups. 1991 figures suggest considerable increases in vulnerability. In that year, for example, half of the country’s households were below the average national monthly expenditure. Indeed, the bottom 30% of Zambians utilized (in 1991) up to 85% of their total income on food purchases per month.
Against the above background, reduced household access to nutritionally adequate food basket has resulted in serious health problems, particularly for children. 1992 statistics present the following picture:

- 40% of children (0-5 years) are chronically malnourished;
- approximately 20-30% of hospital admissions in children 0-5 years are associated with malnutrition;
- severe clinical protein energy malnutrition is a major cause of morbidity and mortality in children;
- malnutrition is the leading cause of death in children aged one and 14 years, accounting for 31.3% of deaths.

Access to basic education has also been severely affected by the government's austerity measures as budgetary cutbacks, chiefly targeted towards the 'non-productive' social sectors, have affected both enrollment levels and the quality of the service delivered. The declining educational standards are explained by a host of reasons chief among which being the declining real public expenditure on education over the years (under the policy of cost recovery/sharing). For example, whereas the share of the educational sector in total government expenditure stood at 13.8% over the 1981-85 period (i.e. before fully-fledged SAP), this declined to only 9.8% over the 1987-91 period. Against the above background, it is noteworthy that the social impact of adjustment measures ought to be addressed by way of properly conceived and targeted social service interventions. The country's Social Action Program that aims at addressing these issues is far from being perfect.
Key Points on Structural Adjustment in Mozambique
Daniel Gabriel Tembe
MINISTRY OF COMMERCE

We are honored to be able to present before such distinguished participants something of Mozambique's experience on the implementation of its structural adjustment program.

In our opinion, gatherings of this kind and magnitude merit special attention from all of us, as they provide an excellent opportunity for policy makers to reflect on the policies being implemented in each of our countries, helping motivate African economies to think about models that are more appropriate to our realities.

This meeting is taking place at an unprecedented moment in the history of our continent. The victory of the ANC and the election of Nelson Mandela in South Africa synthesizes the triumph of democratic processes in Africa, a process which Mozambique is currently undertaking.

The changes that have occurred in South Africa will have, forcibly, an impact on the social and economic life of the region. It is vital to take these into consideration in design of policies in each of our countries as well as in the adjustment of strategy on regional co-operation.

Adjustment in Mozambique began in 1987 in the framework of the Economic Rehabilitation Program which, since 1990, includes the social component assuming now the form of Economic and Social Rehabilitation Program (ESRP).

Unlike many developing countries, whether in Africa or Latin America, adjustment in Mozambique is taking place in the economy, a factor which may explain the importance the government places on economic liberalization within the context of the entire program.

Another aspect specific to Mozambique is the fact that the ESRP was introduced during a war, a war which affected the entire country economically as well as socially, particularly the rural areas and the most disadvantaged population. Nevertheless, the government judged the timing to be right to go ahead with the reforms while, at the same time, making all the efforts to end hostilities through negotiations.

The essential aim of the program was to reverse the downward spiral the economy had been experiencing since the early 1980's and to reduce macro-economic disequilibria, thus creating conditions for continuous economic growth. Within the program, special attention was to be given to the most vulnerable population, through specific programs of humanitarian assistance, education and job creation.

The strategy of liberalization set in motion in Mozambique was based, essentially, on the following points:

- Reforms of foreign trade, which included ending the monopolies on import and export operations and significant reduction of tariff and non-tariff barriers;
• Elimination of administrative controls on most internal prices, allowing market forces to determine them freely;

• Privatization, which includes not only small and medium-size enterprises but also large state enterprises in the agricultural, industrial and service sectors. Where the state is retaining ownership of enterprises, efforts are being made so that they are run efficiently allowing market-based operations. There are also other modalities including management buy-outs and management contracts;

• Legal-institutional reform, which includes revising legislation and adjusting institutions to respond to the new environment. It should be emphasized here the importance of effective implementation of institutional capacity-building programs or projects;

• Reform of the financial system, which includes opening the market to private capital both national and foreign. Successful examples of this reform can be seen in banking and insurance sectors;

• Removal of administrative controls on interest and exchange rates;

• Expansion of the financial sector to new enterprises and products, including the creation of the Secondary Exchange Market.

Evidence shows that the economy has reacted quite positively to the reforms. Effectively, since the introduction of the ESRP, the country has registered positive economic growth. Furthermore, agreements entered into with multilateral organizations have enabled our country to benefit from international experience and we have strengthened our capacity for macro-economic management, internal co-ordination among various institutions and improvement in the preparation of statistics.

In terms of the real economy, the adjustment program has focused on the promotion of exports as a mean of economic growth and a source of foreign exchange with the aim of improving our balance of payments. Since the implementation of the ESRP, and notwithstanding the fact that the volume is still modest, export of goods and services have shown real increases and are much higher than the growth of the GDP. We can state with satisfaction that, besides the effort in terms of increase, the economy has also reacted to the reforms through the diversification of exports, which means a larger internationalization of the products made in Mozambique.

In Mozambique, we have learned that the success of adjustment programs requires that the entire society be familiar with the program. Accordingly, we would like to point out that in our country we have established a technical team, known as the "Group Technico", which is comprised of experts from those institutions most involved in the definition of macro-economic policies. This group is responsible for the technical negotiations with the Bretton Woods institutions. This experience is proving to be quite useful. In fact, this group has been producing reports for the government on the program's implementation, which has resulted in an increasingly greater involvement by all sectors in the reform process.

Despite the progress made up to now, which is the result of countless sacrifices borne by the Mozambican people and the support made available by the international community, there are still many problems which continue to exacerbate the situation. Mozambique is still a poor country with a per
capita income far below the average for African countries and a high illiteracy rate. The country continues to suffer the burden of a growing foreign debt.

Regarding the running of the adjustment program and its collateral aspects in the economy and the society in general, certain points merit our reflection:

- The functioning of the Mozambican economy, within the framework of the program and as the result of existing structural problems, is dependent on foreign aid in the form of confessional loans and grants. However, there are disturbing factors such as the granting of tied aid, which constitutes an exogenous factor affecting the relative prices within the economy. With nearly three hundred NGO's operating in Mozambique channeling foreign aid, the government has to expend additional efforts to co-ordinate, harmonizing criteria and control their work;

- Regarding the phasing of implementation of the program, the reform of the financial systems is preceding sectoral reforms; this has macro-economic and structural implications. This poses a problem of sequencing in that changes in the financial sector should result from the needs and requirements of a dynamic entrepreneurial sector and not vice versa;

- Still, regarding sequencing, a question has been raised about how long each stage should last. The experience in Mozambique shows that the adjustment and subsequent liberalization of prices, such as interest and exchange rates, should be gradual while, at the same time, authorities should be preparing the community for the subsequent adoption of indirect controls, especially in the financial sector.

- Finally, the adoption of reforms by each sector involved in the program raises many areas of conflict, which can only be resolved with persistence and courage.

In Mozambique's case, monetary policy has meant credit restriction while, on the fiscal side, the increase of expenditures has been unavoidable given the involvement of the Government in the peace and democratization process. These two potentially contradictory situations have prevented state savings from being channeled to the private sector, an important factor for economic growth.

We are clear that the battle for economic development in Mozambique is far from over. However, we are encouraged by the environment created by the Peace Accord signed in Rome in 1992. Indeed, the positive indicators of 1993 - the first year of peace after the introduction of the ESRP - only confirm that war was one of the main obstacles to economic development in Mozambique. It is with this hope that we are moving towards a democratic and multi-party electoral process, convinced that in a climate of peace and appropriate economic policies, we will be able to create the necessary conditions for a sustainable economic growth.
The Worker's View of Structural Adjustment
Soares Nhaca
MOZAMBIKAN WORKERS ORGANIZATION

Introduction

This document was prepared primarily to summarize and systematize the viewpoint and suggestions of Mozambican workers regarding the negative impact of the Structural Adjustment Program (SAP) in Mozambique. The principal elements discussed in this document basically come out of the labor movement's internal debates and participation in conferences on socio-economic development in Mozambique. It is not our intent to address every aspect of the issue in this document, but rather, to offer a critique as well as concrete proposals from the perspective of the labor movement.

Negative Impact of the Structural Adjustment Program

The problems facing the Structural Adjustment Programs (SAP) in Mozambique are not very different from those facing programs in other countries in the region. For Mozambique, the past seven years have cast yet another dark cloud over the lives of the poorest workers, who are our members. In a desperate effort to salvage our economy, our government has engaged in the SAP. Needless to say, these programs have had a devastating effect on the vulnerable members of our society, including the workers.

In virtually every major country with a Structural Adjustment Program, life has become unbearable due to the stringent measures taken, including retrenchments, removal of all subsidies (even on staple foods), privatization, massive currency devaluation and labor redundancies which they undertake en masse without consulting the social partners in general and the trade unions in particular. The cumulative effect of these measures is seen in the worsening standards of living due to unemployment and the high cost of living. The negative effects of the SAPs, especially the profound cuts in the social sector, are socially unacceptable and politically unsustainable since they have strong repercussions on the quality of life and on political, economic, and social stability.

Today we are also faced with the stagnation, or decline in real terms, of the flow of foreign aid to Africa, and to our region in particular, as a consequence of the state of abandonment to which Africa has been relegated by the region's traditional creditors and donors, who recently have been more concerned with Eastern Europe and Asia. Furthermore, we are faced with the continuous and persistent deterioration of the terms of trade. That is, our imports are increasingly more expensive and our exports increasingly worthless. This places almost every African country in a position of extreme dependency on foreign assistance in the form of donations, credits, and foreign investment and, consequently, vulnerable to the fluctuations in the flow of foreign assistance. In Mozambique, our exports only cover on average 15% of our imports and we cannot even pay the interest on our foreign debt, which totals some US$ 190 million. In Mozambique, our external debt in 1993 reached US$5.3 billion, or almost five times the value of the Gross National Product (GNP).

For structural adjustment programs to succeed in Africa, donors must take a more realistic position, as well as some courageous measures. It is necessary to go further and attack realistically
and objectively the problems of aid dependency, the unsustainable burden of the foreign debt, the scarcity of external financing for the normal functioning of the economy, the rising costs of inputs caused by constant currency devaluations, and the increased cost of capital. The World Bank and the International Monetary Fund should re-examine realistically the "Lagos Plan of Action" and other African initiatives designed to help narrow the gap separating North and South.

This is the scenario that characterizes the majority of developing nations, and Africa in particular, where three-fourths of the world's population lives. In fact, a significant portion of the world's population continues to be excluded from all possibilities of participating in the formation of viable strategies for socio-economic development. They are treated as mere spectators, with negative consequences for social equality and the very survival of democracy.

In our countries today, troublesome phenomena are increasingly more common. For example:

- the deterioration of moral values and increased corruption;
- increased social injustice;
- acute crisis in education and health;
- increased incidence of violence, crime, and marginalization;
- rising unemployment and under-employment; and
- high rates of inflation that stem especially from insufficient structures of supply in comparison to demand.

The serious political, economic, and social situation in which Africa is buried and the gloomy prospects for short-term economic growth have already begun to precipitate social instability with unsustainable social and economic costs. It is therefore vital and urgent that financial institutions give indications that they understand the gravity of the problems; not simply formal declarations of intent but concrete and comprehensive decisions that will redress whatever was unable to withstand the test of reality.

We firmly believe that only credible and socially acceptable macro-economic policies can reverse the present situation. Thus, we propose that:

- international financial institutions, such as the World Bank and International Monetary Fund (IMF), ease the rigid conditions they normally impose on countries receiving credit and donations as conditions for concession of these credits;
- the World Bank and IMF be more receptive to socio-economic development plans designed by local experts in those countries;
- the human development index be considered a principal indicator and that mechanisms to raise the index be activated; it is not socially just that important sectors such as health and education be sacrificed under the pretext of containing social expenses;
- the World Bank and IMF review their current policies in order to give new impetus to the development of coherent assistance policies and to establish new medium- and long-term strategies;
• governments should assume their roles as champions of morality by adopting effective measures of justice and social solidarity that the real economy can permit;

• within the context of the "Year of the Family" proclaimed by the United Nations, governments should increase their commitment to families through concrete action;

• measures be adopted that involve real austerity in public expenses and better utilization of foreign aid;

• all social partners be more involved in the adoption of macro-economic development policies. Within the context of implementing the Social Charter of the Workers of Southern Africa, regional governments should create the conditions necessary to strengthen the role of the social partners. Strengthening the role of the tripartite system must not be seen as an obstacle to economic reform. On the contrary, strengthening this role would be an important step in the development and integration of a global development strategy at all levels.

• In the development of short- and medium-term policies, particular attention be paid to supporting small- and medium-size enterprises as levers for development and the condition for creating new jobs. Small and medium enterprises present themselves today as the renewed hope and privileged pole for development. It is important to know how to attract small- and medium-size enterprises from the northern hemisphere to cooperate in joint ventures with the small- and medium-size enterprises in the southern hemisphere.

• Structural policies be adopted with the goal of improving the qualifications and adaptation of the work force to new demands.

• It is urgent that the phenomenon of excluding local technical experts be reversed by adopting accessible, less complex development projects in order to increase their involvement and guarantee the continuity of such projects. By excluding local technical experts from the conception of development projects, these projects no longer become viable after the foreign experts leave. This also constitutes a subtle drain of donated funds, which revert to the donor countries. Technical experts who come to a country in the name of co-operation programs often consume a significant part of donated funds in administrative, advisory, and other costs. The same occurs with certain non-governmental organizations which, in the name of concerned citizens, continually mount assistance campaigns and then end up themselves as the primary beneficiaries of such assistance by using them to cover the administrative costs of their organizations.

Although Mozambique is the largest recipient of foreign aid in all of sub-Saharan Africa, this still does not translate into viable results because a large portion of those funds were drained back to the donor countries. It is therefore urgent that the World Bank, IMF and governments in the region take a clear stand so that the policies necessary for rapid reversal of the present situation can be made quickly and implemented in order to respond to the expectations of the majority of citizens and re-establish their confidence in the viability of agreed upon socio-economic development projects. The industrialized nations must change their attitude with regard to co-operation programs with developing countries. The very foundations of these programs must be different from those used in the past.
Specific Constraints to Structural Adjustment Programs in Mozambique

Structural Adjustment in Mozambique is strongly influenced by four endogenous and interdependent processes:

- the shift from a centralized economy to a market economy;
- the transformation from a country devastated by a prolonged war to the re-initiation of an economy for national reconstruction;
- the transformation from one a one-party state to a multi-party state; and
- the unfolding of an international environment unfavorable to the development of the underdeveloped countries.

Such complex transition processes taking place simultaneously on a foundation of deeply rooted weak structures and widespread poverty proves that the problems of development in Mozambique can only be overcome in conjunction with political and social stability and a change in attitude by the potential creditors, given the specific problems of a post-war Mozambique.

