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PROJECT PERFORMANCE ASSESSMENT REPORT

ZAMBIA

ECONOMIC RECOVERY AND INVESTMENT PROMOTION CREDIT
(Cr. 2764-ZA)

SECOND ECONOMIC AND SOCIAL ADJUSTMENT CREDIT
(Cr. 2910-ZA)

PUBLIC SECTOR REFORM AND EXPORT PROMOTION CREDIT
(Cr. 3167-ZA)

October 29, 2003

Country Evaluation and Regional Relations Group
Operations Evaluation Department

Currency Equivalents (annual averages)

Currency Unit = Kwachas (K$)

1995	US$1.00	K$ 864.12	1999	US$1.00	K$2,388.02
1996	US$1.00	K$1,207.90	2000	US$1.00	K$3,110.84
1997	US$1.00	K$1,314.50	2001	US$1.00	K$3,610.94
1998	US$1.00	K$1,862.07	2002	US$1.00	K$4,398.00

Fiscal Year

January 1 – December 31

Abbreviations and Acronyms

AAC	Anglo American Corporation
AIDS	Acquired Immunodeficiency Syndrome
CAE	Country Assistance Evaluation
CAS	Country Assistance Strategy
CDC	Commonwealth Development Corporation
DBZ	Development Bank of Zambia
DDB	Duty Drawback
ERIP	Economic Recovery and Investment Promotion Credit
ESAC	Economic and Social Adjustment Credit
ESAF	Enhanced Structural Adjustment Facility
Eximbank	Export-Import Bank
GDP	Gross Domestic Product
GRZ	Government of the Republic of Zambia
HIPC	Highly Indebted Poor Countries
HIV	Human Immunodeficiency Virus
ICR	Implementation Completion Report
IDA	International Development Association
IFC	International Finance Corporation
IMF	International Monetary Fund
KCM	Konkola Mining Company
MOF	Ministry of Finance
MUB	Manufactured Under Bond
NAPSA	National Pension Scheme Authority
NFNC	National Food and Nutrition Commission
NGO	Nongovernmental Organization
OED	Operations Evaluation Department
PIA	Pension Insurance Authority
PPAR	Project Performance Assessment Report
PRGF	Poverty Reduction Growth Facility
PRSP	Poverty Reduction Strategy Paper
PSPF	Public Service Pension Fund
PSREP	Public Sector Reform and Export Promotion
SSA	Sub-Saharan Africa
VAT	Value Added Tax
ZCCM	Zambian Consolidated Copper Mines
ZIMCO	Zambian Public Enterprise Holding Company
ZNPF	Zambian National Provident Fund
ZPA	Zambia Privatization Agency

Director-General, Operations Evaluation	:	Mr. Gregory K. Ingram
Acting Director, Operations Evaluation Department	:	Mr. Ajay Chhibber
Sr. Manager, Country Evaluation and Regional Relations	:	Mr. R. Kyle Peters
Task Manager	:	Mr. John H. Johnson
Initial Team Author	:	Mr. William Battaile

OED Mission: Enhancing development effectiveness through excellence and independence in evaluation.

About this Report

The Operations Evaluation Department assesses the programs and activities of the World Bank for two purposes: first, to ensure the integrity of the Bank's self-evaluation process and to verify that the Bank's work is producing the expected results, and second, to help develop improved directions, policies, and procedures through the dissemination of lessons drawn from experience. As part of this work, OED annually assesses about 25 percent of the Bank's lending operations. In selecting operations for assessment, preference is given to those that are innovative, large, or complex; those that are relevant to upcoming studies or country evaluations; those for which Executive Directors or Bank management have requested assessments; and those that are likely to generate important lessons. The projects, topics, and analytical approaches selected for assessment support larger evaluation studies.

A Project Performance Assessment Report (PPAR) is based on a review of the Implementation Completion Report (a self-evaluation by the responsible Bank department) and fieldwork conducted by OED. To prepare PPARs, OED staff examine project files and other documents, interview operational staff, and in most cases visit the borrowing country for onsite discussions with project staff and beneficiaries. The PPAR thereby seeks to validate and augment the information provided in the ICR, as well as examine issues of special interest to broader OED studies.

Each PPAR is subject to a peer review process and OED management approval. Once cleared internally, the PPAR is reviewed by the responsible Bank department and amended as necessary. The completed PPAR is then sent to the borrower for review; the borrowers' comments are attached to the document that is sent to the Bank's Board of Executive Directors. After an assessment report has been sent to the Board, it is disclosed to the public.

About the OED Rating System

The time-tested evaluation methods used by OED are suited to the broad range of the World Bank's work. The methods offer both rigor and a necessary level of flexibility to adapt to lending instrument, project design, or sectoral approach. OED evaluators all apply the same basic method to arrive at their project ratings. Following is the definition and rating scale used for each evaluation criterion (more information is available on the OED website: http://worldbank.org/oed/eta-mainpage.html).

Relevance of Objectives: The extent to which the project's objectives are consistent with the country's current development priorities and with current Bank country and sectoral assistance strategies and corporate goals (expressed in Poverty Reduction Strategy Papers, Country Assistance Strategies, Sector Strategy Papers, Operational Policies). *Possible ratings:* High, Substantial, Modest, Negligible.

Efficacy: The extent to which the project's objectives were achieved, or expected to be achieved, taking into account their relative importance. *Possible ratings:* High, Substantial, Modest, Negligible.

Efficiency: The extent to which the project achieved, or is expected to achieve, a return higher than the opportunity cost of capital and benefits at least cost compared to alternatives. *Possible ratings:* High, Substantial, Modest, Negligible. This rating is not generally applied to adjustment operations.

Sustainability: The resilience to risk of net benefits flows over time. *Possible ratings:* Highly Likely, Likely, Unlikely, Highly Unlikely, Not Evaluable.

Institutional Development Impact: The extent to which a project improves the ability of a country or region to make more efficient, equitable and sustainable use of its human, financial, and natural resources through: (a) better definition, stability, transparency, enforceability, and predictability of institutional arrangements and/or (b) better alignment of the mission and capacity of an organization with its mandate, which derives from these institutional arrangements. Institutional Development Impact includes both intended and unintended effects of a project. *Possible ratings:* High, Substantial, Modest, Negligible.

Outcome: The extent to which the project's major relevant objectives were achieved, or are expected to be achieved, efficiently. *Possible ratings:* Highly Satisfactory, Satisfactory, Moderately Satisfactory, Moderately Unsatisfactory, Unsatisfactory, Highly Unsatisfactory.

Bank Performance: The extent to which services provided by the Bank ensured quality at entry and supported implementation through appropriate supervision (including ensuring adequate transition arrangements for regular operation of the project). *Possible ratings:* Highly Satisfactory, Satisfactory, Unsatisfactory, Highly Unsatisfactory.

Borrower Performance: The extent to which the borrower assumed ownership and responsibility to ensure quality of preparation and implementation, and complied with covenants and agreements, towards the achievement of development objectives and sustainability. Possible ratings: Highly Satisfactory, Satisfactory, Unsatisfactory, Highly Unsatisfactory.

Contents

The initial version of this report was prepared by William Battaile, and revised by John Johnson, who served as Task Manager. Tirsit Dinka provided administrative support.

Ratings and Responsibilities

Performance Ratings

	Region	*OED*	
	ICR	***ICR Review****	***PPAR***
Economic Recovery and Investment Promotion Credit (Cr. 2764-ZA)			
Outcome	Satisfactory	Satisfactory	Moderately Unsatisfactory
Sustainability	Uncertain	Uncertain	Likely
Institutional Development Impact	Substantial	Substantial	Modest
Bank Performance	Satisfactory	Satisfactory	Unsatisfactory
Borrower Performance	Satisfactory	Satisfactory	Highly Unsatisfactory
Second Economic and Social Adjustment Credit (Cr. 2910-ZA)			
Outcome	Satisfactory	Satisfactory	Unsatisfactory
Sustainability	Uncertain	Uncertain	Unlikely
Institutional Development Impact	Partial	Modest	Modest
Bank Performance	Satisfactory	Satisfactory	Unsatisfactory
Borrower Performance	Satisfactory	Satisfactory	Unsatisfactory
Public Sector Reform and Export Promotion Credit (Cr. 3167-ZA)			
Outcome	Satisfactory	Moderately Satisfactory	Moderately Unsatisfactory
Sustainability	Likely	Likely	Unlikely
Institutional Development Impact	Modest	Modest	Modest
Bank Performance	Satisfactory	Satisfactory	Satisfactory
Borrower Performance	Satisfactory	Satisfactory	Satisfactory

***** The Implementation Completion Report (ICR) is a self-evaluation by the responsible operational division of the Bank. The ICR Review is an intermediate OED product that seeks to independently verify the findings of the ICR.

Key Staff Responsible

Project	*Staff*	*Appraisal*	*Completion*
Economic Recovery and Investment Promotion Credit (Cr. 2764-ZA)	Task Managers	Emile Sawaya	Emile Sawaya and Lucy Fye
	Division Chief	Ataman Aksoy	Ataman Aksoy
	Country Director	Phyllis Pomerantz	Phyllis Pomerantz
Second Economic and Social Adjustment Credit (Cr. 2910-ZA)	Task Manager	John Todd/Sudhir Shetty	Hinh Dinh
	Division Chief	Ataman Aksoy	Ataman Aksoy
	Country Director	Phyllis Pomerantz	Phyllis Pomerantz
Public Sector Reform and Export Promotion Credit (Cr. 3167-ZA)	Task Manager	Sudhir Shetty	Hinh Dinh
	Division Chief	Ataman Aksoy	Philippe Le Houerou
	Country Director	Phyllis Pomerantz	Yaw Ansu

Preface

This Project Performance Assessment Report (PPAR) covers the following operations:

- The **Economic Recovery and Investment Promotion Credit** (*ERIP*, Credit 2764, Project P003240) for SDR 90 million (US$140 million equivalent), approved on July 11, 1995. A first tranche (SDR 45 million) was released upon effectiveness on September 6, 1995 and a second tranche (SDR 45 million) on August 22, 1997, nineteen months later than originally planned. Associated IDA reflows of SDR 8 million (US$11.6 million equivalent) were disbursed in May and June 1996. The project was closed on December 31, 1997, after a one year extension.

- The **Second Economic and Social Adjustment Credit** (*ESAC II*, Credit 2910, Project P003224) for SDR 62.4 million (US$90 million equivalent) was approved on August 1, 1996. A first tranche (SDR 31.2 million) was released upon effectiveness, October 17, 1996 and a second tranche (SDR 31.2 million) on December 9, 1997, eleven months later than planned. Associated IDA reflows of SDR 5.4 million (US$7.4 million equivalent) were disbursed on March 10, 1997. The project was closed on December 31, 1997.

- The **Public Sector Reform and Export Promotion Credit** (PSREP/*ESAC III*, Credit 3167, Project P035641) for SDR 122.7 million (US$170 million equivalent) was approved January 26, 1999. A first tranche (SDR 46.9 million) was released upon effectiveness on January 28, 1999. A floating tranche focused on public sector reform (SDR 28.9 million) was disbursed on July 9, 1999 and the final tranche (SDR 46.9 million) on April 4, 2000, immediately after the sale of key assets of the Zambian Consolidated Copper Mines (ZCCM). Associated IDA reflows of SDR 2 million (US$2.8 million equivalent) were disbursed on June 3, 1999. The project closed on December 31, 2000.

The PPAR was prepared by the Operations Evaluation Department (OED), building upon Implementation Completion Reports, project documents, and correspondence about the three operations. An OED mission visited Zambia during February/March 2001 to discuss the operations' effectiveness with Government officials, business representatives, and donors. Their assistance, along with that of the IDA Country Team, is gratefully acknowledged. Major developments transpiring after the original field work necessitated an updating mission in April 2002.

A draft report was sent to the Borrower for comments. No comments were received.

Summary

1. Attached is the Project Performance Assessment Report (PPAR) for the above credits to Zambia, approved and operative from 1995 to 2000.

