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EBS/84/135

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June 21, 1984

To: Members of the Executive Board

From: The Secretary

Subject: Zambia - Staff Report for the 1984 Article IV Consultation and Request for Stand-By Arrangement

Attached for consideration by the Executive Directors is the staff report for the 1984 Article IV consultation with Zambia and its request for a stand-by arrangement equivalent to SDR 225 million. Draft decisions appear on pages 41 and 42.

It is understood that the Executive Director for Zambia will be requesting the Board for a waiver of the circulation period, to enable this subject to be brought to the agenda for discussion on Monday, July 16, 1984.

If Executive Directors have technical or factual questions relating to this paper prior to the Board discussion, they should contact Mr. Edo (ext. (5)8750) or Mr. Sharer (ext. (5)8752).

Att: (1)

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INTERNATIONAL MONETARY FUND

ZAMBIA

Staff Report for the 1984 Article IV Consultation and Request for Stand-By Arrangement

Prepared by the African and the Exchange and Trade Relations Departments

(In consultation with the Fiscal Affairs, Legal, and Treasurer's Departments)

Approved by J.B. Zulu and S. Kanesa-Thasan

June 20, 1984

Contents | Page

		Page
I.	Introduction	1
II.	Background	3
III.	Performance Under the last Stand-by Arrangement	4
	1. External sector	5
	2. Public finance	10
	3. Monetary policy	13
	4. Production, prices, and wages	13
IV.	Outlook for 1984, the Proposed Economic and Financial Program	17
	1. External policies	17
	2. Public finance	24
	3. Monetary policies	27
	4. Supply oriented policies	27
	5. Performance criteria	30
V.	Medium-Term Outlook	30
VI.	Staff Appraisal	36

Text Tables

1.	Fund Position During Period of Arrangement	2
2.	Selected Economic and Financial Indicators, 1981-84	6
3.	Quantitative Performance Criteria, 1982-83	7

Contents

Page

Text Tables (cont'd)

4. Balance of Payments, 1982-84 — 8
5. Central Government Finance, 1982-84 — 12
6. Monetary Survey, 1981-84 — 14
7. ZCCM, Consolidated Profit and Loss Account 1980/81-1984/85 — 16
8. Summary of Financial Program for 1984 — 18
9. Performance Criteria for 1984 — 31
10. Medium-Term Balance of Payments, 1984-89 — 32
11. Medium-Term Exports and Imports, 1984-89 — 33
12. Medium-Term External Debt Service, 1984-89 — 34

Appendices

I. Stand-By Arrangement — 43

II. Letter of Intent — 47

III. Relations with the Fund — 61

IV. Financial Relations with the World Bank Group — 63

V. External Payments Arrears, 1982-March 1984 — 64

VI. Basic Data — 65

Charts

1. Market Price and Purchasing Power of Copper Exports, 1973-83 — 4a
2. Real and Nominal Effective Exchange Rates, January 1978-May 1984 — 10a

I. Introduction

The 1984 Article IV consultation discussions with Zambia were held in Lusaka during the period February 7-22, 1984, concurrently with negotiations on a new stand-by arrangement, on which discussions continued in Washington during the period April 4-10, 1984, and in Lusaka during the period May 22-June 2, 1984. The Zambian representatives included Mr. L.J. Mwananshiku, Minister of Finance; Mr. D. Phiri, Governor of the Bank of Zambia since February 17, 1984, and his predecessor Mr. B. Kuwani; and other senior officials concerned with economic and financial matters. The mission head also met with President Kaunda. The staff representatives were Mr. E.L. Bornemann (head), Mr. R.L. Sharer, Mr. J. Greene (all of the African Department), Mr. H. De Zoysa and Mr. R. Schneider (both FAD), Mr. T. Hatayama (ETR), and Mrs. S. Ghafir (ADM) and Miss S. Boyle-Hebron (AFR) as secretaries. Mr. J. Paljarvi, the Fund resident representative in Zambia, participated in the discussions. Mr. J. Mills Jones, Assistant to Zambia's Executive Director, also participated in the policy discussions.

In the attached letter of intent dated June 1, 1984 (Appendix II), the Government of Zambia requests a stand-by arrangement in an amount equivalent to SDR 225 million, or 83 percent of quota, covering the period until end-April 1986; this would be equivalent to 47.5 percent of quota at an annual rate. Of the amount requested, SDR 112.5 million would be from the Fund's ordinary resources and SDR 112.5 million from borrowed resources. As of May 31, 1984, the Fund's holdings of Zambian kwacha subject to repurchase amounted to SDR 678 million, or 251 percent of quota, of which 180 percent of quota were under tranche policies and 71 percent under the CFF. Purchases under the proposed stand-by arrangement, together with repurchases scheduled during the program period, are set out in Table 1.

The staff analysis of the balance of payments shows that it would be necessary for Zambia to obtain additional debt rescheduling and eceptional balance of payments assistance for both the program period and in the medium term, and that the success of orderly adjustment policies will hinge largely upon obtaining this aid. For that reason, approval of the stand-by arrangement is being proposed in principle only. The Zambian authorities have made a request to Paris Club creditors for further debt rescheduling, and a meeting to consider their request has been tentatively scheduled for mid-July. Discussions are also continuing with other official and commercial creditors. Moreover, a Consultative Group meeting on Zambia, chaired by the World Bank, was held in Paris May 22-24, 1984.

The first purchase under the arrangement would be available upon its activation and the second purchase would be subject to satisfactory completion of a review of the program, to be completed before end-September 1984, as well as to Zambia's observing the end-July performance criteria.

Table 1 . Zambia: Fund Position During Period of Arrangement, 1984-86

	Outstanding at May 31, 1984	1984 July-Sept.	1984 Oct.-Dec.	1985 Jan.-March	1985 April-June	1985 July-Sept.	1985 Oct.-Dec.	1986 Jan.-March
				(In millions of SDRs)				
Transactions under tranche policies (net) 1/	--	17.5	25.6	22.7	-2.0	29.0	1.1	29.0
Purchases	--	30.0	50.0	29.0	29.0	29.0	29.0	29.0
Ordinary resources	--	(15.0)	(25.0)	(14.5)	(14.5)	(14.5)	(14.5)	(14.5)
Enlarged access resources	--	(15.0)	(25.0)	(14.5)	(14.5)	(14.5)	(14.5)	(14.5)
Repurchases	--	-12.5	-24.4	-6.3	-31.0	--	-27.9	--
Ordinary resources	--	(-12.5)	(-9.4)	(-6.3)	(-3.1)	(--)	(--)	(--)
Enlarged access resources	--	(--)	(-15.0)	(--)	(-27.9)	(--)	(-27.9)	(--)
	--							
Transactions under special facilities (net) 2/	--	--	--	-7.4	-7.4	-7.4	-7.4	-11.7
Purchases	--	--	--	--	--	--	--	--
Repurchases	--	--	--	-7.4	-7.4	-7.4	-7.4	-11.7
Total Fund credit outstanding (end of period)	678.2	683.3	708.9	724.2	714.8	736.4	730.1	747.4
Under tranche policies 1/	487.7	492.8	518.4	541.1	539.1	568.1	569.2	598.2
Special facilities 2/	190.5	190.5	190.5	183.1	175.7	168.3	160.9	149.2
				(As percent of quota)				
Total Fund credit outstanding (end of period)	250.9	252.8	262.3	268.0	264.4	272.4	270.1	276.5
Under tranche policies 1/	180.4	182.3	191.8	200.2	199.4	210.2	210.6	221.3
Special facilities 2/	70.5	70.5	70.5	67.8	65.0	62.2	59.5	55.2

Source: IMF, Treasurer's Department.

1/ Ordinary and enlarged access resources.
2/ Compensatory Financing Facility.

The third and fourth purchases under the arrangement would be subject to the end-September and end-December performance criteria; in addition, the latter purchase would be subject to a review with the Fund before end-March 1985, to discuss the annual program for 1985 and to reach understandings on performance criteria for the remaining period of the arrangement, including the dates of further reviews. The last purchase will depend on observance of the end-1985 performance criteria as well as on satisfactory understandings on policies for 1986, especially regarding the budget, before end-March 1986.