Countries in a situation such as Mozambique, with a GNP per capita of about US$ 80 in 1993 and an economic fabric in virtual ruin with high unemployment and underemployment, with high infant mortality and malnutrition, with 60% of the population living below the poverty level, with 5.6 million people to relocate, and with 1.6 million refugees in neighboring countries, half of whom have already returned home, it will be difficult for such rigid measures to have a positive impact on the country.

Mozambican workers are increasingly aware of the seriousness of the socio-economic crisis facing the country and of the necessity of structural adjustment programs. However, the sacrifices must have limits. Based on what we have read and reflected upon regarding the present pace of development, the transition to sustainable development will take much longer than originally foreseen. However, the destruction of such a situation will inevitably have serious consequences for Africa which can be likened to the delayed effects of a bomb.

Based on the available data, we feel that the predictions made when the Structural Adjustment Program was introduced were done so on an unrealistic basis. It is urgent they be revised in order to reflect the objective reality and relieve the Mozambican people of the heavy sacrifices the program demands they make. In that context, we are apologists of a more humane development strategy whose epicenter resides in people and which can combine and harmonize economic and social aspects.

We are in favor of people-centered development. Equitable and socially and ecologically sustainable development. Pro-poor, pro-employment, pro-public health, pro-education, pro-women and youth, and pro-environment development. This program fails by its inability to reconcile the need for economic return with the demand for equality and protection for workers and their families.
Mozambican workers are increasingly pessimistic and disillusioned with the ruinous results of the Structural Adjustment Program. Unless its mentors can read the signals that the workers have been sending out day after day, such programs cannot count on our sympathy.

Given this situation, it is important that the international financial institutions know and are aware that Mozambique's socio-economic development will continue to require the substantial mobilization of external financial assistance for a long time to come. Since internal savings will continue to be negative or low in the foreseeable future, growth will have to be significantly supported by direct foreign investment.

On Unemployment

In present circumstances in Mozambique, unemployment has already taken on fatal proportions. Those with jobs as well as those without find themselves in an emergency situation. Dissipating work of its value and its ensuing devaluation is a danger with incalculable economic and social costs.

Unemployment in Mozambique must be viewed seriously and with considerable reflection. It is a phenomenon caused by demographic growth indices surpassing economic growth indices, the entry into the job market of both first-time employees and those who have been laid off by public and private enterprises, the exodus from the countryside to the city, and lastly of the war that ousted thousands of peasants from their homes and workplaces. All of these factors have had serious implications for unemployment and under-employment rates.

Given this situation, we must ask the question: How can we minimize unemployment and maximize employment? In our opinion, small- and medium-sized enterprises are the best means to lead us in the desired direction.

Training Professionals and Technical Experts

Technical and professional training is of indisputable value to the sustainable development of the Mozambican economy.

The poor quality of Mozambican workers has to do with the overall lack of qualified personnel, a situation which has been exacerbated by the drain of personnel from government and state enterprises to non-governmental organizations and international organizations. This also exacerbated the weakness of the government structure and reduced its capacity. Thus, it is urgent that the interested parties, namely the social partners, work relentlessly towards encouraging the training of the labor force as human capital vital to development.

Final Considerations

In conclusion, we would like to emphasize that the objectives of the Structural Adjustment Program present themselves as technically attractive. For this reason, we are convinced that, if coherently implemented, they can constitute a valid instrument to stem the decline of Mozambique's socio-economic development and re-launch development.
Keeping in mind that each country has its own characteristics and circumstances, we believe that an economic rehabilitation model cannot be transferred to countries that are so different in such a rigid, automatic, and standardized manner. The international financial institutions seem to be more concerned with applying liberal economic theories in countries that do not yet have the conditions, the culture, or the mentality to operate a free market completely open to international competition, than in confronting objective reality in order to develop coherent alternative development theories based on the realities and characteristics of those countries.

The Structural Adjustment Program should start from the presupposition that there is no one sole prescription for so many different situations. For example, many of the measures anticipated in the Structural Adjustment Program for the restarting of production here have not had the desired impact and so Mozambique has become a preferential market for imports from neighboring countries. As for us, the workers, a market economy without rules is not a market economy. Although we are convinced that the path of structural readjustment is essential and useful, we are in favor of a more humane and balanced program that can accommodate and reconcile both economic and social aspects.
Introduction

A land-locked country in South Eastern Africa, Malawi has a total area of 118,484 square kilometers, a fifth of which is covered by water. Malawi’s economy is characterized as fragile as well as having a narrow resource base. Of the total population of at least 8 million, 89% live in rural areas. An estimated 81% of this population are smallholder farmers residing in the rural areas.

The economy is mostly modelled around a dualistic agricultural sector that is constrained by a rapidly growing population and limited resources. Agriculture is the economic backbone of the country generating approximately 40% of GDP. Agriculture also accounts for about 77 per cent of national export revenue. Almost 90 percent of all Malawians earn their livelihood from agriculture.

Malawi has one of the lowest per capita income levels in the world as well as pervasive poverty. GDP per capita in 1988 was US $170. The Malawian economy registered strong growth and structural transformation in the 15 years following independence in 1964. The annual growth rate of real GDP averaged over 6% or around 3% in per capita terms. Gross domestic investment which was 8.6% of GDP at independence when domestic savings were virtually nil, rose to 28% of GDP by 1979 with a savings rate of 15.2%. Export performance was also impressive with the volume of exports growing at an average rate of 4.5% compared to that of imports which was 3.5%.

This impressive economic performance was a result of favorable policy and an economic environment which supported rapid expansion in export-oriented agriculture. The economic environment was generally conducive to the operations of private enterprise: state-owned enterprises (parastatals) were confined to a few key sectors; tight monetary policies contained inflation at 8% per annum during the 1970s; the foreign exchange rate was not allowed to appreciate and in fact the real effective exchange rate depreciated by 15% between 1968 and 1980 while those of other Sub-Saharan countries appreciated; the trade regime was relatively open with low nominal tariffs (averaging 12%) and minimal use of quantitative import restrictions thereby discouraging inefficient import substitution; a wage restraint policy improved the competitiveness of the country’s exports.

These successes were interrupted by problems from three sources, namely: external and exogenous shocks; the policy responses; and internal structural imbalances. This combination resulted in no growth of GDP in 1980 and a decline of 5.2% in 1981.

This paper reviews the causes of the crisis in Malawi’s economic performance and her response to it under the World Bank/International Monetary Fund (IMF) sponsored economic reforms amid a worsening debt situation.

Contrary to the generally held view, the economic problems had perceptible beginnings in the early 1970s and only precipitated in the late 1970s due to compounded external pressures.
The experience of the 1980s has not been uninterrupted sustained growth. In fact, 10 years after the introduction of the first reforms, economic growth has not reached sufficiently high rates to reverse losses suffered earlier and to accommodate a fast-rising population and the requirements of debt servicing. The structural changes that have been achieved so far have been limited partly because some of the reforms are still quite recent while others have not been fully implemented. Because of poor industrial linkages and still undiversified export base, the economy will continue to be vulnerable to external market conditions. The balance of payments and the external debt servicing problems will continue to rely on massive financial inflows.

Other considerations, such as pressure to improve the situation in the human resources area, continue to impose pressure on the government deficit and hence external borrowing. Given the circumstances, it is unlikely that Malawi will be able in the short to medium-term to extricate herself from a spiralling debt problem even though the terms have become milder. Performance in the external sector will continue to depend on the external transportation routes whose problems still remain.

The Structural Adjustment Program (SAP) launched during the 1981/82 period was introduced so as to restore the economy to some level of sustainable economic prosperity.

The Malawi Poverty Scenario

Before we discuss the Structural Adjustment Program it is imperative that we first show the extent of poverty in Malawi so as to appreciate the impact of SAPs on one major sector of the society. According to the "Situation Analysis of Poverty in Malawi", poverty in Malawi is characterized by the lack of productive means to fulfill basic needs such as food, shelter, education and health. The major common economic characteristic of the poor is that they lack productive assets. Their economic and social marginalization is reflected in the indicators of social well-being. They suffer from undernutrition even after spending a higher budget share of their income on food (>63% of the low income urban population in Malawi spend their budget share on food alone - see Chilowa and Shively, 1989). Average death rates and infant and child mortality rates are high. Illiteracy, like undernutrition is almost synonymous with absolute poverty.

Taking the above as a measure of poverty in Malawi, then it is clear that there is indeed pervasive poverty in the country (see Annex 1 for the country's socio-economic indicators). More than half of the population of Malawi live below the poverty line. Rural poverty is estimated at 60% while the same is true of 65% of the urban dwellers. The poor in Malawi, therefore, include all those unable to meet their nutritional requirements and essential non-food needs equivalent to $40 per capita per annum. (United Nations/GOM, 1993).

Malnutrition rates in Malawi are among the highest in Africa. Infant mortality rate is 135/1000 live births. Child mortality rate is 234/1000 live births. (DHS, 1992). Total literacy rate is 41% of which 33% are women and 67% men. Female literacy rate is only 25%. Per capita income (at 1978 prices) has been MK118.94 on average between 1978 and 1991.

The Malawi Government has identified the following functional groups of households as being vulnerable:
(a) smallholders with less than 1 hectare of land
(b) estate wage employees
(c) estate tenants
(d) the urban poor
(e) female headed households and
(f) children (United Nation/GOM 1993).

Below are six factors that have been identified by the World Bank as contributing to high levels of poverty in Malawi:

(a) limited employment opportunities
(b) low physical productivity of labour and land
(c) low levels of human capital
(d) limited access to land and economic rents
(e) minimal income transfers; and
(f) rapid population growth.

According to the Poverty Situation Analysis in Malawi, limited access to resources by the majority of the population appears to have been the key factor influencing the persistent poverty in the country. A related factor is inappropriate development strategies. The analysis further states that "poor distribution of resources coupled with rapid population growth and a hostile external environment appear to be the major reasons for limited access to resources. Land constraint is the main reason for food insecurity and this is made worse by limited access to improved technology and inputs. At the same time it has been shown that in some areas, the little land that is available is highly concentrated in a few hands.

Fifty five percent of smallholders cannot satisfy their subsistence requirements from their own production. These have less access to fertilizer, extension advice and incomes. Lack of income leads many farmers to work at very low wages or to sell part of their subsistence produce. Obviously this increases their food insecurity situation. Another major cause of poverty in Malawi is underemployment and unemployment. The formal industrial sector has stagnated in the last decade and it is unable to absorb the unemployed labour force. Wage adjustments in relation to the cost of living have consistently fallen behind. Between 1989 and 1990, for example, the purchasing power of the minimum wage fell by 12% (of Poverty Situation Analysis).

Malawi's Experience with Structural Adjustment Policies

For over a decade (between independence in 1964 and 1978) Malawi's economic performance was significant in that almost all key economic indicators experienced comfortable growth rates. During the same period, especially in the 1970s, the economy in general and the agricultural sector in particular experienced the fastest growth in GDP and exports in Sub-Saharan Africa (Christiansen et al, 1988).

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3 See Kandoole, 1989; and World Bank, 1990, for a thorough review of the macroeconomic indicators during this period.
However, this rapid growth accrued to the estate subsector in many instances at the expense of the smallholder subsector. A policy of wage restraint combined with a tax on smallholder agriculture (through the maintenance of a gap between producer prices and international prices) helped to keep Malawian goods competitive on the world market. This favorable economic environment did indeed attract foreign investment.

After 1978 the economy began to weaken. The government and even some western experts (e.g. Harvey, 1981) viewed most of the problems as being rooted in factors external to the Malawian economy. The disruption of trade routes through Mozambique, falling commodity prices, a decline in the terms of trade, oil shocks, and the rise in interest rates on international financial markets, have all been cited as potential sources of difficulty for the Malawian economy.

Indeed, these problems did plunge Malawi from late 1979 into a period of negative GDP growth, with GDP growth rates ranging from -0.4 in 1980 to -5.2 percent in 1981. As shown in Table 1, this resulted in a deterioration of the trade balance, and an increase in budget deficits.

During the late 1970s and early 1980s, the government began to realize that these problems also reflected basic structural weaknesses in the economy that could be attributed to:

- inefficiencies in the production sector as a result of price controls;
- the poor performance of the smallholder agricultural sub-sector in the 1970s due to pricing structure that favored the large-scale estate sub-sector;
- inadequate funding of the principal sectoral activities such as agriculture;
- inefficiencies of most parastatals due to unsystematic and wasteful investments, which resulted in poor financial performance;
- emphasis on a few agricultural commodities (tobacco, tea and sugar) which are subject to wide fluctuations in international prices; and

The Malawi government, therefore, embarked on a program to deal with its structural problems when it became apparent that the economic problems could not be alleviated by continued high levels of commercial borrowing. Three Structural Adjustment Programs were implemented between 1981 and 1986 (see Table 1). These programs have been designed in such a way as to give incentives to the production of tradeables, rationalize government expenditure and strengthen key institutions with a view to setting the stage for sustained macro-economic growth.  

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4 These policies included: diversification and export; price incentives for agricultural production; price decontrol on manufactured goods; high tariffs to discourage imports; wage increase restraints; currency devaluation (about 12 times since 1982); removal of food and fertilizer subsidies; reduced Government expenditures; restructuring and strengthening parastatals with a view to making them self-sufficient; and restructuring the tax system to raise revenue.
Table 1: SUMMARY OF REFORM PROGRAMS, MALAWI 1981-1988

**Smallholder Agricultural Sector**

Policy measure (a): Price incentive  
Problem addressed: Stagnation of production and worsening of food security situation; **Increase export diversity**  
Program: SAL I-III  
Comments: Annual large producer price increase started in 1981, followed by improvements in ADMARC’s purchases.

Policy measure (b): Elimination of fertilizer subsidy - Insufficient fertilizer usage  
Problem addressed: Reduce budgetary deficit  
Program: SAL II-III  
Comments: Four-year subsidy phase out program 1985-86 to 1988-89

Policy measure (c) Expansion of credit and extension services  
Problem addressed: Inadequate credit and low adoption rates of high yielding crop varieties

Policy measure (d) Enhance the role of private traders  
Problem addressed: Financial and operational inefficiency of ADMARC  
Program: SAL I-III  
Comments: ADMARC’s restructuring and divestiture started in 1982. Private traders involvement in marketing enhanced by the 1987 Act.

