UGANDA

Introduction

In the period 1971-86, the economy declined rapidly due to a conjunction of poor economic policies and severe social disturbance. In the early 1980s there were two stand-by arrangements, but both collapsed under the pressure of events. The NRM government took power in 1986, inheriting a devastated economy with a number of distinctive features. Per capita income was among the lowest in the world; the public revenue base had collapsed, with coffee taxation accounting to close to half of revenue, and high inflation had eroded the demand for money. Since there was little scope for external borrowing, government expenditure had fallen. A by-product of this was that while public sector employment had expanded enormously, public sector wages had become derisory. As a result, while the public sector was large it was not well-suited to service delivery. The private economy had retreated into subsistence activities, and exports and investment had declined. By 1986, government expenditure, exports, and investment were each only 9 percent of GDP.

The new government was initially suspicious of Fund and Bank involvement in economic policy. It dismantled aspects of the previous stand-by arrangement, notably refixing the exchange rate. By 1987, inflation had accelerated to over 200 percent and such early failures of the policy changes led the government to seek an agreement with the Fund. A Structural Adjustment Facility was initiated for the period 1987-90.

The SAF Program, 1987-89

A major objective of this program was to restore exports. For this, it was seen as necessary to shift from dependence upon export taxation. The producer price for coffee, the main export crop, was tripled, and there were efforts to make payments to farmers on time and to improve transport. Price controls in manufacturing were removed. There was a start to foreign exchange liberalization with a 60 percent devaluation in 1988 followed by frequent smaller devaluations. There were plans for the privatization of public enterprises and for the removal of ghost workers from the government payroll. The targets were for GDP growth of 5 percent and inflation of 10 percent.

The period of the SAF program coincided with a deterioration in the world coffee price. Between 1986/87 and 1989/90, the terms of trade deteriorated by 24 percent. Despite this, there was a strong recovery in output, with the growth rate of per capita GDP exceeding 3 percent per annum. In view of this satisfactory performance, the SAF program was revised before its planned completion into an ESAF program.

The First ESAF Program from 1989 to the crisis of 1992

The ESAF program had three objectives: continued growth of at least 5 percent, a reduction in inflation to 7.5 percent, and a balance of payments surplus of $11 million. The new program included exchange rate liberalization, the removal of import licensing, rehabilitation of infrastructure, improved fiscal controls, and public enterprise reform. From the viewpoint of the government the core of the program was exchange rate liberalization: in 1990, it introduced foreign exchange bureaux while maintaining an official exchange rate for some transactions.

The social impact of the program was explicitly considered. It was recognized that some vulnerable groups would not benefit in the short run. This concern led to the setting up of a program to alleviate poverty and the social costs of adjustment (PAPSCA). The main components of the program were assistance for retrenched government workers, projects in primary education, in primary health care, and in rural infrastructure rehabilitation.

There was a further sharp deterioration in the terms of trade of 22 percent between 1989/90 and 1992/93. This created a dilemma: the collapse in the world coffee price was liable to accelerate the shift by farmers out of coffee, yet to prevent it would require the government to reduce export taxation which was central to its revenue.

In 1991/92 there was a fiscal crisis. In part, this was due to an interruption in donor inflows because of the introduction of the dual exchange rate. However, the major reason was an extreme loss of control of expenditure: the share of government expenditure in GDP rose from 16 percent in 1990/91 to 23 percent in the following year. This loss of fiscal control produced a rapid acceleration in inflation. By March 1992 the annualized rate had reached 230 percent and per capita GDP growth had decelerated to 2 percent. In response, the President merged the Ministries of Finance and Planning, dismissing the Finance team and giving control to Planning, which had been the main base of analysis and advocacy for economic reform.

ESAF Programs from the crisis of 1992 to 1997

The new team thus faced a short-term stabilization problem and a longer term need for policy reform. The fiscal crisis had cost the government the limited credibility with investors which it had achieved. The risk rating of the country by the *Institutional Investor* fell to the lowest of the 25 African countries rated. To stabilize the economy the government introduced a cash budget. This brought about a reduction in expenditure of 3 percentage points of GDP. The cash budget had a dramatic effect on inflation. Within four months of its introduction, prices were stable. The cost of this disinflation in terms of lost output was modest. Between 1992 and 1993 the growth in per capita GDP actually accelerated to 3 percent.

In 1994, a further ESAF program was agreed (1994-97). By this time the economy was already stabilized. We should note that this makes the Ugandan ESAF program of 1994-97 unique in our sample, since its focus could have been entirely on structural reforms. In the event, the program also included important fiscal objectives. Reserves were to be accumulated to five months of imports, and the fiscal deficit (which was largely aid-funded) was envisaged to fall from 10.6 to 5.5 percent of GDP. This would involve substantial repayment to the banking system. Indeed, the objective of the fiscal adjustment was not to reduce inflation but to improve access of the private sector to credit.

The fiscal adjustment was to be achieved primarily by increasing revenue as a share of GDP by 1 percentage point per annum. This was achieved by a combination of institutional and tax rate changes. An independent revenue authority was established outside the structure of the civil service. Taxes on petroleum were increased sharply so that Uganda came to have fuel prices more than double those of its neighbors. Import duties were raised, so that even by 1996 more than half of revenue was from trade taxes. The remaining fiscal adjustment was to be through reduced expenditures. To protect social expenditures during this phase of fiscal tightening a “core budget” was created in which social programs were given priority. This was partly a response to the difficulties created by the cash budget, which increased the volatility of expenditure and thereby reduced its efficiency.

The government embarked upon a wide range of radical reform measures. With respect to export crops it first abolished the export tax on coffee, then removed the monopoly of the Coffee Marketing Board, and finally removed the rail monopoly on coffee transporting. The introduction of private road haulage for coffee had the beneficial side effect of expanding the market for road haulage sufficiently that the market structure of the industry became much more competitive: with the demise of the haulage cartel freight rates nearly halved.

With respect to foreign exchange, the government first unified the exchange rate at the Bureau de Change rate, then introduced an inter-bank market (November 1993), thereby achieving Article VIII status, and finally moved to full capital account convertibility (July 1997).

With respect to public employment both the civil service and the army were drastically reduced, the civil service by one third and the army by one half. Prior to the army demobilization, there had been considerable concern that it would lead to an increase in unrest, with demobilized soldiers resorting to crime. The government implemented a program of financial and material assistance for the demobilized. In the event, crime rates actually fell and there is evidence that the demobilized reintegrated into their rural communities.[103]

With respect to financial markets the government gradually developed the Treasury Bill market. Initially, interest rates on the market were very high. There was substantial new entry into the banking sector, breaking a long-established cartel. However, the capitalization requirements were initially set far too low. This reflected the failure to revise the relevant legislation in response to the high inflation of the previous two decades. As a result, some of the new banks had to be placed under supervision and their existence was a serious constraint upon the operation of monetary policy: the interventions which would have absorbed liquidity in aggregate, would have made the weaker banks unviable. A distinct and major problem was posed by the Uganda Commercial Bank which had a large, weak and politicized portfolio. The process of privatization of UCB was slow, and the one important respect in which the implementation of reform fell behind schedule. However, its completion was in prospect at the time of writing and there have been over 60 other privatizations. Both the Fund and the Bank were heavily involved in financial sector reform.

In contrast to the first two program periods, the terms of trade sharply improved due to a temporary increase in the price of coffee. Between 1992/93 and 1994/95, there was an improvement of 76 percent. The Fund and the government were concerned that such a large favorable shock would cause powerful real exchange rate appreciation or inflation, and so introduced a stabilizing export tax. In the event, this raised little revenue. However, neither of the concerns proved well-founded: the private sector sharply increased its savings and investment rates. The liberalization of the coffee sector and the stabilization of the economy had been achieved just in time for the windfall to be well used by private agents. The government reduced the export tax in 1995 and abolished it in 1996. Unlike many governments in similar circumstances, the government was able to contain its expenditures through the temporary windfall.

The record during the liberalization phase has been impressive. Over the whole period 1992-97 the growth rate of per capita GDP has averaged 4.2 percent and inflation 8 percent. Foreign exchange reserves have increased to five months worth of imports despite rapid import growth. The investment risk rating has improved from 5.4 in 1992 to 20.1 by September 1997, a level equal to that of Côte d'Ivoire.

Aggregate Performance: an Assessment

[103] See P. Collier, "Demobilisation and Insecurity in Uganda", *Journal of International Development*, 1994.

Over the decade 1986-96 the Ugandan government transformed the economy with per capita GDP increasing by 40 percent. To an extent this remarkable performance was made easier by the disastrous decline which preceded it. However, the government achieved both stabilization and substantial decontrol. By the end of the period, private investors were regarding Uganda as a credible location.

The Ugandan stabilization and adjustment programs were relatively unproblematic because there were no features of a transition economy: there was no large, heavily protected import substitute sector which would become unviable through liberalization, and the public sector was small.

After the preceding years of economic disorder a highly flexible informal economy had developed. Prices therefore responded rapidly to policy changes and there was a large natural safety net for those displaced by reform. The major category of those who lost from reform, those civil servants who lost their jobs, had already largely learnt to live from the informal sector because their official salaries were below a living wage. Thus, the social costs of adjustment were unusually low.

However, for most of the period policy change conferred only limited benefits on many of the poor because of their initial dependence upon subsistence. The liberalization of cash crops had limited beneficiaries because only a minority of rural households grew coffee, and its importance in the rural economy had greatly diminished as a result of the retreat into subsistence. Fiscal policy did not always assist the reversal of this process. First, although coffee taxation was abolished, trade taxes were little reduced. Rather, there was a shift from the taxation of exports to that of imports. Analytically, these are broadly equivalent in their incidence, both being borne by the export sector (i.e., coffee farmers), although the taxation of coffee has a more transparent incidence than the taxation of imports. Hence, the shift to import taxation appeared to confer benefits on the export sector, while largely failing to do so.[104] Second, the massive increase in the taxation of petroleum will to an extent have offset the decline in transport costs in rural areas which have resulted from other aspects of the programs, notably better roads and greater competition.

A further reason why reform may not have conferred substantial benefits on the poor is that the poor are concentrated in agriculture, Uganda being one of the most rural societies in the world. Other than improving transport and raising coffee prices, the government interventions in agriculture were limited. For example, only 11 percent of rural households reported ever having

[104] In trade theory this is known as the Lerner Equivalence Theorem.

been visited by an extension worker,[105] and there are cases of old cotton seed being distributed to farmers. This reflected the collapse of the extension service in the pre-NRM period.

Distributional Effects

Over the decade 1986-96 per capita GDP grew by 40 percent. Growth was sustained throughout the decade (Table 2), with the most rapid growth being in the last five years. With such strong aggregate growth it would be expected that there would be room both for rising household incomes of most major social groups and for rising social expenditures. We consider incomes and social expenditures in turn. A notable feature was the shift from private to public expenditure. The share of public expenditure in GDP more than doubled over the decade, financed partly by extra revenue and partly by aid.

Incomes

The private component of GDP grew in per capita terms by 31 percent over the decade. As a result of rising aid and private capital inflows, private expenditures were able to grow much more rapidly than this, namely by 48 percent. Here, however, we focus on income.

There have been three household surveys within the period, conducted in 1988/89, 1992/93 and 1994/95. Between them, these thus span much of the reform period. However, unfortunately, they present severe problems of comparability. We adopt two approaches. First, between 1992 and 1995, the surveys are comparable. In Table 1 we show the resulting headcount measures of moderate and severe poverty. In both rural and urban areas over this period, there was a substantial fall in both measures of poverty. Second, taking the longer period, we can avoid the problems of comparability to some extent by using, from each survey, not the income levels but only the ratio between urban and rural incomes. Taking total private income from the national accounts rather than from the surveys, we arrive at the income series shown in Table 1. These results suggest that urban per capita incomes increased rapidly, by almost 60 percent over a six-year period. Rural incomes, by contrast, on this measure virtually stagnated, rising by only 4 percent. For the sub-period 1992-95, the two measures show rather different results. If the headcount series are right, it seems likely that rural incomes rose more rapidly than implied by the indirect inference from national accounts. There is some reason to consider the headcount measure as more reliable.

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[105] CIET International, "Baseline Service Delivery Survey in Support of Results Oriented Management in the Uganda Institutional Capacity Building Project", Report for UNICEF, 1996, p. 31.

Although (as everywhere in Africa) urban incomes were higher than rural incomes, at the start of the period there was less difference in Uganda than in most other societies. The modern economy, both public and private, had been so eroded that the structure of incomes of urban households was similar to that of rural households: few urban households depended upon wage income, and most of them had incomes from farming.[106] The headcount index of poverty for rural households showed 46 percent in poverty in rural areas and 13 percent in urban areas. Thus, a substantial number of urban households were poor. However, the divergence of urban and rural incomes over the reform period must have substantially reduced urban poverty (proportionately), substantially more than rural poverty.

There is also some evidence that by the mid-1990s within rural areas incomes were markedly higher in those areas closest to the urban economy. The rural area closest to the urban economy was the Central Region. As a percentage of rural incomes in this region, the rural incomes in the Northern, Eastern and Western Regions were estimated as 51 percent, 54 percent, and 62 percent, respectively.[107]

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[106] A. Bigsten and S. Kayizzi-Mugerwa, *Economic Development in Uganda, 1960-90*, London: Macmillan, forthcoming.

[107] UNDP, *Uganda Human Development Report, 1997*, Appendix 2, Table D.

Table 1: Rural and Urban Per Capita Private Incomes, 1988/89, 1992/93 and 1994/95

	1988/89	1992/93	1994/95
Rural (index)	100	101	104
Urban (index)	100	130	159
Urban/Rural	2.1	2.7	3.2
Headcount of poverty:			
Rural poor	-	49.2%	43.5%
Rural very poor	-	13.1%	6.4%
Urban poor	-	10.9%	9.0%
Urban very poor	-	1.9%	1.0%

Note: Urban/rural ratios are from *Uganda National Household Budget Survey, 1989*, for 1988/89, and for 1992 and 1994 from *Background to the Budget, 1997*, Table 27. For 1994/95 we take the average of the first and second monitoring surveys. We estimate the growth in private per capita income for the survey years from per capita GDP (Table 2), adjusted for the share of GDP accruing to the public sector as revenue in each fiscal year. The headcounts of poverty are from Tables A2 and A4 of *Poverty Trends in Uganda,1989-95*, Discussion Paper No. 1, May 1997, Department of Statistics. Note, this source also gives data for 1989-92, but these are not comparable and so we do not report them.