2. The objectives of the *Economic Recovery and Investment Promotion Credit* (*ERIP*) were to promote private sector investment in the Zambian Consolidated Copper Mines (ZCCM) through privatization, alter mining sector policy to stimulate private sector-led sectoral development, increase the supply of long-term bank finance, and maintain a satisfactory macroeconomic policy environment. Other goals included supporting introduction of a value-added tax (VAT), maintaining a minimally-acceptable level of social sector spending, and initiating reforms of the pension and social security systems.

3. The objectives of the *Second Economic and Social Adjustment Credit* (*ESAC II*) included macroeconomic stabilization, promotion of import tariff liberalization; land and labor market reforms to stimulate export competitiveness; enhanced delivery of social services; strengthened nutritional and pharmaceutical policies; and improved public procurement.

4. The objectives of the *Public Sector Reform and Export Promotion Credit* (*PSREP*) included completing the transfer of ZCCM mining assets to the winning private bidder; financing the costs of redundancy for ZCCM miners; redesigning the public sector reform program; easing restrictions on imported inputs; streamlining approvals by the Zambian Investment Center; and maintaining budgetary allocations for the social sectors.

5. *ERIP*'s results were mixed but disappointing, for the most part. Sustainable progress toward macroeconomic stability was modest, despite successful introduction of a value-added tax strengthening the tax base. ZCCM was brought to auction, but the auction was cancelled by the Borrower after *ERIP* had completely disbursed, introducing uncertainty into the mining sector and deepening Zambia's fiscal crisis. The supply of long-term banking finance did not significantly increase. And, maintaining the *share* of public spending devoted to social purposes was not enough to shore up the social safety net, not only because the *level* of real public spending declined so rapidly that real social spending during this period actually contracted, but also because the public sector's capacity to deliver basic services actually deteriorated. Only the reforms of the pension system were largely achieved, although with major delays.

6. In light of these developments, the outcome rating for *ERIP* was downgraded from satisfactory at the time of OED's initial review to *moderately unsatisfactory.* On the other hand, since the pension and tax reforms remain intact, sustainability was upgraded from a rating of uncertain to *likely.* Institutional development impact, which depended, at its core, on successful ZCCM privatization, was downgraded from substantial to *modest.* Finally, because of the weaknesses in *ERIP*'s design noted previously, IDA performance was downgraded from satisfactory to *unsatisfactory.*

7. Achievement of *ESAC II*'s objectives was also mixed. Macroeconomic management was compromised by erratic expenditure discipline, inadequate monitoring and control, and a lack of

sustainable external financing. Trade liberalization measures were fully achieved, but results have been mixed—better for consumers, but modest for exporters, given continued non-price structural barriers, such as the poor infrastructure, as well as continued protectionism in the markets of some important regional trading partners. *ESAC II* conditionality for protecting the *share* of 1996 social spending in total budgetary allocations suffered from the same deficiency as the earlier, and similar, conditionality in *ERIP*. Added to this were complications arising from the operation of the cash budgeting system. In light of these developments, the rating of outcome was downgraded to *unsatisfactory*, from satisfactory at the time of OED review. Given evidence of continued weak GRZ commitment, sustainability was downgraded from uncertain to *unlikely* and Bank performance from satisfactory to *unsatisfactory.* Only the rating of institutional development was maintained unchanged at *modest.*

8. The *PSREP*'s most important objective was achieved, then severely disrupted by a buyer change-of-heart. Five years after donors first identified ZCCM privatization as a core reform, the state enterprise was finally sold in March 2000. Sadly, the sense of triumph and relief at achieving this long-sought goal lasted barely two more years. In August 2002, the winning bidder abandoned its mining interests in Zambia, announcing that it could no longer find economic justification for further investment.

9. Other supported reforms fared modestly better. Weak government commitment continued to undercut efforts to improve the efficiency of the civil service. Tariffs on imported inputs were lowered, but provided only marginal benefits for exporters beset by more pressing operating problems. Following introduction of streamlined procedures, the number of applications to the Zambia Investment Center actually declined, and, to date, the Center has failed to become the envisioned "one stop shop" for foreign investors. And, as in *ESAC II*, social budgets were maintained in real terms during *PSREP* implementation, but expenditures were not adequately monitored for results, and a wide number of social indicators deteriorated. In view of these factors, the outcome rating has been downgraded from moderately satisfactory in the ICR Review to *moderately unsatisfactory,* and sustainability from likely to *unlikely.* Despite some shortcomings in project design, IDA did all that could be reasonably expected to try and salvage ZCCM privatization, the operation's most important objective. On this basis, IDA performance was maintained unchanged at *satisfactory,* as was the *modest* rating for IDI.

10. Major lessons of general applicability include:

- When pressures to maintain a Client current on the service of its external debt have a major impact on lending decisions, it is incumbent upon Management to discuss these pressures, and any impact they had on the timing, content, and size of a proposed operation, with the Board at the time of loan presentation.

- "Stroke of the pen" measures are an unreliable indicator of Borrower commitment to undertaking deeper structural reform.

- Uneven macroeconomic performance sharply reduces the expected long-term benefits of structural reform, and cripples the prospects for private sector-led growth.

- Efforts to diversify Zambia's production base have not succeeded, in part because non-price constraints, such as poor infrastructure, weak governance, and public sector inefficiency, have not been adequately addressed.

Gregory K. Ingram
Director-General
Operations Evaluation

1. Background

1.1 At independence in 1964, Zambia enjoyed one of the highest *per capita* incomes in Sub-Saharan Africa (SSA). The economy was, then as now, dependent on the mining sector, with copper exports accounting for virtually all foreign exchange earnings. The newly-constituted government rapidly assumed a dominant economic role, keeping social spending high, and financing it from the copper export earnings of the state-owned enterprises.

1.2 By the early 1980s, after years of public sector mismanagement, exacerbated by a recession in international copper markets, these policies were no longer viable. Public spending remained high for a time, financed by massive external borrowing. But, then, even this option was foreclosed, compelling Zambia to seek emergency assistance from external donors. After several abortive attempts at reform, the Kaunda Administration suspended regular contacts with the Bretton Woods institutions in 1987, and began to accumulate arrears on its international obligations. Talks resumed in 1989, and were followed in early 1991 with Borrower pledges to initiate structural reforms, which were matched by donor actions to clear Zambia's arrears with IDA. Following the electoral defeat of the incumbent administration in November 1991, IDA embarked on a more ambitious reform dialogue.

Macro Stabilization in the 1990s

1.3 The newly-elected administration implemented tough fiscal, exchange rate, and financial sector reforms, despite being beset by social tensions exacerbated by severe drought. Recurrent expenditures, excluding interest payments, were slashed from 18 percent of GDP in 1991 to 12 percent in 1992. Price controls were dismantled, the exchange rate was unified and became market-determined, interest rates on loans were liberalized in the Fall of 1992, and regular auctions of treasury bills initiated.

1.4 However, problems in synchronizing these measures delayed price stabilization for more than two years. Strong fiscal measures were upstaged, to some extent, by the decision to prematurely liberalize the capital accounts. Combined with exchange rate devaluation, this decision led to a prolongation of Zambia's inflation.[1] This, in turn, eroded the real growth of tax revenues, undercutting fiscal austerity. In turn, delays in stabilizing the economy extended the period of stagnant growth, distracting policymakers from undertaking much-needed structural reforms.

1.5 To a great extent, official donors concentrated on helping Zambia stay current with its external debt, and meet other urgent balance-of-payment needs, needs made even larger because unfavorable international markets and faltering local production

[1] As discussed in the *External Evaluation of the ESAF – Report of a Group of Independent Experts* (http://www.imf.org/external/pubs/ft/extev/), opening the capital account prior to achieving stabilization led to a large one-time flight of capital and a sharp decline in money demand. Hence, the dampening effects of public expenditure reduction were swamped by the ensuing monetary and capital market pressures placed on prices.

combined to seriously depress Zambia's copper export earnings, the primary source of foreign exchange. Thanks to an increase in official aid, Zambia was able to restructure its external obligations, increasing the ratio of concessional to commercial debt from 9-to-1 in 1990 to over 100-to-1 in 1999.

IDA Lending

Table 1.1: World Bank Adjustment Lending Commitments to Zambia: 1991-2001

	Credit		*Calendar year*										
Operation	***Approval***	***Closing***	***91***	***92***	***93***	***94***	***95***	***96***	***97***	***98***	***99***	***00***	***01***
Economic Recovery Credit 2	Mar-91	Jun-92	247										
Privatization & Industrial Reform I	Jun-92	Apr-95		200									
Privatization & Industrial Reform II	Jun-93	Jun-97			100								
Economic & Social Adjustment	Mar-94	Dec-95				150							
Econ. Recovery & Invest Promo.	Jul-95	Dec-97					140						
Economic & Social Adjustment II	Aug-96	Dec-97						90					
Pub. Sect. Reform & Export Promo.	Jan-99	Dec-00									170		
Fiscal Sustainability	Jun-00	Dec-01										140	

Note: The three adjustment operations covered by this assessment report are highlighted.
Source: IDA lending database.

1.6 IDA lending far outpaced that of other donors, totaling over US$900 million during FY96-01, half of which was delivered as quick-disbursing adjustment lending (Table 1.1). Subtracting reflows from service of leftover IBRD debt, IDA net transfers were more modest. For example, during 1991-95, service on IBRD debt reduced IDA net transfers by 44 percent, but by 18 percent during the latter half of the decade, when the IBRD debt had been largely repaid. Between 1996 and 1999, waning bilateral assistance stemming from concerns about Zambia's governance made IDA disbursements indispensable for Zambia to continue servicing its external debt, but left little for financing other development needs.[2]

Macroeconomic Management

1.7 Macroeconomic management performance in the nineties was mixed, trending from acceptable to distinctly unfavorable during the evaluation period. A rapid pace of early reform at the start of the 1990s was followed by a loss of momentum in the latter half of the decade, during which fiscal laxity, rising inflation, a hesitancy in carrying out

[2] OED's *1996 Zambia Country Assistance Review* (Report No. 15675, June 3, 1996) called attention to the danger that IDA might be left largely alone in Zambia, should the bilateral donors withdraw, a prediction fulfilled soon thereafter.

further structural reform, and deterioration of the investment climate stymied growth. Between 1995 and 2001, performance targets agreed with the IMF were largely missed.

Table 1.2: Zambia Macro Indicators

	Percent					
Indicator	***1994***	***1995***	***1996***	***1997***	***1998***	***1999***
Real GDP	-8.7%	-2.5%	6.6%	3.3%	-1.9%	2.4%
Real GDP per cap	-11.2%	-5.1%	3.9%	0.8%	-4.2%	0.2%
Inflation (CPI)	53.6%	34.2%	46.3%	24.8%	28.6%	26.5%
	Kwacha/$					
Official exchange rate	669	864	1,208	1,315	1,862	2,388
	(Share of GDP)					
Gross private investment	7.3	7.3	5.2	7.7	5.2	5.4
Gross domestic savings	7.4	12.2	5.3	9.4	3.9	-1.1
Overall balance (accrual basis)	-7.9	-4.3	-3.9	-2.4	-6.9	-3.6
Domestic balance (cash basis)	-1.3	0.3	1.3	1.1	0.4	0.4
Govt. revenue (excl. grants)	20.1	19.9	20.7	19.9	18.7	17.6
Total external debt (US$ mil)	6,804	6,952	7,054	6,654	6,865	6,717

Source: African Development Indicators, 2001, IDA. For budget balances, IMF statistical annex, July 2000.

Growth and Poverty Reduction

1.8 Real GDP fell at an annual average rate of—1.2 percent between 1991 and 1995, turning moderately positive between 1996 and 2000, when it averaged 2.8 percent. Little real diversification occurred. The share of agriculture and manufacturing in national value added increased, but this was largely due to a contraction of the mining sector. Increases in non-traditional exports peaked in 1997, and have largely stagnated since.

Table 1.3: Sector Performance

Indicator	***1994***	***1995***	***1996***	***1997***	***1998***	***1999***
Real growth of agriculture (%)	10.7	33.3	-0.7	-5.2	1.7	13.9
Real growth of manufacturing (%)	-6.3	-14.0	0.5	7.2	-11.3	-4.9
Real growth of services (%)	-21.4	-2.3	15.0	4.0	4.4	5.2
Resource balance (share of GDP)	-0.8	-3.8	-7.5	-5.2	-12.5	-18.6
Exports (US$ millions)	1,500	1,252	1,336	1,593	1,671	1,754
Imports (US$ millions)	1,217	1,383	1,322	1,385	1,449	1,473

Source: African Development Indicators, 2001; IDA.