Policy measure (e) Review land tenure system.  
Problem addressed: Inequitable and inefficient land allocation  
Program: SAL IV  
Comments: Estate expansion in densely-populated areas to be frozen

**Estate Agricultural Sector**

Policy measure: Estate credit facility, training, and extension.  
Problem addressed: Supply constraints and lack of diversity  
Program: SAL I-III  
Comments: AGRIBANK yet to be implemented

**Industrial Sector**

Policy measure (a) Price decontrol.  
Problem addressed: Stagnation and inefficient resource allocation  
Program: SAL I-III
Table 1: SUMMARY OF REFORM PROGRAMS, MALAWI 1981-1988

(Continued)

Policy measure (b) Liberalize licensing
   Problem addressed: Monopolistic pricing lengthy and complicated licensing process and criteria.
   Program: SAL III
   Comments: Industrial Development (Amendment) Act(1988) removed protection

Policy measure (c) Credit guarantee scheme
   Problem addressed: Banks lending only to large-scale enterprises

External Trade Sector

Policy measure (a) Export Incentives.
   Problem addressed: Export diversity and balance of payments
   Program: SAL I-III

Policy measure (b) Maintenance of an active exchange rate policy
   Problem addressed: Deteriorating terms of trade
   Program: SAL III
   Comments: A string of devaluations

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Policy measure (c) Northern Corridor Transport project.
   Problem addressed: Diversification of access routes to sea ports
   Program: SAL II
Table 1: SUMMARY OF REFORM PROGRAMS, MALAWI 1981-1988

(Continued)

Fiscal Sector

Policy measure (a) Tax and tariff reform
Problem addressed: Narrow tax base, inefficient and complicated system, inadequate incentives to producers, uneven protection

Program: SAL I-III
Comments: Shift tax burden from producers to consumers

Policy measure (b) Reduce subsidies on education, health, housing, and agricultural services.
Problem addressed: Budgetary deficits.
Program: SAL III
Comments: Loan scheme for the university, fertilizer subsidy removal program, house ownership scheme, raised departmental charges and fees

Monetary Sector

Policy measure: Flexible interest rates, Reduce domestic public borrowing.
Problem addressed: Negative real bank rates, and savings. Crowding out of private sector borrowing requirements.
Comments: Interest rates raised substantially, but bank liquidity crises occurred early in 1988. Rates revised downwards

Parastatal Sector

Policy measures: Restructure parastatal sector and tariff/price flexibility.
Problem addressed: Poor financial performances and inefficiencies.
Program: SAL III
Comments: Divestiture and asset exchange. Setting up of Department of Statutory Bodies


Following 1982, the economy did begin to regain positive growth in a number of areas; however, real per capita income still remains below its 1970s level. The economy again began to show some strains following 1984 due to an influx of refugees from Mozambique, poor weather conditions, the closure of the traditional transport routes to the sea (Nacala and Beira corridors by 1984), declining levels of foreign aid, and worsening terms of trade, etc. (Cf. Kandoole, op.cit). These contributed to commodity shortages and an increase in inflation. Inflation escalated from 11 percent in 1984 to 31.5 percent in 1988 (Table 2 below). GDP growth fell from 4.3 percent in 1985 to 1.4 percent in 1987. Fiscal deficit rose from 10 percent of GDP in 1985 to 13.1 percent in 1986 (cf. World Bank 1990).
As a response to this further deterioration of the economy the Government formulated a three-year program (covering the period April 1988-March 1991) aimed at deepening and continuing the adjustment reforms. This program seeks to: (a) align aggregate demand with the available resources through stricter fiscal, monetary and credit policies, as well as active exchange rate management; (b) strengthen the role of the private sector through liberalization and improved incentives; (c) improve productivity through addressing policy and investment constraints on performance of the major economic sector; (d) enhance efficiency in the use of public resources.

After the third structural adjustment program, the emphasis has shifted from global to sector credit, Education sector Credit and Trade Policy Adjustment Credit (ITPAC). By and large these sectoral projects are an expansion of the policies contained in the adjustment program. However, a brief mention of ITPAC is in order.

From 1987, Government began the Industrial and Trade Policy Adjustment Credit program. The main aims of the program include:

(a) improving efficiency of resource use;
(b) generating employment; and
(c) increasing exports.

Essentially, this is a trade liberalization and export promotion package which is supported by fiscal and monetary policies, tax reform program and exchange rate management. Some measures have already been implemented such as devaluation of the currency in order to increase the country's competitiveness in international markets and prior Reserve Bank foreign exchange approval has been removed on 25 percent of imported raw materials and spare parts in order to make foreign exchange easily available to basic industries. Fiscal measures such as tax reform which favors investments in the industrial sector have been introduced.

The economy has since 1988 shown some signs of recovery. GDP grew from 3.3 percent in 1988 to 4.3 percent in 1989, 4.7 percent in 1990 and 4.4 percent in 1991. In 1992 GDP growth fell to -7.2 percent mostly as a result of the withholding of development aid to Malawi. However, by 1993 there was a positive growth of 10.8 percent as a result of strong performance of the smallholder agriculture due to very good rainfall during the first quarter of 1993. Although the smallholder sector's output (GDP) grew by 84 percent in 1993 over 1992, the formal sector suffered from a decline of about 4.6 percent in 1993. This is as a result of lack of foreign exchange precipitated by lower export earnings and lower capital inflow. The expected GDP growth in 1994 is -6.2 percent. This can partly be explained by the erratic rainfall and insufficient agricultural input uptake in 1994.

The rate of inflation, though, has continued to be high. It is currently estimated to be around 30 percent (Table 2 below). It should be stressed, however, that improvements in the macro-economic balance (both external and internal) have been caused mainly through the contraction of domestic demand rather than a change in the real structure of the economy, i.e. expenditure reduction rather than expenditure switching.

Although the policy reforms to date might be said to have been necessary in avoiding further deterioration in the economy, they have not been sufficient for increasing the incomes and growth potential of the majority of the Malawian population. Smallholder production (especially maize yields)
has stagnated with the result that pressure on land is for food production rather than diversification into export crops. The majority (over half) of the Malawian population, therefore, continue to have very low incomes.

In part the primary causes of this pervasive poverty can be attributed to high population growth, limited employment opportunities, low incomes and purchasing power, low productivity of land and labour in agriculture, low quality of human capital as a result of low nutrition levels and limited access to education and health services (which are further exacerbated by some of the reform policies) etc.

In order to reduce the deficit the Government embarked on an expenditure reducing policy. For a low-income country like Malawi, this policy is bound to adversely impact the poor. Government expenditures declined from 36 percent to 29 percent of GDP between 1981 and 1986. At the same time, debt servicing consumed an increasing share of Government funds. Debt servicing more than doubled as a share of Government expenditure going from 17 percent in 1977 to 36 percent and 39 percent in 1986 and 1989, respectively (Chilowa, 1988; Kandoole, 1989). By 1990 it was forecast to decrease to 30.1 percent, before debt relief. Interest repayment on external debt amounted to MK105.9 million and MK134.4 million in 1992 and 1993, respectively.

Obviously this high level of debt servicing has been leaving fewer funds available for other categories of Government expenditure. As shares of government expenditure, all other broad categories of recurrent expenditure have dropped between 1977 and 1986.

All in all, it is our belief that these factors, coupled with direct and indirect taxes, have had adverse repercussions on private consumption and hence the welfare of the majority of Malawians, especially the poor.

External Transport Routes

The disruptions of external transport routes through Mozambique have adversely affected Malawi’s BOP performance.

One of the important components of SAP has therefore been to diversify the external trade routes through the Northern Corridor Project involving combinations of road/rail/lake to the port of Dar-es-Salaam. The comparative distance of the different sea-port routes are as follows (Economic Report, 1974):

- Blantyre-Beira/Nacala; 649 Km/807 Km
- Blantyre-Karonga-Dar-es-Salaam (lake/road/rail): 1,784 Km
- Blantyre-Tete/Lusaka-Durban: 2,661 Km/3,762 Km

It is quite evident therefore that the Northern Corridor project led to substantial distance saving compared to the Durban route despite its associated problems of transhipment of cargo between modes. Substantial gains have been made in increased traffic through this route. But there has still not been significant shift from the longer and costly Durban route because work on some of the facilities was only scheduled for completion in 1991.
The Energy Sector

In 1981, imports of petroleum products and coal totalled K46m or 15% of the total value of imports. In 1982 Malawi commissioned its Ethanol plant which helped achieve a 20% replacement of petroleum imports by 1984 and an estimated gross foreign exchange savings of K40m by 1987. Apart from foreign exchange savings, the backward and forward linkages created with agriculture and industry, this venture has cushioned the impact of disruptive developments on the international oil market. The other positive development has been the commencement of coal mining by the state-owned Mining Investment Development Corporation (MIDCOR) established in 1985 which has nearly completely replaced coal imports and generated further foreign exchange savings. Coal development encountered substantial initial transport and logistical problems since it is extracted far away from demand centres. As a utility sector, there are other measures being undertaken to make sure that energy does not become a constraint to developments elsewhere in the economy.

The Least Cost Power Development programs to the year 2000 aim to exploit the country’s estimated hydro-generated capacity of 1000 MW which is currently only being exploited at 14%. The wood energy sector remains the crisis subsector since it serves the vast majority of the households and tobacco and tea estates, amid concerns of an alarming rate of deforestation compounded by the land-pressure. Rural and peri-urban women spend an average of five hours looking for firewood. Re-afforestation measures are being undertaken in conjunction with the agricultural development effort as well as measures to improve the efficient use or replace biomass energy both for household use and on the agricultural estates.

The Industrial Sector

Apart from the promotion and establishment of key industrial projects, other measures that are likely to have direct long-term impact on industrial performance include:

(a) the industrial price de-controls of 1983 and 1985;

(b) the rehabilitation of the three key industrial development institutions, Press ADMARC and MDC in 1985 and 1986 through divestiture and asset swaps;

(c) the broadening of the Development Finance Institutions sector through the financing by the IFC of the first leasing and finance company; and

(d) the beginning made under SAL III to broaden the focus of the industrial sector policies beyond price liberalization and to include the improvement of the Industrial Development Act, the return to free trade and import competition, and the active promotion of small-and-medium scale enterprises and non-traditional exports.

The composition of manufacturing output in 1983 represents significant structural changes compared to the situation in 1975 with shares of food products (excluding beverages) and tobacco declining while those of other products rose. This has resulted from entry by medium-scale firms as well as that of larger firms such as the Ethanol Company. In addition, a survey conducted in 1989 indicates that after the price decontrol exercise, many of the large-scale firms were realizing higher
levels of profitability and were more ready than before to embark on replacement and expansionary investment (Khan, Kaluwa and Spooner, 1990).

As has been the case with agricultural marketing liberalization, the timing and sequencing of the industrial sector reforms was rather unfortunate because there has been no analysis of the probable effect of the measures. The industrial price decontrol preceded moves to foster greater competition through better availability of imports. The Industrial Development (Amendment) Act which made licensing almost automatic only came in 1988 and more active promotion of medium-scale enterprises has also been quite recent. Due to the increased revenue requirements by the government, import duties as a proportion of the value of imports which were only 17.8% in 1973 had risen to 38.8% in 1986. The Foreign exchange constraints during this period also led to considerable import compression with imports (FOB) falling as a percentage of GDP from 24% in 1980 to 14% in 1986. The economy, which had been relatively open during the 1973-79 period had become increasingly protectionistic and this affected industrial efficiency. The average annual increase in prices for a selected basket of basic commodities rose from 17.1% during 1980-84 to 26.9% during 1984-88. Average price-cost margins for 1980-83, 1984-85 and 1986-87 were respectively 20.4%, 21.1% and 28.3%. This was of course inflationary. Some of this was due to devaluation and scarcity-augmented expectations.

Some of these problems have since been resolved with subsequent introduction of liberalization measures. The Investment Policy Statement released with the Budget Statement in 1991 will perhaps offer tremendous improvements to the existing incentives to investment in industry since it completely frees the investment environment. The government has for the first time also been more aggressive in promoting competition by breaking down monopolies through more active promotion of entry by Malawian entrepreneurs. Areas affected so far include food products, household consumer goods, leather products and some intermediate goods. The potential for such interventions, however, is still substantial.

Incomes and Employment

Inflationary pressures due to devaluation, government borrowing from the Central Bank and price reviews and decontrols considerably lowered real wages for the low income before 1989. The government has made reviews of the wages and salaries of its employees as follows (the range for those earning less than K100 in brackets): 1982 (15%), 1983 (20-43%), 1985 (13-19%) and 1986 (5-12%). The statutory minimum wages were also raised in 1982, 1985, and 1989. For the government as a major employer, the reviews have represented increases in the wage bill which put pressure on the recurrent budget deficit. Employment in the public sector also shows a steady increase from 76,102 in 1981 to 91,034 in 1987. The only decline was between 1983 and 1984 when it fell by less than a thousand from 79,983 to 79,158.

There is a growing surplus labour problem. Up to 1996, it is estimated that between 5,000 and 12,000 people in the labour-force will likely not find employment in any of the employing sectors, namely public and private wage sector, the non-agricultural informal sector and smallholder agriculture. The absorptive capacity in the latter two is constrained by low productivity and population pressure while that in the public sector has been constrained by the SAP undertakings. Although the agricultural export sector is said to have manifested some responsiveness to some SAP measures such
as devaluations (Kaluwa and Kandoole, 1989) this has still not led to an adequate improvement in the employment trends.

The Parastatal Sector

The parastatal sector accounts for nearly one quarter of GNP and a substantial proportion of investment and public debt. In 1990, the 12 largest commercial parastatals accounted for 30% of total fixed investment or 59% of public sector investment and the parastatal sector as a whole accounted for 15% of the Central Bank’s total credit to the official sector. In 1986 the total loans outstanding for these amounted to K363m and had nearly doubled to K644m by 1991. In the mid-1980s, subsidies and grants to the parastatal sector amounted to 10% of government recurrent expenditure.

As far as the central government is concerned, good financial performance by commercial parastatals has a positive impact on the budget and public debt levels through reductions in subsidies and increases in tax revenue. The parastatals themselves would be able to generate internally more of their investment, and thus, reduce the public debt requirement.

These considerations have provided the government with the main motive for the parastatal reform program which started in 1988 after the earlier establishment of the Department of Statutory Bodies to monitor their financial performance. This followed the crisis starting in 1981/82 when several parastatals experienced serious financial trouble. During this crisis, the government had to defer or suspend new capital projects for the sector and had to render assistance for some in the form of deferred repayment of government loans and assistance in servicing of the external debt, as it did for Malawi Development Corporation and the Capital City Development Corporation in 1983 and 1984.

While some of the causes of the problems have been external, such as production cost increases and the cost of external commercial borrowing, others have been internal, such as poor investment planning and financial control. The parastatal reform program has, therefore, introduced a system of 5 year corporate planning along with financial and efficiency audits. The internal performance enhancing systems are to be accompanied by greater managerial autonomy in the day-to-day decision making. The corporate plans set out the objectives of a corporation and the strategies intended to achieve them. A system of performance contracting has also been introduced as an incentive for management to attain goals set out in their corporate plans (Budget Statement, 1991).