Social Service Provision

Recall that per capita GDP grew by 40 percent over the decade. We have also noted that total government expenditure rose substantially as a percentage of GDP, financed partly by higher revenues and partly by increased aid. Over the decade the share of the government in national expenditure more than doubled, although from a very low base. The division of public expenditure between the recurrent and development budgets was fairly volatile, but over the decade as a whole there was a small shift towards the development budget. Despite this shift, per capita recurrent expenditure rose in real terms by 166 percent (Table 2). This evidently provided considerable scope for increased social expenditures. We now consider health and education expenditures in turn.

As a result of decentralization, total government expenditure on health and education cannot presently be determined post 1994/95 since there is uncertainty about the expenditure patterns of the districts.

Prior to the decentralization the share of the recurrent budget allocation to the health sector rose between the beginning and the end of the decade, although there was no steady trend (the first line shown under *Health* in Table 2). Hence, the health sector benefited both from the strong growth in the total recurrent budget and from an increasing share. However, offsetting this, the price of health care services rose substantially more rapidly than average prices across the economy.[108] Hence, a given amount of health spending bought a smaller quantity of health services. This was partly because of the rising wages of workers in the health sector and partly because of the depreciation of the exchange rate, which raised the cost of many material inputs. This effect was large: costs of health services rose by 65 percent relative to average prices (the second line under *Health* in Table 2).

Despite this increase in relative costs, the provision of health care per capita increased substantially in real terms, more than doubling on our estimate (shown in the third line under *Health* in Table 2). There is also some evidence that the increased provision was disproportionate in terms of non-wage material inputs. The number of health workers per capita rose by only around 10 percent. This is shown as value-added per capita in the fourth line of the Table. This suggests that health workers were becoming more effective, since they were better supplied with inputs such as drugs and vaccines.

Turning to direct measures of performance in the health sector we can see such a change. For example, the proportion of children receiving full immunization rose by nearly 60 percent over the decade (from a coverage of 31 percent to one of 49 percent).

However, direct measures of health states of the population show a less satisfactory picture. The proportion of children who are malnourished on various measures shows no systematic improvement. This is consistent with the evidence on rural incomes which, as we have seen, suggests little change.

We now turn to education. Unlike in the health sector, prior to decentralization there was no systematic increase in the share of education in the recurrent budget. Indeed, other than for a large increase between 1986 and 1987 (which precedes the SAF program) there was a substantial

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[108] That is, the GDP deflator for the health sector rose relative to the GDP deflator for the economy.

decline in its share. This will have been at least partially reversed by the move towards universal primary education (UPE) in 1997, but data are not yet available.

As in the health sector, the price of providing education service rose substantially relative to other prices (this is shown in the second line of Education in Table 2, with an increase of 68 percent). Combined with the declining share of the recurrent budget, this was sufficient to reduce the provision of educational services per capita. As shown in line three of Table 2, this tended to decline from 1987 onwards. This is borne out by the decline in the enrollment rate for primary education which also deteriorated prior to the move to UPE.

Again as in the health sector, there is some evidence of an increase in the inputs available per teacher: output per capita tends to increase more than value-added per capita. This is supported by some direct evidence on the number of books per pupil which tripled over the period, although there has presumably been a recent deterioration as a result of UPE.

In summary, the provision of health services has improved while that of education services has been erratic prior to UPE. However, the level of service provision remains extremely poor. A major reason why service provision did not improve more despite increased recurrent expenditure was that the costs of provision rose relative to other prices. This was broadly reflected in health and education outcomes: health outcomes such as vaccinations improved, while educational outcomes such as primary enrollments until recently deteriorated.

A further reason why health and educational outcomes might be poor despite increases in expenditures is that only a fraction of budgetary releases from the central government actually reach the rural population. A study which tracked the vote for non-salary primary education from its release by the Ministry of Finance through to the primary schools found that only 36 percent of the vote was received by the schools.[109] Moneys were retained by higher levels in the educational administration. Finally, professional standards had collapsed in public service delivery: teachers were not inspected, and medical workers diverted supplies to their private practices.

Thus, despite the very large increases in overall real recurrent expenditures, social provision improved relatively little. This was made more serious by the heavily skewed distribution of the direct benefits in terms of the growth of private incomes. The rapid aggregate growth was largely

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[109] Economic Policy Research Centre and Management Systems and Economic Consultants Ltd., “Tracking of Public Expenditure on Primary Education and Primary Health Care”, June 1996.

confined to the urban economy. Urban households experienced large gains in income, whereas rural incomes virtually stagnated.

Table 2: Social Indicators, 1986-96

	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996
Real recurrent expenditure per capita:											
GDPpc	1000	1038	1081	1118	1146	1172	1183	1218	1301	1371	1396
tot/GDP	9.2	11.6	10.7	13.5	15.6	22.5	19.8	20.1	18.4	19.2	19.3
rec/tot	62.5	54.9	66.5	56.2	48.2	55.5	45.0	47.8	54.4	55.8	57.0
rec.pc.	1000	1138	1328	1466	1483	2517	1810	2017	2241	2534	2655
Health											
% rec	3.2	3.5	4.0	4.6	5.4	-	5.1	4.8	4.5	-	-
deflator	1.00	0.88	0.95	0.93	1.37	1.64	1.57	1.76	1.51	1.58	1.65
output.pc	100	141	175	227	183	-	184	172	209	(226)	(226)
val.add.pc	1.7	1.7	1.7	1.7	1.7	1.8	1.8	1.9	1.9	1.9	1.9
vaccinations:											
BCG			70							83	
DPT3			38							63	
Pol3			38							62	
Measles		49								61	
full immun.			31							49	
stunting m/s			43							38	
underweight m/s			23							25	
wasting s				2							5
infant m						122				97	122
rural safe water %					19	25	28	32	36	39	
Education											
% rec		12.9	19.7	15.1	14.9	16.7	-	14.1	12.0	12.0	-
deflator	1.00	0.82	1.04	1.05	1.29	1.38	1.30	1.75	1.59	1.59	1.68
output.pc	100	212	149	161	149	-	152	107	131	(148)	(147)
val.add.	4.2	4.0	4.1	4.2	4.5	4.5	4.5	4.6	4.5	4.8	4.9
Prim enr.		78	80	81	71	77	69	70	72		
pupils/book				10						3	

Sources: immunizations, nutrition and rural safe water, Government of Uganda and Uganda National Council for Children, `Equity and Vulnerability: a Situation Analysis of Women, Adolescents and Children in Uganda. 1996 a Statistical Update', Kampala, 1996, Figures 3, 6 and 15. Infant mortality, *Uganda Human Development Report, 1997*, UNDP. National accounts: health and education at constant 1991 prices, *Background to the Budget*, 1996 and 1997, Table 2. Primary enrollment, calculated from Government of Uganda, *Statistical Abstract, 1996*, Tables B2 and L1, assuming 3 percent growth of the school-age population. Pupils per textbook from Government of Uganda and Uganda National Council for Children, *op. cit*., p. 23.

Notes: We derive output of health and education by deflating government recurrent expenditures in these sectors by the sector-specific GDP deflator. The value-added for health and education is calculated by deflating current price value-added in these sectors by the same deflator.

Conclusion

Uganda has evidently been successful both in terms of stabilization and growth. Over the decade the economy was transformed from a stagnant, subsistence orientation to fast growth. Although there were continuous Fund programs through the decade, most of the key decisions were taken by the government on its own initiative. This was the case both for highly successful policies, such as the liberalization of the exchange rate, and for potentially disastrous policies, notably the loss of control of public expenditure in 1991. However, the growth was urban-led.

It is not evident how policy could significantly have improved on this outcome. The rural development strategy was based upon the reintegration of the rural economy into the market, through better roads and deregulated markets. In the medium term this strategy can be expected to raise rural incomes substantially. However, in the short term the main way to reach the subsistence economy would have been through the delivery of services. However, the legacy of a large and virtually non-performing civil service precluded effective public service delivery. The government increased real recurrent expenditure massively, but much of this did not reach the poor. Recall that only 36 percent of the non-wage vote for primary schools actually reaches the schools. The government tackled the problem of civil service non-performance in two ways. First, across the board it shed staff and raised wages. However, because of the very large initial size of the civil service this strategy inevitably takes a long time. Secondly, in the one area which both it and the Fund regarded as critical, namely revenue generation, the government by-passed its civil service and set up an independent revenue authority which was reasonably successful. It is possible that this model could have been applied in the field of rural service delivery.

If growth is sustained at recent rates it is very likely that poverty will gradually be reduced. However, to sustain high growth the economy will need to increase the investment rate. To date, there have been many opportunities for growth without investment as the policy environment has been improved: the economy was very far inside its production possibility frontier. To raise investment from the present level of 16 percent to the 25-30 percent range needed for sustained rapid growth, the economy will need to increase its capital inflow, both private and public. To date, the Fund has correctly urged both domestic and external deficit reduction. However, with the stabilization task completed, this can become counter-productive. The public investment program needs to be expanded relative to GDP, yet the scope for further increases in revenue to GDP is very limited in the short term. Indeed, at the margin the major taxes, those on trade and petroleum, are probably a serious impediment to growth. The present strategy of raising tax revenue in order to run a surplus with the banking system may both underestimate the marginal cost of taxation and overestimate the capacity of the new banking system for financial intermediation.

The revenue constraint can be overcome by an expansion in the aid program. Several of the large donors appear willing to provide this expansion, yet the Fund has been planning on the basis of a rapid and substantial reduction in aid dependence. Similarly, with full convertibility and the most rapidly improving investment rating in Africa, Uganda is likely to attract substantially increased flows of private capital. An increased inflow, whether of aid or of foreign investment, will appreciate the real exchange rate. This will directly reduce the incentive for exports and so give rise to a potential trade-off between exports and investment. Fears of this trade-off at present heavily influence Ugandan policy makers. However, it has not been explicitly addressed by the Fund, either qualitatively or quantitatively. Ugandan policy makers note that the exchange rate is seldom even discussed by Fund missions.

This is an example of a more general issue. The ESAF program of 1994-97 was the only one in our sample not to need a stabilization component. It therefore rightly focused upon a development agenda of structural reforms. However, as a result, the scope of policy dialogue between the Fund and the government focused on a range of issues not traditionally within the Fund's area of expertise. The Ugandan government values the continued presence of the Fund, which is potentially of importance not only for advice and resources but also for credibility. However, the role of the Fund in low-income countries outside the context of stabilization requires examination. We return to this in the thematic discussion.

The social impact of the program has had both good and bad aspects. The good aspect is that there have been few outright losers from the reforms. The main exception would be retrenched civil servants, but even here the losses were small because civil service pay was so low that households were not reliant upon it. The bad aspect is that parts of the rural population have yet to gain substantially from the program. Rural poverty has fallen, but proportionately less than urban poverty. The quantitative evidence for this from surveys is consistent with the qualitative assessments of local and foreign NGOs. Social service provision gradually improved with respect to health, but the improvement in education is only very recent.

The government has recently given much greater attention to poverty reduction through a new Poverty Action Plan. A dilemma faced by the government in attempting to target its expenditures more effectively on the poor is that this has to be reconciled with the new decentralization to the district level. While it is possible that decentralization will directly improve targeting through greater local political participation, early indications are not entirely encouraging. Two initiatives which are being considered in order to increase the pressure on district level authorities to deliver social services are the promulgation of minimum standards, so that the population might know what to demand from its local government, and the use of conditional grants by the central government.

THE OWNERSHIP ISSUES - AN OVERALL ASSESSMENT

Uganda presents a rather interesting ownership case which much resembles Zimbabwe's in some respects and Ghana's in almost every respect. For this reason, it is useful to detail somewhat the processes and dynamics that helped the maturation of national ownership. The government of the National Resistance Movement (NRM), under President Museveni, which came to power in 1986, had come out of a protracted guerilla and civil war, had a radical and socialist ideological orientation which was decidedly anti-reform and anti-IMF, and gradually came round to negotiating an ESAF program after a long process of internal debate and consensus-building.

Museveni had attacked the previous government's economic policies and condemned previous stabilization programs as Fund impositions. Accordingly, upon assuming power, he had re-imposed price and foreign exchange controls in the apparent belief that this would help curb inflation. And all this over the vigorous protestations of the bureaucrat reformers in some of the technical ministries. But in an early sign of his openness to debate, the President had shielded these technicians from political victimization and kept them in their jobs.

By end-1986 to early 1987, it had become increasingly evident that the new policies of interventionism were a failure. By May 1987, inflation had accelerated to 380 percent from 120 percent in May 1986, when the exchange rate was revalued, and aid flows had all but ceased. But the apparent failure of these policies, while it did not swing the debate conclusively in favor of liberal reform, discredited the control regime enough to pave the way for a renewed search for alternatives. In 1986, the IDRC, including Ugandans, was commissioned to do precisely that, i.e., to propose alternatives. The team ended up proposing two models, one based on market reforms and the other, on central controls although it advised strongly against controls.[110]

Although dissension within the government continued, President Museveni felt confident enough about the base of his political support to invite the Fund back in early 1987 for discussion and to conclude, in May 1987, a SAF supported by the Bank in the context of a three-year Economic Recovery Program (ERP). The President's confidence was well-founded. By 1987, the government had gained widespread support for restoring peace to the country and although

[110] Lamont, T., 1994, p. 13.

isolated cases of fighting still continued, the policy of amnesty to the vanquished forces had brought about a great deal of reconciliation and improved the security situation, even if it had to bear the cost of a vastly increased army whose numbers jumped rapidly from 14,000 at the beginning of 1986 to over 100,000 in 1990.

It is interesting to observe though and, a cross-section of interviewees did indeed confirm this, that ownership of the program was still very tentative and partial at this stage. Debates within the government still raged and the President himself was not the wholehearted convert that he was to become a few years later.

