



# 1 ~ Introduction

## 1.1 The UNDP Regional Programme

This case study of Zambia is the first in a regional project on Economic Policies for Poverty Reduction by the Bureau for Development Policy and the Regional Bureau for Africa of the UNDP that aims to reinforce, at the country level, programmes to strengthen the capacity for formulating and implementing macroeconomic, sectoral and structural policies that are more supportive of poverty reduction.

The project has the following major focus areas: 1) integrating poverty reduction objectives into policymaking and socio-economic development strategies; and 2) facilitating practical policy options and institutional mechanisms to foster more pro-poor macroeconomic stabilisation strategies, economic restructuring and sustainable growth.

The project complements other related regional and country programmes supporting preparation and implementation of Poverty Reduction Strategy Papers (PRSPs), Millennium Development Goals (MDGs) progress reports including ongoing work on governance.

During the 1990s the need for poverty reduction in most parts of the world progressively emerged as a major development challenge for the international com-

munity. At the 2000 Millennium Summit, poverty was designated as one of the main development challenges of the new century, which required a robust response both at the national and international levels. The heightened concern about poverty was prompted by the increasingly evident contrast between the rising incidence of poverty and growing inequality both within nations and among them; and, achievements in economic growth and significant advances on the technological front in many parts of the world.

It has also been prompted by the failure of macroeconomic stabilisation and structural adjustment programmes, which dominated economic policy during much of the last two decades, to produce poverty-reducing growth. This failure was contrary to expectations of both the adjusting countries and international financial institutions. With their foundations in neo-classical theory, the stabilisation and adjustment programmes assumed that poverty reduction would flow automatically from resumption of growth and higher levels of employment. The record on both counts has not matched expectations.

Analysis of the performance over the past decade of sub-Saharan countries as a group suggests that significant progress has

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been made by most of them in stabilizing their macroeconomic environments.

However, growth performance continued to be well below levels required to impact substantially on poverty. Although there has been a reversal of the downward trend over the five-year period through to 1999, annual average growth rates since the turn of the century have been three percent.

This is well below the minimum rates of seven to eight percent required to meet the Millennium Development Goals target (MDGs) for poverty reduction. UNDP estimates that as of 2001, up to fifty percent of the region's population lived in absolute poverty, a level that projected to worsen over the following five years if these trends continued. Performance with respect to other areas of human poverty was as well not satisfactory.

Meeting the poverty reduction objectives established in the MDGs, halving the proportion of people living in extreme poverty, is a daunting challenge, but attainable in the sub-Saharan region if growth is combined with policies of redistribution of the growth increment. The initial poverty reduction strategies in the 1980s, to the extent they existed, and in the 1990s focused on 'social safety nets', programmes directed at what was considered to be transitory adverse effects of the adjustment programmes on the poor and other disadvantaged groups. These *ad hoc* measures accounted for what was called the 'social dimensions of adjustment' approach.

Partly as a result of UNDP's advocacy for a broader approach to the challenge of poverty, as set out in the global Human Development Reports and reinforced by the 1995 World Summit on Social Development, a new generation of poverty reduction programmes emerged by the mid-1990s. These took a more comprehensive and active approach to poverty, attempting to identify its root causes and integrating poverty reduction measures in national development programmes. The changes in approach stressed the importance of

designing macroeconomic policies to be pro-poor, an explicit rejection of the faith that growth would 'trickle down' to the poor sufficiently to have a major poverty reducing effect. The evolution of comprehensive Poverty Eradication Action Plans and later Poverty Reduction Strategy Papers (PRSPs) were outcomes of this process. The objective is to put in place a set of macroeconomic, structural and sector policies that make an impact on poverty reduction by combining sustainable growth and equity. The introduction of PRSPs also constitutes a response to the need for broadening participation in economic policy formulation and implementation processes.

The regional programme to which this case study contributes aims to promote greater consistency between participating countries' economic policies and poverty reduction strategies. It will foster understanding of potential trade-offs among strategic economic and sectoral policy objectives as a prelude to formulation of macroeconomic and sectoral policy options that facilitate generating growth along a sustainable and equitable path towards poverty reduction. This requires deeper and sustained analytical work on stabilisation policies, that they can be more flexible on inflation and fiscal deficits in relation to promoting output expansion and poverty-reducing growth through higher levels of investment. An important policy option in this connection is giving more scope under appropriate circumstances to fiscal expansion to allow for increased public investment that can stimulate growth.

It is also notable that the strategic principles that will underpin the proposed regional project are in line with those of UNDP Africa's Second Regional Cooperation Framework for the period 2002-2006. The key elements of that strategy include: advocacy, policy advice and support for mainstreaming human development initiatives in overall development programmes; reinforcement of knowledge networking for building on shared experi-

ences, knowledge and best practices in UNDP's focus areas; adding value to country programmes; and promotion of regional cooperation and integration.