The overall performance of the commercial parastatal sector has experienced a turnaround from the losses characteristic of the first half of the 1980s to rising profits thereafter. The major factors that have contributed to this have been: the rationalization of the assets of the major development finance institutions ADMARC, MDC, and Press and the raising of tariffs and rents for ESCOM and MHC respectively.

ADMARC’s performance has been greatly enhanced by its reorientation towards marketing activities, the liberalization of food marketing in 1987 which has reduced ADMARC’s cross-subsidies on such food trading accounts as that for maize, the sale to the government in 1987 of the strategic maize reserves and the national grain silos, and management contracting for performance incentives.

The Malawi Railways (MR), Blantyre Water Board (BWB) and WICO continue to make losses. In the case of MR the major problem continues to be the deterioration of the operations of the lines in
Mozambique. BWB financial performance will continue to depend on the level of the government-controlled water rates as have the producer prices, tariffs and rents for ADMARC, ESCOM, and MHC respectively. Raising these have in turn depended on the feasibility of eliminating or reduction of subsidies. While some degree of success is being achieved with respect to the other parastatals the conflict among objectives is still prominent for BWB. It is a commercial organization but is still expected to provide a subsidized product especially for some urban-based subgroups. Although the government has approved the increase in water rates, this has been infrequent and the level of increase inadequate to meet the requirement of the Board’s maturing debts.

WICO's financial position is improving although it is still loss-making. This corporation's performance is particularly worrying in view of the fact that it enjoys privileged access to logs from state plantations. In 1990, the government announced its intention to sell off nearly half of the shares of WICO in a bid to strengthen its performance and therefore reduce its burden on the budget.

Although Malawi's parastatal sector is not as dominating as, for example, that of Zambia, the issue of state participation in areas which are not clearly natural monopolies (e.g. the utilities sector) is still a pertinent one. In the first stage of the parastatal reform program during 1985 and 1986 initial attempts were made to rationalize the portfolio holdings of the three major investment institutions namely ADMARC, MDC and Press. The package which included asset swaps and outright sells to the private sector, has contributed to the financial turn-round and improve performance of ADMARC and Press.

According to the Budget Statement (1991) although most of the ADMARC's assets which have been earmarked for divestiture had already been sold, further moves are underway to further tighten its portfolio holding. These include: the formation of a holding company for remaining assets with the possibility of share sells to the public through a unit trust; the sell of some assets through an Employee Share Ownership Scheme; the sale of some of ADMARC's shares in Auction Holding to tobacco growers.

From a development point of view, divestiture by parastatals streamlines them for more efficient performance. But apart from this and in the wider context of dismal prospects for foreign direct investment (FDI) and declining domestic savings effort, this strategy stimulates self-reliance. In the first place, private savings are stimulated through greater private sector participation in investment which in the industrial sector also disperses the financial capital which enables the public corporations to better play their expected pioneering role in financing or directly investing in completely new ventures for industry, which in turn helps broaden the manufacturing base. This might be the most hopeful source of investment in such strategically important and propulsive new areas like glass and pulp and paper. In the absence of privately sourced FDI, such ventures might solicit the equity participation of institutions like the International Finance Corporation (IFC) and the Commonwealth Development Corporation which in the Malawian context have been showing a readiness for such partnership.

The idea of a Unit Trust to serve as a conduit for the small private investor's participation in share ownership had been first entrusted to the MDC. This was also expected to serve as the basis for the establishment of a future stock market. Nothing, however, has been done so far after a number of years. As stock markets begin to mature in other countries in the region notably Zimbabwe and Kenya, it is also imperative that this avenue be opened up quickly in Malawi.
The average employment growth rate in the urban sector has been just above one percent between 1975 and 1985 which is well below that of the urban labour-force considering that the urban population growth rate exceeds 6%. In such circumstances it is important that employment generation both in the urban and rural areas becomes a major area of focus.

A major failure of the structural adjustment program is that to date the export base has not been diversified. Our contention here is that the program has not led to a significant structural change in the economy, leaving the country still dependent on tobacco for its foreign exchange earnings. Only the stabilization instruments have been significantly addressed. Obviously, the combination has adversely affected poor households.

Recently more recognition has been given to the adverse effects of SAP and the Government, albeit to a lesser extent, has embarked on the Social Dimensions of Adjustment program whose main thrust in Malawi is policy development and institutional capacity building so as to better integrate social and poverty concerns in the development planning process.

**The Impact of Structural Adjustment on the Poor**

It has been observed that almost all Malawian's were adversely affected by the recession and curtailment of consumption as a result of the stabilization and adjustment program. The prices of basic commodities, especially food, have increased, and government expenditure on basic services such as health and education have fallen. Furthermore, real wages and employment have been reduced, especially for low-income households. However, different groups in the society have been affected differently.

This discussion of the impact of the various structural adjustment programs on these groups should be read with caution, outcomes cannot be attributed to structural adjustment programs, per se.

**Public Expenditure to Basic Social Services**

As part of the SAP, the Government embarked on an expenditure reducing policy so as to reduce the deficit. For a low-income country like Malawi, this policy is bound to adversely impact the poor. Government expenditures declined from 36% to 29% of GDP between 1981 and 1986. At the same time, debt servicing more than doubled as a share of Government expenditure going from 17% to 36% and 39% in 1986 and 1989, respectively.

Obviously this high level of debt servicing has been leaving fewer funds available for other categories of Government expenditure. As a share of Government expenditure, all other broad categories of recurrent expenditure have dropped between 1977 and 1986.

Social services declined from 24 percent to 17 percent and economic services fell from 20 percent to 15 percent during the same period. Education and social development expenditures also suffered reductions from 13.7 to 8.9 per cent and 2.8 to 0.5 per cent, respectively, over the same period.
In 1994/95 the share of social services to recurrent expenditure is expected to go up while that of health is expected to go up from 6 percent to 10.1 percent. Per capita real expenditures in all categories have shown decreases, except debt servicing.

Since the commencement of reform, the growth of Government expenditure on average has slowed down. According to Sahn et al (1990), the average annual growth rate of Government expenditure was 32% from 1978 to 1980 but it slowed down to 12.2% from 1981 to 1988. Expenditure on the development account has also experienced relative decline. Between 1978 and 1982, the share of development expenditure averaged 39% but had declined to an average of 27% between 1983 and 1988 (cf. Sahn et al, op.cit). In 1982, 1986 and 1988, negative growth rates in development expenditure of 24%, 15% and 9% were recorded, respectively.

Reductions in the per capita allocation of resources to social services since 1980 would have had a direct negative impact on the welfare of the poor. Some of the macro-economic fiscal imperatives of the reforms, therefore, may have had an adverse effect specifically on vulnerable groups due to the relatively low levels of investment and unequal redistribution of public resources.

The underfunding of recurrent expenses relative to prior development expenditures has been more severe in health and education (World Bank, 1989). This implies that the welfare of those employing these services may have been adversely affected.

In per capita terms, Malawi has not done well in social spending after the adjustment period. According to Sahn et al, this is primarily due to population growth rather than a decline in real expenditure levels.

Soon after the commencement of the SAP (from 1983\84 to 1987\88), expenditure on health averaged 6.6% of total Government spending. However, the overall real increases in Government spending on health have been just enough to keep pace with the rapid growth in population. Real per capita health expenditure in 1987\88 remained nearly the same as 1983\84 levels, despite considerable yearly fluctuations.

Historically Government development policy has given directly productive sectors priority over social sectors (tables 3 and 4). As a concomitant to this Government spending on education, for example, has been low in comparison with other African countries. Total Government expenditure on education has always been around 3% of national income in Malawi, compared with over 5% in Zambia, nearly 7% in Zimbabwe and more than 8% in Botswana (Nyirenda,S and Moyo C.W). According to the Bank Education Policy Study Report Malawi’s education share in the public budget fell from 13.2% in 1970 to 9.6% in 1975 and further to 8.5% in 1988.

In schools there is an acute shortage of desks, other furnishings, quality textbooks and teachers. Although this data on health and education expenditure provide some insight into changes that have occurred in recent years, their actual implications for living standards and welfare are less clear in the absence of knowledge of basic behavior of households e.g. their price responsiveness to health care services. On education, on the other hand, while the introduction of raising fees can relieve the public financial burden, this can have an impact on drop out rate and on overall enrolment. There is concern, therefore, about the impact of the policy on equity since for any given ability level, the high fees would tend to increase the ratio of high income to low income applicants.
The 1991/92 budget showed that education and health still maintained their shares of 9.9% and 6%, respectively, in total recurrent expenditure allocation. It is our contention that these factors, coupled with direct and indirect taxes, have had adverse repercussions on private consumption and hence the welfare of the majority of Malawians, especially the poor.

Private Consumption

Overall consumption expenditure takes up a high proportion of GDP. Between 1977 and 1989 the percentage consumption to GDP has ranged from 68 to 89 (Kandoole, 1990). This total expenditure includes both government and private consumption where the latter is more pronounced than the former. In nominal terms, consumption has shown a consistent upward trend (the 1989 figure is over 6 times that of 1976 and per capita income went up by 372 percent over the same period). However, at constant prices, total consumption increased only by 15 percent and its Per Capita fell by 25 percent between 1976 and 1989. This shows that inflation accounted for most of the increases in nominal consumption expenditure.

As a percentage of total consumption, private sector is predominant, since in all years its share was in excess of 75 percent. However, the share of Government tended to increase during the periods of economic decline. For instance, the share of the private sector was lowest and that of Government the highest in 1980.

In nominal terms, private consumption like total consumption increased during the period of study so did the private consumption expenditure at constant prices. But the increase was not as dramatic in constant prices as the one found when current market prices are used. Again, this is the influence of rising prices. A reversal of the situation takes place when the figures are expressed in per capita terms. While per capita private consumption in nominal terms increased by 368 percent, at constant prices, private per capita consumption fell by 25 percent. This indicates that in real terms, consumption in 1989 was worse than in 1976 - people were consuming less in 1989 than they did in 1976.

The above statement implies that on average, people are worse off now than they were before. But some have gained and others lost during the period under study. Since there has been a general fall in per capita consumption, those who have seen an improvement in consumption are few and their improvement has not been high enough to compensate the consumption expenditure of the losers.

The negative changes in economic conditions contributed to the decline in consumption. With low output, both consumption and investment expenditure are also expected to be low. But aggregate consumption in both nominal and real terms has shown an upward trend which means that most of the decline has been absorbed by investment, while consumers maintained their levels probably by reducing their current savings or in actual fact dis-saving (withdrawing past savings for current consumption purposes).

The decline in per capita consumption shows that the rate of increase in GDP and Consumption was lower than the population growth rate. Therefore, it is necessary to increase the growth of GDP to a rate that will match the growth rate in line with GDP or both.
Another reason for the decline in consumption is the inflexibility of wages and salaries. The Government has been reluctant to substantially increase wages for fear of worsening the government deficit. Since parastatals have to get the approval of Government to increase their wages, the situation in the statutory bodies has been similar to that in Government with the consequence of people having less personal income at a time of high inflation. Therefore, real consumption has to go down. Recently though, there has been a reasonable increase in wages. For instance minimum wages have nearly doubled, "commercial parastatals are known to have received approvals to increase wages and salaries by between 25 and 35 percent, while other institutions are now able to give professional allowances to their members of staff. Although this is not enough considering the rising prices, it is a move in the right direction and one could only hope that the trend will continue.

Taxes are also responsible for the falling real consumption expenditure. In its desire to reduce deficit, Government has adjusted taxes several times in the 80s for the purpose of mobilizing internal resources. On personal income tax, some of the measures have been the removal of personal allowances and deductions such as family allowances. Coupled with high tax rates, the disposable income for some families has been going down resulting in low real consumption.

In addition to the increase in income tax, the consumer is also hit with indirect taxes. On domestically produced goods there is excise duties and surtax which are levied on the producers who, in the final analysis, transfer the taxes to the consumer through high prices. With limited disposable income these high prices discourage consumers from purchasing the commodities.

On international trade, the Government has imposed customs duties, levies and surtax in order to raise revenue and discourage imports so as to improve the balance of payments position. All these charges have been going up over the years achieving the aim of reducing imports and hence making the commodities less available in the country. With this scarcity and the high cost of imports due to customs duties, the prices of these commodities become unaffordable to most consumers.

Devaluation has been a cause for the increase in prices of both imports and domestic products. Devaluation makes exports cheaper and hence the country's commodities become competitive on the world market but at the same time, makes imports expensive in terms of local currency. Therefore, the frequent devaluations of the kwacha in the 1980s and 1990s have made importation of both consumer goods and inputs more expensive and these costs filter through to the consumers in the form of high prices, thus reducing real consumption.

Public Consumption

This section looks at public consumption which may compensate for the declining private consumption alluded to in the previous section. Whilst recurrent expenditure has increased markedly over the period (from 14.2 percent of GDP in 1977 to 21.2 percent in 1986 (the increases have been heaviest in interest payments on the national debt from 17.22 percent of recurrent expenditure in 1976 to 38.98 percent in 1989). all other broad areas show a decline in their shares of recurrent expenditure. The ratio of social services has been falling so have its individual components.

As already pointed out above, education's share has declined from 14 percent in 1976 to 9 percent in 1989. With increasing population, enrolment rates in primary schools are increasing while the shortage of trained manpower still exists, this creates a very serious problem. Classrooms in both
secondary and primary schools are overcrowded and pupils are under supplied with basic items such as books. Higher education is under financed, resulting in understaffed departments with very few resources to work with, resulting in serious consequences on the quality of education.

The second important item under social services is health which is also experiencing a drop in its share. Given the high population growth rate and the child spacing program aimed at controlling it, high levels of infant and child mortality, and the need to continue implementing the rural primary health care program, this state of affairs is not satisfactory.

The Rural Poor

The rural poor have been affected through several channels including price incentives for agricultural production, subsidy removal on agricultural inputs, devaluations, and agricultural product marketing liberalization, among others. In 1981/82, there was a 67 percent increase in the producer price of maize, resulting in a substantial increase in maize production. Although this did ensure self-sufficiency in food for the country as a whole, it did not ensure food security at the household level for everyone. It should be borne in mind that there are different types of smallholders which we classify here by their landholding size.