The government's decision to adopt the 1987-89 SAF was dictated mostly by the need to obtain access to donor funds. Indeed, a 1988 internal Fund document does note correctly of this period that "the authorities were anxious to rally the support of the donor community." One of the most thoroughgoing assessments of the political economy of Uganda's reform experience by the Institute of Development Studies (IDS) confirms this view and adds, in our view, correctly, "Given the lack of government conviction, it is not surprising that no progress was made at first with structural reforms; the liberalization of agricultural marketing, the reform of the banking system, the reform of the civil service, and the reform and privatization of the parastatal sector .... The Coffee Marketing Board resisted pressures to introduce coffee auctions; the government-owned commercial banks ignored liquidity and capital ratios while recklessly expanding their branch networks. The civil service continued to expand and parastatals continued to declare heavy losses. The government persisted with control on the official price of current exchange and continued to direct the lending of the government-owned banks."[111]

Against the background of continuing dissension and debate in government circles over the direction of economic policy between the date of adoption of the SAF in May 1987 and end-1989, Parliament decided in 1989 to bar further devaluation. The key economic ministries themselves were divided, with the Ministry of Finance opposed to market reforms and the Ministry of Planning and Economic Development arguing for them in a rather unusual reversal of roles. In these circumstances, and to help break the impasse and thereby create space for corrective action, the President launched a debate under the auspices of the Presidential Economic Council (PEC), and under his direct chairmanship, in which proponents and adversaries of contending alternative policies were invited to canvass their positions openly and with written presentations which the President himself reportedly read diligently.

The high point of the debate was a national conference convened in December 1989 to debate the issues of exchange rate policy and management. All members of Parliament, trade unions, academics with research interest in the subject, and technocrats in the ministries were invited to

[111] Harvey and Robinson, *Economic Reform and Political Liberalization in Uganda*, Institute of Development Studies, 1995, p. 7.

dispassionately and objectively canvass their positions.[112] The most important outcome of this phase of the debate and one which was to prove a major development in the resolution of the continuing policy stalemate was the shift in the position of the President who had thus far straddled the divide between market and anti-market forces now to the side of the reformers. Of particular importance was the decision to legalize exchange rate bureaux. This decision conclusively resolved the debate on exchange rate policy, leaving still unresolved the issues of fiscal policy and the management of inflation.

The Ministry of Finance supported an expansionary fiscal stance and continued to resist pressure from the Ministry of Planning and Economic Development to curb spending. Once again, the President intervened on the side of the Ministry of Planning and Economic Development when in April 1992, with the rate of inflation accelerating, he removed the Minister of Finance, merged the Ministries of Finance and Planning, and put the merged ministry under the erstwhile Minister of Planning and Economic Development. With this, the government's ownership of the program of reform deepened as the IDS report correctly observes. [113] The relative success of the ESAF programs that followed this period, and the government's success in dealing with the fiscal crisis of 1992 are largely attributable to this deepening of ownership. At the same time, delays have continued to characterize the implementation of those aspects of the program on which disagreement between the Fund and the government persists, notably the areas of privatization, civil service reforms, and defense expenditure cuts.

The Scope of ESAF Support

Although ownership had deepened tremendously by the time of the adoption of the first ESAF in 1989, the scope of support for the program naturally was by no means complete. A number of key members of government still did not share the President's keen commitment to the reforms. This was particularly evident in the first period of the program from 1989 to 1991 during which, as we have pointed out, tensions continued between the Ministry of Finance on the one hand and the Ministry of Planning and Economic Development on the other, especially over fiscal policy. Again, many internal Fund documents make references to government indecision.[114]

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[112] Lamont, 1994: 15.

[113] Harvey and Robinson, *ibid*.

[114] A June 1989 internal Fund document noted that "the authorities were not able to commit themselves to any specific measures" and also makes reference to a draft Memorandum on Economic Policies "which was extensively discussed with the authorities but is not yet fully agreed".

Beyond this phase though, it would seem that the program now enjoyed a broad measure of support well beyond the small circle of highly committed and unusually forceful technocrats in the Ministry of Finance and Economic Planning (MFEP), who had initially carried it with the support of the President. This was due in part to the greater degree of political openness that characterized the political economy of the reform process, especially since the mid-1990s. There is currently a growing perception that government is much more open to dialogue and debate.[115] But this general assessment requires some important clarifications. First, there are new, as well as continuing, tensions within government which have been fueled especially by the re-separation of the Ministry of Finance and that of Planning and Economic Development. Moreover, thanks to this very process of political liberalization, powerful interest groups have emerged that are now capable of influencing policies in significant ways. Pockets of opposition to various aspects of the program undoubtedly still remain. One such grouping is the Uganda Manufacturers' Association (UMA), a group which was largely moribund through the 1970s and early 1980s but which has been revived and now represents a large cross-section of business associations and includes about 400 members.

Thanks to financial support from the USAID and technical assistance from Canada, the UMA is a well-organized group with a credible policy unit that submits policy recommendations and position papers to government regularly. The Association can be a fairly effective lobby as it demonstrated in 1993 when it mounted a campaign against increases in excise duty rates introduced in the 1993-94 budget which took the intervention of the President, and a compromise in the way of a reduction in some of the proposed rates, to resolve. The Association enjoys the patronage and support of the President to whom they have ready access. For this reason, they separate the President from the Minister of Finance and senior officials of his ministry; the President, in their view, consults while the implementers, i.e., the Minister of Finance and his advisors, do not.[116] They have often used this access to great advantage and by their own admission, were instrumental in getting the President to once again separate the Ministries of Finance and Planning because in their words, "the [incumbent] Minister of Finance and his Principal Secretary came from Planning to Finance, and promptly forgot all about plannning."[117]

The future direction of the program and the sustainability of the government's commitment to the program, especially in the areas of fiscal policy, privatization, and financial sector reforms will be influenced significantly by the effectiveness, or otherwise, of the UMA lobby and the outlook of the Minister of Planning whose support for these aspects of the reforms is far from whole-hearted. Another grouping, the Uganda National Chamber of Commerce and Industry (UNCCI), is not quite as well organized and lacks the policy analysis capability of the UMA.

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[115] Interviews, August 1997.
[116] Interviews, August 1997.
[117] Interviews, August 1997.

For this reason, it is not as effective a policy lobby although it has some political influence, especially with members of Parliament.

The Uganda Exporters' Association (UEA), on the other hand, although not quite as organized as the UMA, is more effective than the UNCCI and is capable of militant agitation. In 1994, it organized a short-lived but disruptive protest by coffee exporters against a newly introduced graduated coffee tax. The Association's technical capabilities appear to be improving and their attitude to government would seem to be more positive and less antagonistic than that of the UMA. This disposition, if nurtured by government through active dialogue, can be turned into a useful counterweight to the protectionist pressures from the UMA.

Uganda also has a fairly large number of non-governmental organizations (some estimates put the number at over 800), mostly formed apparently after the NRM government came to power. It would seem that in spite of their numbers, the NGOs are as yet not very influential as a policy lobby, except perhaps in the area of human rights advocacy, a notable exception being OXFAM which, in the past, has campaigned for debt relief. Moreover, tensions between local and foreign-based NGOs have tended to dampen the effectiveness of the NGO community in policy advocacy and if not resolved, will continue to undermine their potential impact on policy.[118]

Another institution whose support for the program is increasingly becomingly crucial is Parliament. In the initial stages of Parliamentary practice, Parliament's role in economic policy making was limited and the Minister of Finance usually got his budget passed by lobbying influential members of Parliament before bringing budget proposals to the full house for debate. It would seem that this has now changed and with the exception of monetary and exchange rate policy, which is left more or less exclusively to the central bank, major economic policy changes, especially those affecting the budget and structural changes like privatization, civil service reform and financial sector reforms, are now subject to much fuller Parliamentary oversight through the work of various Parliamentary committees which review major policy reform proposals and report to the full house which then adopts the proposals through reports of the Parliamentary committee chairmen. Parliament has been particularly active in the implementation of the privatization program; in March 1993, it effectively stopped the implementation of the program on a private member's bill when government sought to implement the program without obtaining the prior approval, by Parliament, of appropriate legislation in the form of a parastatal enterprise reform and divestiture bill. The bill was later to be passed in August 1993 in a closed session of Parliament, under the chairmanship of the President himself and at his prodding. Two members of Parliament sit alongside ministers and others on the Divestiture Implementation Committee which oversees the implementation of the

[118] Interviews, August 1997.

divestiture program generally while Parliament as a whole participates in decisions affecting the privatization of large enterprises, such as the Uganda Commercial Bank. Indeed, Parliament's extraordinary interest in the privatization of this particular bank was brilliantly caricatured in one of the local newspapers while we were visiting Kampala; the cartoon had a number of Parliamentarians standing in front of the Parliament building and threatening that Parliament would not pass a bill sanctioning the privatization of the Uganda Commercial Bank unless the bill contained provisions obliging the government to intervene if the new owners of the bank should attempt to seize the properties of loan defaulters, many of whom apparently were members of Parliament!

Finally, through its Committee on Social Services, Parliament also gets involved in issues of poverty alleviation. Interestingly, the two issues that appear to occupy the majority of members of Parliament are: (1) the sustainability of the reforms when formal arrangements with the Bretton Woods institutions come to an end, and (2) ways of ensuring that poverty alleviation is mainstreamed into the reform program itself rather than through more or less adventitious safety netting. Finally, the most significant, even if unorganized, source of opposition to these reforms are middle to senior level civil servants, and staff of state-owned enterprises who have either lost income from scarcity premia and the perks that came with the administration of economic controls, or are threatened by potential job losses from privatization. In the end, therefore, the sustainability of the reforms will depend crucially on greater consultation by government with business and political leaders and with trade unions whose power is bound to increase with better organization, and also with middle to senior level public sector employees who, for now, feel some dis-affection on account of their marginalization from the gains of the recovery. In this way, the program's longer-term sustainability can be better safeguarded by a reduction of its undue dependence on the role of the President himself.

Authorship of Policies and Agenda Setting

The government's role in setting the policy agenda and authoring major policy documents, especially those in the area of exchange rate reform and to some extent, the area of fiscal policy, has been reasonably strong, especially from the beginning of the nineties when the dissension within government subsided with the conversion of the President to the side of the reformers. In other areas that were essentially products of compromise, areas such as military spending, privatization, and civil service reforms after the initial round of layoffs, the government's leadership in setting the policy agenda and the pace of implementation does not appear to have been as strong. Moreover, given the usual asymmetry in technical expertise between the Fund and ESAF governments, not excluding Uganda, Fund staff input into technical work, especially in the initial stages of the program, was much larger the government's.[119] Even so, the general policy framework of the SAF had been under discussion within government long before the Fund was invited, in early 1987, to negotiate the SAF.[120]

The Promotion of Ownership

The Uganda reform experience, as we have seen, benefited from a great deal of public education and consensus-building initiatives by government. Mention has already been made about the debates and the culminating National Conference that took place in December 1989. Another distinguishing feature of the Uganda reform program in this regard is the role of President Musebeni himself in canvassing support for the program through public speeches, addresses and seminars. Many of these initiatives are reported in various staff reports. Of particular importance is the President's role in defending policies, even in the face of popular opposition and protest rather than opt for the path of political expediency as most presidents are wont to do in such circumstances. Without his personal intervention, for instance, the Value-Added Tax would not have been passed.

On the part of the Fund, a notable initiative for promoting ownership was its proposal to, and acceptance by, government to publish the PFP in 1995.

The Resident Representative

A resident representative has been stationed in Kampala since 1982. Government private sector and NGO representatives interviewed generally had a favorable impression of the role and effectiveness of the incumbent resident representative and the office of the representative mission. In the first years of the program period, Fund missions tended to interact, as is customary, mostly with the government, particularly Ministry of Finance and central bank officials, and importantly, with the President, with whom (according to some staff reports) they had even more extensive meetings on occasion than they had with technical staff. In recent years, however, the mission has met a broader range of people, again as noted in staff reports and as confirmed by our field interviews. These include other ministries than the economic

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[119] In November 1988, for instance, a Fund mission reported that it "prepared several technical notes at the request of the Minister of Finance – e.g., requirements for crop finance, impact of exchange rate changes on the budget, and on domestic prices; revenue enhancement from corporate taxes". Similarly, a 1992 report states "the authorities welcomed the mission's proposal that the Fund staff would prepare for the authorities' consideration, an outline of the main elements of the exchange rate system to be implemented."

[120] Interviews, August 1997.

ministries, committees of Parliament, NGOs, private sector organizations, and UN agencies. Finally, donors appear to be satisfied with briefings by Fund missions.

VIETNAM

Vietnam represents a particularly interesting case from the point of view of its general reform experience, but particularly for the lessons it offers on the issues of ownership, for a number of reasons.

First, market reforms were started long before the Bank and the Fund resumed operations in the country following the termination, in October 1993, of Vietnam's ineligibility to use the general resources of the Fund.[121] Secondly, these reforms took place in a largely war-torn economy. Thirdly, the reforms were started and have continued largely without accompanying political liberalization. And fourthly, the country benefited from a remarkably large program of technical assistance under two UNDP/IMF programs spanning the period 1990 through 1996, with a total of some 25 person-years, and this evidently without any real loss of ownership over the direction of its policy reforms.

The first three-year ESAF program, approved by the Board in November 1994, was preceded by a 12-month stand-by arrangement which was canceled and replaced by the ESAF.

The Ownership and Governance Issues

The first period of reform – which entailed largely stabilization measures – and the follow-up program under ESAF which entailed a larger measure of structural reform – have both been conducted under a highly centralized decision-making system that characterizes Vietnam's one-party political system. Accordingly, Party Congresses have been an important forum for policy making and consensus-building, and contrary to the teachings of conventional (Western) political theory, this has meant, in practice, that decisions are taken after lengthy periods of internal debate, especially at the upper echelons of the party. The decisive landmark in the government's liberalization effort was the decisions taken by the Sixth Party Congress held in 1986 which recognized the need for a fundamental modification of the socialist model of development. These paved the way for the adoption in the ensuing years, of comprehensive measures of stabilization and structural reform.

The stabilization measures of the 1980s and early 1990s brought about a rapid transformation of the economy and thanks to accompanying structural reforms, and expanding flows of foreign

[121] The ineligibility was lifted after Vietnam settled its arrears with the Fund, totalling SDR 100.2 million, with funds arranged by the Support Group for Vietnam and supplementary bridge finance from conventional sources.

direct investment (FDI), have helped to achieve spectacularly high rates of growth with an expanding and increasingly diversified export base.

The first phase of the go-it-alone reforms was characterized by a high level of government support and commitment although, of course, there were some in the party leadership who were less than enthusiastic in their support.[122]

Government leadership in setting the agenda and determining the pace of reforms was clearly decisive in this initial phase. Policies were adopted by government after thoroughgoing debate and without any external pressures although government sought technical assistance from varied sources, including the Fund, whose technical opinion it often sought in the framework of the intensive collaborative approach. Such technical assistance and advice merely aided the process of decision-making without determining its outcome as such.