Taking into account a purchase in January 1984 of SDR 67.5 million under the previous stand-by arrangement, total purchases from the Fund during 1984 would amount to SDR 147.5 million, and net purchases would be SDR 73.5 million. If all purchases under the proposed arrangement are made, total purchases from the Fund during 1985 would amount to SDR 116.0 million, and net purchases would be SDR 21.0 million. By the end of the period of the arrangement at end-April 1986, the Fund's total holdings of Zambia's currency subject to repurchase would amount to SDR 747.4 million, or 277 percent of quota, of which SDR 598 million, or 221 percent of quota would be under tranche policies. A waiver of the limitation in Article V, Section 3 (b) (iii) of the Articles of Agreement will be required. Zambia continues to avail itself of the transitional arrangements of Article XIV.

The staff report on the last consultation discussions and on the last stand-by arrangement were considered by the Executive Board on April 18, 1983. The economic background and developments leading up to the 1983 financial program are reviewed in Section II of the current paper. In Section III developments in 1983 are reviewed in the context of the 1983 stand-by arrangement. Section IV deals with the outlook for 1984 and the Government's program for 1984, and Section V assesses the medium-term outlook. The staff appraisal and the proposed decisions are included in Section VI. A summary of Zambia's relations with the Fund is provided in Appendix III and of Zambia's relations with the World Bank Group in Appendix IV. Appendix V provides data on Zambia's external payments arrears while Appendix Vl lists basic economic data for the period 1979-83.

II. Background

In recent years Zambia's economic and financial performance has deteriorated markedly, despite periodic adjustment efforts supported by the use of Fund resources. In large part this reflects a steep decline in the terms of trade, which has consistently exceeded projections made at the time of program initiation. However, it also reflects the impact of periods of inappropriate domestic policies leading to growing financial imbalances.

During the period 1977-82 the budget deficit averaged 13 percent of GDP, and the current account deficit averaged almost 11 percent of GDP. In the past decade the real purchasing power of Zambia's exports has fallen by almost 60 percent, as indicated in Chart 1, which shows movements in the price of copper as against movements in the unit price of exports from industrial countries. Output of the mining sector, which accounts for about one third of real GDP and virtually all exports, has also declined markedly since the mid-1970s, while other productive sectors of the economy have generally stagnated, due mainly to the impact of the severe shortage of foreign exchange. Real GDP has followed a declining trend, with an average annual decrease of about 1 percent, indicating a drop in real per capita income of some 4 percent per annum. Throughout this period domestic consumption has been sustained only by the accumulation of substantial external indebtedness, including arrears on commercial payments and, more recently, on publicly guaranteed debt.

The economic and financial deterioration was particularly marked in 1982, when Zambia did not have a Fund-supported financial program following the cancellation in 1982 of the extended arrangement that had been approved in 1981. 1/ Fiscal performance deteriorated sharply, in relation to both the 1981 outturn and the original budgetary goal, and the budget deficit rose to 19 percent of GDP. 2/ Domestic bank financing of the deficit almost tripled, and the growth of broad money accelerated from 8 percent to 34 percent. Real GDP fell by 2 percent, reflecting the acute shortage of foreign exchange and a drought that reduced agricultural output. Zambia's balance of payments worsened, as the terms of trade deteriorated by a further 10 percent and net capital inflows fell sharply, leading to a widening of the overall deficit to SDR 561 million. There was a further accumulation of external payments arrears, and by year-end arrears on commercial payments and external debt were equivalent to 112 percent of exports.

III. Performance Under the last Stand-by Arrangement

A one-year stand-by arrangement, in an amount of SDR 211.5 million, or 100 percent of quota at that time, was approved by the Executive Board on April 18, 1983 (EBS/83/67) in support of a comprehensive adjustment program. The aim of the program was to reduce substantially the serious internal and external imbalances facing Zambia and thereby establish conditions that would permit a sustained recovery in overall economic activity when external conditions improved. The program also

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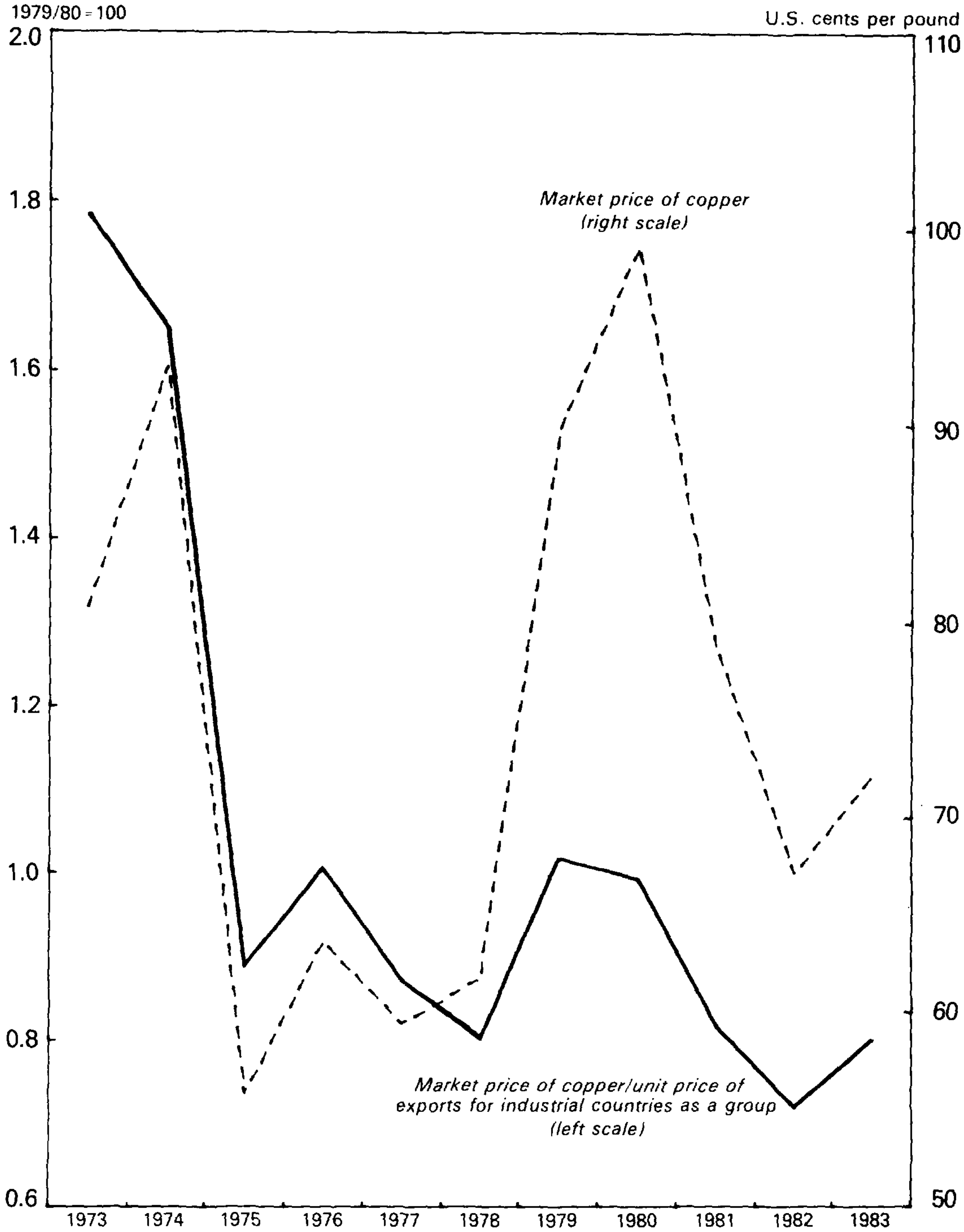
1/ The implementation of the extended arrangement in 1981, and the factors that led to its cancellation, are described in detail in EBS/83/67, 3/30/1983, pp. 7-12.