The first group are the net sellers who produce more than they consume. These comprise about 25 percent of the smallholders, they have holdings in excess of 1.5 hectares (ha) and grow cash crops as well as food crops. The intermediate group is that of farmers who produce just enough for subsistence and sometimes have a meager amount for sale. These farmers have land holdings between 0.7 and 1.5 ha. The third group is that of net food buyers who produce less than the required amount for subsistence and must buy food in order to meet their food (security) needs. These are classified as those with holdings of less than 0.7 ha and account for more than 35 percent of smallholders. 5

It is easy to see from the above that an increase in prices will affect these groups differently. The incomes of the net sellers will increase and higher prices may also encourage those with zero balances to increase production. One could also argue that net buyers could be encouraged to increase production and perhaps become self-sufficient in food. But this can only occur when land and labour are readily available for this expansion. Since land is a scarce resource in Malawi, it is reasonable to assume that the net buyers will remain so after the price increase, and will end up seeking more wage employment either as laborers on estates or for those with larger holdings. According to our preliminary results (Chilowa, 1990b) agricultural laborers produce the least and have got the least food (maize) balances than any other groups, confirming their food insecurity problem. Nyanda (1989) pointed out that remuneration for estate laborers is below the legislated minimum wage, hence this group still lives in marginal poverty. The effect of the price increase in this case may be a decline in welfare and nutritional status since the poor are net buyers of food, and cannot increase non-farm income sufficiently. Increasing the prices of non-food crops will not help them either, maybe only if they shifted to the use of improved maize technology, but then the land scarcity problem makes this prospect untenable.

Subsidy removal on agricultural inputs will affect different farm families differently depending on the amount of fertilizer they use. Those who use more will be affected more than those using less,

5 Other calculations show that these represent about 55.3 percent of smallholders (cf. Kandoole, 1989).
ceteris paribus. It should be borne in mind that fertilizer uptake among smallholders is determined by nutrient prices relative to output prices, physical responsiveness to fertilizer use, access to fertilizer through cash or credit and the ability of the extension agents to reach and appropriately train them in modern techniques. According to Lele (1990) there have been problems with all of these in Malawi.

Malawi’s high fertilizer prices are mainly due to high transportation costs as well as the frequent exchange rate adjustments, hence the argument for Government subsidy. It transpired then that after two years of phased subsidy removal in 1987, the Malawian fertilizer price/official maize price ratio was still one of the highest in the developing world. As a result of growing national food security concerns and the increasing influx of Mozambican refugees, the Government withdrew from the subsidy removal agreement and resumed subsidizing smallholder fertilizer by about 25 percent (Lele, op.cit).

In the 1988/89 growing season, the producer price of maize was again raised, this time by 44 percent and that of fertilizer by only 11 percent so as to encourage fertilizer use by smallholders. The problem here is that this adversely affects the food-deficit households in the rural areas who are in the majority, and who depend on the market for the purchase of the food staple, maize. Smallholder fertilizer, therefore, is unlikely to be profitable in the absence of a Government subsidy and technological advancement.

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* Forecast

Source: NSO.

For a thorough analysis of this see Kandoole and Kirchner, 1986.
As part of SAP, the grain marketing reforms were initiated whereby private traders were allowed to compete with the Agricultural Development and Marketing Board (ADMARC) in the marketing of some agricultural produce.

However, a liberalized market alone is not sufficient for the attainment of household food security. In order to provide the necessary conditions for price stabilization and food security, ADMARC needs to continue its role of marketing smallholder crops as well as that of buyer of last resort, obviously with the Government’s assistance.

The Government, as a concomitant to this, must incorporate policy measures for reaching the food insecure households on short and long terms bases. The private traders’ capacity to efficiently take over the domestic marketing system in Malawi has yet to be conclusively established. These have constraints especially in terms of access to commercial credit, poor infrastructural support especially as it applies to roads in some rural areas and storage facilities (Chilowa, 1990b).

The Urban Poor

Although difficult to prove quantitatively given available data, our contention is that the households hardest hit by the economic changes are the urban poor. This is supported in part by data on incomes and food prices. High rates of inflation in relation to money incomes have drastically reduced real wages (cf. Sahn et al., 1990). Data from the National Statistical Office show that while in January 1985 a minimum wage earner in Blantyre city could purchase a 90kg bag of maize (a family needs one 90 kg bag of maize per month to meet minimum calorie requirements) with less than 20 days wages, by January 1988, the same bag could be purchased only by working in excess of 35 days (OPC, 1989). The situation is worse now.

The inflation is rooted in the constant currency devaluations, the price decontrols, and liberalization of markets. Increases in domestic borrowing by the Government in order to cover the budget deficit have also contributed. Officially the inflation rate was 15 percent in 1986/87, 26.5 percent in 1987/88 31.5 percent in 1988/89 and is forecast at 30 percent in 1994 (Table 2).

This inflation particularly hurts those wage earners on fixed incomes, those whose incomes lag behind that of prices, the elderly on pension and the urban unemployed. Looking at per capita income it is very clear that despite the impressive growth in GDP, per capita income has been falling.

Our contention here is that structural adjustment has not led to increases in per capita incomes. While increases in GDP have occurred, we do not subscribe to the view that in the long run all will benefit from these changes. Although some individuals' incomes have increased under structural adjustment, these gains have not been great enough to offset the losses of the poor. While the returns from higher savings are cumulative gains, they accrue disproportionately, and those who have less will remain consistent losers. As Streeten (1987) has pointed out, "... in the long run the identity of the individuals changes, and it is illegitimate to compare the gains of our generation with the losses of another."

During SAL II, all prices of locally manufactured goods were decontrolled so as to stimulate the industrial sector of the economy. Considering that the same exercise was not extended to the primary
product markets, the prices of manufactured goods were relatively higher. Table 3 shows the price changes of a few locally manufactured consumer goods. It is evident from this table that especially in 1983, 1985, and 1987, the prices of soap and cooking oil, which are basic necessities, rose sharply due to this policy.

Looking at the currency devaluations that have been taking place since the commencement of the SAPs, it is our contention that they have led to drastic changes in consumption patterns. As we have pointed out above, some individuals are now consuming less than they did in the 1970s. The devaluations have affected the poor through wage and employment effects, price effects and stagflation.

The policy of wage restraint (in order to reduce the Government's total wage bill and to make Malawian goods more competitive on the world market) has had negative effect on the welfare of the minimum wage earners. Salaried employees have suffered as well, as the price of manufactured commodities have continued to increase faster than salaries.

In a study undertaken in the two major urban areas of Malawi, it was found that food expenditures alone took more than 60 percent of total household expenditures. Over 40 percent of pre-schoolers in the sample population exhibited some signs of a nutrition problem, this being a manifestation of food insecurity. The results of this study further indicated that the urban poor have suffered more from the macro-economic reforms (Chilowa and Roe, 1989; Chilowa and Shively 1989).

**Government and Other Actors' Response**

The Government, as well as other donor agencies and NGOs realized that the SAP did not address the distributional effects especially the adverse ones accruing to the poor segments of the economy. As a concomitant to this, a section was established in the Economic Planning and Development Department of the Office of the President and Cabinet called, the Food Security and Nutrition Unit. This Unit has

| Table 3: Annual Percentage Price Changes for Selected Consumer Goods (1981-1988) |
|---------------------------------|--------|--------|--------|--------|--------|
| Lifebouy Bath Soap              | Reward Bath Soap (min) | 500 ml Kazinga Cooking oil | 500 ml Covo Cooking Oil | Surf (Giant) |
| 1981 15.4                        | 12.1               | 2.9                      | 1.4                      | 8.0 |
| 1982 53.3                        | 24.3               | 0.0                      | 0.0                      | 12.6 |
| 1983 34.8                        | 8.7                | 66.2                     | 63.9                     | 12.2 |
| 1984 6.5                         | 4.0                | 17.8                     | 29.7                     | 4.2 |
| 1985 48.5                        | 46.2               | 12.2                     | 21.6                     | 39.2 |
| 1986 4.1                         | 3.9                | 0.0                      | 0.0                      | 2.3 |
| 1987 33.3                        | 40.5               | 31.4                     | 48.9                     | 55.6 |
| 1988 14.7                        | 19.8               | 6.3                      | 0.0                      | 22.0 |

Source: Own calculations from Lever Brothers (MW) Ltd. Prices.

been charged with a co-ordination role for food and nutrition policy issues including policy overview, analysis, formulation, information dissemination and incorporating food security and nutrition considerations into national development planning machinery.
The Social Dimensions of Adjustment (SDA) program is also being undertaken by the Government in the same Department to cushion the adverse effects of SAP on the poor and vulnerable groups in the Malawian society. Its main concern in Malawi is on policy development and institutional capacity building.

A number of studies have also been commissioned by the Government, the University of Malawi and various other actors to look at the impacts of the SAP so as to help policy makers and planners to come up with appropriate policies that will help those that have been adversely affected. The NGOs, donor agencies and other actors have also been involved in this exercise (see Chilowa and Gaynor, 1992).

Conclusion

From the nature of the reform program in Malawi one can conclude that it has been primarily concerned with overall macro-economic growth through the promotion of economic efficiency and less emphasis put on the distributional considerations.

In both the estate and smallholder subsectors, performance has been fluctuating tremendously and in recent years output has fallen significantly. It is only in the contribution of Government to GNP that a visible favorable trend can be discerned. Even here, improvements in the balance of payments, for example, have been caused by a detrimental contraction of domestic demand.

A major failure of the SAP is that to date the export base has not been diversified. Our contention here is that the program has not led to a significant structural change in the economy, leaving the country still dependent on tobacco for its foreign exchange earnings. Only the stabilization instruments e.g. devaluations, have been significantly addressed with the obvious adverse effects on the poor households.

For the rural poor smallholders the differential distributional effect of structural adjustment is very clear. It has not improved access to or rates of return on their agricultural assets, and according to Hawksley et al, (1989), both real producer prices and real wages have declined during the adjustment period.

Inappropriate credit packages and extension advice continue to be detrimental to smallholders. This coupled with population pressure further restricts access to land, hence poor households remain risk-averse and unwilling to produce high value but more risky cash crops (Chilowa, 1990a).

Market liberation has probably been the single most detrimental reform on poor households since these have traditionally depended on ADMARC for purchase of maize. The closure of some "uneconomic" ADMARC markets, therefore, has contributed to these households' continued food insecurity situation.

For the urban sector, food price increases have been detrimental to the poor who spend large part of their budget share on food (Chilowa and Shively, op. cit). The result emanating from reduced food consumption or the substitution to lower quality foods as a consequence of food price increases further reduce nutritional status. Likewise, falling per capita real wages and incomes, reduction in food
subsidies, reduced Government expenditures on education, health, housing, sanitation and other social services has had a severe and adverse effect on the poor.

The programs have tended to emphasize more on demand management than supply-oriented policies. They have tended to concentrate on promoting market and price mechanisms and less on production constraints facing the economy. Non-price structural factors require renewed attention if the growth for the economy is to be enhanced. Attention has to be paid to increasing incomes of the majority of the population. In this context, the structural constraints facing agriculture have to be tackled in order to elicit the supply responses necessary to generate sustainable income and sufficient foreign exchange resources.

Recently more recognition has been given to the adverse effects of SAP and the Government, albeit to a lesser extent, has embarked on the Social Dimensions of Adjustment program whose main thrust in Malawi is policy development and institutional capacity building so as to better integrate social and poverty concerns in the development planning process.

The SAPs, have no doubt provided a learning experience, especially in the areas of program design and sequencing of policy actions. One result of the adjustment programs in Malawi has been the worsening of social indicators which partly has been compounded by the high rate of population growth and other factors.

While a number of social action interventions have been initiated by government, NGOs and donor agencies, most have only recently been launched and their effects cannot yet be evaluated.

All in all, it is our contention that for a resource-poor open economy country as Malawi’s, it is vital that donors give adequate time and resources in designing country-specific interventions. Donors should likewise attempt to pay ample attention to lessen the adverse external developments impacting on the country as well as allowing enough time for the impact of interventions to work through the economy. A thorough analysis of the likely impact of each reform policy should be done prior to any intervention failing which the programs might not achieve the intended economic impact, and may conversely work to the detriment of the majority of the less endowed sector of the economy as the Malawian case has demonstrated. The efforts of the Government and other actors in attempting to alleviate the adverse effects of SAP accruing to the poor should be commended.
List of Socio-Economic Indicators

Total population (excluding refugees) = 8.2 million
Children 0 - 14 years = 47%
Females of child bearing age (15 - 49 years) = 1.97 million
Child dependency ratio = 1:0.95
Population density 85/sq km
GDP per capita US $180
Crude birth rate = 54/1000 population
Total Fertility Rate = 7.6
Crude death rate = 20.9/1000 population
Infant mortality rate = 151/1000 live births
1 - 4 child mortality rate = 320/1000
Population growth rate = 3.2% p.a
Life expectancy for males = 43.5 years
Life expectancy for females = 46.8 years
Females aged 12 - 19 years married = 41%
Mothers below 18 years of age = 33%
Females practicing modern methods of child spacing = 3%
Primary/Secondary enrolment for 5 - 19 years old = 34/37%
Total Literacy rate = 41% (of which 33% are women and 67% are men)
Female literacy rate = 25%
Literacy rate, rural women = 18%
Agriculture as percentage of GDP = 35%
Agriculture as percentage of export earnings = 88%
Agriculture sector = 45.8% of formal paid labour force.
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RESERVE BANK OF MALAWI

Introduction

Malawi started implementing structural adjustment programs in the early 1980's, in response to structural weaknesses that had emerged. These weaknesses came up against the backdrop of a series of exogenous shocks but also on account of inappropriate domestic policies. Significant among these were:-

(i) Transport bottlenecks - since Independence, Malawi had depended (for its external traffic) on rail routes to the sea. Both of these routes pass through Mozambique to the ports of Beira and Nacala. Towards late 1970's the country started experiencing periodic disruptions on these routes as a result of insurgent activities in that country, and by end, 1982 the routes became completely closed. The closure of the routes resulted in high landed cost for merchandise imports while exports became less competitive; and 90 percent of the external traffic which had been by rail had now to be moved on a long haul road routes, through the port of Durban. The cif/fob margin rose from 14 percent to nearly 40 percent.

(ii) Increased external debt service - towards the end of 1970's the industrial countries were pursuing strict monetary stance following the second oil price shock. The tight monetary stance resulted into high interest rates in the international financial markets. This coupled with the appreciation of the US dollar and the cut-back of aid to less developed countries (LDC's) brought about serious debt servicing problems for LDC's.

(iii) Poor weather conditions - this, particularly in 1980 and 1981, adversely affected the agricultural production.

(iv) Terms of trade - which occurred against the background of fluctuating international commodity prices, coupled by the worsening transport situation.

(v) Inappropriate domestic policies - this was reflected partly in an expanding but inefficient public sector, price controls, poor agricultural pricing policies and growing budget deficits of the central government.