In contrast, the second phase of reforms has been characterized by an unmistakable slowing down in the pace of implementation and this, against the background of an equally unmistakable erosion of ownership and commitment on the part of the government to the reforms. First, there is a widespread view in government circles that government has lost the initiative in setting the agenda and determining the speed of change. Government officials and key functionaries, interviewed on the occasion of our visit to Hanoi, were at pains to explain that while no policies had been imposed on the government as such, there have been many instances in which government felt it had surrendered to compromises, so as to conclude agreements with the Bank and the Fund in the full knowledge that they risked the prospect that opponents would maintain their reservations through the implementation period.[123]

There is the added factor that the reforms in the ESAF period have been largely in the nature of structural changes – privatization, tax reform, trade liberalization – whose political economy is usually more difficult to manage in any political situation than purely macroeconomic reforms. Naturally, in a country that had had no previous experience whatever with market reforms, and

[122] In 1990, a leading Vietnamese official expressed his hope, that the successful implementation of the intensified collaborative approach "will disperse suspicion of the Fund among various circles in our country".

[123] In an interview with the Governor of the State Bank of Vietnam, a leading figure in government relations with the Fund (who, unfortunately, lost his position a day after we interviewed him but for reasons, we were assured, that had nothing to do with our interview!), we were told that whereas in negotiations with the Fund, consensus was always quickly reached on the general objectives, disagreements invariably arose on specifics, among which he cited tariffs and state-owned enterprises (SOEs) where government often felt that Fund staff came with fixed positions which they merely wished to impose without sufficient understanding of the specific conditions prevailing in Vietnam, especially its long period of state controls in economic management. He added that in these areas of disagreement, there often were "compromises which then run into difficulties in implementation because not everybody is convinced".

in which the closed economy had developed such strong political and ideological roots, it was bound to be even more difficult. Predictably in these areas, the government preferred a more gradualist approach to what it perceived as the Fund's unreasonably fast pace.[124]

It is probable also that the building of support for the reforms and the deepening of the government's commitment to the program may have been compromised by some incompatibility between the tortuous and often protracted nature of the decision-making process and the negotiating style of the Vietnamese government[125] on the one hand, and the time frame and negotiating strategy of the Fund on the other. Vietnamese negotiating teams would typically negotiate after obtaining a mandate from the party on key issues to be negotiated. They would then begin negotiations and in the course of the negotiations, provide briefings as required to the party, and when necessary, seek fresh mandates for such concessions as needed to be made. The internal negotiating process is thus often protracted and rather unhurried and, as the Fund missions for their part, are always unavoidably time-bound and also mandate-constrained, there is often a rush to conclude discussions which then result in compromises that have little support within government.

In the area of privatization which is perhaps the most difficult in the policy agenda for the continuing reform,[126] the pace of reform has been hampered, not only by opposition from workers and management for the usual reasons, but also by the absence of a clear legal framework. For some reason, in Vietnam, and in most other ESAF countries undertaking programs of public sector reform, the privatization process has always begun before an appropriate legal framework in the form of a divestiture implementation or state enterprise law is passed, clarifying not only the institutional framework but also ownership rights in the case of Vietnam. Indeed, a number of officials interviewed pointed out that one of the reasons for the difficulties encountered in the public sector reform program was precisely that the government's own guidelines for the program were unclear.[127]

Our sense is that the implementation of the privatization program will now move more smoothly, as a number of officials pointed out, because these initial difficulties have been mostly overcome. First, there is broader support among management and workers of the affected enterprises, thanks

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[124] The government's preference for a more gradual approach to privatization and for the transfer of user rights rather than of property rights to private citizens, was not lost on the staff as this was alluded to in a number of internal Fund documents. But this did not stop the staff from maintaining pressure on the government to accelerate the pace of reform. The result inevitably was delay in policy implementation.

[125] It is a negotiating strategy that has been influenced, not only by the centralized nature of decision-making in Vietnam but also by the long history of Vietnam's participation in the COMICOM system which is notorious for interminable horse-trading.

[126] There are over 6,000 state-owned enterprises on the agenda of the reform.

[127] Interview with the Governor of the State Bank of Vietnam, Hanoi, September 27, 1997.

to initiatives by government to explain the objectives and allay their concerns. Second, there are more specific and clearer guidelines from government on the program. And third, the program which used to be under an Enterprise Reform Committee before, is now under the Ministry of Finance which has greater experience in managing state assets and probably has a keen eye on the resources that can be mobilized from their privatization.[128]

The Consensus-Building Process

The effectiveness of the processes of consensus-building is obviously an important factor influencing the extent of government commitment and public support for policy reform. In Vietnam, the process is played through the various layers of the party, culminating in debates in the Party Congress and in the National Assembly. The Party Congress sets out major policy directions for socio-economic development; the National Assembly is the Supreme law-making body which, in addition to the passage of laws, approves major objectives and targets for economic development programs, including growth rates and other macroeconomic targets and budget projections for both recurrent and development expenditure; the government is the executive body responsible for formulating and implementing specific policy measures aimed at realizing the broad directions and goals set by the Party Congress and the National Assembly. There is, of course, the electorate whose voice and leverage are important in the politics of the party. [129] In the most recent elections held in the last week of September 1997, a new leadership representing this tendency and headed by President Tran Duc Luong and Prime Minister Phan Van Khai, was elected. This change in leadership holds great potential for an acceleration in the pace of reforms, and a strengthening of the government's commitment to the Fund-supported reforms.

Authorship of Program Documents and Policy Initiatives

As we have already noted, government ownership of the reform agenda was particularly strong in the first years of the program of reform, with the government itself clearly defining the agenda, in spite of the extensive technical assistance which it sought and used in the development of the policy framework in many areas.[130]

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[128] Interviews with officials with the Ministry of Planning and Investment, September 29, 1997.

[129] A leading national newspaper commenting on the election of this new team noted correctly that "unlike their predecessors who spent most of their lives in an atmosphere of battle, with the two wars going on, first between Vietnam and France, then between Vietnam and the United States, most members of the newly elected leadership have been carefully trained at professional institutions at home and abroad." (Nguyen Tri Dung, "Lawmakers prepare for the tough times to come", *Vietnam Investment Review*, 29 September – 5 October 1997, p 2).

[130] In 1990, for instance, the Vietnamese government sought the views of the Fund on proposed financial sector reform measures which it planned to put before the Council of Ministers.

Indeed, the government's management of technical assistance and the way it ensured government ownership, even with such extensive reliance on external technical assistance, was especially skillful as a 1995 internal Fund document duly noted. According to this report, "Partly stemming from the authorities' desire for 'ownership' of the program, and the emphasis on institution building, proposals requested from the [Fund's] advisors are usually compared with those made by other donor-assisted technical assistance programs before any action is taken."

Thanks to this same concern for national ownership, the government's participation in the negotiation of the PFP has been particularly active and detailed.[131]

The Resident Representative and Fund Cooperation with Donors and the Bank

The Fund has had a resident mission in Hanoi since 1992. The present resident representative is fairly new. We did not have the opportunity to assess how well established the mission is since our meetings in Vietnam were arranged and coordinated entirely by the State Bank of Vietnam.

Regarding the Fund's relationship with the Bank, although the staff documents describe this cooperation as close, and although numerous documents refer to joint work and the participation of the Bank in discussions with the authorities, there have been conflicts, especially in the coordination of policy on state-owned enterprise reform and banking sector reform, as we have already noted. On a more general level, it would seem that Fund missions have not always fully involved Bank resident mission staff and consulted them adequately on issues of mutual interest such as, for instance, those of privatization and banking sector reforms.[132]

In the view of some staff members, the asymmetry in the levels of authority exercisable by Bank and Fund resident missions – Bank resident missions have greater decision-making authority than Fund resident representatives - makes it difficult to conduct proper dialogue on, and coordinate, policy discussions in the field as conflicts often have to refer to Washington where they are not always resolved satisfactorily. Any strain in relations would be unfortunate as the Bank has been in Vietnam longer and has more in-depth knowledge of the country's economic and political profile which can only be beneficial both to the Fund's resident mission and to visiting missions.

[131] Interviews, Vietnam, September 1997.

[132] Although the Bank staff we interviewed were understandably cautious in their reactions, they cited one recent example in which a Fund mission ignored the Bank's comments and handed in policy recommendations which were at variance with the Bank's position.

ZAMBIA

Introduction

During the first decade of independence, the government built a controlled, state-owned economy with high social spending financed by a booming copper sector. This system was probably the most extreme example on the continent of state involvement in the economy, and was unsustainable except in the context of rising copper prices. The state sector (the civil service and state-owned industries) had little incentive to be efficient and was used as the basis for a massive patronage system.

This inherently unviable system was hit by a large deterioration in the terms of trade. By 1976, the government was seeking assistance from the Fund. Since then, Fund involvement in the economy has been almost continuous.

Program Design

The First Phase of Fund Involvement: 1976-91

Between 1976 and 1986 there were five stand-by arrangements and one extended arrangement, all in support of adjustment. The last two of these programs aimed at limited structural reforms centered on the liberalization of exchange rate and pricing policies. These liberalizations began to be reversed in 1986 and collapsed completely in 1987. By 1987, the economy was subject to intense rationing over a wide range of activities and the budget deficit reached 18 percent of GDP. Between 1976 and 1986, per capita GDP declined by about 25 percent. Within the same period external debt rose by $3 billion.

Between 1987 and 1989 there was no program. The government again began dismantling some aspects of the control regime which it had restored in 1987. By 1989, the Kaunda government again approached the Fund.

An internal Fund document described the Kaunda government's strategy as follows: “In 1989 Zambia embarked upon an economic adjustment program that was designed to create a diversified and market-oriented economy...The Zambian authorities set out to end administrative controls in both financial markets and markets for goods, diversify the economy's export base, rebuild its infrastructure, and exert control over domestic finances.” Given the record, this characterization of government intentions was implausible. Formally, most price controls were lifted, but informally they continued. Parastatals were restructured but little role was accorded to the private sector. “Rather, the authorities intended that the Government would remain the dominant participant in the economy."There is little reason to believe that this program would have been more successful than its six predecessors. Economic events were overtaken by political events and the Kaunda government was heavily defeated in the elections of late 1991. In the run-up to the election the government had increased expenditures considerably, leaving a large fiscal deficit.

The ESAF Phase of Fund Involvement: 1991-97

The new government was elected on a program of radical structural adjustment, but faced an immediate stabilization task. It negotiated a Rights Accumulation Program with the Fund which began in 1992. The program envisaged a reduction in expenditure from 31 percent of GDP in 1991 to 27 percent in 1992. Revenue was to rise from 16 percent to 17 percent and total resources (revenue and grants) from 24 percent to 32 percent, largely on account of additional aid. A complicating factor was the severe drought of 1992. The government devoted 4 percent of GDP to drought-related expenditures, but these were more than covered by an increase in aid of 6 percent of GDP. These plans envisaged a transformation in net borrowing from the banking system from 5 percent of GDP in 1991 to -2 percent in 1992 despite the drought.

The actual expenditure reductions implemented during 1992 were considerably more draconian than had been planned. Non-drought recurrent expenditure excluding interest payments fell from 18 percent in 1991 to 12 percent in 1992. However, this reduction in expenditure occurred in the context of very high inflation and very weak accounting systems. As a result, the government did not recognize the severity of its own expenditure reduction and interpreted the inflation as a symptom of loss of fiscal control. Indeed, in 1993, it introduced a cash budget to regain control.

Contemporaneous with this fiscal adjustment, the government liberalized the foreign exchange market in October 1992 and shortly afterwards the domestic financial market. It has been shown that this resulted in a large, one-off reduction in the demand for money, resulting in the inflation which the government mis-attributed to loss of fiscal control.[133]

Hence, while the fiscal adjustment was dramatic, as a result of the sequencing of structural reforms it did not succeed in reducing inflation. In the first half of 1992, the tight fiscal position had succeeded in reducing annualized inflation from close to 400 percent to less than 50 percent. However, following the liberalization, inflation rose again to nearly 500 percent. Such a level of inflation poses two problems. First, with an open capital account there was a severe danger of hyper-inflation driven by falling real money demand. The introduction of the cash budget

[133] C.S. Adam, "Fiscal Adjustment, Financial Liberalization and the Dynamics of Inflation: Some Evidence from Zambia", *World Development*, Vol. 23, 1995, pp. 735-750.

effectively removed this potential danger by stabilizing expectations: inflation fell to zero within four months. Second, very high inflation erodes the real value of tax receipts. This indeed happened: non-drought revenue collapsed from 18 percent of GDP in 1992 to only 13 percent in 1993. This collapse in revenue when combined with the cash budget, led to a further drastic reduction in expenditure: non-drought expenditure fell from 17 percent to 12 percent of GDP.[134]

There is thus evidence that the sequencing of the stabilization and the macroeconomic components of structural adjustment was mistaken. The exchange rate and financial liberalization's undertaken prior to completed stabilization produced a large step-increase in the price level. If these reforms had been postponed until the fiscal adjustment had completed the process of bringing inflation down they would not in themselves have been inflationary. This is because while the reforms would have made capital flight possible there would no longer have been an incentive for it. Hence, the demand for money would not have collapsed.

The consequence for public expenditure was dramatic: between 1991 and 1993 expenditure halved as a share of GDP. This was massively deviant from program plans and may be presumed to have imposed very high political costs. The problems in achieving stabilization did not prevent the government from proceeding rapidly with the microeconomic components of its structural adjustment program. It started a massive program of privatization, eliminated subsidies, and liberalized trade.

The domestic budget was intended to be partitioned from both debt service and aid. Aid inflows were planned to cover debt service with any surplus aid being used to reduce foreign debt. There was no provision for domestic debt service in the cash budget. This created two ways in which the overall budget could be in deficit even though the cash budget was balanced, and both became important. Due to interruptions in aid inflows the central bank purchased foreign exchange to meet the shortfall in debt service payments, thereby increasing the money supply. The net transfer to Zambia of external assistance declined sharply from $407 million in 1992 to $48 million by 1996.[135] This reflected a fall in debt relief and in balance of payments support partly offset by reduced debt service. The reduction in aid inflows was the result of the dissatisfaction of donors with political developments. Although the initial stock of domestic debt was very small, extremely high interest rates made domestic debt service increasingly significant, amounting to 4.4 percent of GDP by 1994. A third inflationary factor was a bail-out of a failing domestic bank. Between them these three factors maintained inflation at high levels until 1997 despite continued fiscal stringency.