2/ This figure includes the payments of arrears of K 153 million for 1982; excluding this amount, the deficit would have been 14.6 percent of GDP.

CHART 1

ZAMBIA

MARKET PRICE AND PURCHASING POWER OF COPPER EXPORTS, 1973-83



Source: Staff computation.

sought to initiate a framework for the diversification of economic activity. As part of the program the authorities introduced a wide variety of measures, including an initial depreciation of the kwacha of 20 percent followed by adoption of a more flexible exchange rate policy, price decontrol, sharply higher prices for maize meal and fertilizer, increases in agricultural producer prices and interest rates, and a number of fiscal actions designed to sharply reduce the budget deficit. The Government obtained a substantial rescheduling of its debt due in 1983 to Paris Club creditors and initiated discussions with other official and commercial creditors. However, at the time of the mid-term review, it became apparent that the implementation of the program was facing difficulties, in large part due to deteriorating external prospects. In order to keep the program on track, many corrective actions were taken, mainly in the area of fiscal policy. In particular, the newly introduced minerals export tax was doubled, and the exchange rate was depreciated by a further 24.1 percent in the period end-June to end-January 1984.

These actions enabled Zambia to make considerable progress toward the program's objectives, as set out in detail in subsections 1-4 below. However, at year-end the country's external position remained precarious, as the authorities continued to encounter a number of difficulties that led to aggregate performance being less favorable than had been anticipated, both at the program's inception and at the mid-term review. In particular, copper prices and export volumes were considerably less favorable than envisaged, and reduced export receipts and foreign exchange shortages affected other areas of economic performance as well. Nevertheless, as illustrated in Tables 2 and 3, all the program's credit ceilings were observed at the end of 1983, but the shortage of foreign exchange led to the criteria on arrears under debt rescheduling agreements and on commercial payments being exceeded (Table 3). Consequently, the last purchase of SDR 67.5 million under the program was not made.

1. External sector

Developments in the external sector in 1983 fell considerably below expectations. There was a severe shortage of foreign exchange, reflecting lower export earnings and reduced inflows of capital and official transfers, including an unanticipated delay until January 1984 in receipt of the Fund purchase of SDR 67.5 million associated with the end-October performance criteria. Preliminary data indicate export receipts were only SDR 853 million, compared with a projection of SDR 963 million at the time of the program's inception and SDR 943 million at the time of the mid-term review in August (Table 4). The shortfall reflected both price and volume factors.

The program assumed an average copper price of US$0.76 per pound for 1983. Until August 1983 world prices were in line with this estimate, which was retained at the time of the mid-term review. However,

Table 2. Zambia: Selected Economic and Financial Indicators, 1981-84

	1981	1982	1983 Program 1/	1983 Prelim.	1984 Program
	(Annual percent changes, unless otherwise specified)				
National income and prices					
GDP at constant prices	4.7	-2.2	--	0.8	--
GDP deflator	9.4	5.6	25-30	17.1	25
Consumer prices	14.0	12.5	25-30	19.6	25
External sector					
Exports, f.o.b. (millions of SDRs)	833	839	963	853	765
Imports, c.i.f. (millions of SDRs)	1,050	1,049	841	775	688
Non-oil imports, c.i.f. (millions of SDRs)	839	878	660	588	532
Export volume	-8.2	7.9	1.8	-4.2	-4.0
Import volume	--	-4.0	-17.0	-19.7	-9.5
Terms of trade (deterioration -)	-14.1	-10.5	2.7	3.4	-7.4
Nominal effective exchange rate (depreciation -) 2/	1.6	-2.8	...	-31.8	...
Real effective exchange rate (depreciation -) 2/	7.9	15.7	...	-15.8	...
Government budget					
Revenue and grants	5.3	4.2	26.9	19.5	15.5
Total expenditure 3/	9.4	8.8	-4.3	-3.7	7.3
Money and credit					
Net domestic assets 4/	41.2	75.3	23.7	22.8	23.9
Government 4/	18.1	49.9	11.4	8.8	12.0
Money and quasi-money (M2)	7.9	33.8	12.5	11.1	15.4
Velocity (GDP relative to M2)	3.5	2.5	2.7	2.9	3.1
Interest rate (maximum lending rate, percent per annum)	12.0	12.0	13.0	13.0	15.0
	(In percent of GDP)				
Central government budget deficit (cash basis)					
Including official transfers	13.4	18.9	5.6	6.9	4.5
Excluding official transfers	14.1	19.7	6.3	7.6	5.3
Domestic bank financing	4.7	13.7	3.7	2.7	3.3
Foreign financing	7.2	3.1	0.5	1.8	-0.3
Gross domestic investment	19.5	16.9	...	15.3	15.5
Current account deficit					
Including official transfers	18.9	17.7	7.4	8.7	10.5
Excluding official transfers	19.6	18.7	8.8	9.8	11.6
External debt 5/	89.7	91.5	...	...	...
Debt service ratio 6/	34.3 7/	50.4 7/	53.3 7/	35.5 8/	91.6 7/
Interest payments 6/ (including Fund charges)	11.5 7/	19.8 7/	18.1 7/	15.4 8/	39.0 7/
	(In millions of SDRs, unless otherwise specified)				
Overall balance of payments	-327 7/	-561 7/	-295 7/	-98 8/	-455 7/
Gross official reserves (weeks of imports)	4.5	6.3	7.8	7.4	7.5
External payments arrears 9/	501 10/	947	695 11/	635 12/	597 11/

Sources: Data provided by the Zambian authorities; and staff estimates and projections.

1/ Data differ from the original program paper to reflect revisions in 1982 data and 1983 GDP estimates.
2/ Year-end data, adjusted for relative consumer prices.
3/ Includes net lending but excludes payment of past arrears.
4/ As a percentage of money and quasi-money at the beginning of the period.
5/ Inclusive of use of Fund credit but excluding all external payments arrears.
6/ In percent of exports of goods and nonfactor services.
7/ Before debt relief.
8/ After debt relief.
9/ Consists of commercial payments arrears, arrears on external debt, and arrears of the mining company.
10/ Excluding unknown amount of arrears on debt service.
11/ Excluding reductions through rescheduling and in kwacha denominated arrears through depreciation.
12/ Excluding reductions through rescheduling.

Table 3. Zambia: Quantitative Performance Criteria, 1982-83

	1982	1983							
	Dec.	April		July		Oct.		Dec.	
	Actual	Ceiling	Actual	Ceiling	Actual	Ceiling	Actual	Ceiling	Actual
	(In millions of kwacha)								
Net domestic assets	2,933.0	3,063.9	2,972.8	3,117.8	2,996.9	3,221.2	2,989.7	3,243.0	3,231.1
Claims on Government	1,983.4	2,058.4	2,110.1	2,158.4	2,127.0	2,158.4	2,055.0	2,158.4	2,098.5
Bank of Zambia claims on ZCCM	165.5	170.5	170.5	170.5	170.5	170.5	165.5	170.5	165.5
	(In millions of SDRs)								
Commercial payments arrears 1/	669.3	669.3 2/	686.5 2/	669.3	659.7	654.3	638.4	639.3	571.0 3/
Arrears under debt rescheduling agreements	...	...	...	--	--	--	--	--	38.0
New external borrowing contracted or guaranteed by Government (cumulative)									
1-10 years' maturity	...	100.0	--	100.0	--	100.0	--	100.0	--
1-5 years' maturity	...	--	--	--	--	--	--	--	--

Memorandum item: Exchange rate (end of period)	Dec.	Jan.	July	Aug.	Sept.	Oct.	Nov.	Dec.	Jan. - Dec.
									(Change in percent)
SDRs per kwacha	0.9763	0.7810	0.7531	0.7031	0.6949	0.6983	0.6657	0.6332	-35.2
U.S. dollars per kwacha	1.0756	0.8458	0.8045	0.7345	0.7345	0.7397	0.6939	0.6619	-38.5

Source: Letter of Intent.