Given that the overall objective of the regional project is to contribute to policy making, applied research and policy analysis, the mission drew on considerable Zambian expertise. The core mission included Zambians, and the Ministry of Finance and Economic Planning provided information and background papers essential to the report, as did the Bank of Zambia.

It would be pretentious and condescending to suggest that the role of the external consultants was 'capacity building', because the capacity of Zambian economists, both in the government and outside of it, to carry out all the tasks of policy design is considerable. The contribution of the external collaborators was to bring to the study experience from other countries, and recent analytical developments in the policy field.

## 1.2 Lessons from the Asia-Pacific Programme

The regional programme for Africa draws on previous work of a similar type in the UNDP Asia-Pacific Regional Programme on the Macroeconomics of Poverty Reduction. As for this programme, it focussed on macro policies to generate pro-poor growth. The Asian studies, complemented by several on transition countries in Eastern Europe and Central Asia, together comprise the Global Programme on the Macroeconomics of Poverty Reduction.

In its first stage, the programme produced policy-oriented research on the impact on poverty of macroeconomic policies (fiscal, monetary and exchange-rate policies) and adjustment policies (financial liberalisation, trade liberalisation, and privatisation/de-regulation). The conclusions from the nine case studies provide lessons for the African studies, which are distinctly different from the neo-liberal policy

matrix that has dominated economic prescriptions for the last two decades.

The conclusions include the necessity for an active fiscal stance, focused on public investment as the basis not only to foster more rapid growth but also as a mechanism to focus resources on poverty. Monetary policies should play a complementary accommodating role to expansionary fiscal policies and avoid restrictive inflation targeting, as is done in Zambia and will be discussed in detail.

In order to finance additional public investment, a more concerted effort is required to mobilise domestic public resources, which are too low in many countries to support a pro-poor growth strategy in many African countries, and especially in Zambia.

The Asian studies also included in the macroeconomic framework recommendations for stronger regulation of financial institutions and external short-term capital flows, and the use of state financial institutions to direct credit for both growth-promoting and poverty-reducing purposes.

The study is sceptical about the ability of trade liberalisation to foster exports. Alternatively, the study points towards backing a trade regime with active industrial policies, allowing medium-term protection of vital domestic sectors and focusing development on sectors, such as agriculture, where poor workers are concentrated and are likely to suffer from unbridled liberalisation. As presented later, there is wide agreement that trade liberalisation in Zambia had a negative impact on both manufacturing and agriculture, and was anti-poor.

In order to heighten the pro-poor impact of growth, the alternative policy framework arising from a synthesis of the Asian studies placed priority on sectoral measures, such as employment generation and agricultural and rural development, as critical complements to macroeconomic and adjustment policies. For job creation, the emphasis was on not only fostering a more employment-intensive pattern of growth, but also taking explicit public policy mea-

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sures to boost the productivity of poor workers. For agricultural and rural development, the emphasis is on deploying public investment for critical public goods (such as rural roads and irrigation), improving agricultural terms of trade and providing equitable and sustainable access to productive resources, such as through secure use-rights to land.

In evaluating this impact, the research also identifies complementary policies that can enhance the impact on poverty of macroeconomic and adjustment policies. This paper reviews two complementary sectoral policies, namely, agricultural development and employment generation, which figured prominently in many of the studies. The research also investigates whether a country is able to mobilise the domestic resources (for example, through savings, taxation or borrowing) to finance a high rate of public and private investment for accelerated economic growth.

The Asian case studies addressed seven issues relevant to the sub-Saharan countries, and Zambia specifically: 1) investment-led fiscal policy 2) inflation targeting, 3) the revenue/GDP ratios, 4) agricultural and rural development, 5) financial liberalisation, 6) employment, and 7) pro-poor trade policies.

As for this report, the objective of the Asia-Pacific regional programme was to broaden the policy dialogue on the prerequisites for pro-poor growth and promote greater consistency between countries' Poverty Reduction Strategy Papers and their macroeconomic and adjustment policies. Whereas, for the rest of this section will focus on fiscal policy and employment, the major issues in Zambia.

UNDP's basic approach to pro-poor growth Strategies stemmed from its 2002 report (UNDP 2002), which concentrated on generating growth how to make it equitable. Its focus was on the economic opportunities of the poor, namely, their access to assets, resources and employment that enable them to secure a decent material standard of living and thereby significantly

widen their options for human development. The policy note took the position that if countries were to reach the target of halving extreme income poverty by 2015, rapid growth would be essential, more rapid than the average of the last three decades. However, if growth is more equitable, the incomes of the poor grow faster than the average, and countries have a much greater chance of reaching the MDG target.

Hence, a strategy of such 'equity-based' growth would need to be rapid enough to improve the absolute incomes of the poor, and equitable enough to improve their relative position, preferably by enhancing equity at the start of the growth process as through land reform or universalising basic education, or by decreasing high inequality over time through increasing wages by generating widespread employment among low-skilled workers. Equity-based growth can be achieved through a variety of strategies, which depend in part on each country's initial conditions.