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[134] World Bank, Public Expenditure Review, 1995, Annex Table 5.

[135] Republic of Zambia, *Economic Report, 1996*, Table 2.9. The figures exclude maize provided as drought relief.

A corollary of the rise in inflation, given that interest rates were liberalized, was that there was a squeeze on private sector liquidity. This drove real interest rates to very high levels and appreciated the real exchange rate.

Until 1996 the effect of the stabilization and adjustment programs on GDP was heavily negative: per capita GDP declined over the first four years of the program by 22 percent. However, in 1996 the economy started to rebound, GDP growing by 10 percent.[136] There is evidence of considerable structural change. The growth rate of 10 percent is measured at 1994 relative prices; when measured at 1977 relative prices, GDP growth is much lower (6 percent). This implies that growth has been concentrated in activities which have been favored by the relative price changes brought about by liberalization. Within manufacturing there was a large switch from import-substitute sectors, such as fabricated metal products, to agro-processing activities such as food, beverages, and tobacco. Within agriculture, resource reallocation has been slower but there is evidence of considerable recent crop diversification. In 1997 the area devoted to maize declined by 4 percent, offset by expansions of 52 percent in cotton, 41 percent in groundnuts, and 32 percent in cassava.

The prolonged period of rapid decline must raise questions about program design. However, given the initial configuration of the economy, even with an ideally designed program there was likely to be an initial phase of decline.

Agricultural value-added declined by around a quarter in the first four years of the program. There were four factors accounting for this decline. First, there were three years of drought. Second, the government withdrew public marketing agencies before private agents entered the market. This was to a large extent unavoidable since private agents were deterred by the expectation of renewed government interference in food marketing. Third, the government withdrew the fertilizer subsidy. While at world prices this probably enhanced allocative efficiency, the agricultural response is currently only measured at the highly distorted prices prevailing in Zambia in 1977.[137] Fourthly, the previous system of pan-territorial pricing of maize and fertilizer had encouraged over-production in the remote areas.

While these factors were reducing the economy, the forces of expansion released by the liberalization were initially likely to be atypically weak in Zambia. First, the heritage of the Kaunda era was the restricted size of the private sector, with most manufacturing and all rural trade in the public sector. Although markets were liberalized, there were initially few agents to

[136] This figure is based on provisional National Accounts data, kindly supplied by the Central Statistical Office.

[137] At present only aggregate GDP is available at 1994 relative prices, the sectoral level growth rates are still reported at relative 1977 prices.

take advantage of the new opportunities.[138] There were few private traders: even by 1996 only 40 percent of farmers were within 5 km. of a food market and only about a quarter of farmers received satisfactory information on output markets.[139] There was a lack of farmers in the age groups likely to innovate: Zambia was unique in Africa in the extent of its migration to urban areas, leaving the rural areas denuded of prime-age, educated adults. Second, the rural road network was very poor, having deteriorated through neglect of maintenance. This presented a serious constraint upon the switch from food to cash crops. The bus network gradually improved, but even by 1996, over 40 percent of the rural population was more than 5 km. from a bus. Where the transport network was well-developed, particularly along the line of rail, a substantial switch to new crops occurred. Third, the initial situation was one in which few crops other than maize were grown. Hence, the agricultural sector was producing at a `corner solution'. This specialization implied that there were neither existing growers for the newly profitable crops from whom techniques could be diffused, nor the necessary market institutions. Some coordination was therefore needed between potential growers and potential buyers.

In the event, there were several respects in which the program was not ideal. As we have discussed, there were in our view sequencing errors which delayed the attainment of stabilization. The delay in stabilization produced an avoidable credit crunch which had two serious consequences for the private sector. First, and probably most important, it delayed the emergence of private trading in rural areas, an activity which was vital in view of the removal of public trading, the limited extent of on-farm storage, and the need for changes in the production mix. Secondly, the credit crunch squeezed private investment. A survey of manufacturing firms in 1995 found that three quarters faced liquidity problems.[140] Private investment was also deterred by lack of credibility.[141] In one sense a lack of credibility would be surprising in view of the sweeping structural reforms and massive expenditure reductions. However, the continuing inflation could well be mis-interpreted as a lack of commitment, while the large debt overhang potentially constituted a future tax liability for the economy.

The delay in stabilization also unnecessarily squeezed public expenditures, in particular on maintenance and investment. This reduced the road program which, as we have seen, should have been a high priority in terms of the critical path to renewed agricultural growth. A further error of sequencing was the failure to privatize ZCCM early in the program. The cost of

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[138] In this respect Zambia was similar to transition economies. However, it did not have the other characteristic of such economies: a large sector which was intrinsically uncompetitive at world prices. Zimbabwe was just the opposite, having private agents but a large, uncompetitive manufacturing sector.

[139] Central Statistical Office, University of Zambia and World Bank, "Rural Poverty and Performance of the Agricultural Sector", June 1997, p. 10.

[140] V. Seshamani, "Economic Policy Reforms, Economic Growth and Sustainable Human Development: a Comparative Study of India and Zambia", Institute of Developing Economies, Tokyo, April 1997, p. 50. The data are from the RPED Survey. Comparable data for other African countries show a much lower incidence of liquidity problems.

[141] World Bank, "Zambia: Prospects for Sustainable Growth, 1995-2005", August, 1996.

continued mismanagement of the copper sector was foreseeably high. Fund staff justify program sequencing as follows. What we regard as premature financial liberalization is defended as “the urgent need for liberalizing the economy which had been stifled by controls was so great that the potential short run costs were probably unavoidable’. Conversely, what we regard as unwarranted delay in privatizing the export sector, is defended as “a reflection of the Fund’s flexibility to allow the authorities more time to deal with this highly sensitive issue”.

Distributional Effects

The First Phase of Fund Involvement: 1976-91

We consider in turn the two routes by which a Fund program might have a social impact, changes in incomes and changes in social expenditures.

During this phase per capita GDP declined by a quarter. Against this background, it is to be expected that most social groups would face severe declines in income. Real wages in the formal sector declined to around one fifth of their initial level.[142] Urban household incomes halved while rural household incomes were protected.[143] Since wage earners were much better off than smallholders, and since within the formal sector there was powerful wage compression, there was a considerable reduction in inequality. The ratio of income in the top quintile to that in the bottom, initially very high at 18, narrowed to 9.[144]

By 1991, despite the increased equity, Zambia had a severe poverty problem. The two major socio-economic groups among which poverty was concentrated were smallholders and urban wage earners. The two groups were of similar size and accounted for around 87 percent of the population. The incidence of poverty among smallholders was double that among wage earners: 81 percent as against 42 percent.[145] Although urban wage earners had borne the brunt of the income decline during the period, the poverty problem remained concentrated among smallholders who accounted for two-thirds of the poor.

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[142] Source: UNFPA, Lusaka, `Background Information on Population and Development Issues in Zambia', 1997.

[143] Central Statistical Office, *Household Budget Survey 1993/94*, Vol. 1, Table 1.3. We have compared data from the 1974/75 Household Budget Survey with the 1991 Prices and Incomes Commission Survey, assuming that the ratio of metropolitan/urban households and of non-metropolitan/rural households was the same in 1991 as in the 1993/94 Household Budget Survey.

[144] *World Development Report*.

[145] Source: Central Statistical Office, *Social Dimensions of Adjustment, Priority Survey 1, 1991 Report*, 1993, Table 11.4. The poverty line is nutritionally based.

Health and education spending sharply declined even relative to GDP (Table 1). In conjunction with the decline in incomes, this produced a deterioration in most of the health-related social indicators. Whereas at the beginning of the period the social indicators for Zambia had been much superior to the African average, by 1991 they had deteriorated to below the average.

In summary, during the first period of Fund involvement there was a severe fall in income and a deterioration in social indicators. Poverty was concentrated among the rural population.

Table 1: Social Indicators, 1976-91

	1976 (or nearest)		1991 (or nearest)	
Health				
health spending	100	(1981-85)	45	
quality of hospital care	12	(1978)	44	
stunting	37%	(1970-72)	40%	(1992)
underweight	23%	(1970-72)	25%	(1992)
wasting	5%	(1970-72)	5%	(1992)
infant mortality	135		107	(1992)
child mortality	180		190	
life expectancy	50	(1980)	47	(1992)
Education				
education spending	100	(1980)	60	
primary school enrollment	80%		70%	

Sources and definitions:

health spending: index of spending in constant prices per capita, from World Bank, Zambia Poverty Assessment, Vol. 1, p. 95.

education spending: index of spending in constant prices per capita, from Government of Zambia and United Nations, *Prospects for Sustainable Human Development in Zambia*, 1996, Fig. 5.8.

quality of hospital care: malaria deaths per 1000 hospital admissions, from *Prospects for Sustainable Human Development in Zambia*, Fig. 5.6.

primary school enrollment: for 1976, percentage of children aged 7-14 attending school, from Ministry of Education, *Educational Statistics*, 1976, Table A13; for 1991, percentage of children aged 7-13 attending school, from *Social Dimensions of Adjustment*, *op. cit.*, Table 7.1.

The ESAF Phase of Fund Involvement: 1991-97

The program explicitly considered the social consequences both of the reforms and of the contemporaneous drought. The measures envisaged included the distribution of maize, largely in rural areas, either at a 50 percent discount or free. Part of the savings from the removal of urban consumer subsidies were earmarked for welfare programs for the rural poor. There were also labor-intensive public works programs for the creation of infrastructure in poverty-targeted rural public services. The share of health and education expenditures in the budget was raised. However, in view of the scale of the reduction in public expenditure, the protection of social expenditures was inevitably going to be difficult.

Again we first consider the impact of the program on incomes. Per capita GDP declined by 22 percent between 1991 and 1995, rising by 7 percent in 1996. We focus mainly upon snapshots of the economy in 1991 and 1996 over which period it declined by 16 percent.

Recall that as of 1991 the major poverty group was smallholders. Somewhat surprisingly, real wages in the formal sector appear not to have declined between 1991 and 1996.[146] However, urban household incomes nevertheless declined because of the reduction in formal sector employment opportunities. Urban formal sector jobs declined by around a quarter relative to the urban workforce.[147] Formal sector employment was atypically important as a component of income in Zambia because of the suppression of informal economic activity. We estimate that in 1991 it accounted for around 56 percent of urban household incomes.[148] Hence, had per capita informal sector income been constant, mean urban household income would have fallen by around 14 percent. This may exaggerate the decline in urban incomes because the informal sector rapidly expanded.

Smallholder value-added per capita declined by 13 percent during 1991-96. Hence, comparing the two major social groups in the two snapshot years, 1991 and 1996, both appear to have experienced income losses of around 13-14 percent, a magnitude which is corroborated by the national accounts. However, the path between these snapshot years was probably very different for the two groups. Smallholder income was markedly lower than in 1991 and 1996 partly because of three droughts. Between 1991 and 1994, rural household incomes fell by around 30 percent whereas urban incomes rose slightly.[149]

This picture of fairly equally shared losses by the end of the period with rural households bearing the brunt of the larger intervening losses is broadly supported by the evidence from self-assessment. Asked whether living standards were higher, the same, or lower in 1996 than in

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[146] Real mean earnings of central government workers remained constant between December 1991 and June 1996. In local government, parastatals and the private sector real mean earnings rose, but this may be a statistical artefact because of compositional changes, notably the privatisation of parastatals. Compositional changes are unlikely to account for the constancy of central government wages. However, it should be noted that calculations of real wages over periods of very rapid inflation are liable to be subject to wide margins of error.

[147] In absolute terms, formal, non-agricultural employment declined by 12 percent. There are no data on urban population growth over the period and we assume, conservatively, that it grew only in line with the national population, at 3 percent per annum.

[148] Urban employment in 1991 is taken from the *Quarterly Digest of Statistics, 1996*, Table 47 (excluding agriculture). Average earnings in December 1991 are from the *Quarterly Employment and Earnings Statistics*, June 1992, Table 2. This gives an estimate of the urban wage bill at the end of 1991 of K 3721 million per month. Mean urban household income and the number of urban households for 1991 is from Social Dimensions of Adjustment, 1991, Priority Survey Report, Table 9.1. This gives monthly urban household income as K 6700 million.

[149] *Household Budget Survey 1993/94*, Table 1.3.

1991, urban respondents split 36 percent-27 percent-37 percent, whereas rural respondents split 23 percent-28 percent-49 percent.

We now turn to the provision of social services. Government spending on health and education increased as a share of GDP. As a result, per capita spending on health and education increased in value terms (i.e., deflated by the GDP deflator) despite the fall in per capita GDP. However, the cost of providing the services rose relative to the GDP deflator. These services were labor-intensive and by protecting the real incomes of its workers at a time when productivity across the economy was falling in terms of consumption goods, the government increased their cost. Table 2 shows these divergent effects. The volume measure is derived by deflating expenditure by its own GDP deflator, which is dominated by government wages. The value measure is derived by deflating by the aggregate GDP deflator. Table 2 presents a third measure, namely, value-added (rather than government spending) in the health and education sectors, deflated by the sector-specific GDP deflators, as in the case of the volume measure.

For health care, both volume measures decline. However, the value series shows a substantial increase, hence, the government was devoting more of the economy's resources to the health sector but this was producing less. As elsewhere in Central Africa, over the period, the need for health care was rising because of the incidence of AIDS and by 1992, AIDS-related illnesses accounted for 43 percent of in-patient days in hospitals.[150] The evidence on the indicators is mixed. The access of the rural population to health facilities, drinking water, and latrines improved, but there is evidence of increasing malnutrition. This is not surprising given the fall in incomes.

Cost recovery had started in 1989 and was extended in 1993. In rural areas this was not a good time to implement cost recovery. The rural population had faced a depletion of its real cash balances as a result of inflation, and was not in a good position to replenish them in view of the drought and the breakdown of the marketing system.