1/ The 1983 arrangement excluded arrears of ZCCM.
2/ Actual end-May.
3/ The total reduction in arrears in 1983 was SDR 98 million, of which SDR 63 million was through a reduction in the SDR value of kwacha-denominated arrears in the pipeline, SDR 15 million through refinancing, and SDR 20 million through cash payments. As the program had envisaged a cash reduction of SDR 30 million, this criterion was not observed.

Table 4. Zambia: Balance of Payments, 1982-84

(In millions of SDRs)

	1982	1983 Program	1983 Revised program	1983 Preliminary actuals	1984 Program
Trade balance	-210	122	157	78	77
Exports, f.o.b.	839	963	943	853	765
Imports, c.i.f.	-1,049	-841	-786	-775	-688
Services and unrequited transfers (net) 1/	-405	-360	-364	-351	-374
Investment income	-226	-217	-221	-236	-253
Other services	-155	-111	-111	-98	-100
Private transfers	-60	-75	-75	-51	-50
Government transfers	36	43	43	34	29
Current account	-615	-238	-207	-273	-297
Nonmonetary capital (net) 1/	33	-57	-63	-43	44
Government	109	-43	-19	11	22
Mining company	96	36	36	-7	22
Other, including errors and omissions	-172	-50	-80	-47	--
SDR allocation/Gold revaluation	21	--	--	-8	--
Debt relief on original maturities (gross relief)	--	267	267	267	--
Debt service due on rescheduled debt 2/	--	-92 3/	-95 3/	-41 4/	-202 5/
Overall balance after 1983 debt relief	-561	-120	-98	-98	-455
Financing:					
Use of Fund resources (net)	-52	150	128	60	74
Purchases	(34)	(264)	(242)	(174)	(148)
Repurchases	(-86)	(-114)	(-114)	(-114)	(-74)
Incurrence of arrears	447	--	--	38 6/	--
Debt service	(222)	(--)	(--)	(--)	(--)
Commercial	(225)	(--)	(--)	(--)	(--)
Rescheduled debt	(--)	(--)	(--)	(38)	(--)
Reduction of arrears 7/	--	-30	-30	-65	-38
Commercial	(--)	(-30)	(-30)	(-65) 8/	(--)
Rescheduled debt	(--)	(--)	(--)	(--)	(-38)
Other foreign assets (net) (increase -)	166	--	--	65	419 9/
Memorandum item:					
Market price of copper (US$/lb.)	0.67	0.76	0.76	0.72	0.65

Sources: Data provided by the Zambian authorities; and staff estimates and projections

1/ Payments represent originally scheduled debt service.
2/ Includes debt service arising from rescheduling of arrears outstanding at the end of December 1982.
3/ Excludes debt service arising from rescheduling of commercial arrears in the pipeline at the end of December 1982.
4/ Relates to the bilateral agreements that were signed by the Paris Club members (except for the Federal Republic of Germany and Italy) in 1983.
5/ Involves the amounts due in 1983 if the bilateral agreements had been signed by the end of 1983.
6/ Represents overdue payments under bilateral agreements concluded in 1983 with Paris Club members.
7/ Excludes cash reduction associated with rescheduling of arrears on debt service.
8/ Comprises pipeline and ZCCM arrears. Includes gross reduction through a refinancing arrangement.
9/ Unfinanced gap.

prices fell sharply in mid-September and averaged only US$0.64 for the last three months of the year, giving an annual average of only US$0.72 per pound. Also, copper shipments were reduced in the first half of the year, due mainly to transportation difficulties in the TAZARA railroad. In addition, toward the end of the year the shortage of foreign exchange began to lead to production difficulties. Thus, export volume was about 575,000 tons, some 6.5 percent below the original program estimate of 615,000 tons. The shortage of foreign exchange constrained the level of imports, which amounted to SDR 775 million, some 8 percent below the original program estimate, and a reduction in volume terms of about 20 percent compared with 1982, with consequent adverse effects on both industrial activity and the government budget.

The balance on services and transfers was about as anticipated, as higher payments due on scheduled debt service were offset by a shortfall in the outflow for private transfers, again mainly due to the shortage of foreign exchange. The current account deficit (before debt relief) thus amounted to SDR 273 million, equivalent to 8.7 percent of GDP, compared with the original program estimate of SDR 238 million, or 7.4 percent of GDP. Aggregate movements of nonmonetary capital were in line with original projections, although within the total the mining company's net inflow position was reversed because of delays encountered in financing a major project, and the Government's position was positive compared with an originally anticipated outflow, partly related to refinancing arrangements for commercial payments arrears and somewhat greater other gross inflows. The overall deficit was SDR 98 million, compared with the original program projection of SDR 120 million. However, there was a deterioration in the underlying balance of payments situation. Following the meeting of the Paris Club in May 1983, the Government had concluded bilateral agreements with most creditors by year-end, 1/ but total payments under these agreements amounted to only SDR 3 million, and there were arrears of SDR 38 million under the bilateral agreements concluded. 2/ Furthermore, a number of other rescheduling agreements relating to payments due in 1983 had not been concluded. These totaled an estimated SDR 106 million, mainly due to commercial creditors, the remaining bilateral 1983 Paris Club agreements, and non-Paris Club governments. An estimated total of SDR 144 million is therefore payable in 1984 in addition to regular 1984 maturities falling due.

The shortage of foreign exchange also prevented the authorities from making all of the SDR 30 million reduction in commercial payments arrears in the pipeline through cash payments that the program had required.

1/ At the end of 1983, bilateral agreements with the Federal Republic of Germany and Italy had not yet been concluded.

2/ In January 1984 the Government made additional payments of SDR 19 million.

However, these arrears were reduced overall by SDR 98 million through a combination of cash payments (SDR 20 million), refinancing (SDR 15 million), and a reduction in the SDR value of kwacha-denominated arrears through the depreciation of the kwacha (SDR 63 million). 1/ Moreover, ZCCM was able to reduce its overdue payments to overseas suppliers of goods and services by SDR 30 million, as compared to the target under the program that such overdue payments should not, as a minimum, increase over 1983. 2/ Consequently, the total reduction of external commercial payments arrears through cash payments and refinancing amounted to SDR 65 million in 1983 (for details see Appendix Table V).

Preliminary data indicate that at end-1983 Zambia's medium- and long-term public debt amounted to SDR 2.5 billion, about the same level as at end-1982. Of this amount 58 percent was accounted for by bilateral Government loans, 20 percent by international agencies, with the remainder on commercial terms. In addition, Zambia's short-term debt is estimated at about SDR 490 million. Thus, Zambia's total indebtedness, including commercial payments arrears and obligations to the Fund, amounted to an estimated SDR 4.2 billion at the end of 1983.

With respect to exchange rate policy, between January 6, 1983 and end-January 1984 the kwacha was depreciated by about 38.5 percent relative to the U.S. dollar, or 62.4 percent measured in local currency terms. This protected the profitability of the mining company despite the drop in export receipts and the imposition of the minerals export tax. It also restored the competitiveness of a number of agricultural crops and provided a basis for export diversification and import substitution. Zambia's nominal effective exchange rate depreciated by 31.8 percent in 1983, while the depreciation of the real effective rate was 15.8 percent (Chart 2). During the first five months of 1984 the kwacha was depreciated by a further 12.4 percent against the U.S. dollar. A review of Zambia's exchange rate policy under the stand-by arrangement was concluded by the Executive Board on January 9, 1984 (EBS/84/274).

2. Public finance

The 1983 program sought to achieve a major part of the domestic adjustment effort through a tight fiscal policy, which aimed at reducing the budget deficit to 5.6 percent of GDP (of this reduction, about 1 percent of GDP was on account of debt relief for interest payments), compared to 18.9 percent for 1982. To achieve this, total expenditure and net lending was to be reduced by 4 percent (a substantial reduction in real terms), while revenues were to be raised 27 percent, despite the stagnant

1/ Includes payments by domestic residents for items such as profits and dividends for which no exchange rate guarantee is given at the time of entering the pipeline. Thus a depreciation reduces the foreign currency value of these arrears.