In general, if growth is to immediately reduce poverty, it should have a pattern that directs resources disproportionately to sectors in which the poor work, such as small-scale agriculture, the areas in which they live, underdeveloped regions, and to the factors of production that the poor possess, such as unskilled labour or land.

The long term objective of all development is to move the workforce, and poor workers in particular, out of low productivity sectors, poorly resourced regions and low-skilled employment. In most cases, this would imply poor workers shifting from agriculture and into industry and a modern service sector.

In the past, import-substitution strategies have succeeded in achieving this effect in some countries. Strategies based on emphasizing the exports of manufactures have been successful. In the short run, inequality is not likely to be reduced, and may even rise.

If inequality is reduced, it is more likely to be due to initial prosperity in agriculture

or an initially equitable distribution of endowments, such as land or human capital.

In examining the impact of macroeconomic and adjustment policies, the UNDP-supported case studies were directly concerned with these vital issues of growth and inequality, and their interaction. The policy recommendations favoured more expansionary, investment-focused fiscal policies and more accommodating monetary policies than 'neo-liberal' orthodoxy allows.

The pro-poor growth strategies in the Asia-Pacific reports put a premium on boosting domestic savings and investment, instead of the orthodox focus on allocative efficiency and price stabilisation, and using public investment as a stimulus to private investment.

This implies a more activist policy role for the state and a larger revenue base, with which it can finance capital expenditures and direct them to poverty-reduction purposes. The case studies tended to be critical of the impact of conservative policies of financial liberalisation, both domestic and external, and favour capital controls, stronger regulation of the financial sector, and some scope for directed credit, especially for poverty-reduction purposes.

The case studies gave trade liberalisation mixed reviews. Compared to financial liberalisation, greater trade openness had, in some countries, a more positive impact on growth and poverty reduction. However, this has often been combined with import substitution policies. If trade liberalisation is not complemented with other active measures, especially poverty-focused interventions such as the building of rural infrastructure, financing of agricultural development and the provision of adequate credit to small and medium enterprises, then trade liberalisation can exacerbate inequality and bypass the poor, especially the rural poor. As we see in subsequent chapters, this tended to be the case in Zambia. To be most effective, liberalisation of trade should be designed carefully and go hand-in-hand with a pro-active industrial strategy. Despite

the widespread rhetorical commitment to pro-poor growth, employment is often a 'missing link' in the chain that connects growth to poverty reduction. This is *prima facie* evidence of a deep-seated inconsistency between the orthodox stabilisation-fixated growth strategies, on the one hand, and national poverty reduction strategies, on the other hand. In trying to link growth to poverty reduction, the UNDP-supported Asia-Pacific case studies had to address the importance of generating widespread employment; and, such employment has to be at decent wages to be poverty reducing. This implies that self-employment, micro-enterprises and the micro-finance services supporting them cannot serve as the foundation for a pro-poor employment strategy. Although such micro programmes can help raise incomes, secure and remunerative employment cannot be sustained by these alone. The emphasis needs to shift to small and medium enterprises, and large enterprises that are employment-intensive and skill-enhancing.

A major initial finding of the regional programme is the need to use fiscal policy more proactively to expand pro-growth and pro-poor public investment. The case found that public investment could, if growth-oriented, have a 'crowding-in' effect on private investment (Roy & Weeks 2004), as this study finds for Zambia. Boosting aggregate demand through public investment can have the advantage not only of sparking recovery in a stagnant economy, but also of loosening the supply constraints on long-term growth. However, 'crowding-in' cannot be automatically assumed. Public capital expenditures have to be carefully designed as part of a well conceived pro-growth as well as pro-poor strategy.

The multipliers for expenditures on public investment can be substantial if such investment helps boost the productivity of labour and capital. The higher marginal propensity to consume in developing countries, compared to industrial countries, is an additional factor that can increase these multipli-

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ers (Hemming, Kell and Mahfouz 2002, 12). Also, the multiplier impact of public investment can be powerful if there is excess capacity in an economy and households are liquidity constrained, as is the case in many developing countries, including Zambia.

The common concern among Washington-Consensus economists has been that increasing public investment will enlarge public deficits and these, in turn, will lead to higher inflation, depreciation of the exchange rate and higher real interest rates. There is little evidence in the literature that public investment crowds out private investment through changes in the interest rate or exchange rate (Hemming, Kell and Mahfouz 2002, 36).

Moreover, multipliers remain large, and crowding out is minimised, when a moderate monetary expansion accompanies an increase in public investment. As long as deficits are used to finance public investment that expands aggregate supply, then the aggregate demand effects should not be unduly inflationary. Public investment can be a powerful instrument for the reallocation of public resources to poverty reduction.