For education the two volume measures also show a decline, but in this case there is considerable divergence between them. The most likely reason for this is that expenditure for school books and other materials fell relative to the wage bill. This would reduce the expenditure measure (a gross output concept) relative to the value-added measure. Pupil textbook ratios in primary

[150] Foster, `Cost and Burden of AIDS in the Zambian Health Care System', 1993, cited in O.S. Saasa, `Capacity Building for Economic Development in Zambia: Challenges and Prospects', consultancy study for the World Bank, 1996.

education currently range between 5 and 50.[151] As with health care, the government was devoting more of the economy's resources to the sector, reflected in a substantial increase in the value measure, but this was purchasing reduced services.

The outcome measures show that enrollment was stable in urban areas and increased a little in rural areas. Although we lack quality indicators, there must be a presumption that in view of the decline in material inputs the quality deteriorated.

In summary, there was in this period a sharp fall in per capita income. While urban wages were protected, formal sector employment contracted. Both urban and smallholder incomes fell in per capita terms by about 13-14 percent. 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, since poverty was initially concentrated in the smallholder sector, it is the losses in this sector that 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. Part of the increase in malnutrition was presumably due to the series of droughts during the adjustment period. However, drought relief programs were quite effective, and there are identifiable failures in safety net design for those adversely affected by the adjustment.

There were several channels through which these adverse effects arose. First, the removal of the fertilizer subsidy reduced food production. While in the long term this will improve allocative efficiency and thereby income, in the short term it reduced food consumption. There was no automatic mechanism directing the resources released from the removal of the subsidy to rural households. Second, the removal of pan-territorial pricing abolished the implicit subsidy on maize production in the remote areas. Third, the previous subsidy system had implicitly discouraged on-farm storage: farmers could purchase milled grain for less than they could sell their unmilled grain. Fourthly, the removal of the public marketing system created an interval in which there were too few private marketing agents.

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[151] Saasa *et al.*, *op. cit*., p. 59.

Table 2: Social Indicators, 1991-96

		1991		1996
Health				
budget actuals per capita (volume)		100		91
budget actuals per capita (value)		100		127
health value-added per capita (volume)		100		85
Rural				
households within 5 km. of health facility		42%		52%
households with clean drinking water		20%		31%
households with pit latrines		50%		63%
incidence of stunting		46%		52%
children under-weight		25%		27%
incidence of wasting		5%		5%
Urban				
households within 5 km. of health facility		92%		100%
households with clean drinking water		90%		88%
households with pit latrines		49%		51%
incidence of stunting		35%		41%
children under-weight		20%		19%
incidence of wasting		7%		6%
National			1994	
vaccinations:	BCG	96	100	
	DPT3	91	86	
	OPV3	90	90	
	measles	89	89	
	full	67 (1992)	78	
Education				
budget actuals per capita (volume)		100		72
budget actuals per capita (value)		100		124
education value-added per capita (volume)		100		85
rural primary school attendance aged 7-13				
	boys	60%		62%
	girls	59%		63%
urban primary school attendance aged 7-13				
	boys	82%		81%
	girls	82%		81%

Sources: Central Statistical Office, "Some Major Changes in Living Conditions in Zambia, 1991-96"; vaccinations: Government of Zambia and United Nations, *Prospects for Sustainable Human Development in Zambia*, 1996, and Central Statistical Office, Ministry of Health and Macro International Incorporated, *Zambia Demographic and Health Survey, 1996*, 1997; health and education volume measures from National Accounts data on GDP in education and health (in 1994 prices), corrected for population growth assumed at 3 percent per annum.

These changes affected particular groups of farmers differently. The loss of the fertilizer subsidy affected all farmers. Farmers in remote areas had to adjust to a situation in which maize was only economic as a subsistence crop, but as a subsistence crop it required on-farm storage, which was lacking. For them, the absence of grain traders was not a temporary phenomenon but a new permanent feature. In other areas maize would remain economic as a cash crop so that the absence of private traders would be only temporary. During the phase in which markets were developing in these areas, market access would be unreliable and so they also would face a storage problem. These effects were predictable and hence had implications for program design. In the remote areas there was a clear policy problem: more on-farm storage was required than was initially available. There was a need for a targeted program supplying these farmers with on-farm storage facilities. In other areas the best that the government could do was to facilitate the emergence of private marketing, and the concomitant commercialization of smallholdings through diversification into new crops. This would involve road repair and targeted extension advice. The first step in improving extension advice would be to retrain extension workers. The focus of the service was initially the maximization of maize yields and needed to be switched to the maximization of agricultural income.

Conclusion

Zambia has had an unusually long relationship with the Fund in the area of adjustment. We have grouped the various programs into two phases, corresponding to the previous and current governments (1976-91 and from 1991 to the present).

In the first phase the economic philosophy of the government was fundamentally antipathetic to the liberalization of the economy. As a result, Fund and donor involvement led to the accumulation of massive debts and a record of failure in both stabilization and adjustment. Although the present reform program was begun in the final years of the Kaunda regime, there seems little reason to expect that it would have been sustained had it not been for a change of government.

The debt overhang has had consequences for the current program. While at the time the new government took office there was an understanding that the donors would meet debt service obligations, political concerns have led to sporadic interruptions in donor support, worsening the stabilization problem.

There have been three weaknesses in the design of the current program. First, the move to capital account convertibility and interest rate liberalization prior to the attainment of stabilization created an avoidable bout of inflation which had multiple adverse effects. It created a credit crunch in the private sector, delaying the emergence of rural food markets and reducing the private investment required for structural change. It induced the government to reduce expenditures far in excess of program plans, while creating the impression that it was fiscally irresponsible. Secondly, the structural reforms needed to be sequenced in a particular way in order to produce growth. Two important sectors, copper and agriculture, needed early policy attention. Reform of the copper sector required the privatization of ZCCM, a policy which has still not been implemented. Given the fundamental importance of the copper sector this was a major error. Agricultural growth required early improvement of rural roads and the refocusing of the extension service to new crops.

Finally, although there was some discussion of safety nets in program design, the scale of resources was not commensurate with the problem. Further, insufficient analytic attention was paid to the identification of target groups. In the health sector, user charges were extended at just the time when the rural population was facing a serious liquidity problem. In the education sector, the squeeze imposed through the cash budget reduced non-salary relative to salary expenditures, as a result of which the availability of teaching materials declined. Identifiable groups of smallholders were adversely affected in ways which could have been better offset. Smallholders in remote areas had to make a transition into maize subsistence and urgently required assistance in building up on-farm storage capacity. In more accessible areas the transition to the private market could have been accelerated by increased road maintenance and refocusing of extension.

ZIMBABWE

Introduction

By the late 1980s, the government of Zimbabwe had come to regard its development strategy as unsustainable. This strategy had two core components. One, inherited from the UDI regime, was an extensive system of economic controls to support industrial autarky. The other, initiated by the post-independence government, was a massive redistributive system of social expenditures: notably high levels of health and education expenditures. The former strategy was condemning the economy to slow growth. As a result, the latter strategy was seen as becoming fiscally unsustainable.

The control regime had resulted in a very large and diversified industrial sector serving largely the domestic market. By 1990, manufacturing accounted for a quarter of GDP. The export sector had stagnated because the same control regime which sustained the industrial sector implicitly heavily taxed the export activities. Since there was no scope for further import substitution, industrial growth depended upon growth elsewhere in the economy. However, since the export sector was handicapped by the policy regime, the only dynamic component of the economy during the 1980s had been the public sector which became fiscally constrained. Hence, the government was in our view correct to regard economic policy change as being necessary for faster growth.

Many of the existing industrial firms produced inputs which would be needed by potential export activities. Many of these firms were producing at high cost and were intrinsically uncompetitive at world prices. Hence, export expansion required the demise of these activities. The peculiar industrial structure of Zimbabwe thus left no option for continued protection: in order to make viable the activities with the potential for growth, the existing industrial sector had to contract. This made the reform process in Zimbabwe more analogous to that in the transition economies than that in the rest of Africa: the first years of reform would be likely to be contractionary. In the event, between 1991 and 1996, manufacturing output contracted by 14 percent.

The economic control regime inherited from the UDI period had been extended to cover the labor market by the post-independence government for redistributive purposes by means of minimum wage rates and employee rights. Minimum wages were sharply increased in the early 1980s. To prevent firms shedding labor in response to the increase in wages, employee rights were introduced with severe restrictions upon firing. While these changes redressed an inherited imbalance of power in the workplace, over time they reduced employment. There is evidence that employment declined significantly as a result both of higher wages and of restrictions on firing.[152] Hence, reform was necessary for enhanced growth. However, the short-term effects of removing employee rights was likely to be a reduction in employment as firms shed workers that were surplus to existing requirements. Therefore, as with trade policy, the effect of reform on employment while ultimately positive was likely to be negative in the short run.

The core of the government's redistributive agenda was through increased public expenditures on education, health and public sector employment. During the 1980s much was achieved, both in terms of an expansion of these expenditures and in terms of measurable indicators of performance. In the process, government expenditure rose rapidly to around 47 percent of GDP. This was financed partly through high explicit taxation, at around 37 percent of GDP, with the remaining large fiscal deficit of 10 percent financed by domestic borrowing. This borrowing was done at heavily negative real interest rates as a by-product of financial repression, so that the allocation of credit was part of the economic control regime.

Program Design

The program had in effect two components, fiscal adjustment and economic liberalization. Since some aspects of economic liberalization had large fiscal consequences the two were connected.

The fiscal aspects of the reform program had three elements.

First, as noted, the fiscal stance had come to be seen as unsustainable since it depended upon rising indebtedness. There was seen to be a need to reduce the fiscal deficit from 10 percent to 5 percent of GDP. One potential option would have been to increase explicit taxation to reduce the implicit taxation of forced savings. However, this was not considered.

Second, there was a perception that taxation was already dysfunctionally high. Part of the reform program was, therefore, to reduce explicit taxation rates. It was hoped that lower tax rates would sufficiently stimulate activity so that revenue would be at least somewhat protected. The original agreement with the Fund (requested in December 1991) envisaged reducing the "high tax burden" but targeted the revenue/GDP ratio at 34 percent for 1994/95 which had been the average for the 1986-89 period. The actual revenue/GDP ratio in that year was 28.3 percent. This

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[152] See e.g. P. Fallon and R.E.B. Lucas, `Job Security Regulations and the Dynamic Demand for Industrial Labor in India and Zimbabwe", *Journal of Development Economics*, vol. 40, 1993, pp. 241-275; C. Jenkins and J. Knight, "Post-Independence Economic Policies and Outcomes in Zimbabwe: Lessons for South Africa", mimeo, Centre for the Study of African Economies, Oxford, 1997.

was a point of contention between Fund and Bank advice. The Fund supported the Ministry of Finance in its proposals for reductions in tax rates whereas the Bank tended to oppose them, partly on the grounds of equity and partly because of the likely revenue impact. In the event, revenues as a share of GDP, declined by 5 percentage points.

Third, the government wished to dismantle the system of non-market credit allocation. In the December 1991 request, it announced that there would be a "complete deregulation of interest rate". However, the liberalization of financial markets would be fiscally costly. As of 1991 domestic debt of the central government was 26 percent of GDP. In 1990, the government was paying around 9.5 percent nominal interest on its domestic debt with an inflation rate of 23 percent so that its real interest rate was heavily negative. By 1996, the Fund and the Bank were projecting a real interest rate of 8 percent on domestic debt. Hence, even if domestic debt remained constant as a percentage of GDP, the eventual cost of financial liberalization would have been about 5 percentage points of GDP although the cost would be phased according to the maturity of the existing debt. In the event, by 1995/96 the interest bill on government debt had already risen by the full 5 percentage points of GDP.[153] This was because, although not all the low-interest stock had matured, the failure to meet fiscal targets had necessitated further domestic borrowing so that the domestic debt burden had increased to around 55 percent of GDP.

Thus, the fiscal aspects of the reform program presupposed an astonishing contraction of non-interest expenditures. The three policies noted above required a combined reduction in non-interest expenditures of 15 percentage points of GDP over the four years 1992-95. The program itself estimated that the reduction would have to be 7.5 percent of GDP. Of this, the `excessive burden' of public sector enterprises was estimated at 3 percent of GDP. The program, thus, radically underestimated the fiscal implications of its policies. Since non-interest expenditures amounted initially to 37 percent of GDP they would (in the absence of GDP growth) have to be cut by 40 percent. In the absence of growth, this would involve expenditure reductions of 40 percent. With expenditure reductions on anything like this scale it would be inevitable that social and redistributive expenditures would be massively curtailed. Nor, as we have noted, was it likely that in the first years of the reform program there would be rapid growth. In the event, GDP per capita declined by 9 percent over the period 1990-96. Hence, the macroeconomic decline compounded the fiscal problem: to meet the fiscal goals real per capita non-interest expenditures would have needed to be reduced by 46 percent.

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153 World Bank, *Zimbabwe Public Expenditure Review*, 1996, Vol. 1, Table 1.1.

Such a severe reduction in social and redistributive expenditures would inevitably have put the reform program under great political strain. Arguably, this would have been feasible only had there been wide consensus in the government, the party, and civil society on the need for such drastic change. That no such consensus was built reflected two miscalculations. First, there was an economic miscalculation: the government was not fully aware of the aggregate implications of the three desired components of fiscal adjustment. The scenarios envisaged by both the government and the IFIs were unduly optimistic. We should note that this goes beyond the failure to build in the risk of drought. While the 1991/92 drought derailed the program, the likely political unsustainability of the program could have been anticipated. The second miscalculation was political. The above fiscal adjustments proved to be politically unfeasible: in particular, the fiscal deficit actually increased and this was the reason for the 1995 interruption in the Program. The reformers in the government failed to campaign for a sufficiently broad-based consensus to sustain the program, although it must be doubted whether any political campaign could have sustained such a drastic reduction in social expenditures as that required to meet the fiscal objectives.

The core of the economic liberalization program involved dismantling the system of non-market allocation of foreign exchange, including comprehensive protection of the large manufacturing sector. This was very substantially accomplished by 1996. Similarly, the financial sector was decontrolled with interest rates market-determined and many new banks established. The labor market was deregulated, with free collective bargaining replacing centralized wage setting, and firing restrictions removed. Reform of the parastatal enterprises was much slower, but by 1996 the monopoly of the Grain Marketing Board had been ended and a start had been made on privatization of state enterprises.