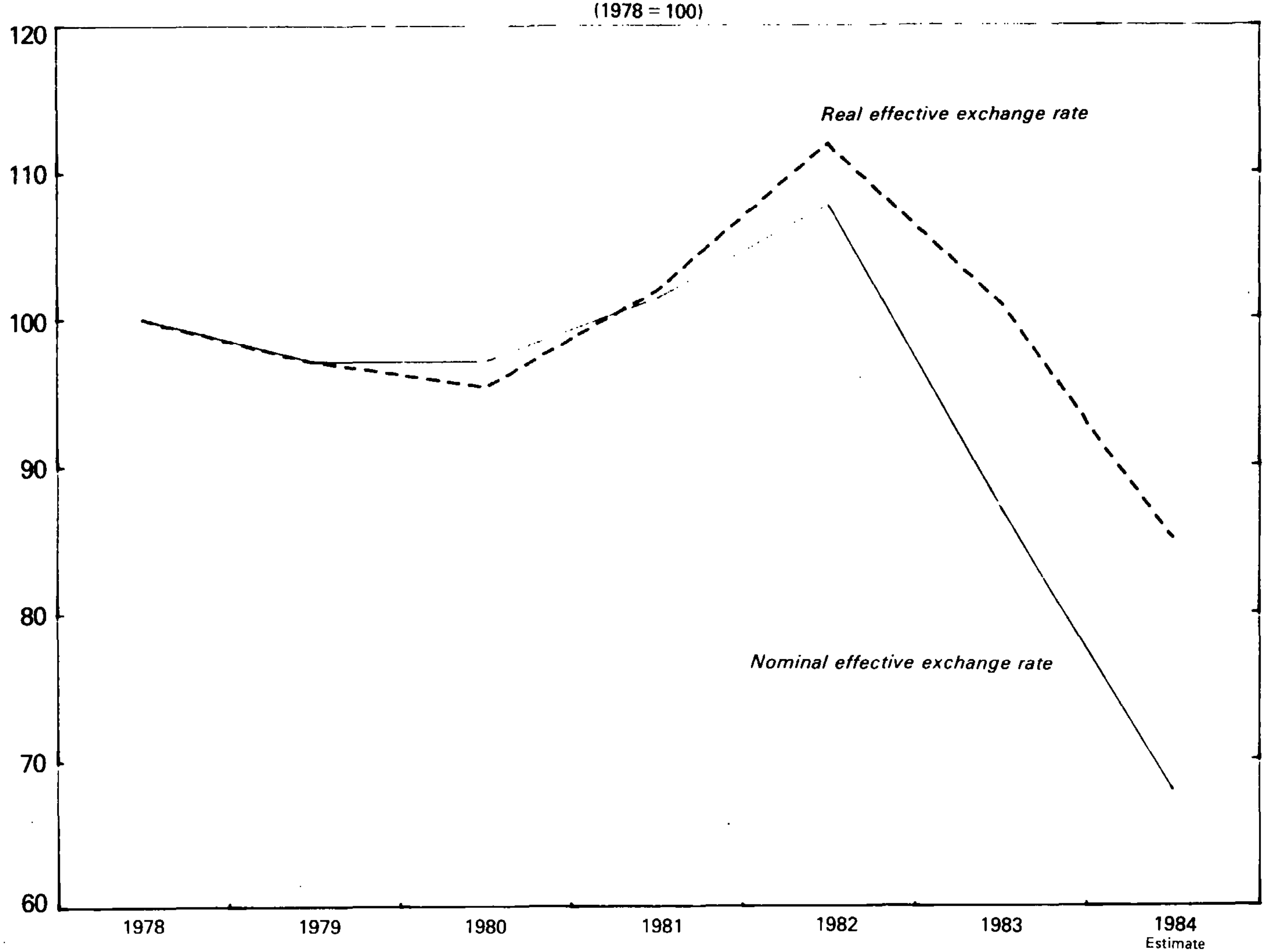
2/ This requirement was not a performance criterion in the program.

CHART 2

ZAMBIA

REAL AND NOMINAL EFFECTIVE EXCHANGE RATES USING CURRENCY BASKET, 1978-84

(1978 = 100)



Source: Staff computation.

economic environment and foreign exchange constraints. Revenue measures equivalent to 3 percent of GDP were introduced, including a new 4 percent tax on all mineral exports and sharp increases in sales taxes and excise and import duties. Measures to contain expenditure included a 12 percent reduction in nominal capital outlays, a reduction in subsidies for maize meal and fertilizer of 35 percent, and strict containment of other recurrent outlays (Table 5). In addition, the program provided for no increase in the level of employment and no general salary increase. However, in order to accommodate the last of three annual wage adjustments that had been announced earlier by the Government and which had aimed at substantial increases for the lowest paid government employees, planned expenditure for personal emoluments was increased by 9 percent. In addition, debt relief was expected to reduce substantially budgeted external interest and amortization payments.

As reported in the staff paper on the mid-term review (EBS/83/176), there was an extraordinarily large carry-over of payments into 1983. As a result, the program's end-April ceiling on net bank credit to the Government was exceeded, and new measures were introduced in mid-year to get the program back on track. The minerals' export tax rate was doubled, and tax collection efforts were intensified. There was to be a scaling back of outlays on capital projects, and anticipated recurrent spending was also to be reduced.

While the authorities implemented virtually all the fiscal measures provided for in the program, provisional information indicates that the 1983 fiscal deficit was higher than expected, with a cash deficit of K 292 million, or 6.9 percent of GDP (Table 5). A shortfall in revenue and grants of K 25 million, or 2 percent from the mid-term review estimate, reflected mainly the impact of the shortage of foreign exchange, which led to a compression in dutiable imports and lower receipts from import license, levies, and dividends. A drop in the personal income tax was more than offset by sharply higher company income taxes, due to improved company profitability following the decontrol of prices and an advance in collections. Total estimated expenditure was K 1,339 million, 4 percent below the nominal level of outlays for 1982 and virtually unchanged from the original as well as revised program estimates. This reflected in part difficulties in quickly implementing the additional reductions in capital and recurrent outlays planned during the mid-term review. The overrun in capital and recurrent expenditures was covered by increased external capital inflows, higher domestic nonbank borrowing, and an increase in arrears on amortization payments. Government borrowing from the banking system amounted to K 115 million, or K 60 million less than the target of K 175 million set at the mid-term review. Moreover, as explained in subsection 1 above, the lack of foreign exchange led to Zambia's not meeting its external obligations, and actual budgetary payments for external interest and amortization were less than envisaged in the program. However, even if the level of debt service obligations that were provided for in the budget had been made, the performance criterion on credit to Government would have been observed.

Table 5. Zambia: Central Government Finance, 1982-84

(In millions of kwacha)

	1982	1983 Program	1983 Revised program	1983 Provisional outcome	1984 program
Revenue and grants	868.2	1,101.7	1,061.9	1,037.2	1,222.8
Tax revenue	744.3	945.9	903.7	941.9	1,071.2
Nontax revenue and grants	123.9	155.8	158.2	95.3	151.6
Total expenditure and net lending	1,389.7	1,329.7	1,295.9	1,338.6	1,461.8
Current expenditure	1,162.1 1/	1,139.7	1,155.5	1,185.3 2/	1,311.8
Personal emoluments	356.3	387.8	387.8	393.8	437.4
Recurrent departmental charges	236.3	2[illegible]3.1	217.1	216.7	228.3
Subsidies	125.5	82.8	82.8	82.8	91.6
Constitutional and statutory	302.6	309.2	322.1	322.3	411.1
Interest payments	(149.6)	(147.0)	(159.9)	(142.8) 2/	(247.7)
Other 3/	(153.0)	(162.2)	(162.2)	(179.5)	(163.4)
Other payments 4/	141.4	156.8	145.7	169.7	143.4
Capital expenditure	100.9)	190.0	140.4	153.3	150.0
Net lending	126.7)				
Payment of arrears	153.0	--	--	-9.4	--
Overall deficit (cash basis)	-674.5	-228.0	-234.0	-292.0	-239.0
Financing	674.5	228.0	234.0	292.0	239.0
External (net)	111.6	19.9	13.6	77.3	-13.3
Gross borrowing	(193.0)	(80.5)	(62.5)	(94.1)	(57.9)
Amortization	(81.4)	(60.6)	(48.9)	(16.8)	(71.2)
Domestic nonbank (net)	38.9	58.1	105.4	125.2	77.9
Domestic bank (net)	488.8	150.0	175.0	115.1	174.4
Other	35.2	--	-60.0	-25.6	--
Memorandum item					
Estimated reduction in debt service payments as a result of debt rescheduling 5/	--	161.2	165.0	165.0	376.9

Sources: Ministry of Finance, Financial Reports (Annual), 1979-82; Estimates of Revenue and Expenditure, 1984; data provided by the Zambian authorities; and staff estimates.