1.9 HIV/AIDS has had a devastating impact. Life expectancy rate has fallen below 40 years, according to a 1998 household survey, while one in every six children has lost one or both parents.[3] The AIDS-related death rate among teachers is among the highest in the country.[4] Not surprisingly, the decline in social well-being has been enormous. The poverty headcount worsened from 69.7 percent of the populace in 1991 to 72.9 percent in 1999. *Per capita* real GDP fell from US$ 463 in 1991 to US$ 394 in 2000. Education indicators stagnated, with total illiteracy rate increasing slightly from 37

[3] World Bank, *Interim Poverty Reduction Strategy Paper* (I-PRSP), Report No. 21183, July 12, 2000.
[4] An internal document.

percent in 1991 to 38 percent in 1998, and the primary school enrollment rate showing no improvement.

Privatization of Copper Operations[5]

1.10 Since two of the three operations evaluated in this PPAR focused on privatization of Zambia's major state-owned copper company, ZCCM, what follows is an overview of the copper sector and a chronology of the key events surrounding privatization of that company.

1.11 Copper, Zambia's main export, has been declining since 1970. As a result of a lack of investment and maintenance, the gradual exhaustion of existing mines, and periodic low international copper prices, copper output fell from over 680,000 metric tons in 1970 to 260,000 metric tons in 2000, and copper exports from over 99 percent of total exports in 1970 to 66 percent in 2000. In 1995, the GRZ announced its decision to privatize Zambia Consolidated Copper Mines (ZCCM), a large integrated copper mining and processing parastatal, by the end of June 1997.

1.12 Implementation of the plan took far longer than expected, and was completed only in March 2000. After protracted negotiations from mid-1997 to early-1999 collapsed, the GRZ started negotiations with Anglo-American Corporation (AAC), ZCCM's largest private sector shareholder. On March 31, 2000, ZCCM sold its Konkola and Nchanga divisions and the Nampundwe pyrite mine to KCM, a company established in Zambia for this purpose. KCM is 65 percent owned by Zambia Copper Investments (ZCI), a subsidiary of Anglo-American, 7.5 percent by International Finance Corporation, 7.5 percent by CDC Group, and 20 percent by ZCCM-IH. During 2001, it is estimated that KCM produced about 200,000 tons which represented about 67 percent of the total copper production in Zambia.

1.13 The primary rationale for Anglo's participation was the development of the Konkola Deep Mining Project (KDMP). After completing a feasibility study for the KDMP in January 2001, Anglo informed the GRZ in October 2001 that it intended to defer development of KDMP, due to weak market conditions and the inability to secure needed project financing. On 24 January 2002, Anglo advised the GRZ that it would not make further investments in KCM, following two years of heavy financial losses, weak copper prices, and a lack of funding for KDMP.

1.14 An emergency task force comprised of the GRZ and the World Bank Group was formed immediately to deal with the crisis engendered by this announcement. The PRSP for Zambia, completed in March 2002, assumed average annual growth of roughly 4 percent over the near term, implying that the negative effects of closing the ZCCM mines would be tangible, but manageable—on the order of 1 percent of GDP annually for the next few years. Although Anglo's withdrawal had a depressing effect on copper mining investment in 2002, other companies are proceeding with their investment programs, with the result that overall copper production is expected to resume growth over 2003-2004.

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[5] This section draws heavily from *Zambia: Looking Beyond Copper;* a report of the World Bank Task Force on the Zambia Copper Crisis, June 28, 2002.

2. Operations Under Evaluation

2.1 This PPAR covers three of the five adjustment operations approved by IDA during the latter half of the 1990s—the Economic Recovery and Investment Promotion (*ERIP*), the Economic and Social Adjustment Credit II (*ESAC II*), and the Public Sector Reform and Export Promotion (*PSREP*) operations. All of these credits shared stated goals of supporting macroeconomic stabilization, private sector development, and the targeting of social expenditures.[6]

2.2 *ERIP* sought to promote private sector investment via privatization of the Zambian Consolidated Copper Mines (ZCCM), to transform mining sector policy so that it would better serve the needs of the expected private investors, and to provide increased long-term bank finance. To a lesser degree, *ERIP* supported the introduction of a value-added tax (VAT), the maintenance of the share of social sector spending in the budget, and incipient reforms of the pension and social security systems.

2.3 *ESAC II* aimed to improve export competitiveness via import tariff liberalization and reforms which would ease bottlenecks in land and labor markets. Other objectives included enhancing the delivery of social services, strengthening nutritional and pharmaceutical policies, and improving public procurement.

2.4 The *PSREP* operation addressed major impediments to ZCCM privatization. The initial tranche financed mainly the costs of a redundancy program for miners, while the second facilitated transfer of ZCCM's mining assets to a private bidder plus ZCCM's conversion into a holding company. A third floating tranche backed a redesign of the Public Sector Reform Program (PSRP). *PSREP* also backed measures permitting Zambian exporters to more easily import inputs, streamlining approvals by the Zambian Investment Center, and maintaining budgetary allocations for social sectors.

3. Assessments of Individual Operations

3.1 Adjustment lending is particularly difficult to evaluate. It is not easy to disentangle the impact of successive operations, especially when, as in Zambia, the periods of implementation, and the reforms supported, overlap to a considerable degree. A case in point was the attempted privatization of ZCCM. *ERIP* supported the original bidding process, started in 1995, then suspended in 1997 in favor of a new process preferred by the Borrower. *ESAC II* had no conditionality covering ZCCM privatization, and was left without any legal remedy when the GRZ unexpectedly annulled the results of the first round of bids, a few months after *ESAC II* was approved. Under the *PSREP*, ZCCM's sale was finally consummated, but not for long. Hardest of all is to determine the probable impact of these operations, given that the specific conditions triggering disbursement were not always closely linked to the achievement of higher-order project objectives, impairing the relevance of the project design.

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[6] The specific objectives associated with each operation are discussed in greater detail later in this report.

Economic Recovery and Investment Promotion Credit (ERIP, Cr. 2764-ZA)

Overview

3.2 *ERIP* was the fifth in a series of IDA adjustment credits to Zambia during the 1990s. Balance of payments support of SDR 90 million (US$140 million equivalent) was disbursed in two equal tranches, one at credit effectiveness, the second when release conditions were satisfied. At approval, full disbursement was projected within six months of effectiveness.

Design, Implementation, and Outcome

3.3 *ERIP*'s stated objectives included[7]: (i) macroeconomic stabilization, with an emphasis on maintaining austerity in public spending, while increasing expenditure effectiveness; protecting social sector allocations; and completing selected trade and tax reforms; (ii) mobilization of term finance for private businesses from banks, insurance companies, and pension funds, while maintaining the viability of the contractual savings institutions; (iii) establishment of a new basic pension system; and (iv) reform of the legal, fiscal and environmental framework for mining, while preparing the Zambia Consolidated Copper Mines, Ltd. (ZCCM) for privatization. Of the four objectives, the macroeconomic and the mining reforms were the most important. *ERIP* financing went toward meeting Zambia's external financing requirements for the second half of 1995 and all of 1996.

3.4 During appraisal, concerns were expressed internally about whether this quick-disbursing operation: (a) had conditionality sufficient to advance the reform agenda significantly;[8] (b) would do enough to shore up Zambia's capacity deficiencies; (c) was sufficiently realistic about the prospects for fiscal discipline, given the approach of elections in late-1996; (d) would be the proper instrument for delivering not just balance of payments support, but consolidated structural reform; and (e) would be buttressed by sufficient Borrower commitment to complete privatization of ZCCM. The latter concern was heightened by the perception that past GRZ steps to privatize small and medium public enterprises, close down the Zambian Public Enterprise Holding Corporation (ZIMCO), and comply with the conditions for second-tranche ESAC disbursement had been surrounded by hesitation and delay. In retrospect, all of these concerns appear to have been well-founded.

3.5 **Macroeconomic management.** Lower-than-expected revenues, combined with higher-than-expected public spending, led to a fiscal crisis forcing a two-month delay in Board presentation to July 1995. This, in turn, exacerbated Zambia's already grave external financing shortfall. A key stumbling block was GRZ insistence on bailing out Zambia's largest commercial bank, Meridien, with public transfers amounting to nearly

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[7] From an internal document.

[8] One Regional economist observed that the content of the operation appeared to be low in requiring final actions, but high in upstream, but incomplete, measures, such as the development of action plans or the presentation of legislation to Parliament. He concluded that the project was surprisingly timid, given IDA's longstanding relationship with Zambia. From an internal memorandum.

1.5 percent of GDP. Eventually, the GRZ acquiesced in putting Meridien into receivership. Weak macroeconomic policy performance meant that Zambia's eligibility to tap into the IMF's Rights Accumulation Program had to be postponed as well. By June 1995, Zambia's international reserves had declined to precariously low levels.

3.6 Fitting a recurrent pattern, the policy slippages of the first half of 1995 had to be rectified in the second half.[9] So, in this instance, expenditure cuts and introduction of a value-added tax in July 1995 led to immediate gains in revenue, declining interest rates, reserve accumulation, and currency stabilization. However, no sooner had Zambia won agreement on a new ESAF in early December 1995, then Zambia was, once again, out of compliance, this time with six of the ten specified performance criteria. Prominent among the GRZ's fiscal problems was coping with the immense fiscal drain of a cash-strapped ZCCM.

3.7 With a few variants, much the same story was repeated in 1996. As predicted, electoral pressures did trigger substantial unbudgeted expenditures, with the result that Zambia could not meet all its mid-term ESAF benchmarks, leading to suspension of the February 1996 agreement with the Paris Club for rescheduling of its official external debt. By end-1996, inflation, at 35 percent, soared far above the original 10 percent ESAF target.

3.8 The GRZ exceeded the *ERIP* targets for social sector spending, setting aside 35 percent of non-debt service budget releases in 1995 for this purpose (compared to the minimum requirement of 33 percent), and maintaining the share of non-personnel public expenditures in this sector at 25 percent (compared to a minimum of 24 percent).[10] Yet, as noted by the Government, because overall public spending had to be reduced sharply in real terms during this period, an increasing set aside for social spending was not sufficient to prevent a contraction in the real public social spending during this period.[11] The Borrower noted that school attendance rates declined during this period, which conforms with other evidence that the delivery of health and education services stagnated, if not deteriorated, around this time.[12]

3.9 **Term lending initiatives.** EximBank and Lima Bank were both liquidated as agreed, and without major difficulty. However, reform of the DBZ could not take place, in part because Parliament failed to approve creation of a new apex institution.

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[9] The IMF documented a historical pattern between 1992 and 1995 of fiscal problems emerging during the first half of each year, followed by corrective actions and renewed stability during the second.
[10] From an internal document.
[11] Ibid.
[12] For example, for a different time period—1991 to 1996—a panel of independent international experts concluded that: "Government spending on health and education increased as intended, but the output of these services fell. Although all major social groups appear to have lost,…losses in [the smallholder] sector…are of particular concern for the design of safety nets. Malnutrition worsened among smallholders and this at least raises the question as to whether safety nets were adequate." *External Evaluation of the ESAF—Report of a Group of Independent Experts*; *Country Profiles*, Section IV, p. 43. In addition, see *Zambia: Poverty Reduction Strategy Paper and Joint Staff Assessment;* Report No. 24035-ZA; April 23, 2002. Table 2.2, p. 22, displays a variety of social indicators tracked between 1996 and 1998, the vast majority of which show either stasis or deterioration. For example, the share of population 5 years and older with no education rose from 18 to 27 percent; primary grade net attendance declined from 69 to 66 percent; and the percentage of stunted children rose from 46 to 53 percent.

Thereafter, the DBZ continued to engage in new retail lending operations, contrary to its commitment to focus on recovering its existing retail portfolio. Eventually, the GRZ decided to recapitalize the DBZ with its own resources.[13]

3.10 **Private sector development of the mining sector.** *ERIP* was intended in part to provide early support for Zambia's transition from a state-owned to a private sector-dominated mining sector.[14] The GRZ announced its willingness to privatize ZCCM only months before *ERIP* was approved. As a condition of effectiveness, the Government agreed to select qualified international legal and investment banking advisors to help prepare and implement an action plan for privatization. Submission of a satisfactory plan was a condition of second tranche release.