The case studies concluded that fiscal policy should not be held captive to inflation targeting. The Neo-liberal recommendation to national policymakers is that they should insist on maintaining inflation rates of zero to five percent, even though there is little empirical evidence to suggest that inflation rates above that level, or even above ten percent, have an adverse effect on growth. The case studies suggest that some inflation must be expected in a rapidly growing economy, due to temporary sectoral bottlenecks. In an economy with strong growth, inflation may reflect the adjustment of relative prices to reallocate resources from less to more profitable sectors. If monetary policies are excessively restrictive and some prices are downwardly 'sticky'; then inflation targeting can nullify the required reallocation of resources, and cancel the growth stimulus of expansionary fiscal policies. Low inflation is more appro-

priate after a sustainable rate of economic growth has been achieved; trying to maintain low inflation before growth has a chance to take off is likely to throttle any economic expansion.

The Asia-Pacific studies indicate that a policy framework with an active fiscal policy at its core can generate pro-poor growth in which the income of the poor rises faster than average income. However, active fiscal policy must be accompanied by an accommodating monetary policy, and strong redistributive measures, some through fiscal instruments themselves.

This case study of Zambia finds the lessons from the Asia-Pacific region relevant, though they must be adapted to the regional and national context. The lessons from the Asia-Pacific Programme must be placed in the context of Zambia's structural characteristics, which differ notably from those of most of the Asian countries covered in the programme's case studies. The most important of these structural characteristics are:

- 1) A long-term decline in per capita income, dropping the country from middle-income status in the early 1970s, to low-income status in 1990s
- 2) Until the 2000s, almost total dependence on a single primary commodity export, copper;
- 3) An agricultural sector whose output is extremely weather-sensitive;
- 4) Inefficient domestic commodity markets, in part due to poor and deteriorating infrastructure;
- 5) Underdeveloped financial sectors;
- 6) Heavy dependence on concessional development assistance (especially from the World Bank), that is strongly conditional;
- 7) A large debt burden; and
- 8) A near-catastrophic incidence of HIV/AIDS.

Taken together, these characteristics produce in Zambia what is of central importance to the design of a pro-poor macro

policy, a high level of growth instability. From the 1960s through the end of the 1990s, the annual variation in the growth rate, of GDP and GDP per capita, was extremely high, with the absolute value of the year-to-year change almost four times the average annual growth. This instability resulted primarily from the dependence of the economy on a single export whose price was volatile, copper, and from the inability of underdeveloped and ineffective internal markets to generate supply adjustments to accommodate that volatility.

### 1.3 Country-driven & Nationally Owned Development

Three problems lie at the heart of the high levels of poverty in Zambia, and the stunted recovery after 2000: a heavy debt burden, lack of diversification of the economy, and the HIV/AIDS pandemic. The first derives directly from explicit decisions by outside agencies, and was characterised by the Operations Evaluations Department of the World Bank as 'not realistic'.<sup>1</sup> The second was exacerbated by stabilisation and structural adjustment programmes whose design was flawed.<sup>2</sup> To some degree these programmes, stressing balance of payments support, reflected the priorities of funders rather than the needs of the Zambian economy.<sup>3</sup> And, the lack of attention by the major funders to the HIV/AIDS pandemic undermined the effectiveness of the large scale lending that occurred.<sup>4</sup> Discussions with government officials and representatives of international agencies, and a review of documents including evaluations from those agencies, indicate that at least over two decades, programme assistance to Zambia was inappropriately designed and characterised by excessive conditionality.<sup>5</sup>

These deficiencies in programme lending resulted in what most external funders described as a 'lack of commitment to reform' by the various Zambian governments over more than two decades. Given the poor design and inappropriate priorities

in the programmes, a lack of government commitment should not come as a surprise.

Overall, the relationship between the Zambian governments and external agencies from the 1980s into the new century was one of 'donorship'. The relationship was one in which donors and lenders collectively acted as setters of policy priorities, designers of economic programmes, active participants in the implementation of policy, and assessors of the outcome of policy; in other words, a case of profound aid dependency that went beyond dependency on funding.<sup>6</sup>

It would appear that in Zambia, donors and lenders have not distinguished between actions required by the government in order that the funds be used effectively, and those policies that the donors and lenders have the bargaining power to impose, be they crucial to success or not. Further, donors and lenders have tended to exercise an external judgementalism, assuming the authority to pass judgement on the appropriateness of conditionalities, and whether the government has shown sufficient commitment to those conditionalities. There is an obvious inconsistency in this approach; donors and lenders played a primary role in setting conditionalities, and the government was expected to show full commitment to these externally defined conditionalities (take ownership of them). By contrast, in a national ownership regime, the recipient government assesses policies in consultation with the donor. National ownership does not require external development agencies to suspend all judgements; rather, implies that those judgements arise out of an interactive process with national stakeholders.