The early stabilization/adjustment programs which were implemented with the support of the International Monetary Fund, the World Bank as well as other multilateral and bilateral institutions therefore emphasized on the following aspects:

- price decontrol;
- restructuring of the parastatal sector;
- improved public sector resource mobilization and management;
- rationalization of external sector policies including domestic credit; and
- exchange rate policies.
Perhaps a much more broad based SAP was that introduced at the beginning of 1988 under the Enhanced Structural Adjustment Facility (ESAF). In fact Malawi was the first country to access under the ESAF Arrangement of the International Monetary Fund. The SAPs implemented up to this point appeared to be narrow in focus as they emphasized on specific sectors in a 'stand alone' fashion as opposed to having an integrated approach covering several sectors of the economy.

A clear result of the SAPs implemented since 1980's was the deteriorating social indicators, intensified by continuous cuts on government expenditures allocated to social sectors such as health and education. The cuts were taken as part and parcel of demand management. The ESAF program, thus, was viewed to be broad based since it incorporated concerns in the social sectors and actually allowed for increased expenditure allocations to the sectors.

The Enhanced Structural Adjustment Program

The program was embarked upon in the face of continuing macro-economic imbalances and the need to restore growth within an environment of stable prices and sustainable balance of payments position. Gross domestic product (GDP) stagnated in the two years, 1986 and 1987, as growth rates of 1.1 percent and 2.1 percent, respectively were recorded. At the same time, the rate of inflation started picking up, reaching a level of 27.0 percent at the end of 1987.

The fiscal position had worsened. The fiscal deficit as a proportion of GDP averaged 8.0 percent in 1986 and 1987. In the external sector the overall balance on the country's balance of payments recorded significant deficits in 1985 and 1986. Although a surplus was recorded in 1987, this occurred against the background of import compression combined by suspension of debt servicing, pending debt rescheduling with both the Paris and London Club Creditors. Although there were exchange rate adjustments in 1985 through 1987, these seem not to have been large enough to fully compensate the loss in external competitiveness.

Money supply was also growing at somewhat excessive rates in 1986 and 1987. In 1986 money supply expanded by 23.8 percent and in 1987 by 34.7 percent. In both years, the rates of monetary expansion exceeded the rate of price inflation. Finally the crowding out effects of the central government on the private sector in the use of banking system resources became so serious, as the share of credit to the government in total banking systems credit reached a high of 66 percent in 1987.

The ESAF program embarked at the beginning of 1988 complimented by the World Bank's Industrial and Trade Policy Adjustment Credit (ITPAC) was more broad based. It focused on policy reforms in the following areas:

(i) trade liberalization - this was the major thrust of the program. And administered foreign exchange allocation system was abolished and access to foreign exchange by the manufacturing sector and industry as a whole was greatly eased. The list of goods requiring a license before importation was significantly shortened and measures to encourage competition were initiated.

(ii) monetary reforms - the thrust of monetary policy was re-oriented from being based on direct control of credit and liquidity of the banking system towards an indirect approach of monetary control and credit allocation. In this regard, credit ceilings which the central bank used to impose on the commercial banks were abolished, so too the direct control of interest rates was
ceased. Reserve requirements and auctioning of treasury bills were introduced. The discount rate at the central bank became an instrument with which to send signals in the market on what interest rate structure to be followed.

(iii) the fiscal position - a more comprehensive system of expenditure control and monitoring was put in place. For the first time in history, the central bank started bouncing government cheques. Budgetary allocations were reviewed and within the strict expenditure control and monitoring exercises, the allocations to the social sectors (i.e., education and health) were allowed to increase. A tax reform program was also embarked upon which aimed at broadening the tax base of the government as well as improve the buoyancy of the tax system.

(iv) creation of the enabling environment for Private sector investment - government took a deliberate strategy to withdraw from active participation in economic activity and to give room to the private sector. The tax reform program thus included elements of phased reduction of corporate tax, uniformization of trade tariffs and other forms of fiscal incentives for encouraging investment. A 'one stop shop' for facilitating investment, the Malawi Investment Promotion Agency (MIPA) was created.

The Performance of the ESAF Program

The program was well supported by both the multilateral institutions as well as the bilateral donors. Significant amounts of balance of payments assistance was made available. The total financing package was in the region of US$200 million.

There is no doubt that some positive results accrued to the economy following the implementation of this program. Growth in real GDP rose steadily from the stagnation of 1986-1987 and peaked at 7.8 percent in 1991. The rate of inflation was brought down to 11.5 percent by end 1990 after reaching a high of 31.4 percent in 1988. The drop in the rate of inflation was, in part, a reflection of a return of competition and restoration of confidence in the domestic economy.

Fiscal and monetary conditions also improved. The fiscal deficit as a proportion of GDP was brought to more manageable levels. At the same time, the uptake of credit by government from the banking system's credit reached a low of 24 percent by 1991 while the rate of monetary expansion was satisfactory to keep the momentum of growth. In the external accounts however, the current account deficit as a share of GDP took the opposite turn and reached a high of 13.4 percent in 1989, reflecting essentially the impact of the import liberalization.

While the macro-economic situation overall looked better since 1988 through 1991, events took a different turn beginning 1992. First was the incidence of drought that engulfed the whole of the Southern Africa region.

Second, donors at the May, 1992 Consultative Group Meeting unanimously resolved to suspend balance of payments assistance to Malawi because of some concerns with certain aspects of the country's human rights and governance issues. In the same year the country started experiencing 'wild cat' strikes for wage increases. All these combined to destabilize and wipe out the gains that had been attained since the beginning of 1988. Real GDP was down (-7.9 percent); fiscal pressures mounted-up as government endeavored to deal with the drought, but also the industrial disputes which saw the
wage level in the civil service rising by nearly 90 percent. Obviously government did not have adequate revenue and consequently resorted to borrowing from the central bank. The costs associated with the political transition also put a lot of pressure on the central government budget.

It therefore should not be much of a surprise to see the worsening of the economic situation in 1992. Inflation accelerated, so too monetary growth. The balance of payments deteriorated markedly against the backdrop of unfavorable terms of trade (particularly for tobacco) as well as the withdrawal of donor support. Expansionary fiscal and monetary policy thus set-in.

During the period of the drought, Malawi remained under a financial program with the International Monetary Fund; also getting the support from the World Bank. During the period, a number of corrective measures were implemented but in the absence of resumption of balance of payment assistance the impact of the measures was subdued. The worsening economic situation continued in 1993 although growth in GDP was significant reflecting largely favorable weather and therefore agricultural production during the 1992/93 growing season.

The measures implemented during the period included the freezing of posts in the civil service, increasing the price of petroleum products which represent a revenue source for the government, and reduction of external travel. In the monetary sector, interest rates rose following a change in the discount rate of the central bank to 25 percent. The prime lending rate for the commercial banks reached 26.0 percent while the ordinary savings rate was raised to 24.5 percent. At the time of the change in interest rates (July 1993) the overall interest rate structure had been raised by 5 percentage points. Finally in the external sector, the exchange rate of the Malawi Kwacha was depreciated by 37 percent (in nominal terms) in 1992.

Towards the end of 1993, donors became increasingly satisfied with the on-going political reforms as well as the improvements in Malawi's human rights record. Consequently, the Consultative Group Meeting was reconvened in December, 1993 at which donors restored the balance of payments aid. In view of the developments in the external accounts during the period, it became increasingly necessary to review in a major way, the exchange rate policy in Malawi. Against this background and following some consultations and receipt of technical assistance from the International Monetary Fund, the Malawi Kwacha was floated, effective February 7, 1994.

The Floatation of the Malawi Kwacha

As a first step, it is important to appreciate the background against which the decision to float the Malawi Kwacha was made. Since January, 1994, the Malawi Kwacha was pegged to a basket of seven currencies comprising the US dollar, the pound sterling, the deutsche mark, the French franc, the South African rand, the Japanese yen and the Dutch Guilder. This basket was constituted on the basis of trade weights. Throughout the years, the trade pattern between Malawi and the rest of the world was continuously changing so that the trade weights in the currency basket became outdated.

The periodic devaluations particularly in the period 1987 through 1992 while they partly addressed the imbalances in the external accounts, they also created elements of speculative behavior on the part of the business community. This translated into hedging in domestic pricing of commodities and also in delays on repatriation of export proceeds back into Malawi; a development
which resulted into further worsening of the balance of payments as foreign exchange became even more scarce.

More importantly also, during the last two to three years, the exchange rate for the Malawi Kwacha became increasingly over valued. This occurred against the background of several factors, namely:

(i) the suspension of aid and the balance of payments support at the May, 1992 Consultative Group Meetings;

(ii) the upsurge in the rate of inflation resulting partly from the wage hikes and the impact of the drought;

(iii) a worsening of the terms of trade, particularly for tobacco exports; and

(iv) the rising budget deficit which added pressure on aggregate demand in the economy;

As a result of the over-valued exchange rate, Malawi's exports, on one hand, became increasingly uncompetitive on the international markets; thus exacerbating the already low prices of exports, including tobacco auction prices. On the other hand, the over-valuation created a strong appetite for imports of mainly consumer goods, since on international basis, foreign prices became relatively cheaper. The central bank then found itself in a situation whereby foreign exchange reserves were continuously declining while at the same time import payments arrears started accumulating.

It is therefore, against this background that a market-based system of determining exchange rates for the Malawi Kwacha was introduced on 7 February, 1994. Under the system, authorized dealers are free to quote their own rates. There are at present only four authorized dealers; and in order to broaden the market for buying and selling foreign exchange, weekly fixing sessions are held at the Reserve Bank Headquarters in Lilongwe. The fixing session is simply a market at which offers of foreign exchange are paired against bids and a market clearing rate is determined.

The introduction of the new system has been accompanied by the lifting of exchange controls. Practically all imports of goods and services are no longer subject to prior approval of the Reserve Bank of Malawi. However, there is a small negative list comprising certain types of 'invisible' payments which still have to be referred to the central bank for prior approval. These services include: freight and clearing charges, inter company transfers, profits, dividends, and principal as well as interest payments. This negative list is temporary and will be reviewed periodically with the view to eliminate it in due course.

The new system has also allowed for the operations of foreign exchange bureaux and brokers so as to widen the foreign exchange market and encourage competition. Since the launching of the new system, no bureaux or brokers have been established; but there have been a number of enquiries and applications for licenses which are being processed.

There are a number of positive aspects about the new system. In the first instance, the system will create an environment conducive to increased investment particularly in export-oriented industries.
Secondly, it will assist in rationalizing the use of available foreign exchange in that imports of non-essential goods will be discouraged. Other expected positive aspects will be as follows:

a) it will discourage speculative behavior, thereby encouraging repatriation of export proceeds to Malawi;

b) it allows the public to obtain foreign exchange for purpose of travel (holiday, medical and business) in a timely manner;

c) ensure the country's external competitiveness, and therefore a sustainable balance of payments situation;

d) enable the economy to flexibly adapt to exogenous factors as the exchange rate will begin to reflect developments in Malawi, other than those from other countries;

e) create more employment opportunities as the productive base of the economy expands; and

f) expedite export diversification through a conducive pricing structure;

In the short term, however, it is expected that there will be some instability in the system due to the prevailing excess demand. Domestic prices will go up, but the rate of increase will slow down especially as more foreign exchange becomes available and as production responses begin to occur.

Of course, the kingpin to this will be the maintenance of fiscal discipline and prudent monetary policies.

Lessons from the Malawi Experience

A number of lessons can be drawn from Malawi's experience with structural adjustment programs. The first of these is that there is no end to the structural adjustment process. The process is continuous, and necessary for the development of each country. Malawi has been on the economic adjustment programs since early 1980's, but until today, she is continuing with the programs as we seek to hasten the development process of this country; to widen its productive base and expand employment opportunities within the framework of macro-economic stability.

The second lesson is that the programs need adequate funding to ensure that the gains achieved are not short-lived. In the context of Malawi, we saw that during 1988 through 1991 the economy grew at very encouraging rates; but the withdrawal of donor support during 1992, notwithstanding the incidence of the drought, added to the problems facing the economy. As a result, business confidence was lost and the investment climate became uncertain. Sufficient financial support from donors is required for these programs. A country cannot, for example, go for import liberalization when its coffers are empty.

Third lesson is that timing for implementation of these programs is of the greatest essence. It does not help to keep on postponing structural adjustment because by doing so the prescriptions necessary to correct the situation can be very painful or are impossible to implement.
Fourth lesson learnt is that structural adjustment cannot be undertaken in abstract, i.e., just looking at numbers. There are people involved especially the poor. When we started the process, the social dimension of adjustment were not taken into account both by us and our partners from the Fund and the World Bank. As a result, a large segment of the population became worse off as a result of the policies we put in place. It is however, pleasing to report that this social aspect of structural adjustment is now being addressed.

For structural adjustment to work, there is need for full commitment on the part of all organs of government and to a large extent the people themselves. This can only be brought about if everyone looks at the program as their own, not imposed on them by outsiders, such as the IMF and the World Bank. In other words, the policies put in place should be debated and agreed upon by government itself on one side, and the Multilateral Institutions on the other. Structural adjustment programs have failed elsewhere because organs of government felt that the policies were imposed on them by the IMF or the World Bank.

Conclusion and Recommendations

The list of lessons learnt can go on, but suffice to point out that Malawi remains committed to structural adjustment in all its facets. We have come a long way and, unless we get factual view to the contrary, we believe the course we have taken is the right one. The government budget is slowly coming under control, the private sector has been re-invigorated, parastatal sector reform is on stream, the banking sector is now more open and issues to do with the oligopolistic nature of industry and the structure of ownership are now being addressed.

In the manner that SAP’s have been designed and implemented, there is need to understand more the structural constraints facing our economies. SAP’s appear to be emphasizing more on removal of price related constraints. On the other hand, non price related constraints such as social values as well as culture play an important role. A deeper understanding of the social ethics of the African people and how such ethics impact on their economic behavior is an important step in the formulation of appropriate SAP’s.

There is need for countries to develop institutional and human capacity that can ably formulate, implement and manage SAP’s. A strong and well cultured civil services combined by good political leadership is also a pre-requisite to the success of SAP’s.

The industrial world must also endeavor to implement policies which should be seen to be supportive of the adjustment process of the developing countries. As noted earlier the restrictive trade and financial policies of the developed countries have had adverse impact on the terms of trade for the developing countries, particularly those dealing in primary commodities. For most of the countries particularly in Sub-Saharan Africa, there is no alternative to adjustment. The real issues are only in terms of what form and over what time frame policy adjustments should take in order to maximize social benefits while at the same time minimizing the cost of the reforms.
Background

Oxfam’s interest in structural adjustment stems directly from its work supporting community initiatives aimed at reducing poverty. In sub-Saharan Africa we are involved in projects providing primary health care services, education, water and sanitation. We also provide seeds, credit and other inputs for poor and marginal farmers, and support a wide range of environmental protection initiatives. In the urban sector, our programs include rehabilitation and employment creation. Work with women, who have borne the brunt of Africa’s social and economic crisis, figures prominently in each of these areas.