3.11 Advisors were selected by ZPA in 1995. The plan they developed called for the sale of ZCCM assets in nine parcels, so as to increase bidding interest and maximize the proceeds to the Government. This plan was approved by the ZCCM board, the ZPA, and the Cabinet, and issued in May 1996, meeting a key second tranche release condition.[15]

3.12 Bidding proceeded normally during 1996, with ZPA receiving a number of offers, including one from the Kafue consortium[16] for more than half of ZCCM's assets. Bidding was completed on schedule in February 1997. However, just before an award was to be announced, the GRZ removed control from ZPA, which had legal responsibility under the Privatization Law, and transferred it to an ex-CEO of ZCCM, known to have been critical of ZCCM privatization. The negotiating team was re-staffed with ZCCM employees hostile to privatization. The Kafue bid was formally rejected in November 1997. By June 1998, all negotiations with Kafue had ceased, leaving the Anglo American Corporation (AAC) as the sole remaining potential buyer.

3.13 Some improvements to the policy and regulatory framework were achieved, with further backing from the *ERIP* Technical Assistance Project (C2875-ZA). A new Mines and Minerals Act was passed, along with amendments to existing legislation concerning collection of mineral sector taxes and fees and environmental protection regulations. Also, policy coordination was tightened among the Ministries of Mines and Mineral Development, Finance, and Legal Affairs.

3.14 **Social security reform.** *ERIP* supported three reforms in this area: i) establishing a legal and regulatory framework for pension and insurance fund management; ii) transforming the Zambian National Provident Fund (ZNPF) into a basic compulsory social insurance scheme; and iii) paying the outstanding liabilities of the Public Service Pension Fund (PSPF), while rolling it into a new compulsory scheme. A major portion of these objectives was achieved. A Pension Regulation Act and a National Pension Act were adopted in 1996, and a Pension Insurance Authority (PIA) established. These

[13] The decision to recapitalize the DBZ was formally transmitted to the IMF on March 29, 2001.
[14] The Minister of Finance announced this policy change in a January 1995 speech on the budget, in which he highlighted ZCCM's mounting difficulties in maintaining production.
[15] Because of delays associated with preparation of pension legislation, another ERIP condition, actual second tranche disbursement did not take place for another 15 months, in August 1997.
[16] The Kafue Consortium was comprised of Anglovaal Minerals of South Africa, Noranda of Canada, Phelps Dodge of the US, and CDC of the UK.

legislative and regulatory changes proved critical for transforming ZNPF into the National Pension Scheme Authority (NAPSA), per the *ERIP* action plan. Later, the *ERIP* technical assistance credit furthered NAPSA's organizational restructuring through retrenchment, adoption in 1998 of regulations for the National Pension Scheme (NPS), development of an actuarial model incorporating the impact of HIV/AIDS, definition of NAPSA's investment guidelines, and NPS's launch in February 2000. Ownership of these reforms remains high, and *ERIP*'s contributions are viewed positively.

3.15 On the other hand, achievement of the PSPF component was modest. After rapid adoption of an action plan as a Board condition in mid-1995, little follow up took place over the succeeding three years. Only in 1999, under the incentive of a forthcoming IDA FY00 Fiscal Sustainability Credit did modest progress resume with a study of PSPF liabilities and development of a plan for liquidating them. Payments to statutory retirees —totaling KW 140 billion—began only in 2001.

Ratings

Relevance

3.16 Overall relevance is rated modest. Most relevant was the goal of launching a value-added tax, which was vitally needed to shore up Zambia's fiscal position. Of modest relevance were the objectives on privatization, term lending, and social security reform. With one possible exception—the social security reform proposal, which contained a provision for creation of a second pillar in unpromising conditions—ERIP's objectives were uobjectionable. However, in critical instances, they did not go far enough. For example, *ERIP* conditionality pressed the GRZ to formulate a viable privatization plan for ZCCM and the restructuring of mining policy, but stopped short of requiring the GRZ to actually complete the sale before second-tranche disbursement. In other words, because of the way *ERIP* was designed, the Borrower was able to annul the bidding procedure with impunity, as far as IDA was concerned.

3.17 However, the relevance of the pension reforms was considered only modest for several reasons. First, the old-age security provisions of the statutory pension system affected only about one-tenth of the active labor force, mostly those in urban areas already enjoying relatively high wages. This meant the reforms, even when completed, would have had a negligible impact on the retirement security of the far larger segment of poor rural laborers. Secondly, the reforms did little to rectify Zambia's fiscal difficulties, since pension fund payouts represented only a small portion of public sector spending. Finally, given the myriad constraints on development of capital markets, strengthening the pension funds was of relatively low priority.

3.18 Finally, the term lending objective was rated substantial for relevance, because it was, and is, and an important constraint on private sector-led development. However, the likelihood that commercial banks would participate in expanding such lending while facing subsidized competition from the state-owned DBZ required more careful analysis.

Efficacy

3.19 Achievement of *ERIP*'s stated objectives is rated modest overall. On the negative side of the ledger, the Government's record on maintaining macroeconomic performance was disappointing; budgetary protection of the share of social expenditures was ineffectual in shoring up the social safety net; privatization of ZCCM was derailed; the supply of long-term bank credit failed to expand; and the state development bank (DBZ) continued providing subsidized retail credit, in contravention of IDA understandings with the GRZ. On the positive side, a value-added tax was successfully launched and many of the planned social security reforms were achieved.

3.20 Not surprisingly, the supply of term capital to the private sector did not increase significantly during this period, not only because of reluctance on the part of commercial banks to compete with subsidized public term lending, but also because the inflationary environment combined with the appeal of high short-term treasury bill rates left commercial banks, insurance companies, and pension funds with little incentive to undertake riskier long-term lending.

3.21 The intended social security reforms were mostly achieved with adoption of the Pension Regulation and National Pension Acts in 1996; and the establishment of the Pension Insurance (PIA) and the National Pension Scheme Authorities (NAPSA) in 1997. Only the action plan for creating a Public Service Pension Fund (PSPF) was not implemented.

Outcome

3.22 Taking into account the unsatisfactory macroeconomic performance, the negligible results in getting commercial bank term lending up and running, and the long and costly delays in completing the ZCCM auction, against the modestly-relevant achievements of *ERIP*'s social protection agenda, outcome is downgraded from satisfactory at the time of ICR review to *moderately unsatisfactory*.

Sustainability

3.23 In view of the renewed progress since 1999 toward broader social security reform, and the continued operationality of the value-added tax, sustainability was upgraded from uncertain in the ICR review to *likely.*

Institutional Development Impact

3.24 The most significant and lasting change promoted by *ERIP* was the improvement to the tax base resulting from the value-added tax. The social security reforms were of a lesser order, although they represented a modest start toward the launch of a new basic pension system. Finally, little of lasting significance was achieved in the mining sector. Hence, the rating for institutional development impact was downgraded from substantial in the ICR review to *modest.*

Bank and Borrower Performance

3.25 Bank performance was rated *unsatisfactory,* and Borrower performance *highly* so, both of which were downgraded from satisfactory ratings in the ICR review. Both parties share responsibility for *ERIP*'s design shortcomings. In the first instance, the formulation of conditionality was overly-reliant on easy-to-implement preparatory steps, rather than hard-to-reverse final actions. Secondly, there were the GRZ's recurrent lapses in fiscal management, which distracted attention from implementation of the non-fiscal reforms, and limited the potential benefits of those reforms which were implemented. *ERIP*'s framework for monitoring macroeconomic performance was not up to the task. Thirdly, the Parliament's unwillingness to approve a new apex institution doomed the planned restructuring of the Zambian Development Bank, which continued to engage in subsidized retail operations (contrary to its ERIP commitments), and, thereby, discouraged commercial banks from supplying larger volumes of term lending. Fourthly, the social protection measures supported by the project were ineffectual. Finally, the Borrower's decision to annul the results of the *ERIP*-sponsored bidding process for ZCCM privatization was a costly mistake, transforming what might have been a profitable sale under favorable world pricing conditions into an untimely sale under unfavorable circumstances. While awaiting a second chance to privatize ZCCM, taxpayers had to absorb the burden of ZCCM's mounting operational losses and a deterioration in the quality of its assets. As a result, Zambia missed out on its single best chance to kick-start the economy through a private-sector-led growth strategy.

Second Economic and Social Adjustment Credit (ESAC II, Cr. 2910-ZA)

Overview

3.26 The *ESAC II* credit, approved in FY97 represented the sixth IDA adjustment credit to Zambia in as many years. Like the First ESAC in FY94, it focused on maintaining social expenditures, instituting social sector reforms, and improving public service delivery. The stated objectives of the operation were to:[17] (i) support establishment of a stable macroeconomic environment; (ii) improve export competitiveness through rationalization of the structure of effective protection; (iii) accelerate implementation of the land market reforms approved by Parliament in 1995; and (iv) improve the delivery of vital social services.

3.27 Given that ZCCM privatization was a cornerstone of the Bank's adjustment program throughout the 1990s, particularly *ERIP*, it is somewhat surprising that satisfactory progress on privatization was made a condition only for the second tranche.

[17] The stated objectives are taken from an internal document.

Management's rationale was that conditionality should leave sufficient flexibility in the timing and content so as to maintain the playing field level between the GRZ and the mostly large-enterprise bidders.

Design, Implementation, and Outcome

3.28 The design of *ESAC II* was complex and demanding. Borrower capacity was taxed to the limit by design features which included eleven conditions for second tranche release, requiring inputs from eight ministries and several agencies. Moreover, compliance with a recently-approved IMF ESAF (December 1995) was made difficult, due to the effects of drought, declining domestic copper production, and policy drift as elections approached in late-1996. The external financing situation turned critical in the first half of that year, when bilateral donors suspended their assistance on governance grounds. Hence, as *ESAC II* was reaching appraisal, IDA had become the sole significant remaining source of external finance.

3.29 The *ESAC II* operation was approved in August 1996, in the amount of SDR 62.4 million (US$90 million equivalent). Funds were disbursed in two equal tranches, the first upon effectiveness, the second upon meeting release conditions, expected roughly six months after credit approval.

3.30 **Macroeconomic management.** On the macroeconomic front, tight monetary policy lowered inflation. Improved international markets generated higher prices for copper exports, leading to the first consecutive years of real GDP growth (1996-97) since the 1980s. On the negative side, budgetary management remained erratic. A large unbudgeted wage increase for civil servants was just one of several program transgressions during this period. After the elections, the GRZ tightened fiscal management sufficiently to pass the *ESAC II* mid-term review in March 1997. Yet, one month after that review, the Government decreed another large civil service salary increase, boosting the total public sector wage bill by nearly 15 percent above budgeted amounts. The above-program fiscal deficit, the GRZ decisions leading to major delay in privatizing ZCCM, and the suspension of all bilateral assistance doomed continuation of the IMF ESAF arrangement, which was halted in late 1997, and not renewed until early 1999, long after *ESAC II* had closed.

3.31 **Improve export competitiveness through trade, procurement, land, and labor market reforms.** Trade liberalization was successfully achieved, but had little sustained impact on growth in non-copper exports, an important motivation for the reform. Most tariff exemptions were eliminated and the tariff structure was compressed, with duties of zero to 5 percent for most capital goods and basic materials, 15 percent for intermediate goods, and 25 percent for final products. However, continued high trading barriers among Zambia's regional trading partners diminished the immediate benefits for Zambian exporters, although affording some benefit to consumers, whose access to cheap imports improved. With respect to public procurement, *ESAC II* promoted decentralization of the process to line ministries. However, to date, there is little evidence this change has produced significant improvements in procurement transparency or efficiency.