It is the view of this mission that while relations between the government and some donors and lenders have at times been strained, greater national ownership is essential for more effective economic policy. Putting the principle of national ownership into practice, an essential feature of the PRS process, involves the realisation that economic policies and reforms are not purely

1 technical matters, but involve trade-offs and political choices. If donors and lenders take national ownership seriously, it implies that in some cases they must adjust their views to those of recipient government. This adjustment by donors and lenders would be facilitated if they point out what they see as failings of the government, and recognise their own mistakes in their dealings with the government over the last twenty years, some of which they have documented in their in-house evaluations (WB 1996 & 2002).

There is truth to the allegation of observers that the governments of Zambia have made major policy mistakes regarding the economy at critical times. Similarly, the record of outside agencies suggests that a degree of modesty and self-doubt on their part would be appropriate when proposing policies to the government. Since 1990, the expectations of these agencies for positive outcomes from the major policy changes required by loan conditionality have consistently been unrealised. To take but one piece of evidence, growth forecasts by the World Bank for the 1990s proved excessively optimistic. As Table 1.1 shows, the growth forecast of almost four and one half percent for the first half of the decade was far above performance, and the forecast for the second half of the decade, while closer to the actual outcome, was still well off the mark. In part, the projection error arose from over optimistic assumptions about the response of private investment to the policy changes (see 1991-1995 in the table 1.1).

The purpose of pointing out the unreliability of projections is not to allege that they could have been better; but rather, to emphasise the impression of economic analysis, both in terms of its specification of appropriate policies and its ability to relate those policies to outcomes. The lesson to take is that external agencies and the government should treat the policy dialogue as one of cooperative interaction in which the parties learn from each other. The fact that external agencies have funding which the government desperately requires places a

particular responsibility on the former to be modest their assessment of their capability of designing appropriate policies.

#### 1.4 Zambia's Transition: Adjusting from What

Over the thirty years, 1975-2005, Zambia underwent a profound economic transformation. The adaptations required by the transformation were made difficult due to a misunderstanding of the nature of the economy and society by Zambia's most important donors and lenders. The mainstream view appears to be that under the Kaunda regime (i.e., into the late 1980s) Zambia was a 'socialist' country, and the essential character of the transformation would be from a planned to a market economy.<sup>7</sup> This presumption requires close inspection.

Until the early 1990s in the economics literature the term 'socialist economy' was synonymous with 'centrally planned economy', or, more simply, a 'planned economy'. The term has fallen from use since the end of the Soviet Union, to the extent that it no longer appears in many dictionaries of economic terms. However, the *Penguin Dictionary of Economics* of 1987 provides the following definition of a planned economy

An economy where state authorities rather than market forces directly determine prices, output and production. The most important features usually include: (a) production targets for different sectors that determine the supply of different commodities; (b) rationing of certain commodities, to determine demand for them; (c) price- and wage-fixing by state bodies; and (d) (sometimes), a conscripted labour market in which workers take the jobs assigned to them. (Bannock, Baxter & Davis 1987, p. 317)

From independence to the end of the 1980s, the state authorities did not set production targets across sectors; rationing was not important; state bodies did not set the prices of most commodities; and, labour was not allocated administratively. In the most important sector of the economy, mining, output and prices were determined in



international markets, notwithstanding that the sector was state owned. There were consumer subsidies, most notably for maize meal, but not rationing. And, workers found their jobs at the enterprise level through labour markets.

Zambia had a market economy with extensive and intensive state intervention, both in ownership of enterprises and regulation of markets.<sup>8</sup> Defining the economy as 'socialist' reflects the tendency by some neoclassical economists after the fall of the Soviet Union to view centrally planned systems as essentially the extreme version of economies pursuing industrial policies (so-called import-substituting industrialisation). In part this was an extension of the ideological position of the Hayek-von-Mises school that judged all government interventions as socialist, and partly because the Western economists who played a prominent role in 'reform' programmes in the former Soviet Union had not worked on those countries during their central planning period.

The issue of definition has great practical importance. Having defined Zambia as socialist, the international financial organisations concluded that the central problem of the economy was state control, implying the need for rapid deregulation and privatisation. To this end, conditionalities placed great importance on trade liberalisation, divestiture of state assets and reduction of the role of government, including the elimination of economic planning institutions of the public sector. While similar conditionalities were applied to many African countries, in Zambia they were more intense.

### 1.5 The Political Context of Economic Decline

External agencies have tended to assign all economic ills of the economy to the government intervention they defined as socialist, and as a result placed little importance on the regional political factors that profoundly affected Zambia's economy. On the last day of 1963, the Central African

Federation collapsed when North Rhodesia gained independence as Zambia, and Nyasaland as Malawi.<sup>9</sup> In response to the refusal of the government of the United Kingdom to grant independence to the minority regime in Southern Rhodesia, the white settler government declared independence unilaterally in 1965 (Unilateral Declaration of Independence, UDI).