Structural adjustment policies have important effects on the communities we work with. Changes in levels and patterns of social expenditure, shifts in prices and, more fundamentally, reforms which influence the role of the state, have profound implications for poor people, who are seldom consulted about decisions which affect their lives. These implications are not well understood by the architects of adjustment programs. That is why it is important to develop more participatory approaches to examining the links between adjustment policies and poverty. Above all, this means listening to poor people, who are conspicuous by their absence from most official deliberations on the issue.

For its part, Oxfam has welcomed the development of a dialogue on structural adjustment and poverty reduction with the World Bank. That dialogue has given us an insight into constraints and trade-offs faced by macro-economic planners seeking to address problems of growth and poverty reduction. For our part, we have attempted to voice the concerns of the communities we work with and, where possible, to establish direct contacts between our project partners and policy makers in the World Bank. Inevitably, given our different starting points and constituencies, there have been differences - and it is proper that these should be debated in an open and robust fashion. But I believe our dialogue has been fruitful on both sides. Moreover, local communities, African governments, NGOs, bilateral donors, the World Bank and perhaps even the IMF, notwithstanding its current antipathy to dialogue, share a common interest in developing a better understanding of the languages between macro-economic reform and poverty reduction. My own comments on Adjustment in Africa will focus on these linkages, and are intended as part of Oxfam’s contribution to the public debate which the report has generated.

Adjustment in Africa

Adjustment in Africa offers one highly plausible theory and an equally highly questionable assertion. The plausible theory is that good macro-economic growth, in turn, is essential to reduce poverty in Africa. Unfortunately, the mass of useful statistical material in the report, assurances that “adjustment is working” notwithstanding, tells us little about which policies are most appropriate for achieving sustainable growth and poverty reduction. While the benefits of low inflation, broad fiscal balance and realistic exchange rates are self-evident, the precise mix and sequencing of reforms best equipped to achieve these objectives remain unclear. This is partly because the overriding concern is to prove, through a series of questionable statistical exercises, that the type of policies associated with structural adjustment are the right ones. Let me say at the outset, that this is not a prelude to arguing
for a return to the policies of the pre-adjustment era. Rather, it is an appeal for greater caution in proclaiming that we 'understand' the casual relations between policy changes and growth. I shall return to this point later.

The questionable assertion in Adjustment in Africa concerns the relationship between growth and poverty reduction. Admittedly, this is not a subject which the authors of the report claim to have explored in great depth, which leaves me open to the charge that I am about to criticize them for a simple error of omission. Yesterday we heard that Adjustment in Africa is not about development and poverty reduction, but economic growth - and Oxfam has been roundly criticized for failing to recognize this distinction. My response is to ask whether the distinction is valid. Two years ago the World Bank adopted a Directive on Poverty Reduction, committing the institution to an integrated approach to growth and poverty alleviation. And last year we were told by the World Bank President Lewis Preston, launching the report Implementing the World Bank's Strategy to Reduce Poverty, that "poverty reduction is the benchmark against which our performance as a development institution must be judged." What we are offered in Adjustment in Africa, by contrast, is poverty reduction as an optional extra - the happy if incidental outcome of macro-economic reform. Viewed from Oxfam's perspective, this is not good enough.

Growth, Poverty and Adjustment: Will the Real World Bank Stand Up!

In the sixteen pages (out of two-hundred-and-eighty-four) dealing with poverty and the environment we are told, in a classic exposition of trickle-down theory, that "the gains from economic growth may well have benefitted the poor and especially the rural poor." For those skeptics left unconvinced, the subsequent assurance that faster growth will "in all likelihood reduce the deterioration in the conditions of the poor" is likely to amount to something less than a compelling argument. Of course, nobody in their right minds would question the claim that growth is a necessary part of any poverty reduction strategy for Africa; but it is not a sufficient strategy, as implied in the report. In Oxfam's experience the benefits of economic growth, including that associated with structural adjustment, all too often trickle up to the powerful, exacerbating inequalities in the process. That is why we believe any serious analysis of poverty must start by asking critical questions about inequalities in power and income, about the access of poor people to productive assets and to social and economic infrastructures, about gender relations, and about environmental problems. In recent years some of the World Bank's own country poverty assessments, as well as a relentless tide of public statements and policy documents have started to address some of these issues. All of which raises the question of whether Adjustment in Africa marks the revenge of the economic fundamentalists in the Development Economics Division, or a temporary aberration. Whatever the case, perhaps it is time for the real World Bank to stand up.

What underpins Adjustment in Africa's treatment of poverty reduction is not empirical analysis, but a reductionist theory-cum-theology. Briefly summarized, this sees poverty reduction as the inevitable outcome of the deregulation of markets, allied to an improvement in rural-urban terms of trade. Most poor people live in rural areas, so the argument runs, therefore an improvement in agricultural prices will automatically benefit most poor people. State intervention comes in for especially short-shrift, since parastatal marketing boards have taxed producers in the interest of accumulation by the state. Taken separately, some elements of this argument are uncontroversial. Few would dispute the destructive role of state marketing boards in the 1960s and 1970s, when they were liberally funded by the World Bank. And few would endorse the rent-seeking activities which
state intervention has typically underpinned. However, in its concern to mount a case against state intervention per se, Adjustment in Africa goes too far. The fact that the report does not subject the 'free market' to similarly critical scrutiny, speaks volumes about its ideological disposition. There is no consideration of how, in the absence of effective public regulation, monopsonistic trading interests can distort markets against the interests of poor people. Nor is there any recognition of the case for establishing minimum social standards for employment. Instead there is a claim, not backed by any evidence, that such standards cost jobs. Translated into policy terms, this is precisely the argument which has been used to undermine minimum wage legislation and to challenge the fundamental rights of trades unions.

Markets and People

The treatment of market regulation in Adjustment in Africa is part of a wider failing which I have already touched on: namely, the absence of any analysis of power in the market place. In our project work we come up over and over again against the harsh reality that people enter markets as unequal participants, and leave them with unequal rewards. More specifically, because poor people are denied access to productive inputs, marketing infrastructure, information and capital they are severely disadvantaged in the market. That is why, whatever the efficiency of the price mechanism as an instrument of resource allocation, market reforms can be associated with increasing poverty and inequality.

Oxfam has direct experience of how market deregulation can exacerbate inequalities. Let me give some examples from our work in Zambia. In the Petauke, Chipata and Nyimba districts of Eastern Province and in the Mumbwa district of Central Province, we work with women farm co-operatives of between ten and fourteen members. Most of the women involved are heads of households, and therefore among the most poverty prone group in the country (as the World Bank's forthcoming country poverty assessment notes). Because they have pressing cash needs for repaying debt, paying for education and health, and purchasing basic household goods, even food deficit households are forced to sell part of their crop in the immediate post-harvest period - and the prices they receive have a critical bearing on family welfare. Even with effective state intervention to offset the disadvantages of distance from markets, inadequate storage capacity and poor access to transport, these families are in a highly vulnerable situation; without it, they are at the mercy of powerful private trading interests.

In 1992-1993 Oxfam saw the food security problems of our Zambian project partners exposed by the rapid liberalization of the agricultural marketing system and the withdrawal of state purchasing agents. Forced into 'distress sales' to private traders most farmers were receiving less than half the official floor price. Moreover, a large proportion of their sales were conducted on a barter basis, with the women receiving blankets, salt, soap and cooking oil for their maize. This effectively left them facing a doubly exploitative environment, since the price of their maize was heavily depressed and the cost of their purchases artificially inflated. We believe there are many lessons to be learnt from this experience of market deregulation. One of them is that, whatever the past mistakes of parastatal marketing boards, there remains a case for carefully targeted state intervention in the interests of food security. Without that intervention, the benefits of marketing reforms, will in many cases, continue to accrue principally to powerful traders rather than, as World Bank theory dictates, to peasant producers.

Problems such as those I have described in the Eastern Province of Zambia are less widespread in Zimbabwe because of the purchasing activities of the Grain Marketing Board (GMB) - but they are not
unknown. In Masvingo we work with some 4,000 farmers, the majority of them women, whom we provide with revolving credit in the form of seed and fertilizer. All of these farmers are recovering from the 1992 drought, which virtually wiped out their cattle and meager savings. Last year, however, the closure of a temporary GMB depot resulted in sales to traders at heavily depressed prices. Similar problems were reported by our project partners in other marginal communal farming area. This raises an important wider question about the future role of the GMB. One school of thought, typified by the IMF, argues that the GMB should become a commercial venture, operating without subsidies. Judged against the narrow yardstick of reducing the fiscal deficit, this approach clearly has its attractions. But if implemented it would have the effect of excluding many of the country’s most marginal areas and producers from the grain market, depressing household incomes and compounding food security problems in the process.

None of this is intended to make a case for blanket state control over agricultural marketing. Nor is it intended to obscure the very real difficulties involved in setting and administering floor prices, and determining stockholding policy. The central point I want to make is that, if the objective is to reduce poverty, we should not take it as axiomatic that the withdrawal of the state is in all cases the best option. Nor should we assume, as Adjustment in Africa tends to, that market interventions by the state are inherently inefficient. True, it is not difficult to list some disastrous cases of state interventions in agriculture. But there are instances in which an absence of effective state intervention can be as damaging as a surfeit. In the Shinyanga area of Tanzania, where Oxfam works with smallholder cotton farmers, the collapse of the marketing infrastructure has resulted in large amounts of cotton going to waste, depriving poor households of income and the country of desperately needed foreign exchange. Against this background, we are bound to question whether Adjustment in Africa’s definition of the marketing policy “most favorable” to adjustment as the elimination of state intervention is guided more by ideological predilection than empirical research.

More broadly, Oxfam believes that, instead of endlessly rehearsing the ‘good state versus bad state’ debates of the 1980s, we should evaluate state interventions against a more pragmatic set of criteria: namely, are they efficient and do they bring substantial benefits to poor people. Our experience in providing rural credit and other inputs on subsidized terms to poor farmers is that both objectives can be achieved. Repayment rates on our credit schemes average over 90%, probably more than double most state schemes (including, I suspect, those supported by the World Bank itself). Moreover, these schemes give women farmers, who are often excluded from access to credit markets by restrictions on their property rights, opportunities which they would otherwise be denied. Looking to the wider picture, the World Bank itself has acknowledged the crucial role of state intervention in helping underpin the rapid economic growth of dynamic economies in South Asia. Why, then, the antipathy towards the state in Africa?

Looking beyond immediate issues of market intervention, Oxfam believes the state has a wider role to play in ensuring that the benefits of economic growth are to be equitably shared. Indeed, it is state policies which dictate whether development follows the skewed and inefficient pattern of the Brazilian model, or the more efficient and egalitarian pattern of the dynamic economies of South Asia. Admittedly, this raises difficult political issues for governments, but they cannot be wished away through pious and populist declarations in favor of the poor. Take the issue of land reform. Can there be any meaningful discussion of food security and environmental sustainability in Zimbabwe in the absence of far-reaching land redistribution? Not if you listen to the views of communal farmers operating on their fragile and degraded soils. Of course, there is a ready made counter-argument to the
case for redistributive land reform, which asserts that it reduces production and exports. I would reject this argument. In the short-run, there may well be a trade-off between marketed surplus and the food security of the majority, although even this is questionable given the under-utilization of commercial farm land in Zimbabwe. In the longer-term, a properly financed and well managed land reform program could unleash the productive potential of peasant farmers, much as it did in South Asian countries such as South Korea, Taiwan and Japan.

Social Expenditure and User-Fees

Like earlier World Bank reports, Adjustment in Africa makes a compelling case for redistributing social expenditure towards services most heavily utilized by the poor. Oxfam broadly supports that case. In most African countries health budgets remain heavily skewed towards teaching hospitals, and education budgets towards the tertiary sector, and all too often, primary health care and education expenditures are the first to be cut in the adjustment process, even though social and economic returns are highest in these sectors. Against this background the World Bank's growing concern with social policy issues is to be welcomed, especially if it paves the way towards more active collaboration with the specialized UN agencies. But the somewhat rosy picture presented in Adjustment in Africa, which claims that social provision has not been undermined by structural adjustment, needs to be qualified. UNICEF has drawn attention to the erosion of social welfare budgets across sub-Saharan Africa - and Oxfam has direct experience of the consequences. In Tanzania, for example, where per capita spending on health and primary education has fallen dramatically since the early 1980s, our own primary health care program is facing increasing demands in the face of declining state provision.

Zimbabwe has a better record than most in defending the access of its citizens to health and education. But even here a decline in per capita spending on health and education began in the late 1980s and has continued, admittedly accelerated by the drought, until this year. Today, per capita spending on primary school pupils is around a third lower than in 1989/90. The health sector has suffered similar cuts, with an attendant deterioration in the availability of drugs, staff morale and the delivery of services at all levels. What makes these trends so disconcerting is that economic recovery depends heavily on the development of a healthy, well-educated population. It is significant in this context that the World Bank study of the dynamic economies of East Asia suggests that differences in investment of primary education are among the most significant determinants of the divergence in growth paths between that region and sub-Saharan Africa.

Before leaving this subject I want to touch on the issue of user-fees - an area of social policy which Adjustment in Africa does not mention. This omission reflects the narrow focus of World Bank social conditionality on expenditure. In recent years the Bank's public and social expenditure reviews have improved the monitoring of social spending, and generated a great deal of useful information on its composition. However, by focusing on aggregate expenditure these reviews do not address what is the fundamental social policy issue with regard to poverty reduction: namely, the access of poor people to services. This is dictated partly by the provision of services, and partly by the terms on which those services are provided. It is in the latter context that user-fees have become increasingly important, since they have the effect of placing health services beyond the reach of poor people.

The World Bank has a special responsibility to review its policy role in this area. In the mid-1980s the Bank was in the forefront of efforts to persuade governments of the case for introducing user-fees, arguing that a generalized scarcity of financial resources meant that market pricing principles
were required to allocate the supply of health care provision. And its advice has been widely acted on across Africa. In the case of Zimbabwe, the introduction of more stringent user-fee structures followed the recommendations of two influential World Bank reports on Zimbabwe, both of which recommended increases in revenue collection of heroic proportions. One of these reports, Zimbabwe: financing health services, argued for measures to increase to over one-third the share of health expenditure generated by user-fees. Subsequently, the 1991-1995 Framework for Economic Reform envisaged a quadrupling of revenue from user-fees, with the system of fee collection made more stringent in 1992. Tariffs increased sharply in 1994 in line with a broad commitment to meet the revenue targets set in the Framework for Economic Reform. Admittedly, both the World Bank reports and the Government of Zimbabwe expressed a concern to protect the interests of the poor through an income-based exemption system. But neither party was able to set out a coherent (and financially costed) policy for achieving this objective.