3.32 Land reforms focused on implementing the 1995 Lands Act, speeding up processing of applications for leasehold land tenure and issuance of land titles, and regularizing the status of informal urban settlements. Regulations for the Lands Act were issued, a Land Development Fund was established to assist local councils in improving local infrastructure, and a Lands Tribunal created to deal with grievances and disputes. However, the Borrower recently acknowledged that low utilization of agricultural continues, due in part to cumbersome procedures in obtaining title deeds—97 percent of farmers still have no title to the land they cultivate—and that "very little progress had been made in market development for land, titling both customary as well as state lands, and setting up a land administration and procedure."[18] For most of the urban poor, similar lack of title precludes them from capitalizing on income-generating activities. An amendment to the Employment Act, passed in late 1997, eliminated sector-wide wage bargaining and the provision of housing or housing allowances by employers, but failed to redress other key constraints to private sector development, such as lack of a reliable source of long-term capital, poor public services, including for training and business information, macroeconomic instability, and poor governance. Hence, the labor reforms have had little tangible effect in improving business conditions.

3.33 **Social sector services.** Like two preceding adjustment credits, *ESAC II* sought to protect the level of expenditures for education, health, the social safety net, and water and sanitation by stipulating that budgetary allocations should rise over time as a share of total discretionary spending. However, as an instrument for ensuring an increased flow of real public resources to address social needs, this condition left something to be desired. The main problem was that Zambia's rising burden of service on the public debt forced the contraction of real discretionary spending. This meant that even a gradually increasing share set aside for social expenditures translated into declining social spending in real terms.

3.34 Added to this were complications arising from the operation of the cash budgeting system, which disbursed resources erratically, disrupting planning and implementation; and lax expenditure monitoring, which made it virtually impossible to ensure that the cash released was actually spent on the provision of social services. For example, cash releases authorized late in the fiscal year to satisfy the tranche condition on social spending frequently left too little time for line ministries to spend them for their intended purpose before the fiscal year reached an end. This opened the way for poorly-monitored post-fiscal year reallocations by cash-strapped line ministries.

3.35 The evidence, such as it is, suggests that the social expenditure protection clauses had a tangible, but modest, impact on the availability of social services. Cash releases to the social sectors increased gradually, from 33 percent of the domestic discretionary budget in 1995 to 36 percent in 1999 (Table 3.1). It is instructive that, in the only year of this series when no IDA conditionality existed with respect to public sector social spending, 1998, budgetary allocations declined 15 percent in real terms. Otherwise, it would appear that, between 1991 and 1999, real social spending remained roughly

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[18] Op. cit., Report No. 24035-ZA.

constant, although, given continued growth in the target population, this implied a decline in *per capita* terms. In this regard, disaster relief fared considerably better than all the other social categories, while health and education held their own, and spending on social safety nets and water and sanitation fell well behind.

Table 3.1: Public Expenditures in the Social Sectors, 1996-99 (millions of constant 1995 Kwacha) a/

	1996	*1997*	*1998*	*1999*
Disaster Relief Program	1,626	270	1,008	5,141
Education	90,056	97,821	79,955	90,431
Health	64,656	69,005	60,039	66,791
Social Safety Nets	6,365	8,630	5,230	5,711
Water and Sanitation	15,518	8,058	10,865	10,001
Total	178,220	183,784	157,097	178,075

a/ Based on GDP deflator.
Source: An IDA Country Economic Study

3.36 Measuring the impact of available social services on social well-being is necessarily difficult, given the aforementioned deficiencies in the way social spending is classified and accounted for. However, some broad indication derives from data recently released as part of an IDA poverty study on Zambia[19], wherein most social and poverty indicators display a declining trend throughout the greater part of the 1990s, including the time when the *ESAC II* conditions on social spending were being enforced. Nevertheless, given the sparseness of the data, and lags in measuring the impact of social spending over such a short time period, caution is needed in drawing any implications about the efficacy of *ESAC II* social spending requirements.

3.37 *ESAC II* also supported a number of useful preparatory measures, including: i) formulation of a comprehensive plan for health sector reform; ii) adoption of a National Drug Policy; iii) adoption of a framework defining the role of the National Food and Nutrition Commission (NFNC); iv) preparation of an education sector strategy; and v) adoption of a policy on Governmental collaboration with NGOs. Although some of the conditionality with respect to the NFNC and education lacked clarity, it did raise the public profile of these issues, correctly identifying them as prerequisites for more sweeping improvements in basic health, nutrition, and education services. Given the implications of better services for poverty reduction, these measures were substantially relevant.

3.38 The health sector reform plan, the National Drug Policy, the education sector strategy, and the NGO policy paper were approved by the Executive Cabinet. A study on NFNC policy was submitted to the Cabinet, fulfilling a tranche condition. But the study's recommendations were never approved, leaving NFNC in limbo. Implementation of the plans for health and education reform has been disappointing, hampered by declining budgetary resources, a weak political commitment to decentralization, and the heavy burden of HIV/AIDS on operational systems.

[19] Ibid.

3.39 In other areas, the National Drug Policy has provided a useful framework for procuring and distributing essential drugs, but, in practice, the policy remains riddled with inefficiencies. With respect to the NGOs, the policy paper's recommendation for passing enabling legislation never happened, nor were the modalities for GRZ-NGO collaboration ever suitably clarified. Overall, the efficacy of *ESAC II* measures with respect to social services is judged to be modest.

Ratings

Relevance

3.40 Relevance is rated substantial, largely reflecting the centrality of the service delivery and macroeconomic aims of *ESAC II* to Zambia's critical development constraints, and IDA's Country Assistance Strategy (CAS). However, the design of the land, procurement, labor, trade, and ZCCM reforms rendered them at best modestly relevant, since, even under ideal circumstances, their net development impact was unlikely to be significant, because they failed to assemble a critical mass of necessary reform steps sufficient to produce such an impact.

Efficacy

3.41 Overall efficacy is rated modest. Macroeconomic management was compromised by erratic expenditure discipline, inadequate monitoring and control, and the lack of a sustainable program of external financing, once ESAF and bilateral donor financing ceased. Trade liberalization measures were fully achieved, but results have been mixed, better for consumers, but modest for exporters, given continued protection in the markets of regional trading partners. The *ESAC II* devices for protecting social spending did maintain budgetary allocations roughly constant, but failed to address major deficiencies in how that spending is accounted for, and how it translated into increased service availability. Similarly, the health and education measures constituted a useful beginning, and satisfied the relevant tranche conditions, but generally made little difference in increasing the availability of essential social services.

Outcome

3.42 Taking into account the severe disruption experienced with respect to the process of ZCCM privatization and the erratic macroeconomic policies pursued, combined with the modest relevance of the land, labor, health, trade, and education reforms implemented, and continued inadequacies post-closing in delivering and monitoring basic social services, outcome is rated *unsatisfactory,* as compared to satisfactory at the time of ICR review.

Sustainability

3.43 Given evidence of weak GRZ commitment to even these modest project achievements, the rating of sustainability was downgraded from uncertain to *unlikely.*

Institutional Development Impact

3.44 What little institutional development impact did occur took place mainly in the social sectors. The rating of IDI was held unchanged at *modest.*

Bank and Borrower Performance

3.45 Bank and Borrower performance were rated *unsatisfactory*, a downgrade from satisfactory at the time of ICR review. Both actors share responsibility for the project's flaws of design and execution. Too often, *ESAC II* tranche conditions, even when met, did little to advance the reform agenda in meaningful fashion. The omission of conditionality to cover the still-incomplete ZCCM privatization left IDA without an effective remedy when the GRZ backed away from the bidding process. And the GRZ decision to restart the auction process with only one remaining bidder was even more reprehensible, costing the public coffers hundreds of millions of US dollars in additional subsidies to cover ZCCM's operational losses, and substantial capital losses by declining an attractive bid.

Public Sector Reform and Export Promotion Credit (PSREP, Cr. 3167-ZA)

Overview

3.46 During preparation, *PSREP* objectives were revised significantly, reflecting the growing interdependence between fiscal viability and the removal of ZCCM from dependence on public subsidies. Originally, the credit, as its name suggests, was to focus on public sector reform, and, in the process, also supply approximately US$140 million of quick-disbursing, balance of payments support. When Zambia fell out of compliance with the ESAF in early 1998, negotiations on a new IDA operation were suspended. Meanwhile, the fiscal drag of ZCCM losses reached unsustainable levels, averaging $20-$30 million monthly.[20] Growing supplier arrearages brought the threat of lawsuits placing liens on ZCCM's assets, making them effectively unavailable for privatization.

3.47 Moreover, *PSREP*'s putative public sector reform goals appeared increasingly unrealistic, as the realization set in that downsizing from 120,000 to 80,000 civil servants would have resulted in the entire government having fewer civil servants than just those currently in the health, education, and public safety sectors. This was regarded as politically undoable within the relatively short timeframe of an adjustment operation.

3.48 For all these reasons, IDA and the GRZ agreed to reformulate *PSREP* conditionality so that it focused primarily on ZCCM privatization. A financing plan was reached with external donors, after the GRZ signed a memorandum of understanding guaranteeing the sale of ZCCM assets on specified terms. The *PSREP* commitment amount was raised by US$30 million to US$170 million total. Disbursement of two of the three tranches, representing US$130 million, was tied to ZCCM privatization, and

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[20] In an internal document, IDA contended that there was no viable macroeconomic scenario without privatization of ZCCM.

only US$40 million to public sector reform. The first tranche of US$ 65 million was released upon effectiveness, two days after IDA approval, in January 1999. The proceeds financed separation grants for a large portion of ZCCM's workforce, numbering in the tens of thousands, providing the newly laid off workers with termination benefits and retraining. Without this contribution, it is unlikely that the social and political conditions would have been right for making privatization domestically palatable.

3.49 In March 2000, five years after donors first identified ZCCM privatization as a core reform, the state enterprise was sold on terms highly unfavorable to the GRZ,[21] and nullified soon thereafter by the purchaser's change-of-heart. Other supported reforms fared little better. Weak government commitment continued to undercut efforts to improve the efficiency of the civil service. Once again, tariffs on imported inputs were lowered, but provided marginal benefits for exporters beset by a myriad of more pressing operating conditions. Following introduction of streamlined procedures, the number of applications to the Zambia Investment Center actually declined, and, to date, the Center has failed to become the envisioned "one stop shop" for foreign investors. And, similar to the experience with *ESAC II*, social budgets were maintained in real terms during *PSREP* implementation, but continued to be inadequately monitored for results.

Design, Implementation, and Outcome

3.50 The primary stated objectives of the *PSREP* were to (i) complete ZCCM privatization and (ii) implement a ZCCM labor reduction program.[22] ZCCM's large and growing operating losses converted the *PSREP* into something of a rescue operation. Additional *PSREP* objectives included: (iii) improving the public service by reforming pay, employment, and management controls; (iv) promoting private sector activity, especially export trade, by improving access to imported inputs and streamlining investment approvals; and (v) strengthening the delivery of social services and the safety net by monitoring key budgetary allocations and supporting policy reforms.

3.51 By March 1999, ZCCM had begun restructuring itself into a holding company, so it could manage the public sector's remaining claims and obligations vis-à-vis the company's new private mine owners. About this time, a new three-year PRGF was approved, providing an initial infusion of SDR 10 million. However, Zambia could not meet the PRGF performance criteria specified for end-June 1999, resulting in suspension of disbursements from that program. Meanwhile, the sale of ZCCM's assets also ran into an unexpected roadblock in July 1999, when AAC announced it did not want to be the sole stakeholder. Eventually, this obstacle, too, was overcome, when the International Finance Corporation (IFC) and the Commonwealth Development Corporation (CDC) agreed to take minority stakes of 7.5 percent each.

[21] During its last three fiscal years, ZCCM's cumulative operational losses amounted to US$927 million. To complete the sale, the Government assumed outstanding ZCCM debts of US$770 million owed to suppliers (35 percent), official bilateral creditors (39 percent), and multilateral agencies (25 percent).
[22] The objectives are drawn from an internal document.

3.52 With this final push, the sale of ZCCM took place on March 31, 2000. The Konkola and Nchanga Divisions, the Nampundwe Mines and Chinogola Refractory Ores became the Konkola Mining Company (KCM), with AAC, IFC, and CDC as joint shareholders. KCM also agreed to manage the Nkana smelter and refinery under contract. The Mufulira Division and the Nkana mine and concentrator were sold to Mopani Copper Mines, owned by Glencore AG Ltd. and First Quantum Ltd. Retrenchment of the workforce was completed a year later in March 2001.