Though 'Rhodesia' was not officially recognised by any government, it was maintained as a white minority dictatorship for fifteen years with de facto support from the apartheid regime in South Africa and Portugal, which maintained neighbouring Mozambique as a colony. The declaration of independence by the 'Rhodesian' regime caused Zambia to lose its two transport links for exporting its copper, through the white settler state and South Africa. This resulted in a dramatic increase in transport costs, such that despite productivity raising innovations in copper mining and concentrating, Zambia was rendered a high-cost producer on the world market. In 1976, construction was completed of a rail link to Dar es Salaam, but for ten years the Zambia economy suffered from the politically-motivated disruption of its export products.

The slow growth of the economy during 1965-1976 can to a great extent be explained by this disruption, which resulted in low investment in mining, a growing trade deficit and heavy indebtedness. While the principled political stance that Zambia took with regard to the white settler regime in so-called Rhodesia, and the anti-colonial struggle in Mozambique, was not the source of all of its ills, it should not be ignored when assessing economic performance. The implications of this history are developed in more detail in subsequent chapters.

### 1.6. The Key Constraints: Debt and HIV/AIDS *Impact of HIV/AIDS*

Since the mid 1980s the economic and social problems of Zambia have been com-

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 pounded by one of the world's most devastating HIV/AIDS epidemics. Evidence suggests that by the mid-2000s one in every six adults was HIV positive, and eighty-nine thousand people died of AIDS in 2003 (UNAIDS & WHO 2004). As a result, the most pessimistic estimate was that life expectancy at birth fell below forty, and over six hundred thousand children were AIDS orphans (UNAIDS, UNICEF & USAID 2004). Unlike in North America or Western Europe, HIV in Zambia was not primarily a disease of the underprivileged. Infection rates were estimated to be higher among the non-poor and better educated. However, the poorest households were least able to protect themselves from HIV or to cope with its impact.

Whatever the severity of the pandemic, sickness and death and the consequent effect on families and communities has social and economic repercussions that could result in long term changes in social structures. The impact on households included permanent loss of income in the case of death, less labour available for family farms, funeral and mourning costs, and the removal of children from school in order to save on educational expenses and increase household labour.

The longer term effect of withdrawal from education would be loss of future earning potential. Further, a study found that HIV/AIDS results in malnourishment in children of effected households, and that this worsened when the child was orphaned and sent to a guardian (Baggaley & Needham 1997).

In the case of most maladies, households in distress would be supported by extended families; however, the toll of the epidemic reached such severity that family structures could not cope. Social stigma compounded the problem, as many of those affected by HIV/AIDS could suffer exclusion from communities. To make matters worse, when the male head of a household dies it is common for his entire property to be appropriated by relatives rather

than the immediate family, leaving the widow and children with little or nothing (AVERT 2005).

The HIV/AIDS pandemic has and will have a major impact on the age and sex composition and the rates of growth of the population and labour force of Sub-Saharan countries. The scale, scope and timing of the impact on the quantity and quality of labour supplied are extremely difficult to estimate, and varies across countries. The starting point for any analysis of the impact of HIV/AIDS should be recent data on prevalence and mortality rates and any cross-country comparison of the impact of HIV/AIDS must be based on a discussion of the manner in which incidence is estimated.

At a macro level HIV/AIDS has a direct impact on rates of economic growth. Using a Cobb-Douglas production function incorporating labour quantity, Haacker concludes,

While the evolution of HIV prevalence rates and hence HIV/AIDS-related mortality rates, differ across countries, this [model] suggests that the rate of per capita output growth will be between .3 and .7 percentage points lower than otherwise through 2000-2010. (Haacker 2002, 35-36).

However, few studies have been able to incorporate the impacts at the household and firm level in macroeconomic projections. There are several mechanisms by which AIDS affects macroeconomic performance.

- AIDS deaths lead directly to a reduction in the number of workers available.
- A shortage of workers could lead to higher wages, which leads to higher domestic production costs. Higher production costs lead to a loss of international competitiveness.
- Lower government revenues and reduced private savings (due to greater health care expenditures and loss of worker income) can cause a significant drop in savings and capital accumulation.

According to the forthcoming National Human Development Report 2005 the

infant mortality rate in Zambia will be sixty percent higher by 2010 due to the impact of AIDS, the child mortality rate will double, the crude death rate will triple, and life expectancy will decrease from 60.1 to 30.3 years. Overall, population growth would be reduced from 3.1 percent to 1.2, because of the effect of AIDS (Cohen 1997).

Additionally, according to the Zambia Business Coalition, eighty-two percent of known causes of employee deaths are HIV-related and seventeen percent of staff is recruited to replace people who have died or left because of HIV-related infections (Times of Zambia 2004).