1/ Excludes payment of arrears of K 153 million.
2/ Includes incurred arrears on external interest of K 9.4 million.
3/ Mainly defense expediture on wages and goods and services.
4/ Mainly transfers.
5/ Effects of current year's rescheduling only. It includes relief on principal and interest payments for current maturities, rescheduled payments falling due in 1984, and arrears.

3. Monetary policy

In accordance with the program's fiscal policies, the banking system's credit to Government was to be sharply reduced, from K 489 million in 1982, equivalent to 50 percent of the end-1981 stock of broad money, to K 175 million, or 13 percent of end-1982 broad money. Additional Bank of Zambia credit to ZCCM, which in 1982 had been used to finance operating losses, was to be eliminated, on account of the reversal in the company's finances. Credit to the nongovernment sector was programmed to rise by 19 percent in line with projected cost and price increases and the level of economic activity, particularly in the agricultural sector. In summary, total net domestic assets were programmed to rise by 11 percent, and, after allowing for the loss of net foreign assets, broad money was to increase by 14 percent, about half the projected increase in nominal GDP, compared with a 34 percent increase in 1982. The program also provided for increases in interest rates of between 1 and 3.5 percent.

As noted above, the performance criterion on banking system credit to the Government was observed, as was the limit on Bank of Zambia credit to ZCCM. Credit to the nongovernment sector (excluding ZCCM) rose by 16 percent (Table 6), with demand particularly strong in the latter half of the year from the agricultural sector, especially from commercial farmers. There was also a sharp increase in other assets (net) during the last quarter of the year, in part due to valuation adjustments and timing differences on foreign payments, particularly those involving the pipeline of commercial payments arrears. As a result of these factors, net domestic assets of the banking system were only slightly below the ceiling for end-December. If budgetary payments for external debt service had been made as originally budgeted, the net domestic assets criterion would have been exceeded. The increase in broad money was only 11 percent, compared with the increase in nominal GDP of 18 percent. As a result, the velocity of broad money in circulation rose to 2.9 compared with 2.5 in 1982.

4. Production, prices, and wages

The program anticipated no increase in real GDP, despite the assumption of a modest increase in copper production from 604,000 tons to 615,000 tons and a rise in copper prices from an average of US$0.67 per pound to US$0.76 per pound. Agricultural output was expected to be poor, in view of low rainfall during the first part of the 1982/83 growing season. In addition, the critical shortage of foreign exchange was expected to cause output in other sectors to stagnate, thereby offsetting (along with agriculture) any gains achieved in the mining sector. The GDP deflator was expected to rise by 25-30 percent, reflecting the decontrol of most prices, the reduction in budgetary subsidies, and the effect of depreciation and exchange rate scarcity on the cost of imported intermediate goods for production.

Table 6. Zambia: Monetary Survey, 1981-84

(In millions of kwacha, end of period)

	1981	1982	1983	1984 Mar. (Actual)	1984 June (Proj.)	1984 Sept. (Proj.)	1984 Dec. (Proj.)
Net foreign assets	-1,195.1	-1,484.6	-1,875.9	-1,989.5	-2,028.0	-2,105.0	-2,181.0
Net domestic assets	2,291.4	2,933.0	3,231.1	3,265.0	3,417.6	3,500.5	3,579.0
Credit to Government	1,494.5	1,983.4	2,098.5	2,165.0	2,198.5	2,238.5	2,273.5
Bank of Zambia credit to mining company	57.0	160.5	165.5	165.5	165.5	165.5	165.5
Credit to nongovernment sector	703.3	744.9	867.0	874.9	953.5	996.4	1,039.9
Other assets (net)	36.6	44.2	100.1	59.6	100.1	100.1	100.1
Money and quasi-money	978.7	1,309.2	1,454.1	1,393.7	1,579.6	1,630.5	1,678.0
Other liabilities 1/	117.6	139.2	-98.9	-118.2	-190.0	-235.0	-280.0

Sources: Data provided by the Zambian authorities; and staff projections.

1/ SDR allocation, revaluation of official gold holdings, and revaluation losses.

Provisional data indicate that real GDP rose by just under 1 percent in 1983, while nominal GDP increased by 18 percent. Real value added in the mining sector increased by 8.4 percent despite a significant fall in production to 575,000 tons, as the cost reduction program increased domestic value added per unit of output. In addition, agricultural output rose by more than 8 percent, with an even larger increase in the commercial farming subsector, reflecting somewhat better weather conditions and the effects of increased producer prices. Real value added elsewhere in the economy decreased, responding not only to the effects of foreign exchange scarcity but also to the cut in nominal government expenditure. Construction output in particular fell by more than 25 percent in real terms, while real manufacturing output fell by 2 percent.

The increase in prices was somewhat less than expected when measured on a full-year basis. The GDP deflator rose by 17.1 percent, and consumer prices also rose somewhat less than expected, with the price index for low-income consumers rising by 19.6 percent on a year-over-year basis and the high-income index increasing by 17.7 percent. Measured on a year-end over year-end basis, however, consumer price data showed somewhat larger increases, with the low-income index rising by 23.5 percent and the high-income index by 19.2 percent. Average wages in the parastatal sector increased by 9-10 percent over the year, rather than the 5 percent announced initially as an economy-wide guideline. To some extent this reflected the outcome of negotiations in the key mining sector, where workers accepted a two-year wage agreement, limiting increases to 10 percent yearly over the 24-month period beginning August 1983. The program's wage policies were supported by guidelines developed by the Prices and Incomes Commission, which has powers to review wage agreements as well as to monitor prices through the economy.

Price decontrol, efforts at improving productivity, and the improved copper situation led to better performance in the parastatal sector. Numerous ZIMCO enterprises reported profits, and the financial situation of ZCCM improved substantially, as the depreciation of the kwacha offset the effects of the 10 percent wage increase granted to the mining union and the smaller-than-anticipated rise in copper prices (to US$0.72 per pound rather than US$0.76 per pound). During its 1983/84 fiscal year ZCCM earned a before tax profit of K 95.5 million as against a loss of K 126.9 million the previous year (Table 7). Moreover, the company achieved a breakeven position after payment of taxes, compared with a loss of K 130.6 million the preceding year. However, the continuing shortage of foreign exchange adversely affected ZCCM's productive capacity, and in August the Government introduced a scheme whereby the company could retain 25 percent of its export receipts in foreign exchange; this amount was increased to 35 percent in January 1984. Losses began to emerge toward the end of the year at the country's oil refinery and distribution company (ZNEL), as petroleum prices were not adjusted in keeping with the rise in import costs attributable to the depreciation of the kwacha. Higher import costs also contributed to

Table 7. Zambia: ZCCM, Consolidated Profit and Loss Account, 1980/81-1984/85 1/

(In millions of kwacha)

	1980/81	1981/82	1982/83	1983/84	1984/85 Proj.
Sales	1,093.3	974.7	969.8	1,413.4	1,763.3
Of which: copper	(968.8)	(867.7)	(867.8)	(1,278.8)	(1,489.2)
Cost of sales	1,082.7	1,080.3	1,047.1	1,158.6	1,320.1
Profit/loss (-) on sales	85.6	-105.6	-77.3	254.8	443.2
Other costs 2/	51.3	36.1	49.6	159.3	246.1
Profit/loss (-) before taxation	34.3	-141.7	-126.9	95.5	197.1
Profit/loss (-) after taxation 3/	56.5	-148.0	-134.8	0.2	53.4

Source: Zambia Consolidated Copper Mines, Ltd.