3.53 Then, in January 2002, AAC announced that, due to their short remaining life and high operational costs, its existing mining operations were not profitable, and that further investment in them would not be value-enhancing for its shareholders. The company took this decision in the context of a plan for rationalizing its activities worldwide. Needless to say, this announcement dealt an enormous blow to investor confidence, not only in Zambia's mining sector but in its entire economy.[23]

3.54 The floating tranche was released in June 2000, upon Cabinet approval of a Public Sector Reform Program (PSRP) action plan. Some progress was made toward reducing the size of the civil service, from 117,000 at the end of 1998 to 102,000 at the start of 2001, but few improvements with respect to pay or management controls were achieved. Still, given past experience, approval of the PSRP must be regarded as a modest initial step toward securing greater civil service productivity.

3.55 Finally, with respect to the trade and investment components of the *PSREP*, what can be stated is that duty drawback (DDB) and manufactured under bond (MUB) schemes were revamped to improve access to imported inputs. However, these measures had only a tangential impact on exporters, who face a plethora of daunting challenges to become internationally competitive. These include strengthened regional trade liberalization agreements, more efficient public regulation, access to credit, and improvements in labor relations. Similarly, the investment approval processes of the Zambia Investment Center (ZIC) were streamlined, but with minimal effect. In fact, the number of private applications actually declined during *PSREP* implementation, due to the unresolved investment bottlenecks alluded to in the page 12 discussion above.

Ratings

Relevance

3.56 Relevance is rated *substantial*. Sustainable privatization of ZCCM, including retrenchment of its workforce, was the key policy challenge of the decade, and the overriding goal of the *PSREP*. At the time of appraisal, it was justifiably regarded as

[23] The Anglo American Corporation signed a disinvestment agreement with the Zambian government on August 19, 2002. As part of this agreement, Anglo has contributed to the creation of the Copperbelt Development Foundation. The Foundation is expected to invest in non-mining projects in support of diversification of the economy as well as contributing to the health, education, and other social services in the area.

essential to Zambia's economic rehabilitation. Social expenditure protection was also substantially relevant, although its relevance was diminished by the inattention to installing much-needed monitoring and expenditure controls to track impact on the target population.

3.57 In other areas, *PSREP*'s objectives were, at best, modestly relevant. The public sector reform action plan was little more than a rehash of the failed plan drawn up for the 1997 PSRP, and gave little reason to expect a better result. Indeed, IDA has now acknowledged that adjustment lending is an inappropriate instrument for promoting meaningful public sector reform, and has abandoned its support of the PSRP. Instead, IDA plans to rely more heavily on adaptable program lending within a longer-term framework. *PSREP* components for investment and export promotion involved easy-to-meet, but low-impact conditionality, providing, at best, modest relief from the critical constraints in these sectors.

Efficacy

3.58 Efficacy is rated modest, in light of the ultimate failure to privatize ZCCM permanently. As a subsidiary matter, retrenchment of the workforce was successful, and helped clear an important obstacle to completing the sale of ZCCM. However, AAC's withdrawal from the mining sector, and the high investor uncertainty this decision has engendered, have depressed Zambia's near-term growth prospects by something on the order of 1 percent of GDP annually. Finally, the measures undertaken in the areas of investment, export promotion, public sector reform, and social expenditure protection were of moment, but, because of the omission of complementary reforms in the project design, had only a modest development impact.

Outcome

3.59 Given that ZCCM's privatization process was severely disrupted, and that the remaining supported reforms are expected to generate meager net benefits, the rating for outcome has been downgraded from moderately satisfactory at the ICR review stage to *moderately unsatisfactory*.

Sustainability

3.60 Sustainability is rated *unlikely,* rather than likely, after the definitive unraveling of the ZCCM privatization. Private sector activity is expected to continue, but at a lower level than had been envisaged for the next several years. Needless to say, AAC's virtual abandonment of its copper mining investment in Zambia sent a negative signal to other potential bidders for these assets.

Institutional Development Impact

3.61 Institutional development impact was rated *modest*, as at the time of ICR review, reflecting not only a diminished perspective on private sector-led growth prospects, post-Anglo American, but also the modest transformation achieved in non-mining institutions.

Bank and Borrower Performance

3.62 Notwithstanding flaws in the *PSREP* design, which did not achieve critical mass in promoting non-mining growth, there was little more that IDA could have done to promote ZCCM privatization. It agreed to finance important collateral costs associated with restructuring the company, notably separation benefits and training, and afforded the key investor additional "comfort" in the form of a minority IFC equity stake. On these grounds, IDA's performance was rated *satisfactory,* unchanged from the ICR review.

3.63 Nor can the Borrower be held responsible for decisions made by the private investor. The GRZ completed its end of the bargain on ZCCM, and made modest progress on non-mining reform. Therefore, Borrower performance on the *PSREP* was rated *satisfactory,* unchanged from the ICR review.

4. Summary Findings and Lessons

4.1 The summary findings and lessons draw primarily from the performance assessments, but also benefit from the findings of OED's 2002 Country Assistance Evaluation (CAE) for Zambia. Issues transcending the individual operations are raised, particularly as regards the high and sustained levels of Bank adjustment lending to Zambia. In this way, it is anticipated that broad lessons for countries in Africa engaged in long term reform programs will emerge.

Issue 1: When pressures to maintain a Client current on the service of its external debt have a major impact on lending decisions, it is incumbent upon Management to discuss these pressures, and any impact they had on the timing, content, and size of a proposed operation, with the Board at the time of loan presentation.

4.2 *Findings*. Judging from a succession of CAS reports and adjustment lending appraisal documents, there is ample evidence for the view that the volume and frequency of IDA's adjustment lending to Zambia were influenced by the desire to keep the Borrower current on its external debt service obligations. Indeed, IDA staff have defended the frequency of adjustment lending by arguing that, had Zambia failed to meet its payment obligations, the economy would have been thrown into a tailspin. Reflecting this belief, the CASs of 1994, 1997, and 1999 provided for a steady rhythm of adjustment operations, at the rate of one per year. The lending amounts associated with these operations exceeded agreed IDA allotments by a wide margin.[24] Yet, never was the goal of keeping Zambia current with its external debt obligations mentioned among the stated objectives of these operations.

[24] According to IDA financial risk assessment specialists, actual IDA lending commitments exceeded the agreed amounts for the FY98-00 period by +136 percent for Zambia, whereas, in the remainder of the Africa Region, there was a shortfall of 19 percent. Agreed IDA lending targets are determined using a standardized allocation formula based on population and policy performance, adjusted for certain other factors agreed between the Region in question and the financial risk department.

4.3 The pressure for large and frequent IDA credits undermined quality at entry. Pressures to disburse on a schedule compatible with Zambia's debt service requirements led to conditionality which relied on numerous, but often superficial, tranche requirements. Supported reforms relied excessively on easy-to-implement "stroke of the pen" measures, whose ultimate impact was blunted by the lack of wider support inside and outside the public sector for implementation and enforcement. The high volume of IDA quick-disbursing lending also diminished pressure on a reluctant Borrower to act more expeditiously on crucial, but politically-sensitive, reforms, such as privatization of the copper mines. Finally, quick-disbursing instruments were inappropriate vehicles, in many cases, for supporting long and complex reforms (e.g., public sector reform in the *PSREP* operation and ZCCM privatization supported by *ERIP*, *ESAC II*, and *PSREP* operations).

4.4 IDA was slow to acknowledge the fact that Zambia's external debt burden had become unsustainable, and in need of substantial reduction rather than continued servicing, if the considerable investment needs of the economy were to be adequately financed. Other advocacy groups and donors were quicker in giving voice to this reality.[25]

4.5 *Lesson*. Pressures to lend for debt and balance of payments reasons can easily lead to hastily-conceived, superficial conditionality which generates few long-term benefits. The drive to find new sectors to lend often piles on new conditionality, even though previously-supported reforms have not yet been consolidated. The HIPC initiative helps separate debt servicing considerations from support for structural reform, but only partially so. For example, HIPC debt relief to Zambia, as presently configured, will not lower debt service payments significantly until after 2005. Hence, IDA will continue to face pressures to rely excessively on quick-disbursing vehicles in Zambia, such as programmatic lending, when such vehicles have repeatedly failed to achieve the desired reform results.

Issue 2: "Stroke of the pen" measures are an unreliable indicator of Borrower commitment to genuine reform

4.6 *Findings*. The Chiluba regime won international praise for its initial round of reforms in the early nineties. However, many of these reforms were what have been termed "stroke of the pen" measures, meaning they could be placed into effect solely with the consent of the Chief Executive. This included measures to liberalize price, interest rate, and exchange rate controls, which experience has shown were sustained.

4.7 On the other hand, with the benefit of hindsight, other "stroke of the pen" reforms have proven less durable, possibly because they were adopted without having secured the

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[25] For example, OED's 1996 Country Assistance Review (Report No. 15675, June 3, 1996) noted (para. 6.29, p. 107) that "some in Zambia still believe the debt service curtailment in 1987-89 was the appropriate approach. They suggest that paying off arrears and continuing full debt servicing postponed investment in infrastructure and diverted management attention to debt service, both delaying recovery. The implied criticism is that the Bank has failed to deal realistically with Zambia's debt overhang, and has misplaced priorities—focusing on restoring creditworthiness rather than recovery of economic growth, and emphasizing servicing of the debt rather than debt forgiveness."

requisite support of key affected stakeholders. For example, there is the case of ZCCM privatization, wherein the initial bidding process was subsequently annulled, leading to costly and protracted rebidding. Another area was reform of the public sector. The *PSREP* was initially premised on securing reform of the civil service, with the agreement of the President and the Minister of Finance. However, after serious opposition surfaced from affected civil service organizations, *PSREP* had to be refocused, as both IDA and the GRZ acknowledged that the required broad support for such reform did not exist. IDA has now opted for a more gradual approach, extending adaptable program loans for public service reform over the anticipated space of at least a decade.

4.8 *Lesson*. "Stroke of the pen" measures do not provide reliable guidance about the true extent of commitment to structural reform. The small core of reformers in the Presidency and the Ministry of Finance found their efforts quickly stymied, once the affected interest groups became aware of what was being planned, and how it would affect their interests. Participatory approaches, including evidence of public support from key interest groups, stand a better chance of eliciting the requisite support for core reforms, even if the process takes longer, and the reforms diluted relative to what would have been ideal.

Issue 3: Inconsistent macroeconomic performance severely constricts the benefits of reform intended to promote private sector-led growth.

4.9 *Findings*. The appraisal documents of *the ERIP, ESAC II*, and *PSREP* operations underlined the importance of continued satisfactory implementation of an acceptable macroeconomic framework. Yet, the Borrower repeatedly faltered in complying with this framework.

4.10 After lowering inflation from triple-digit levels in 1990 to roughly 50 percent in 1994, budgetary discipline lapsed, with the result that inflation during the remainder of the decade floundered in double digits, with severe consequences for private sector growth. In particular, private sector representatives cited chronic inflation and exchange rate instability, both by-products of the Borrower's uncertain macroeconomic management, as key constraints to investment. Inflation also thwarted the development of a market for long-term credit, a key aim of the *ERIP*-supported bank reforms, which has posed another bottleneck to private sector development, especially for the multitude of small and medium enterprises.

4.11 *Lesson*. Steady progress toward consolidating macroeconomic stability is a *sine qua non* for successfully achieving the sort of privatization and financial sector reforms supported by these operations, as well as for attaining the desired private sector response.

Issue 4: Diversification of production has not occurred at the pace that would have been desirable, in part because the reforms supported did not include measures to address other key non-price constraints, such as the poor condition of Zambia's infrastructure and its weak governance.

4.12 *Findings*. Although recognized as one key to sustainable growth, Zambia's manufacturing sector remains largely undiversified and dependent upon the copper mining sector.

4.13 The reforms supported by IDA adjustment lending in the 90s were necessary, but far from sufficient to produce a tangible result. For example, reductions in import tariffs stimulated only a modest export response, constrained by a variety of supply bottlenecks. One difficulty has been the limited management experience of most Zambian non-mining companies. Other factors included the poor condition of Zambia's infrastructure, inefficiency in the delivery of most public sector services, over-regulation, and the impact of HIV/AIDS on the supply and quality of the work force.