As noted above, Zimbabwe had many of the characteristics of a transition economy, so that the likely initial consequences of economic liberalization were negative. Thus the decline in manufacturing by 14 percent between 1991 and 1996 was broadly predictable. Since manufacturing was a quarter of GDP it was unlikely that other components would offset this decline in the short run. The program agreed between the government and the Fund made no allowance for these short term effects of liberalization. The staff report of January 1992 envisaged an 18 percent growth of GDP between 1991 and 1995. In the event, growth over this period was 1 percent. This very large mis-forecast clearly had the effect of making the fiscal adjustment appear more feasible than was actually the case.

Of the two components of the reform program, the economic liberalization was almost fully implemented whereas the fiscal adjustment, though massive, seriously missed its goals. That the fiscal goals were missed reflected not primarily the droughts but that goals were unrealistic.

Macroeconomic Consequences of Fiscal Incompatibility

The fiscal objectives of the program implied such a draconian reduction in non-interest expenditures that it was unsurprising that they were not fully attained. The government made a huge fiscal adjustment, reducing non-interest expenditures by 7 percentage points of GDP. However, not only was this insufficient to close the original deficit, it was insufficient to meet the new fiscal costs of tax reduction and financial liberalization. As a result the deficit increased from 10 percent to 12 percent of GDP. With such a large and indeed variable deficit, both nominal and real interest rates were high and volatile. Nominal rates at times exceeded 40 percent. There is evidence that these high real interest rates had a strong negative effect on private investment.[154] In the event, total fixed investment (public and private) declined by 9 percent in real terms between 1991 and 1996. Although the breakdown between public and private investment is not known precisely, there is clear evidence that public investment declined sharply. Private investment is likely to have declined both because of the interest rate effect noted above, and because of the uncertainties arising from the unsustainable fiscal deficit and the interruption of the Fund program.

The decline in investment has repercussions for the path of the economy during adjustment. The shift in relative prices is designed to generate growth in newly profitable activities, generating both employment and investment opportunities. Evidence from tracking surveys over the period 1993-95 in the manufacturing sector suggests that, to date, there has been little reallocation of investment in favor of export activities.[155] The lack of investment exacerbated the employment problem.

The other consequence of the insufficiency of fiscal adjustment was that the government entered a debt trap. Since the real interest rate considerably exceeded the growth rate, the ratio of debt to GDP rose rapidly. By 1996, it had reached 80 percent and was projected to rise to over 100 percent within the next decade.[156]

Hence, the macroeconomic consequences of fiscal incompatibility were severe. Given the highly ambitious nature of the original program, some risk assessment of what proved to be the actual

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[154] F. Marande and K. Schmidt-Hebbel, "Zimbabwe: Fiscal Disequilibria and Low Growth", in W. Easterly *et al.* (eds.), *Public Sector Deficits and Macroeconomic Performance*, New York: Oxford University Press, 1994.

[155] M. Ncube, P. Collier, J.W. Gunning and K. Mlambo, "Trade Liberalisation in Zimbabwe", in A. Oyejide, B. Ndulu and J.W. Gunning (eds.), *Regional Integration and Trade Liberalisation in Sub-Saharan Africa, Volume 2: Country Case Studies*, London: Macmillan, 1997.

[156] World Bank, Zimbabwe Public Expenditure Review, 1996, Vol. 1, Table 1.3.

scenario should have been undertaken. However, a much more effective way of introducing a realistic degree of caution into the program would have been to have changed its sequencing. When the Board discussed the original program in January 1992, no consideration was given to sequencing. Yet, both the financial liberalization and the reductions in tax rates, had the potential for being phased-in gradually, behind the implementation of deficit reduction measures rather than anticipating them. Politically, the most difficult reforms proved to be the containment and privatization of public enterprises, which in the event took around six years. The fiscally costly elements of the reform program could have been sequenced to follow public enterprise reform rather than anticipate it. Financial liberalization would have been achieved automatically had the deficit been brought under control because the decline in inflation would have permitted real interest rates to be positive. As it was, the abrupt decontrol of nominal interest rates created fiscal crisis. Similarly, the reductions in tax rates could have proceeded on a more limited and experimental basis, rather than being implemented despite the evidence of continuing and substantial reduction in tax receipts.

From the start, outcomes were very different from program targets. By August 1992, the full magnitude of the drought was apparent: in the staff report GDP was projected to decline in 1992 by 9 percent as against a program projection of +4 percent. However, the longer run projections became more optimistic, so that for 1995 the anticipated fiscal deficit was *reduced* from 4 percent to 3 percent. Thus, the evidence of program divergence was interpreted as being due entirely to the drought. The drought was so severe that it was indeed not feasible to disentangle its effects from those of the reform program so that there were genuinely acute difficulties of monitoring program performance. By January 1994, following an increase in the deficit to around 12 percent, the deficit for 1993/94 was projected to contract to 5 percent (its outturn was 8 percent). Government expenditure was forecast to decline by 6 percentage points of GDP in two years to reach 32 percent in 1995/96 (the outturn was an increase of 3 percentage points to 41 percent).

By July 1994, staff reports began to sound a note of warning on fiscal policy and delays in public enterprise reform. It was stressed that budget deficits led to high interest rates and thereby held back private investment. There appears to have been no concern about the distributional consequences of the program: implicitly, adverse effects were attributed to the drought.

Distributional Effects

As noted, during the 1980s, the government had placed considerable priority on redistribution. The reform program potentially changed distributional outcomes both through its effect upon public service delivery and through its effect on personal incomes.

The program agreed between the government and the Fund discussed the likely social impact of policy change. The program was expected to result in per capita consumption growth of 1.5 percent per annum. These gains were expected to be `broadly shared'. It was anticipated that some groups would suffer from the program, but only relatively small minorities. These were identified as those retrenched (implicitly from the public sector), those affected by price decontrol, and those who would have to start paying for health and education. A Social Development Fund was established to offset these effects. Its strategy was to offer pension and retraining arrangements for retrenched civil servants, to introduce labor-intensive public works, to support informal enterprises, to finance rural resettlement, and to introduce a targeted food subsidy. Reflecting the modest scale of the problem envisaged, few resources were devoted to the Social Development Fund.[157] For example, the SDF allocation for 1993/94 was only Z$ 100 million.There were also targeting problems; a large number of eligible households did not receive the benefits intended for them and there was confusion about the definition of the targeted groups.[158]

The expectations proved to be a massive underestimation of the social costs of the program. Much higher costs could reasonably have been anticipated.

Whereas the program envisaged that between 1991 and 1996 per capita private consumption would rise by around 8 percent, in the event it declined by 37 percent.[159] This alone transformed the group of those who lost from the reforms from a minority to a majority. Further, the program failed to recognize that even had mean per capita consumption not declined, there would have been large groups of losers consequent upon the large resource reallocations, which would result from liberalizing such a highly controlled economy. The decontrol of manufacturing was likely to lead to an initial phase of contraction. Combined with the deregulation of the labor market it was therefore reasonable to anticipate that both, employment and wages, would decline quite sharply in the manufacturing sector.

Public Service Delivery

Recall that in order to meet its fiscal objectives the government would have needed to reduce its non-interest expenditures by 15 percentage points of GDP. In the event, it reduced them by 7

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157 In April 1993, Fund staff expressed concern about the slow implementation of the Social Dimensions of Adjustment project.

158 See M. Chisvo and L. Munro, *A Review of Social Dimensions of Adjustment in Zimababwe, 1990-94*, Harare: UNICEF, 1994; E. Kaseke, “A Situation Analysis of the Social Development Fund”, Ministry of Public Service, Labour and Social Welfare and UNICEF, Harare, 1993.

159 This was partly because private consumption was atypically high in 1991 as a result of import liberalisation. If the base is taken as 1990, a normal year for private consumption, the decline is 26 percent.

percentage points. Because the economy grew by only 12 percent between 1990 and 1996, even this reduction implied a decline in absolute terms: growth was insufficient to offset the reduced share in GDP, so that non-interest expenditures fell by 9 percent in units of GDP.[160] This is corroborated by the National Accounts: between 1990 and 1996, government consumption (which excludes both interest payments and capital expenditures) fell in units of GDP by 10 percent. However, this was made up of a large increase in the volume of government consumption which was more than offset by a large decrease in its unit price: the volume of government consumption increased by 20 percent, with its unit price falling by 25 percent. The unit price fall reflected the reduction in public sector wages. In effect, the government was employing more people but paying them so much less that its expenditure fell in units of GDP. As we will see, the large divergence between changes in the volume and the value of public consumption complicate statements about changes in service delivery.

This pattern applied not only to government consumption in aggregate but also to its key social components. Between 1990/91 and 1995/96, health spending (recurrent plus investment) declined as a share of the budget from 6.4 percent to 4.3 percent and as a share of GDP from 3.1 percent to 2.1 percent.[161] However, the unit cost of health services fell by a third relative to GDP. As a consequence, the volume of health services (public plus private) increased by 45 percent whereas its value in units of GDP declined by 6 percent. Taking into account population growth over the period, there was a substantial *increase* in the volume of health services per capita, and a substantial *decrease* in the value of health services per capita. There are two reasons why despite the large volume increase in health services, there may have been a reduction in health care delivery. First, the measures of volume used in the national accounts make no allowance for changes in quality. It is most unlikely that quality would have remained constant when health workers suffered such large reductions in real wages. The reductions in wages in the public health sector have led to many doctors leaving for the private sector. Over 90 percent of the doctors in rural areas are now non-Zimbabwean. Second, there was a shift from public to private provision. This tended to make the service less accessible to the poorer part of the population. The population certainly received less valuable public health services: in per capita terms government health spending fell in units of GDP by a third. Non-wage spending has declined even more dramatically than wages, so that shortages of drugs are becoming common. Health indicators are deteriorating rapidly.

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[160] Recall that non-interest expenditures were initially 37 percent of GDP. The required reduction is therefore to 30 percent of the new level of GDP, which was 1.12 times its initial level. Hence, the reduction is 37 - 30(1.12)/37 = 9 percent.

[161] World Bank, *Zimbabwe Public Expenditure Review*, 1996, Vol. 2, Annex 3. There are now indications that data revisions may change this picture, so that the decline shown in the PER may turn out to be spurious.

There is no doubt that the previous trend of improving health outcomes was reversed during the period of the reform program.

During the 1980s health outcomes had improved remarkably. For example, the infant mortality rate declined from 100 to 50 between 1980 and 1988 and life expectancy increased from 56 to 64 years. Since then several health indicators have deteriorated. Between 1988 and 1994 wasting in children quadrupled and maternal mortality rates appear to have increased. After many years of decline, the number of TB cases began to rise in 1986 and by 1995 had quadrupled.

However, while health outcomes deteriorated during the phase in which the public health budget was severely squeezed, it is not straightforward to attribute the former to the latter. This is because of the rising problem of AIDS. Zimbabwe has amongst the most serious AIDS problems in the world with about 30 percent of pregnant women and about 10 percent of new-born children now being HIV positive. AIDS alone will therefore soon account for an under-five mortality rate of 100 per 1000, whereas in 1994 its rate from all causes was only 77.[162] The stunting and wasting evidence is consistent with the child health problem being AIDS-driven: while wasting quadrupled, stunting fell. Stunting reflects the long-run effects of food shortages, whereas AIDS often leads to wasting.

Hence, there have been four large changes in the health sector. First, the volume of health care services increased by more than the population. Second, the value of these services decreased very substantially, so that quality is likely to have deteriorated. Third, the demand for health care increased dramatically because of the rising incidence of AIDS. Fourth, health outcomes deteriorated whereas they had previously been improving. Unfortunately, the attribution of the deterioration in outcomes as between AIDS and quality deterioration is not possible. What is, however, evident is that during a period in which the demand for health care was rising enormously and predictably, the resources devoted to public health care were dramatically reduced. Given the present unit cost of treating AIDS patients, the total cost of treating those already infected will be four times the present annual health budget.[163]

Education was given a very high priority by the government. During the 1980s, there was a remarkable increase in educational attainments. During the 1990s, as with health, education services increased in volume but decreased in value in units of GDP. Between 1990 and 1996, the volume of education services increased by 7 percent and their unit price in terms of GDP

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[162] World Bank, *Zimbabwe Public Expenditure Review*, 1996, Vol. 1, p. 86.

[163] Human Development Group, World Bank, “Understanding Poverty and Human Resources in Zimbabwe”, December 1996, p. 64.

declined by one quarter. However, unlike in health care, the volume increase was insufficient to keep up with population growth so that the per capita volume of services declined. While teachers' salaries declined by around one third in real terms, their quality appears not to have declined unlike in health. Student-teacher ratios were maintained and the proportion of qualified teachers actually increased, both for primary and secondary schools. Educational outcomes provide a mixed picture: O Level pass rates increased, but completion rates for primary schools have fallen slightly. In effect, the government managed to pass on the effects of its expenditure reductions in education to teachers rather than to children.

Incomes

The deregulation of the labor market together with the reduced protection of manufacturing and the reduction in public expenditure produced a severe squeeze in the labor market. Both employment and real wages declined sharply. During 1991-96, formal sector employment in manufacturing fell by 9 percent and real wages declined by 26 percent. In public administration employment declined by 23 percent and real wages fell by 40 percent.

At the same time agriculture benefited both from exchange rate adjustment and marketing deregulation. One indicator of this is that the implicit GDP deflator for agriculture increased by 15 percent relative to the aggregate GDP deflator between 1990 and 1996. These developments led to large changes in income distribution.

The major redistribution in the economy was from formal sector wage earners to farmers. This can be seen from the National Accounts which show the share of wages and salaries in gross national income declining from 51 percent in 1990 to 35 percent in 1996. During the same period, the share of unincorporated gross operating surplus (a category which is dominated by the incomes of small farmers) rose from 20 percent to 32 percent: farmers gained almost all the share that wage earners lost.

Unfortunately, there are no nation-wide panel survey data available to assess changes in rural incomes. However, panel data are available for an interesting and important subset, the "resettlement farmers". This group consisted originally of landless poor who were given land by the government shortly after independence. Income data for a sample of these households who have been followed since their resettlement are shown in Table 1.[164] The interpretation of this series is complicated by the fact that two out of the four years for which data are shown are drought years. Two points stand out. First, rural incomes are extremely vulnerable to climatic shocks. The very large income drop shown for 1994/95 shows that the effect of drought is so

[164] We are grateful to Bill Kinsey for making these unpublished data available to us.

large that it swamps any effect of structural adjustment. Secondly, the resettlement farmers have realized rapid growth and this was maintained through the period of adjustment.[165] This group is certainly not representative for the rural population: it is much better able to handle shocks, having built up assets for consumption smoothing. In this case, the resettlement policy, initiated almost a decade before structural adjustment started, may well have been more effective in protecting the poor than the short-run, targeted policies adopted in the context of structural adjustment.