Based on its contacts with rural communities across Zimbabwe, Oxfam believes that, whatever the theoretical case for user-fees, they are systematically depriving poor people of access to health services, with disastrous social consequences. Last year we conducted extensive interviews with women farmers in our project areas to gain a better understanding of their experience of the health sector reforms, and we repeated the exercise earlier this year. These interviews revealed two interlocking sets of problems. First, few of the women understood the exemption system, and almost none believed they were eligible for free treatment. Many of those who had heard of the exemption system said they were unable to afford the time away from their fields and children needed to acquire an exemption certificate, even if they were able to prove their eligibility (which few were). As one woman put it: "This exemption system, it must have been designed by men because they are the only ones who would have enough time to spend queuing for the certificate." Second, it was clear, whatever claims the Ministry of Health were making to the contrary, that many women were basing health care choices on their perceived affordability - sometimes with tragic consequences. We spoke to one woman, a laborer on a commercial farm, at the St. Paul's Mission Hospital near Harare. In what doctors told us was an increasingly common occurrence, she had delayed taking a seriously malnourished child for treatment on cost grounds. In this case the child survived. Others are less fortunate. One woman we interviewed decided against taking her two year old daughter to a clinic for treatment for what she thought to be flu because she was unable to afford the cost of registering for treatment and drugs. The child subsequently died from meningitis. According to Government, such cases should not occur because of the exemption system. But in our interviews with groups of rural women connected to our project in Masvingo, there was a widespread perception that everybody had to pay for treatment, irrespective of income. Even patients in St. Paul's Mission Hospital whom we asked to explain the exemption system were unable to do so - and this was a group which, having gone through an admissions procedure, might have been expected to be well informed on the issue. To make matters worse, many women who were eligible for exemption related stories of state officials failing to fulfil their duties. Doctors at St Paul's told us of how in early February, many sick women had walked to the Hospital, in many cases over long distances, to receive their exemption certificates, only to be confronted by Government officials who arrived with the wrong forms. They have yet to return with the right ones!

We readily acknowledge that these are anecdotal cases, and that policy reform cannot be built on anecdote. But there is a mounting body of evidence, supported by medical personnel, that user-fees are excluding poor people from health provision. For example, statistics from Harare Central Hospital paediatrics unit, show a close correlation between the introduction of health charges and the perinatal
mortality rate. Doctors believe this can be traced to the declining attendance of women at antenatal clinics. Their view is borne out by the increase from 8.8% to 13.6% in the number of children born to mothers who had not registered for antenatal care. The perinatal mortality rate for unbooked patients is some five times higher than for booked patients. Further evidence of the negative impact of user-fees was provided by UNICEF’s second sentinel site survey. This recorded a 22% decline in outpatient clinic attendance in communal farm areas and a 64% drop in commercial farming areas following the introduction of more stringent user-fee collection rules. The survey also revealed that a fifth of those parents who did not take children suffering from diarrhoea to a health centre based their decisions on cost considerations. More recently, evidence from Zambia has suggested worrying parallels with the Zimbabwean experience. One recent survey of six hundred and fifty people in Lusaka recorded that 60% had not visited a health facility for treatment of illness because of cost factors. Unfortunately, governments appear immune to the weight of evidence mounting against recourse to user-fees. For example, the sharp increase in user-fee charges introduced in January 1994, which saw antenatal fees increased from Z$10-12 to Z$50-60 at district hospitals, was surely ill-advised in the extreme given the clear evidence that the exemption system was not working.

It would be wrong to attribute the worsening health indicators in Zimbabwe solely to user-fees - AIDS has probably been of considerably greater significance in this respect. However, it is equally difficult to escape the conclusion that user-fees have contributed. Indeed, evidence from academic research and from NGOs across Africa point to the widespread failure of exemption systems to operate effectively, and to the tendency for user-fees to be accompanied by the exclusion of poor people from services. It is against this background that Oxfam believes there is an overwhelming case for phasing out user-fees on health, or replacing them with nominal charges. There are powerful efficiency as well as equity considerations for such a policy shift. These derive from the simple fact that the costs of administering exemptions systems rises with the number of poor people, while revenue collection falls. This explains why few countries in Africa have succeeded in generating more than 5% of recurrent health expenditure from revenue charge - and in many cases it is likely that the costs of administration are greater than the returns.

Many of the same arguments apply to user-fees in education. As an infrequent visitor to Zimbabwe I have been struck by the enormous weight which poor people attach to educating their children; and it is difficult not to feel humbled by the sacrifices which they make to achieve that objective. In many cases these sacrifices extend to women doing without meals or working extra hours in informal sector employment. In February, I visited with a World Bank team a number of extremely poor households in the Chivi district of Zimbabwe. In several of these households women were ploughing their land by hand, and most were susceptible to periods of hunger and food shortages. I asked one mother among those we spoke to what she would do if she had a bumper crop that left her with a "windfall" gain of Z$100. At the top of her list of priorities came sending her sons and daughters to secondary school!

Surely, given the sacrifices that ordinary men and, more especially, women are making to maintain their access to health and education, governments, bilateral donors and multilateral agencies have a responsibility to use their resources to protect that access in the adjustment process. This is not to deny the importance of achieving reasonable fiscal balances. But there are better and more socially just ways of arriving at this objective than imposing regressive systems of taxation on the poor through user-fees. Unfortunately, the alternatives are all too often ignored in the interest of the rich and politically powerful. For example, subsidies for parastatals and military expenditure still seem
remarkably immune from adjustment pressures in Zimbabwe. So does the income of the wealthy.

Take the case of commercial farmers, who have reaped huge gains from foreign exchange liberalization while seeing their tax burden has been reduced in the interest of an export-led investment strategy. The fact that commercial farm land, the country's prime productive asset, is untaxed compounds the injustice of this distribution of adjustment costs. It is also one of the factors behind what the World Bank itself, in its Agricultural Sector Memorandum, recognizes as the grossly inefficient use of commercial farm land, around half of which is unutilized. Once again, efficiency and equity considerations combine to make a powerful case for a pro-poor alternative.

Is Adjustment "Working"

Finally, I want to return to the central claim advanced by Adjustment in Africa; namely, that "adjustment is working". Let me say first of all that the study constitutes a major advance over previous reviews of adjustment lending. These reviews sought to compare countries "before and after" adjustment, effectively discounting exogenous factors and ignoring the widely divergent nature of adjustment measures actually implemented. The results, for all their triumphalist presentation, provided precious little by way of substance to prove the case. By focussing on specific policies, the current study avoids some of the drawbacks of these earlier studies, even if the packaging sometimes conveniently elides "adjustment" with "structural adjustment".

The problem with the report is that it seeks to argue that the application of a consistent set of policies across different countries will generate higher growth. In fact, this is only partially borne out of the evidence. For example, of the six countries registering the best improvements in macro-economic policy, two (The Gambia and Burkina Faso) experienced negative growth rates across the two reference periods, one (Zimbabwe) barely grew and only the remaining three (Ghana, Nigeria and Tanzania) achieved strong growth. Interestingly, the exclusion of Nigeria would leave the group with a lower average growth rate than the group of small improvers. Are we to deduce from this that the less enthusiastic application of adjustment policies is more likely to lead to higher growth? Even with Nigeria, the "large improvers" in macro-economic policy register an average growth rate of only 0.5% more than the "small improvers", which is probably statistically insignificant as a measure of the effect of macro-economic reforms.

In the last analysis, then, the case for an adjustment/growth correlation rests on Ghana, Nigeria and Tanzania. Disaggregating the data suggests that the strongest relationship is between growth and exchange rate devaluation. In fact, the five countries with the highest growth rates (Mozambique, Nigeria, Uganda, Ghana and Tanzania) are among the six with the highest scores for exchange rate adjustments. In each of the three "strong improvers", these adjustments were enormous, with devaluations of between 250% and 400% - so there was a lot of scope for improvement and, not surprisingly given the scale of over-valuation, it had positive effects. Combined with the abandonment of policies of fixed and over-valued exchange rates and reduced taxation of export crop producers, devaluation created the conditions for recovery from an exceptionally low base generated by the disastrous policies of the previous era. The problem of sustaining this initial burst by supporting currency devaluation with fiscal and monetary policy has proved problematic in Nigeria (terminally so it seems) and Tanzania. Which leaves us with Ghana.

In other respects, too, the packaging of Adjustment in Africa seriously misrepresents the product. For example, the investment performance of the countries with large improvements in the macro-
economic balances is considerably worse than for the small improvers group - a point which has barely been mentioned in the public presentation of the report. Even Ghana has a level of private investment which is insufficient to replace existing capital stock, let alone to sustain accelerated growth. Whatever the growth performance of the stronger adjusters, the evidence in Adjustment in Africa suggests it is being maintained by marginal improvements in the efficiency of existing investment, rather than by our new investment. Unfortunately, the report does not even consider what this says about the policies through which macro-economic improvements are achieved. In particular, have unduly tight monetary and credit policies, enforced through high interest rates, undermined investment? Nor does the report adequately address the question of why agricultural growth rates are lower for the countries with large improvements than for those with small improvements.

There are other fundamental issues around the timing and sequencing of policy reforms which remain unanswered. For example, Zimbabwe registers as a strong performer in fiscal policy on the basis of its success in expanding its revenue base, rather than in reducing its fiscal deficit. Ghana also appears to have improved its fiscal position by expanding its revenue base. This suggests that fiscal stability achieved through revenue expansion maybe more positively correlated with growth than when achieved through expenditure cuts. Similarly, it is significant that some countries which perform poorly on some aspects of monetary policy, including Tanzania, Mozambique and Ghana, achieve high rates of growth. What is the correlation here between monetary policy, availability of credit and investment?

For the non-economist there is another problem in trying to develop a more coherent understanding of the adjustment process, which emerges from reading the IMF's most recent evaluation of ESAF. What is striking from a comparison of that evaluation with Adjustment in Africa is that, measuring broadly the same criteria over slightly different reference periods, the IMF lists two countries (Mozambique and Togo) as strong performers, which the World Bank study categorizes as deteriorating, and another (Tanzania) as deteriorating, which is identified by the Bank as a strong improver. The IMF study also calls into question the Bank's claim that exogenous factors are secondary, arguing that debt relief and terms of trade are critical determinants of growth in adjusting countries.

As a confused and hapless non-economist observer, perhaps I could use this opportunity to ask two other points of information. Throughout the report, the evidence points to a positive correlation between increased agricultural prices and supply. At least they do until they come to the environment section, when we are told that Adjustment does not have adverse environmental impacts because changes in pricing policy have little effect on aggregate production. Surely, the World Bank can't have it both ways. Second, there appears to be a selective interpretation of the evidence in a key places. For example, the claim is made that between 1987 and 1991, Nigeria's agricultural sector grew by 4% a year compared to 2% in Ghana because of policy reforms, and in particular because of Ghana's refusal to eliminate COCOBOD. This ignores the fact that Ghana's initial devaluation came earlier than Nigeria's. It also ignores the fact that (Tables a18 and a20) Ghana increased producer prices by more than double Nigeria, but achieved an agricultural growth rate of 2.2% compared to 2.7% for the period 1981-83 - 1989-91. Leaving aside the fact that the figures for Nigeria are, beyond reasonable doubt, spurious, is the real point the authors want to make here - yet again - that state intervention does not work? Finally, and linked to these concerns, it would have been helpful to have been provided with more information on the sources of the reports figures. For example, how did the
authors determine to what extent the decline in Cote d'Ivoire's exports and the rise in Ghana's exports were the result of changes in marketed production, rather than in patterns of cross-border trade?

Debt Reform

I want to conclude by touching on the issue of debt. The good news here is that Adjustment in Africa restates the conclusion of the World Debt Tables that Africa suffers from an unsustainable debt burden. In fact, the indices of Africa's debt crisis are worse than those of the middle-income countries of Latin America at the peak of their debt crisis. Today, Africa's debt stock is equivalent to around 110% of the region's GDP, compared to 40% for Latin America. Repayments on that debt absorb over $10bn annually, which is equivalent to over a quarter of export earnings. These are stark figures. But, they tell only part of the story since only around a half of Africa's scheduled debt payments are being serviced, with the result that arrears are accumulating at a frightening rate. For reasons which we spelt out in our Africa: make or break report, Oxfam believes that Africa's debt imposes an unacceptable diversion of limited resources away from investment in people and economic infrastructure. It also presents an obstacle to stable exchange rate management because of the implied threat of endless devaluations deterring investors from holding local currencies.

Given the scale of the crisis, Adjustment in Africa's suggestion that "a sustainable solution to the debt problem is still elusive" will appear to many as taking ironic understatement a step too far. The fact is that the international community has abysmally failed Africa on this front. Britain's efforts to secure Paris Club agreement on a modest proposal to write-off two-thirds of eligible debt stock continue to founder on a combination of Japanese intransigence and US indifference. More disconcertingly, multilateral debt problems are reaching critical proportions for a number of countries.

The stock of multilateral debt held by severely-indebted low-income countries has quadrupled to over $43bn since 1982, and some 30% of the actual debt service payments of these (mainly African) debtors are now directed towards multilateral creditors. Repayments to the IMF constitute a special problem in this regard, partly because of the absurdly tight conditions and bad advice that comes with ESAP loans; but more especially because the Fund remains a net drain on African economies. Since the mid-1980s, the negative transfer from sub-Saharan Africa to the IMF has amounted to over $2bn. By contrast, IDA and the Fifth Dimension program have prevented similar problems emerging with IBRD debt, so that the World Bank remains a major net contributor to the region.

In Oxfam's view it was helpful but unnecessary for Adjustment in Africa to restate the dimensions of Africa's debt crisis. Nobody with even a nodding acquaintance with the figures believes that the region's debt is anything other than unpayable and destabilizing. The challenge is to come up with policy prescriptions for improving the current state of affairs. We believe it is time for the World Bank to take the lead in pressing northern governments into adopting a radical debt reform initiative aimed at establishing repayment ceilings compatible with social and economic recovery. For most countries this will involve debt relief going beyond the Trinidad Terms, with write-offs of between 80% and 100%. In the case of a substantial group of countries it will also require action on multilateral debt. In this respect, Oxfam has proposed the sale of part of the IMF's largely redundant gold stocks to finance a debt reduction facility. That facility could be used either to reduce the Fund's exposure, or to provide the resources needed for interest rate subsidies and longer repayment periods on IMF loans.
Conclusion

For reasons which I have explained, Oxfam does not regard Adjustment in Africa as a helpful contribution to the analysis of the linkages between adjustment, economic growth and poverty reduction. I suspect my own contribution may be regarded as similarly unhelpful by the authors of the report. But whatever our differences in this area, Oxfam is committed to developing its dialogue with the World Bank and with governments. In the last analysis, we all have a great deal to learn from each other.
# ANNEX I

## LIST OF PARTICIPANTS

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