4.14 *Lesson*. A multivalent focus, addressing the full range of constraints on private sector development, will be needed, if the pace of diversification is to be accelerated. This task is all the more urgent, now that the largest privately-owned mining company has decided to terminate its mining interests in Zambia.

Annex

Basic Data Sheets

ZAMBIA – Economic Recovery and Investment Promotion Credit (Cr. 2764-ZA)

Key Project Data *(amounts in US$ million)*

	Appraisal estimate	*Actual or current estimate*	*Actual as % of appraisal estimate*
Total project costs	140	140	100%
Credit amount	140	140	100%
Co-financing	-		
Domestic contribution	-		
Cancellation (US$)	-		
Date physical components completed	na		
Economic rate of return	na		

Cumulative Estimated and Actual Disbursements

(US$ million)	*FY96*	*FY97*	*FY98*
Appraisal estimate (US$M)	65.0	140.00	140.00
Revised Estimates[1]	82.80	140.64	140.64
Actual (US$M)	78.19	78.19	139.38
Actual cumulative as % of Credit	55.85	55.85	99.55

Date of Tranche Disbursement: August 22, 1977

Project Dates

	Date Planned	*Date actual*
Identification	May 1994	May 1994
Preparation		August 1994
Appraisal	January 1995	February 14, 1995
Negotiations	April 1995	April 1995
Letter of Sector Policy	May 1995	May 21, 1995
Board Presentation	May 1995	July 11, 1995
Signing	July 1995	July 18, 1995
Effectiveness	August 1995	September 6, 1995
First Tranche Release	August 1995	September 6, 1995
Second Tranche Release	August 1995	September 6, 1995
Credit Closing	December 1996	December 31, 1997

Staff Inputs (staff weeks)

Stage of Project Cycle	*Planned*	*Actual*
Through appraisal (Preparation to Appraisal)	n.a	
Appraisal through Board (Negotiation)	n.a	36.9
Board through Effectiveness	n.a	n.a
Supervision	51.0	44.3
Completion	13.6	9.5
Total	203.2	200.7

1. Includes US$ 12.1 million which was an IDA supplemental Credit (C-27641).

Mission Data

Stage of project cycle	Date (mm/yr.)	No. of persons	Duration of mission (# of days)	Specialized staff skills represented	Performance rating		Types of problems
					Implement. Status	Develop. objectives	
Through Appraisal	April-August 1994	13	38	PPSDS, PE, SE, PME, SFSS, PFSS, FSS, E			
Appraisal Board	February/ March 1995	8	21	PPSDS, PE, SE, PME, SFSS, PFFF, L			
Board Effectiveness	July/ September 1995						
Supervision I	October/ November 1995	4	17	PPSDS, PE, SE, PME	S	S	Review of progress made, especially of ZCCM
II	June/July 1996	4	17	PPSDS, PE, SE, PME	S	S	Delays in preparation of legislation, restructuring of DBZ and establishment of regulatory agencies for insurance and pension funds
III	September 1996	4	17	PPSDS, PE, L, PME	S	S	Delays in preparation of legislation, restructuring of DBZ and establishment of regulatory agencies for insurance and pension funds.
IV	January 1997	3	14	PPSDS, L, AM, SMS,C	S	S	Review of progress made on ZCCM privatization, and financial sector
V	April 1997	3	14	PPSDS, L, AM, SMS, C	S	S	Review of progress made on ZCCM privatization, and financial sector
VI	August 1998	9	1	PPSDS	S	S	
Completion ICR Mission	February 1998	2	14	PPSDS, C	S	S	Review of progress made on privatization of ZCCM

Key:
PPSDS = Principal Private Sector Development Specialist
PE =.Principal Economist
SE = Senior Economist
PME = Principal Mineral Economist
SFSS = Senior Financial Sector Specialist
PFSS = Principal Financial Sector Specialist
SME = Senior Mining Economist
AM = Advisor on Mining
C = Consultant
E = Economist
L = Lawyer

S = Satisfactory

Other Project Data

Borrower/Executing Agency: The Republic of Zambia

Related Bank Credits

Credit title	*Purpose*	*Year of approval*	*Status*
Preceding operations			
1. Second Economic Recovery credit	Macroeconomic stabilization, agricultural sector liberalization, private sector expansion, and restructuring and reforming the civil service and the parastatal sector	1991	Closed
2. Mining Sector Technical Assistance	To assist the Government of Zambia to implement an effective development strategy for the mining sector that would make the mining sector efficient and productive, in order to generate resources needed to support recovery and diversification of the Zambian economy. It would also promote new copper mines by private investors in the framework of joint ventures with ZCCM; and strengthen environmental protection in the mining sector.	1991	Closed
3. Privatization and Industrial Reform I	To modernize business framework, establish market-based exchange rate mechanism, and promote private sector through privatization and improvement in parastatal efficiency.	1992	Closed
4. Privatization and Industrial Reform II	To provide balance of payments support to the parastatal reform and privatization program	1993	Closed
5. Privatization and Industrial Reform TA	To strengthen capabilities in ministries and other responsible institutions for parastatals reforms and privatization.	1992	Closed
Simultaneous Operation			
6. Economic and Social Adjustment	To contribute to filling the in=identified external financing requirements for Zambia in 1994 and 1995 and to support reforms in areas of public sector management, developing a market for land, ending the budgetary drain of Zambia Airways, planning for value added tax, improving the duty drawback system, strengthening and decentralizing social services delivery systems and improving budget allocations to and within social sectors	1994	Closed
Following Operations			
7. ESAC II Second Economic and Social Adjustment Credit	Enhance prospects for sustainable and widely-shared economic growth in Zambia by supporting reforms that will make the private sector more competitive and the public sector more efficient and by providing vitally needed foreign exchange.	1996	Closed

Basic Data Sheets

ZAMBIA – Second Economic and Social Adjustment Credit (Cr. 2910-ZA)

Key Project Data *(amounts in US$ million)*

	Appraisal estimate	*Actual or current estimate*	*Actual as % of appraisal estimate*
Total project costs	90	90	100%
Credit amount	90	90	100%
C0-financing	0		
Domestic contribution	0		
Cancellation (US$)	0		
Date physical components completed	na		
Economic rate of return	na		

Cumulative Estimated and Actual Disbursements

	FY97	*FY98*
Appraisal estimate (US$ million)	97.8	97.8
Revised Estimate[26]	52.23	94.30
Actual cumulative as % of Credit	58.03	104.00
Dates of Tranche Disbursement	10/18/96	12/17/97

Project Dates

Steps in Project Cycle	*Date Planned*	*Date Actual*
Identification	March 1995	October 1995
Preparation	May 1995	December 1995
Appraisal	November 1995	March 1996
Negotiations	January 1996	May 1996
Letter of Development Policy	January 1996	May 28, 1996
Board Presentation	April 1996	August 1, 1996
Signing	April 1996	August 8, 1996
Effectiveness	July 1996	October 17, 1996
First Tranche Release	July 1996	October 18, 1996
Second Tranche Release	January 1997	December 9, 1997
Loan Closing	December 1997	December 31, 1997

Staff Inputs[1] (staff weeks)

Stage of Project Cycle	*Staff Weeks*	***US$'000[2]***
Preparation to Appraisal	46.7	190.7
Appraisal	14.5	60.2
Negotiations through Board Approval	10.5	30.1
Supervision	36.8	141.0
Completion	3.0	15.0
Total	101.0	437.0

1. *Source*: MIS Report (COSA2) – Staff Time Use and Schedule, in Staff Weeks and Dollars
2. Includes travel and labor costs

[26] Revised estimates includes US$7.8 million Cr. 2910.

Mission Data

Stage of project cycle	Date (mm/yr.)	No. of persons	Duration of mission (# of days)	Specialized staff skills represented	Performance rating		Types of problems
					Implement. Status	Develop. objectives	
Through Appraisal	September 1995	2	MEC, HRS	5			
	October 1995	6	MEC, HRS, PRS	4			
Appraisal through Board	March 1996	8	MEC, HRS, PRS, URB	16			
Supervision							
1.	August 1996	4	MER, URB, PRS	9	S	S	Delay in establishing Ministerial Procurement Units
2.	October 1996	6	MRC, AGE, PRS	8	S	S	Same as above
3.	January 1997	4	MEC	9	S	S	Concerns re percentage of spending on social sectors
4.	October 1997	6	MEC, SSE, URB, AGE, PSE, PRS	9	S	S	
Completion	February 1998	2	MEC, CON	9	S	S	

Key:
AGE = Agricultural Economist
HRS = Human Resources Specialist
MEC = Macro Economist
PRS = Procurement Specialist
PSE = Private Sector Economist
SSE = Social Sector Economist
URB = Urban Specialist

S = Satisfactory

Other Project Data

Borrower/Executing Agency: The Republic of Zambia

Related Bank Credits

Credit title	*Purpose*	*Fiscal Year*	*Status*
Preceding operations			
1. Second Economic Recovery Credit	Macroeconomic stabilities, agricultural sector liberalization, private sector expansion, and restructuring and reforming the civil service and the parastatal sector.	1991	Closed
2. Social Recovery Credit	To foster community development efforts in alleviating negative effects on the poor of the economic crisis, through rehabilitation and improvement of existing infrastructure and service delivery.	1991	Closed
3. Privatization and Industrial Reform I	To modernize business framework, establish market-based exchange rate mechanism, and promote private sector through privatization and improvement in parastatal efficiency.	1992	Closed
4. Privatization and Industrial Reform II	To provide balance of payments support to the parastatal reform and privatization program.	1993	Closed
5. Economic and Social Adjustment Credit I	To restore macroeconomic stability, support reforms in the areas of public sector management, develop a market for land, end the budgetary drain of Zambia Airways, plan a value-added tax, improve the duty drawback system, strengthen and decentralize social service delivery systems, and improve budget allocations to and within the social sectors.	1995	Closed
6. Economic Recovery and Investment Promotion	To consolidate improvements in macroeconomic management, stimulate investment, reform the social security system, and support mining industry restructuring, with increased private sector participation.	1996	Closed
Following Operations			
7. Public Sector Reform and Export Promotion Credit	To support Zambia's economic reform program, in particular to: i) improve the performance of the public sector service; ii) promote private investment; iii) facilitate the privatization of ZCCM; and iv) strengthen the delivery of social services.	2000	Closed

Basic Data Sheets

ZAMBIA – Public Sector Reform and Export Promotion Credit (Cr. 3167-ZA)

Key Project Data *(amounts in US$ million)*

	Appraisal estimate	*Actual or current estimate*	*Actual as % of appraisal estimate*
Total project costs	170	167.60	98.58
Credit amount	170	170	100

	FY99	*FY00*
Appraisal estimate (US$M)	170.41	170.41
Actual (US$M)	68.48	174.04
Actual cumulative as % of Credit	40.28	100%
Date of final disbursement	April 4, 2000	

Project Dates

	Actual
Identification	N.A.
Preparation	N.A
Appraisal	N.A
Negotiations	
Board Presentation	January 26, 1999
Signing	January 26, 1999
Effectiveness	January 28, 1999
Credit Closing	December 31, 2000

Staff Inputs (staff weeks)

Stage of Project Cycle	Actual/Latest Estimate	
	Number of Staff Weeks	US$ (‘000)
Identification/Preparation	68	292
Appraisal/Negotiation	102	355
Supervision	14	49
ICR	9	30
Total	193	726

Mission Data

Stage of project cycle	*Date (mm/yr.)*	*No. of persons*	*Duration of mission (# of days)*	*Specialized staff skills represented*	*Performance rating*		*Types of problems*
					Implement. Status	*Develop. objectives*	
Identification/ Preparation	January 1997	6		E, LS	S	S	
Appraisal/Negotiation	September/October 1997	6		E, SS	S	S	
	December 1997	2		E	S	S	
	January 1998	2		E	S	S	
Supervision	November 1999	2		E	S	S	
	January 2000	2		s	S	S	
ICR	March 2001	2		E, C	S	S	