1/ The ZCCM fiscal year is April 1-March 31.
2/ Primarily interest costs.
3/ Including taxation recoverable from the carry-back of losses against profits for the previous year.

heavy losses at the fertilizer company (NCZ), which has suffered from continuing technical problems that have raised costs by keeping production far below potential capacity.

IV. Outlook for 1984 and Proposed Economic and Financial Program

The main objective of the program for 1984 is to consolidate the progress made in 1983 toward reducing domestic and external imbalances. In pursuit of this, policies are being adopted to strengthen the finances of the public and mining sectors and to contain domestic demand, particularly consumption expenditure, to a level consistent with available resources. The program also aims to continue the process of strengthening incentives for the agricultural and manufacturing sectors, thus providing the conditions necessary for diversification of the economy away from the dominant mining sector and for the resumption of a reasonable level of economic growth and development when external conditions permit.

The major assumptions underlying the program's projections, as well as the principal elements of the program, are summarized in Table 8. The most crucial assumptions concern external developments. The program assumes an appropriate level of debt relief following the Paris Club meeting, tentatively scheduled for mid-July. In addition, the program assumes an average copper price of US$ 0.65 per pound and an export volume of 530,000 tons. The staff considers these assumptions to be realistic on the basis of detailed discussions with the mining company and prevailing conditions on world markets. 1/ The program would be severely disrupted by any unanticipated decline in world copper prices, which averaged US$0.65 per pound in the first five months of 1984, and the staff will maintain close contact with the Zambian authorities, with a view to their quickly taking compensating additional action in the event of significant divergence from the program's assumptions, particularly regarding export receipts.

1. External policies

Zambia's external position remains precarious despite the domestic adjustment achieved during the 1983 program. At the time of that program's inception, a copper price of US$1.05 per pound was anticipated for 1984, which was revised to US$0.90 per pound at the time of the mid-term review in August 1983. The present program is based on a price of only US$0.65 per pound, compared with an average 1983 price of US$0.72 per pound. In view of the dominance of the mining sector in Zambia's exports and domestic value added, and its impact on the government budget, the economy remains highly vulnerable to any further adverse external developments.

1/ The estimate used in connection with the April WEO exercise was US$0.79 per pound.

Table 8. Zambia: Summary of Financial Program for 1984

	1982	1983 Prov.	1984 Prog.
Assumptions			
Real GDP growth (in percent)	-2.2	0.8	--
Consumer prices	12.5	19.6	25.0
Change in terms of trade	-10.5	3.4	-7.4
Exports, f.o.b.: (millions of SDRs)	839	853	765
of which: copper:			
Volume (thousands of tons)	604	575	530
Price (US$ per pound)	0.67	0.72	0.65
Targets			
Current account deficit (including grants)(millions of SDRs)	615	273	297
As percent of GDP	18.7	9.8	10.5
External payments arrears (end of period - millions of SDRs)	947	635	597
of which: commercial payments arrears 1/	725	597	597 2/
Arrears under debt rescheduling agreements	--	38	--
Reduction in arrears through cash payments	--	20	20 3/
Budget deficit - (including grants) (percent of GDP)	18.9	6.9	4.5
Total expenditure (percent increase)	8.8	-3.7	9.2
Total revenue (percent increase)	4.2	19.5	17.9

Sources: Letter of intent; and staff estimates and projections.

1/ Includes arrears of the mining company but excluding reductions through rescheduling.
2/ Excludes reductions through depreciation of the kwacha in the case of Kwacha denominated arrears.
3/ To be applied from the end-March 1984 level.

Table 8. Zambia: Summary of Financial Program for 1984 (continued)

Principal elements

1. External sector

Flexible effective exchange policy, with monthly monitoring and adjustments.

Successful rescheduling of external debt with Paris Club and other official and commercial creditors.

Improved foreign exchange budgeting system; better coordination with import licensing.

Increase in foreign exchange retention of ZCCM to 35 percent of all proceeds.

Legalization of emerald mining for private sector, marketing to be conducted by Reserved Minerals Corporation at market related prices with 10 percent of foreign exchange to be retained by the producer.

No arrears under debt rescheduling agreements.

Reduction in commercial payments arrears of SDR 20 million from end-March 1984 level, excluding reduction from rescheduling or refinancing.

No new government-guaranteed loans on commercial terms with maturities of 1-5 years and for loans up to and including one year, other than for trade and bridge financing. An SDR 50 million limit on new government borrowing on commercial terms with maturities of 5-12 years.

2. Budget

Budget deficit (cash basis) limited to K 239 million (4.5 percent of GDP), with domestic bank borrowing limited to K 175 million.

New tax measures equivalent to K 73 million.

Expenditure growth limited to 9.2 percent.

Expenditures on personnel emoluments limited to K 437.4 million, with freeze on net employment levels outside ministries of health, education, and agriculture. Implementation of study of employment levels aimed at freezing and, if possible, reducing total government employment in 1985 budget.

Table 8. Zambia: Summary of Fianncial Program for 1984 (continued)

Establishment of blocked account for external debt service payments, with monthly payments in domestic currency by the Treasury irrespective of the availability of foreign exchange.

3. Money and credit

Increase in net domestic assets limited to 11 percent; increase in credit to nongovernment sector limited to 20 percent.

No increase in Bank of Zambia credit to ZCCM.

Increase in broad money limited to 15 percent.

Increase in maximum interest rate to 15 percent; other rates increased on average by 2 percentage points.

4. Pricing and other structural policies

Implementation of additional measures to reduce costs and increase efficiency at ZIMCO subsidiaries, including K 50 million in savings from new measures at ZCCM, and World Bank studies of improved performance for the oil refinery and NCZ.

Inrease in producer price for maize to K 28.30 per bag for 1984/85, and cooperation with World Bank in formulating medium-term policies for the agricultural sector.

Increase in wholesale prices for petroleum prices averaging 35 percent (effective April 11, 1984).

Increase in beer prices of K 0.08 per bottle.

Rise in retail maize meal price of K 6.5 per 90 kg/bag, or 21.7 percent.

Increase in sale price of fertilizer of K 2.7 per 50 kg/bag, or 11 percent.

Exports in 1984 are projected to decline by 10 percent, or SDR 88 million, to SDR 765 million. The decline is anticipated, despite higher export receipts from cobalt, which are expected to more than double to about SDR 80 million, reflecting sharply higher export volume and world prices. Nevertheless, copper will still account for about 85 percent of total exports. In addition to declining world copper prices, it is expected that export volume will decline by some 7.8 percent to 530,000 tons. This reflects production difficulties in the early part of the year, mainly on account of the shortage of foreign exchange, leading to shortages of essential inputs. In addition, ore grades have been lower than anticipated and there have been transportation difficulties at the port leading to unintended stock increases. In 1984 imports will be constrained to SDR 688 million, or SDR 87 million below the 1983 level in nominal terms. In terms of import volume, there would be a decline of 5 percent in 1984 for items other than oil, maize, and fertilizer, and total import volume would remain 10 percent below the 1983 level and about 55 percent below the level of 1970. In view of the heavy import dependence of the mining, agricultural, and manufacturing sectors, any further reduction in import volumes would likely lead to a downward spiral of falling output and export earnings.

The balance on services and unrequited transfers (before debt relief) is projected to worsen by some SDR 23 million to SDR 374 million, because of high payments due on originally scheduled debt service, and the current account deficit would deteriorate by SDR 24 million to SDR 297 million (Table 4). Such a deficit is clearly unsustainable in view of Zambia's debt service commitments and prospective capital inflows and other balance of payments financing. As shown in Table 12, before taking account of any debt rescheduling for 1984, and including the carry-over of SDR 144 million of 1983 debt service payments not met by year-end both to the Paris Club and other creditors, total debt service payments due in 1984 would amount to SDR 792 million, including the elimination of arrears of SDR 38 million under 1983 debt rescheduling agreements, giving a debt service ratio, including payments to the Fund, of 92 percent; excluding payments to the Fund, the ratio would be 76 percent. Of the total amount of debt service due in 1984, SDR 206 million, or 26 percent, is due to international organizations and is therefore not subject to rescheduling. However, a further SDR 195 million, or 25 percent of the total is due to Paris Club members, and it is estimated that a similar amount is due to other official bilateral sources; these amounts include payments due on debt previously rescheduled in 1983. Medium-term debts to commercial banks account for less than 10 percent of total debt service due.