Table 1. Changes in real income per household, baseline and three most recent growing seasons

}Growing season	No. of households	Mean income[a] (*in 1990 Z$*)	Coefficient of variation	Minimum-maximum
1982/83[b]	356	765	1.51	0 - 8,428
1993/94[c]	397	3,219	1.08	120 - 26,083
1994/95[b]	393	1,778	1.16	0 - 20,829
1995/96[d]	397	4,324	0.97	17 - 35,553

Source: B. H. Kinsey, "Growth-friendly poverty reduction? Long-term, household-level outcomes of land reform in Zimbabwe", paper presented at the Development Studies Association Conference, 11 - 13 September 1997, Norwich, UK, Table 10.

[a]Income is defined as the sum of the market value of crops harvested, revenue from the sales of livestock and livestock products and services, remittances and income from off-farm or nonagricultural employment. Excluded are other transfers, aid and drought relief.
[b]Season was badly affected by drought; rainfall was less than two-thirds of the long-term mean.
[c]Season was drought-affected; rainfall was some 80 percent of the long-term mean.
[d]Season was normal; rainfall was within one percent of the long-term mean.

Recall that overall, per capita private consumption declined by 26 percent between 1990 and 1996. Since the share of small farmers in national income rose by 60 percent, if their consumption had tracked their farm income then their per capita consumption would have risen by around 18 percent. However, there are two reason to expect that consumption will not have

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[165] Comparing the endpoints in the Table overstates the point since the first year was a drought year. However, other evidence, in particular the rapid accumulation of assets (mainly livestock) over this period, supports the conclusion of rapid growth. See B. Kinsey, K. Burger and J.W. Gunning, "Coping with Drought in Zimbabwe: Survey Evidence of Responses of Rural Households to Risk", forthcoming in *World Development*.

tracked farm income. First, as of 1990, remittances amounted to some 12 percent of consumption in rural households.[166] Much of these were probably from wage earners in urban areas and would have fallen, probably in percentage terms, by more than the decline in urban wages themselves. Secondly, food prices rose by around 36 percent relative to overall consumer prices. Rural households have almost double the share of food in their consumption bundle of that of urban households. The increase in the relative price of food thus raises both the income and the cost of expenditure of rural households. The former is picked up in the rising income share of rural households but exaggerates the increase in their welfare. The rise in the price of food raised the cost of living of rural households by 7 percent relative to that of urban households.

Despite this differential change in the cost of living, it is evident that there was a large redistribution from urban wage earners to rural households. This was a progressive redistribution because as of 1990 urban households had been considerably better off: mean per capita consumption of urban households was some 3.6 times that in rural households.[167]

A second but much smaller redistribution was between private sector non-financial companies and the financial sector. Over the same period the share of the former declined from 14.5 percent to 13.5 percent while that of the latter increased from 4.6 percent to 5.9 percent. In addition there is anecdotal evidence that within the private sector non-financial companies, agriculture gained while manufacturing lost.

Against the large reductions in the mean level of consumption and the large changes in distribution the government's targeted programs for offsetting social costs were liable to prove inadequate. An evaluation indeed found them ineffective: there were delays in getting the program started, over-centralization and reliance upon an already over-worked staff, inadequate funding, urban bias, and poor targeting.[168]

Conclusion

The social impact of ESAF to date has been considerable. During the period, average private consumption levels have declined by around a quarter. There has been a powerful redistribution from urban wage earners to the rural population, to the extent that consumption levels of rural

[166] CSO, *Income, Consumption and Expenditure Survey Report, 1990/91*, July 1994, Tables 3.1 and 3.5.

[167] Calculated from CSO, *Income, Consumption and Expenditure Survey Report*, *1990/91*, July 1994. Table 3.6(a) gives mean household figures. Per capita figures were estimated using the household size information in Table 2.2, assuming a mean household size of 12 for households with nine people or more. The comparison makes no allowance for differences in the cost of living.

[168] Performance Audit Report, *Zimbabwe Structural Adjustment Program*, Report 14751, Operations Evaluation Department, World Bank, 1995.

households may have been fully protected and indeed may even have risen a little. Conversely, urban households have suffered severely: there are fewer jobs and real wages are very much lower. In addition to these changes in private incomes, household welfare has also been affected by the decline in public expenditures on social services. The brunt of the fall in these expenditures has been borne by those working in the social services. However, the reduction in their real wages are likely to have resulted in reductions in service quality. There is some evidence that this was much more pronounced in health care than in education.

In describing these large changes we have compared snapshots of the economy around 1990 and 1996. These changes owe little to the intervening droughts and were consequently reasonably predictable by economic analysis. As with other structural adjustment programs, the ESAP involved relative price changes in favor of agriculture and at the expense of the formerly protected urban sector. However, unlike most other African adjusters, Zimbabwe had a very large industrial sector producing not only final goods but also intermediate goods. In this it resembled the transition economies. As in the transition economies, liberalization inflicted an initial phase of contraction: the manufacturing sector, accounting for over a quarter of the economy, has contracted by 14 percent. The analysis underlying the program design did not take either of these features into account. It therefore radically underestimated the social consequences of the program.

In addition to this neglect of the likely social impact, the program was remarkably ambitious in its fiscal objectives. The share of non-interest government expenditures in GDP would have needed to fall by 40 percent over a period of six years. The government could only have achieved this by expenditure cuts which would have massively compounded the negative social impact on the urban population noted above. This implication of the fiscal objectives was not recognized.

The core political achievement of the government had been a redistribution in favor of the indigenous population. In our view, the program as designed was manifestly politically unsustainable since it would have required the government to dismantle these distribution achievements. The program indeed proved unsustainable, in that although there was sufficient political will to persist with the structural policy reforms the envisaged fiscal adjustments were only partially attained. This in turn inflicted considerable damage on the economy. The fiscal crises which characterized the period caused both high and volatile interest rates and a climate of policy uncertainty which presumably reduced private investment.

This political unsustainability could have been avoided. The financial and tax reduction liberalization which were fiscally very costly should have been sequenced after the politically difficult expenditure reductions coming from parastatal reform and public employment reductions. This would have obviated the need for reductions in per capita expenditures on health and education. It would also have accelerated the recovery of employment in manufacturing and reduced the decline in real wages which was partly driven by high inflation. Some of the social hardship was doubtless unavoidable, as in other transition economies. However, because the scale of the costs in urban areas was radically underestimated, the safety net operations put in place were inadequate. Further, the social hardship was avoidably severe because of poor program design. The drought made it more difficult to recognize the design error and obviously added to the social costs.

The design of the program originated with the government. The role of the Fund in design was limited. However, some responsibility must be taken by the Fund for supporting the government in a fiscal strategy which was clearly implausible.

THE SCOPE OF POLITICAL SUPPORT

Although some of the literature portrays Zimbabwe as a repressive one-party state in which decisions are taken centrally and handed down without discussion,[169] the reality bears closer resemblance to what has been called a system of "societal corporatism" which in fact, permits fairly active democratic participation and in which therefore, competing political groupings operate to exert considerable influence on government policy.[170] Consequently, the failure to factor in an appropriate measure of consensus-building was a particularly grave miscalculation.

Two phases in the program period may be distinguished in a general assessment of the scope of government and national support for the program, the first covering roughly the first year of the program through 1993, and the second covering the ensuing period right through 1995 when the program was interrupted.

From the very beginning of the program, there were naturally forces within the government and party leadership that opposed the program. This is of course normal in politics. What distinguished the Zimbabwe situation, however, was the extent of polarization and the strong ideological lines that marked the divide[171] – on the one side, those committed to market-based reforms and economic liberalization, and on the other, those committed to a socialist strategy of development. The former included Dr. Chidzero, senior minister responsible for finance, who was the leading proponent of reform, Reserve Bank officials and technical officials of the economic ministries in the main. The latter group of anti-market reformers, in Zimbabwe's case, were not the bunch of slogan-mongering ideologues that one often finds in these situations but trained and committed intellectuals including the President himself and other senior members of the party leadership who simply did not share the reformers' belief in the efficacy of the

[169] Munkonoweshuro, 1992.
[170] Skalnes, 1995.
[171] Skalnes, p. 132.

market; the difference was that they were open to debate and were not given to mere polemical denunciation. This is an important distinction to bear in mind for it explains how and why the reform program came to be adopted at all, given the polarization in ideological positions in the leadership, and provides a foundation, not only for the Fund's continuing relationship with Zimbabwe in the long run, but also for resolving in the near term, the lingering stalemate in its relations with Zimbabwe.

In the first phase of the program period, the proponents of reform clearly dominated the government position. By mid-1989, President Mugabe had been persuaded that a change in policy was necessary if faster economic growth was to be achieved. As we have noted, this was, in our view, a correct position given that the export sector was weighed down by the control regime while the only other dynamic sector of the economy, the public sector, had become fiscally constrained. The government also, at this time, showed a willingness to discuss major structural issues. This shift in the policy stance was aided by the World Bank's comprehensive study on the Zimbabwe economy, issued in 1987, which formed the basis for wide-ranging discussion between the government and the Bank, as well as by studies conducted by foreign consultants at the government's request.

But by far, the most critical link in the chain of government commitment was undoubtedly the personal role of the Senior Minister of Finance, Dr. Chidzero. Indeed, the fragility of government commitment to the program resided in the fact that it hinged much too crucially on his personal role. The result, as a number of staff documents point out, was that whenever Dr. Chidzero was not available for discussions with Fund missions, the government appeared rather unprepared and unable to present a credible and consistent viewpoint. For instance, a 1993 internal Fund document notes that "the authorities did not clearly state their position with regard to exchange rate reform, partly because of the imminent departure of both the Governor of the Reserve Bank and the Senior Secretary of the Finance Ministry. This also contributed to a slow start to the discussions and an initial lack of preparedness of officials to discuss the issues." Again, in 1993, a mission reported that "in the absence of Senior Minister of Finance Chidzero during the last week of discussions in Harare, the authority's position with respect to some of the accompanying measures remained unclear."

But the weakening of government's commitment from 1993 amid a general stiffening of opposition within government to the reform program was not attributable entirely or perhaps, even mainly, to Dr. Chidzero's deteriorating health and his consequent inability to participate as fully in meetings with Fund missions.

The more fundamental point is that clearly, not enough had been done to create a sufficiently strong and broad-based fund of support for the program, given the drastic fiscal adjustment that it entailed. Indeed, in a situation of such widespread and often violent protest, such as prevailed in 1993, it is doubtful that Dr. Chidzero could have done much by himself at that stage to turn the tide. In 1992, students at the National University embarked on violent demonstrations and boycotted classes to back demands for increases in student grants to offset rising costs resulting from devaluation and inflation. More ominously, in 1993, a wave of bread riots shook the lower income suburbs of Harare as demonstrators smashed bakeries and engaged in widespread looting to protest recently-announced price increases for bread and flour.

At the same time, although in the initial stages of the reform, some important business groups had strongly supported trade liberalization measures despite the increasing competition it was to entail – and this is true especially of the Engineering Employers' Association (EEA) and the Confederation of Zimbabwean Industries (CZI) – the private sector's support for, and commitment to, the program had by 1993 loosened considerably in part as a perfectly understandable reaction to the steady erosion of the substantial regime of protection to which they had long become accustomed, and also partly as a result of a breach in the channels of communication and dialogue with government resulting from the sudden death of the Minister of Commerce and Industry, Chris Ushewokunze who, together with Bernard Chidzero, had been the main proponents of market reforms; interestingly his position was to remain vacant until after the elections in April 1995.

Increasing pressure from business groups to which Fund reports make references from 1992, predictably led to a slackening of the program of import liberalization with the granting of additional tariff protection to a number of industries including the motor, textiles, clothing, and shoe industries.[172]

These gestures of accommodation failed to restore business confidence in the reforms, however. As late as 1996, internal Fund reports were noting that the government's policy making processes were characterized by "inadequate consultation with the private sector and social partners", a view which was also expressed in interviews with officials of the CZI.

Political support for the program was further shaken by increasing agitation among civil servants against retrenchment and other civil service reforms. In the midst of a general recession in the economy and widespread unemployment, the government had by June 1993, abolished over 10,000 civil service positions and reduced the number of ministries from 27 to 22 – results which Fund missions found "disappointing" even as they acknowledged that the slippages in compliance were attributable to "the government's concerns about aggravating unemployment and social dislocation at a time of severe economic downturn and contraction by private employers".

Rising calls for indigenization also undermined the pace of implementation of the privatization program and by implication, the fiscal program. While the Fund and the Ministry of Finance saw

[172] Skalnes, p. 144.

privatization as a critical means of raising funds for budgetary support in a bid to reduce costly bank financing, the advocates of privatization – a policy which the President himself favored – saw privatization as a means of promoting indigenous ownership of productive assets, a political objective whose importance the Fund's 1996 country study paper explicitly acknowledges evidently only in word.

As the pressures mounted, the government began to perceive the Fund's continuing counseling of fiscal restraint and public sector retrenchment as politically insensitive. In 1994, in a speech given to the South African Parliament in Cape Town, the President reportedly called for a democratization of the Fund and accused the Bretton Woods institutions of "financial imperialism" and "dictatorship". In 1995, he was also reported as speaking of "disastrous" reforms imposed by the World Bank and the Fund and adding ominously "we are wiser than we were three years ago and we will not listen willy-nilly to what the international institutions will tell us to do."[173]

The Ownership Issues

Zimbabwe is, in our view, a classic case of a reasonably strong national commitment to reform gone sour from economic and political miscalculation in the sequencing of economic reforms. As we have already noted, the tremendous fiscal crunch and the drastic reduction in social expenditures which the program objectives entailed, made the task of consensus-building difficult enough. In the event, the political economy of the program was further strained by a failure to deepen support for the program within government itself and more importantly, a failure to broaden its scope to cover the highly politicized ranks of the political parties, especially the ruling party and civil society at large.

In general, however, given the tremendous social costs of the program thus far, the government's commitment to the reform has been reasonable. The major structural reforms have now largely been implemented.

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[173] *Africa Research Bulletin: Economic, Financial and Technical Services*, 32.1, 1995: 12018.