Even more significant, AIDS kills people in the prime of life, so the workforce is stripped of valuable skills and experience. The situation becomes yet worse as there are fewer people to teach the next generation. All of this means that production costs rise, while at the same time consumer spending falls because people affected by HIV/AIDS have less disposable income.

The HIV/AIDS disproportionately affects women. It is estimated that 1.2 times as many women are afflicted with AIDS as are men. Women are thought to be 2 to 4 times as susceptible to infection during unprotected intercourse, and more vulnerable to other STDs. Furthermore, women are culturally relatively weaker to protect themselves (GRZ, 2002b, 109). Women are vulnerable to infection due to their lack of decision making power and autonomy within personal relationships and their lesser access to healthcare, social services and education. (Mwale and Burnard, 1992:10)

The disease has a well-recognised gender dimension. Women are affected by HIV/AIDS not only as sufferers, but also in their multiple roles in society and the family, as health care providers, educators, wives, mothers and income providers. Nursing the sick is generally seen as a feminine activity, particularly when unremunerated, as occurs for family members. The development of home based care programmes for chronically ill patients such as those with AIDS,

whilst saving hospital beds, will have an impact on women by increasing their domestic duties (Byrne, 1994, 35-36).

Zambia has been one of the world's poorest countries since the late 1970s, and HIV/AIDS has made a bad situation even worse. Negative trends in the economy and food production fuel the epidemic that helped to create them. As Zambia's Poverty Reduction Strategy Paper acknowledges, 'the epidemic is as much likely to affect economic growth as it is to be affected by it' (Government of Zambia 2002b).

#### *The External Debt Burden*

Poverty in Zambia is exacerbated and magnified by HIV/AIDS, and the government's capacity to deal with the problem is undermined by the country's debt burden.

Fundamentally a legacy of the 1970s and 1980s, the debt burden arises directly from the decline in revenue from copper that resulted from the combined effects of supporting liberation struggles in the region and the decline in the copper price. While the first cause arose from a Government decision, it is one that the international community should applaud. The second was beyond the control of any government. The obvious solution to price instability is the diversification of the economy. But, despite its efforts, the government was no more able to achieve this in the 1970s and 1980s than have subsequent governments that have enjoyed massive external support. Apparent export diversification in the 1990s and 2000s were the result of a catastrophic collapse in the mining sector rather than purposeful policy.

Zambia's crushing debt burden arose through a combination of unsound lending policies on the part of multilateral agencies, which had the active support of bilateral donors (this is discussed in detail in the next chapter), and declines in the terms of trade. Figure 1.1 shows the share of debt service in exports during 1975-2001 using a three-year moving average to reduce the effects of

1 year-to-year fluctuations. The series ends in 2001, before other countries, and eventually Zambia, began to benefit from debt relief, which is considered in a subsequent chapter. The chart also reports the number of countries that had a debt service ratio greater than Zambia's. The overall impression one might take from the chart is that while Zambia's debt service ratio has been consistently high (higher than the average for these countries except in the second half of the 1980s) it continuously declined after the early 1990s. This impression might be reinforced by Figure 1.2, which shows the debt stock per capita in current US dollars, which declined steadily after 1990, approaching the average for the other countries.

However, an external debt must be repaid, as opposed to merely refinanced, through foreign exchange earnings. Therefore, the capacity to pay will be affected by the price of exports, which determine the purchasing power of those exports, and import prices, which affect the cost of producing those exports. When per capita debt is adjusted by the net barter terms of trade, shown in Figure 1.3, the result is quite different from the previous charts. In 2000-2001, the terms of trade adjusted per capita debt stood fifty percent higher than it had been at the beginning of the 1980s, and well above the average for the other countries, with no tendency for the gap to narrow.

In anticipation of the chapters that follow, it can be concluded that in the mid-2000s Zambia remained on of the most heavily indebted countries in the Sub-Saharan region. This indebtedness combined with conditionality-related deficit limits has resulted in a severe fiscal constraint. The two predominant problems facing Zambia, HIV/AIDS and debt, are inseparable. Rarely has a trade off been so clear and so cruel; pay the debt or treat HIV/AIDS victims. This trade-off lies at the heart of the report that follows.

*debt service], rather than debt forgiveness, was not realistic, as was eventually recognized by launching HIPC. This decision left the Bank with few and unattractive options, which led to large IDA transfers to off-set Zambia's repayments to IBRD and other creditors', and 'The result [of the debt strategy] was an unenvisioned "muddle through" scenario in which exceptional allocations of IDA helped to service the debt while net transfers for development were small' (WB 2002, p. 9).*

*2 'Outcomes of many Bank operations, and of the overall Bank programme, were unsatisfactory' (WB 2002, p. ii).*

*3 'Creditor pressure for balance of payments support weakened the design and supervision of successive adjustment operations' (WB 2002, p. ii).*