Key: E = Economists
LS = Local Staff
SS = Sector Specialists
C = Consultant

Other Project Data

Borrower/Executing Agency: The Republic of Zambia

Related Bank Credits

Credit title	*Purpose*	*Fiscal Year*	*Status*
Preceding operations			
1. Second Economic Recovery Credit	Macroeconomic stabilities, agricultural sector liberalization, private sector expansion, and restructuring and reforming the civil service and the parastatal sector.	1991	Closed
2. Social Recovery Credit	To foster community development efforts in alleviating negative effects on the poor of the economic crisis, through rehabilitation and improvement of existing infrastructure and service delivery.	1991	Closed
3. Privatization and Industrial Reform I	To modernize business framework, establish market-based exchange rate mechanism, and promote private sector through privatization and improvement in parastatal efficiency.	1992	Closed
4. Privatization and Industrial Reform II	To provide balance of payments support to the parastatal reform and privatization program.	1993	Closed
5. Economic and Social Adjustment Credit I	To restore macroeconomic stability, support reforms in the areas of public sector management, develop a market for land, end the budgetary drain of Zambia Airways, plan a value-added tax, improve the duty drawback system, strengthen and decentralize social service delivery systems, and improve budget allocations to and within the social sectors.	1995	Closed
6. Economic Recovery and Investment Promotion	To consolidate improvements in macroeconomic management, stimulate investment, reform the social security system, and support mining industry restructuring, with increased private sector participation.	1996	Closed
7. Economic and Social Adjustment Credit II	Enhance prospects for sustainable and widely-shared economic growth in Zambia by supporting reforms that will make the private sector more competitive and the public sector more efficient and by providing vitally needed foreign exchange.	1996	Closed

Attachment 1

Comments from the Region on the Draft PPAR

(i) **Privatization of ZCCM:** Privatization is a long process and even when it runs on smoothly it can take average 18 months. ZCCM is a big enterprise and its privatization was lengthy. Recruitment of its Transaction advisors, preparation of enterprise for privatization, audit reports, valuation of company assets and agreeing on what to privatize was a lengthy process. The fact that the project assisted GRZ on this process was commendable. The completion of privatization is something which nor IDA nor GRZ had control over. The market determine when to buy and after a proper due diligence on assets can decide to complete transaction. In this case, the revision on rating on outcome to moderately Unsatisfactory is not justified.

(ii) As for other ratings in particular that of Borrower and Bank performance to our opinion should be satisfactory. Both the Bank and government worked very hard and cautiously on the project.

(iii) On PSREP, the outcome is proposed to be downgraded to "moderately unsatisfactory" "given that ZCCM's privatization is reversed and that the remaining reforms......." We do not agree with the assessment that ZCCM privatization was reversed; KCM and the Copperbelt region have benefited from the new investments in terms of increased demand from suppliers and economic activity. Also, the Government has put in adequate effort in finding another strategic partner for KCM after Anglo-American's exit. In fact, a successful bidder has been identified and approved by the Cabinet.

(iv) The PPAR argues that for ESAC II, the "outcome" rating now is unsatisfactory, compared to a previous "satisfactory" rating by both OED's ES and the ICR. The reasons, the PPAR argues, are that the "conditionality for protecting the share of 1996 social spending in total budgetary allocations suffered the same deficiency as in ERIP" and that there are "complications from the operation of the cash budgeting system". Yet in the text, the PPAR acknowledges that "Cash releases to the social sectors increases gradually from 33% of the domestic discretionary budget in 1995 to 36%in 1999" and that "in the year in which no IDA conditionality existed, the allocations declined by 15%" (para. 3.33-3.35, PPAR). SO then why does the PPAR have a problem? Perhaps because the PPAR was arguing that "between 1991 and 1999, real social spending remained roughly constant, although, ..., this implied a decline in per capita terms" (para. 3.35).

This argument is not justified in the context of an economy that had to drastically reduce its public spending due to external shocks, and more importantly due to the need for adjusting to a much lower level of resources, given the unrealistic initial levels of public spending in the 1960's and 1970's when copper revenue was abundant. In this tight financial situation, keeping social spending in real terms while the overall ENTIRE GOVERNMENT BUDGET was falling was indeed an achievement. Sure, if one had extra resources, one should increase the per capital social spending, but during this period, this was not the case. It is also not clear what the PPAR would suggest the country should do as an alternative. As far as the cash budget was concerned, it was established before ESACII, and still exist today, and its problems was not discovered until 1998, when the "Budget Management Report" was issued, so I fail to see any connection between the cash budget and ESAC II.

(v) Perhaps because of this weak analysis, the lessons that the PPAR tries to draw have very limited relevance: Whether one should include the fiscal and BOP needs as an objective in the President's Report (and of course these are the raison d'etre for adjustment lending) should have no bearing on the outcome; ex-ante decision to support an adjustment program does not have the luxury of ex-post commitment to reform and has to rely on "stroke of the pen" reforms; and diversification of course cannot be addressed in the context of adjustment lending instruments.

(vi) In sum, we believe the PPAR fails to make a convincing case to change the ratings of OED's ESs and of the ICRs.

Attachment 2

OED's Response to Comments from the Region

1. **Privatization of ZCCM**. OED agrees that privatization is often lengthy and complex. However, three points should be made here:

First, ERIP had four objectives, which included not just (i) mining sector reform and privatization, but also (ii) macroeconomic stabilization, (iii) mobilization of term finance for the private sector, and (iv) establishment of a new basic pension system. The PPAR provided evidence that two of the four—macro stabilization and mobilization of term finance—were not achieved at all, while two—mining sector reform and the new pension system—were only partially achieved. This is the basis for the moderately unsatisfactory outcome rating.

Second, the original bidding for ZCCM failed, not because the market was reluctant to buy (there were many competitive bids on offer), but because the GRZ was fundamentally ambivalent about selling off its major state-owned enterprise, as evidenced by its decision to replace the pro-privatization ZPA team with officials known to be hostile to ZCCM's sale just before an award was to be announced (paras. 3.10-3.12). Since ERIP was designed to support the original bid, the mining privatization objective was not achieved. The subsequent bidding was supported by the PSREP, and, thus, is not germane to the judgment of the ERIP outcome.

Third, with respect to IDA and Borrower performance, the PPAR cited specific reasons for the ratings of unsatisfactory and highly unsatisfactory which the Region's comments did not address. The PPAR notes that IDA and the Borrower share responsibility for the significant flaws in ERIP's design and execution. For example: (a) conditionality relied excessively on easy-to-implement preparatory steps, rather than hard-to-reverse final actions, a concern which was raised within the Region during appraisal, but not acted upon (footnote 8, p. 6); (b) there were recurrent lapses in the GRZ's fiscal management, which distracted attention from implementation of the non-fiscal reforms, and limited the potential benefits of those reforms which were implemented; (c) the Parliament's unwillingness to approve a new apex institution doomed the planned restructuring of the Zambian Development Bank, which continued to engage in subsidized retail operations (contrary to its ERIP commitments) and, thereby, discouraged commercial banks from supplying larger volumes of term lending; (d) the social protection measures supported by the project were ineffectual; and (e) the Borrower's decision to annul the results of the ERIP-sponsored bidding process proved to be a costly mistake, transforming what might have been a profitable sale under favorable world pricing conditions into a virtual fire-sale under unfavorable circumstances. Thus, OED sees no reason to alter these ratings.

2. **PSREP**. With respect to the PSREP, the Region argues that the privatization of ZCCM was actually not reversed; that KCM and the Copperbelt region have benefited from the new investment in terms of increased demand from suppliers and economic activity; and that the Government has put in adequate effort to find another strategic partner for KCM.

OED agrees that claiming privatization was "reversed" may be too strong a term, since, as the Region points out, there are ongoing efforts to find a replacement buyer. So this reference has been amended to read that "the privatization process was severely disrupted". However, whatever the result in finding another bidder, there can be no doubt that Anglo-American's pullout has imposed significant additional costs to the Zambian economy, on the order of 1 percent of GDP per annum, according to IDA's own report on the subject.

The PSREP, like ERIP, had multiple objectives, all of which were taken into account in rating outcome. The PPAR presents evidence that only one of the two primary stated objectives—implementing a ZCCM labor reduction program—was fully achieved. Privatization of ZCCM, was partially achieved in light of the Anglo-American pull out. One secondary objective—strengthening the delivery of social services and the safety net—was also not achieved, based on the evidence presented in the ICR, a recent PRSP, and an independent panel report on the IMF ESAF (para. 3.8 and footnote 12, pp. 7-8).

Lastly, two minor objectives—improving public service by reforming pay, employment, and management controls and promoting private sector activity through export trade—were partially achieved. On this basis, OED believes that the rating of moderately unsatisfactory is well justified.

3. **ESAC II**. Regarding ESAC II, the Region contends that the PPAR's justification for rating the project outcome unsatisfactory is narrow and weak. The Region has understated the reasons the PPAR offered for why the outcome was downgraded to unsatisfactory. This project had *multiple* objectives, which included (i) supporting a stable macroeconomic environment; (ii) improving export competitiveness through rationalization of the structure of effective protection; (iii) accelerating implementation of the land market reforms; and (iv) improving the delivery of vital social services. An unstated fifth objective was to achieve satisfactory progress on ZCCM privatization, which was a second tranche condition. The PPAR presents extensive evidence to indicate that the measures selected to achieve three of these objectives—export competitiveness, land market reform, and delivery of social services —were only modestly relevant and partially achieved, representing, for the most part, "paper" reforms having little or no impact on the ground. The remaining two objectives—macroeconomic stabilization and ZCCM privatization—were not achieved at all. Quoting from the current draft of the PPAR (para. 3.42): "Taking into account the severe disruption experienced with respect to the process of ZCCM privatization and the erratic macroeconomic policies pursued, combined with the modest relevance of the land, labor, health, trade, and education reforms implemented, and continued inadequacies post-closing in delivering and monitoring basic social services, outcome is rated *unsatisfactory,* as compared to satisfactory at the time of ICR review."

With respect to the Region's specific points on social spending and cash budgeting, please note that Management chose to convey this objective to the Board as seeking to "improve the *delivery of vital social services*". The fact that the share of the discretionary budget devoted to social spending increased during this period was insufficient, by itself, to ensure improved service delivery, and not just because the contraction in discretionary spending in real terms largely offset the increasing share of social spending. It was also the case that public sector capacity to deliver social services deteriorated, a fact documented from a variety of sources, including the 2002 PRSP and Joint Staff Assessment (pp. 7-8). Nor should the fact that the GRZ's chaotic management of cash expenditures—cited in the PPAR as an additional dimension of the social service delivery problem—was discovered only a year *after* ESAC II closed in any way imply that this problem did not exist *during* ESAC implementation, as the Region seems to suggest.

The Region asks what IDA or the GRZ could have done in such dire economic circumstances to have prevented the decline in real social spending. IDA could have been more pro-active in lobbying for external debt relief for Zambia during this period, as the 2002 CAE pointed out. Moreover, IDA should have taken an earlier interest in seeing that this and other projects included strict monitoring of cash expenditures to see that they complied, in letter and in spirit, with loan conditionality. As for the GRZ, it was obvious that the Borrower succumbed to the pressures of various interest groups who opposed ZCCM privatization, and did not adopt a good faith attitude toward complying with its fiscal obligations. For example, paragraph 3.30 of the PPAR describes the large civil service salary boost granted just one month after the mid-term ESAC II review. Obviously, this kind of decision crowds out expenditures for key social programs.

4. Lessons. OED has re-characterized the lesson on the role of external debt in IDA's decisions surrounding these operations as follows:

> "When pressures to maintain a Client current on the service of its external debt have a major impact on lending decisions, it is incumbent upon Management to discuss these pressures, and any impact they had on the timing, content, and size of a proposed operation, with the Board at the time of loan presentation."

This point was also highlighted in the November 2002 OED CAE on Zambia, which concluded that the emphasis on exceptional levels of adjustment lending to finance an unsustainable debt overhang was a significant weakness in IDA's adjustment lending program to that country.

Together with the PPAR lesson on the insufficiency of "stroke of the pen" measures, these lessons are highly relevant to decisions the Region will have to make in the future. It is not the case, as the Region contends, that "ex-ante decision to support an adjustment program does not have the luxury of ex-post commitment to reform and has to rely on "stroke of the pen" reforms." There are other, practical ways to gauge the depth and sustainability of Borrower ownership *ex*ante, which can be found in extensive research on the subject.

To summarize, OED does not agree that there is sufficient evidence for modifying the ratings of this PPAR.