*4 'The emphasis on exceptional levels of adjustment lending to finance an unsustainable debt overhang along with the delayed response to the HIV/AIDS pandemic were significant weaknesses [in WB programmes]...' (WB 2002, p. ii)*

*5 This conclusion is epitomised in even stronger language in a WB evaluation of operations in Zambia:*

*The general conclusion of this evaluation is that, given the nature of Zambia's problems and the government's wavering commitment to the reform in the 1980s, there was too much emphasis on policy-based operations, and too much emphasis within policy-based operations on stabilisation rather than on long term structural adjustment. A more balanced approach, with a higher share...going to physical and social infrastructure would have been desirable. (WB 1996, p. 7)*

*6 For a detailed analysis of the relationship between the government and donors and lenders, and aid dependency in Zambia, see Chisala (2005).*

*7 For example, 'A change of regime in Zambia in 1991 initiated a transition from a socialist to a market-oriented economy' (WB 2002, p. I).*

*8 Zambia had a mixed economy: 'A market economy in which both private and public enterprise participate in economic activity, though not necessarily in all sectors, some of which may be reserved for public monopoly' (Bannock, Baxter & Davis 1987, p. 273).*

*9 The official name was the Federation of Rhodesia and Nyasaland, and was established as a semi-autonomous dominion of the United Kingdom in 1953.*

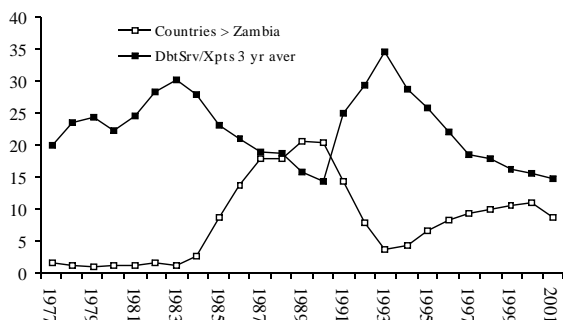
*1 The decision by the international community to deal with Zambia's debt overhang through concessional lending [borrowing for*

Table 1.1: Actual and World Bank forecasted growth rates, 1981-2000

Annual average	1981-1990	1991-2000		1991-1995		1995-2000	
Real GDP growth	Actual 1	Actual 0.6	Projected 4.9	Actual -1.6	Projected 4.4	Actual 1.4	Projected 5.4
Actual- projected			-4.3		-6		-4
Non-mining GDP growth	1.4	2.2		-1.9		3.2	
GDI/ GDP	15	16	19	13	21	17	17

Source: Forecasts from WB (2002, 21)

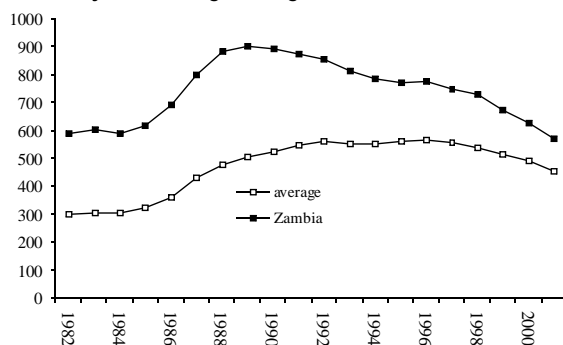
Figure 1.1: Zambia's debt service as a percentage of exports and number of sub-saharan countries with higher ratios, 1975-2001(3 year moving average)



Source: World Development Indicators.

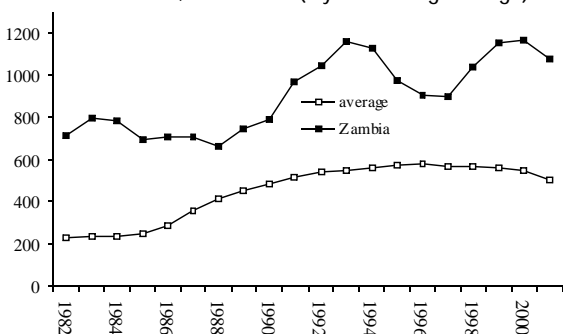
Note: Total number of countries other than Zambia is thirty-one (Botswana, Burkina Faso, Burundi, Cameroon, Central African Republic, Democratic Republic of Congo, Republic of Congo, Cote d'Ivoire, Ethiopia, Gabon, Gambia, Ghana, Guinea, Guinea-Bissau, Kenya, Lesotho, Madagascar, Malawi Mali, Mauritania, Mozambique, Niger, Nigeria, Rwanda, Senegal, Swaziland, Tanzania, Togo, Uganda and Zimbabwe).

Figure 1.2: Debt Per capita, Current US dollars, 1980-2001 (3 year moving average)



Source: See figure 1.3

Figure 1.3: Debt per capita, current US dollars adjusted for the terms of trade, 1980-2001 (3 year moving average)



Source: World Development Indicators.

Note: 'average' is for the thirty-one countries listed in notes to the previous chart.