Taking account of the use of Fund resources in 1984 under the proposed stand-by arrangement, there would be an unfinanced gap of SDR 419 million, as shown in Table 4. To close this gap, the Government has requested additional debt rescheduling and assistance from donors, and has adopted a number of policies to strengthen the balance of payments position.

The Consultative Group for Zambia met in Paris on May 22-24, 1984 under the Chairmanship of the World Bank. At this meeting, the Government of Zambia presented to the participating donors its development strategy, and outlined a number of economy-wide and sectoral policy reforms. Moreover, the Government presented the Group with an expenditure program for 1984-86 totaling US$1.7 billion in line with its development strategy. The World Bank and the participating donors endorsed the priorities incorporated in the expenditure program. The external capital requirements presented to the meeting involved a total for new comitments of $1.5 billion for the period 1984-86. The donors represented at the meeting were asked to commit $400 million a year of this, half of which should preferably be in the form of quick-disbursing assistance; such a level of commitment would be 30 percent higher in nominal terms than that of 1980-82. In his concluding statement the Chairman noted that the response of the donors had been gratifying, and that he had hopes that the aid target could be reached. Within their total commitments of new assistance, a number of delegations pledged to provide quick-disbursing assistance to support Zambia's balance of payments in 1984 either in the form of cash or general commodities. While the timing of this assistance is difficult to predict, it is estimated that it could be of the order of SDR 30 million.

The 1984 external position is critically dependent on the level of payments to be made for debt service. The Government has already submitted a request to the Paris Club requesting further debt rescheduling on exceptional terms, and a meeting has been tentatively scheduled for July 1984. Approaches have also been made to other official and commercial creditors, and the Government intends to comply strictly with such conditions as the Paris Club may set regarding the terms of debt rescheduling to be obtained from other creditors. While it is not possible to indicate the precise amount of debt relief that can be obtained for 1984, the program's targets and policies assume that the additional debt rescheduling to be obtained from the Paris Club and other creditors, combined with the prospective use of Fund resources, will be sufficient to eliminate the estimated unfinanced balance of payments gap of SDR 419 million for 1984. The first test of this assumption will be the forthcoming Paris Club meeting. In order to cover the financing gap, a rescheduling of previously rescheduled debt will be required. The Zambian authorities intend to apply the same terms to other official creditors. On this basis, it would be possible to link the effectiveness of the proposed arrangement to the results of the Paris Club meeting. Progress on debt rescheduling with Zambia's creditors will be a central element in each review of the arrangement.

The Government will continue to maintain a flexible exchange rate policy during 1984, notwithstanding the substantial depreciation undertaken during 1983. The main objectives of this policy will be to maintain the financial viability and operating efficiency of the mining sector, to continue to promote export diversification, and to achieve a better balance between supply and demand for external resources. As noted above, the 1983 depreciation, combined with other actions of the mining company, has restored the profitability of its operations. In addition, a recent comprehensive study of the agricultural sector by the World Bank indicates that the existing exchange rate provides adequate financial incentive for the production of a large number of agricultural goods, both for export and for import substitution. Exchange rate policy for 1984 will be geared toward preserving these incentives. In pursuing this policy, the Government intends to monitor the situation on a monthly basis, particularly regarding any adverse developments in the mining sector, and will make monthly adjustments of the exchange rate. The Government will review exchange rate policy with the Fund during each review of the program.

Reflecting the program's exchange rate policy and current projections of output and world prices, ZCCM is expected to generate an operating profit in 1984/85, even after payment of an estimated K 126 million for the minerals export tax, and to have a positive cash flow. Nevertheless, following the successful cost reduction programs of 1982 and 1983, further measures have been identified to raise efficiency, conserve foreign exchange through increased domestic value added, and improve ZCCM's financial position and profitability. These measures are estimated to save about K 50 million during 1984. An export retention scheme was introduced in 1983 to ease the foreign exchange constraint on ZCCM's productive capacity, and the authorities will monitor the situation closely in cooperation with ZCCM management to ensure that the program's production targets are attained. In addition, the Government and ZCCM have been collaborating with the World Bank and other multilateral agencies in formulating medium-term policies for the mining sector. In support of these policies, in March 1984 the Bank approved an export rehabilitation and diversification loan amounting to US$75 million as part of a US$300 million rehabilitation project cofinanced by the EEC and the African Development Bank. Progress also continues to be made toward disbursements under the Tailings Leach project being financed by a group of commercial and multilateral lenders led by IFC, which will significantly raise export volumes from 1986 onward, as discussed in Section V below.

The authorities are also making efforts to expand and diversify the export base through improved financial incentives, in addition to the impact of the depreciation of the exchange rate, as well as administrative actions. Licenses for mineral prospecting throughout the country are being sold, with the aim of improved exploitation, particularly of emeralds, and the channeling of exports through official channels. The Reserved Minerals Corporation (RMC) has become a buying and marketing agency for emeralds, offering competitive world prices, and producers will be able to retain 10 percent of RMC's purchase price in foreign exchange to be used for imports, subject only to regular import licensing regulations. In addition, foreign-owned companies are being invited to participate in the industry in partnership with RMC, and one joint venture has already been initiated. Continuing efforts are being made to improve the foreign exchange allocation system introduced in 1983, to enable the Government to direct foreign exchange resources toward priority areas such as export promotion while balancing the issuance of licenses with available foreign exchange. Also, to improve export diversification, effective April 1, 1984 the Government established preferential tax treatment of profits from nontraditional exports. Moreover, a scheme was introduced in February 1984 whereby nonmineral exporters are allowed to retain 50 percent of export proceeds to be used for their own imports, subject only to regular import licensing regulations. The Government is also endeavoring to reduce administrative bottlenecks in respect of exports.

As noted earlier, during 1983 Zambia's external commercial payments arrears were reduced considerably. At the same time, due to the extreme shortage of foreign exchange, there were arrears of SDR 38 million at end-1983 on debt rescheduling agreements concluded, 1/ and commercial payments arrears rose by SDR 20 million during the first quarter of 1984. During 1984 the Government will eliminate the external debt arrears through cash payments and additional debt rescheduling. The phasing of this elimination will be determined following the Paris Club meeting scheduled for July 1984. Thereafter Zambia will remain current on its obligations under debt rescheduling agreements. Furthermore, by year-end, as a minimum, commercial payments arrears will be reduced by SDR 20 million, through cash payments, from the end-March 1984 level.

In view of Zambia's existing large debt burden and external position, the program contains strict limits on new government or government-guaranteed borrowing on commercial terms. Such borrowing with an original maturity of more than 5 years and up to 12 years will be limited to SDR 50 million, and no such borrowing will be contracted with more than 1 year and up to 5 years' maturity. The Government will also not contract or guarantee commercial loans with maturities up to and including one year, except for trade financing and bridging loans. The Government will seek to utilize more concessional sources of finance, including assistance from the World Bank and other multilateral and bilateral donors, particularly in areas that can be expected to enhance the country's productive capacity. Where necessary, the Government will support such loans through required policy actions.

In view of its external position, the Government is not yet in a position to relax existing restrictions on imports maintained for balance of payments purposes and on payments and transfers for current international transactions, except for the programmed reduction in payment arrears.

2. Public finance

The program's external policies are to be supported by appropriate demand management policies, geared toward restraining public sector

1/ Of this amount, SDR 19 million was paid during January 1984.

consumption while aiming to provide for an adequate level of productive expenditure. To this end, the 1984 program aims to reduce the overall deficit to K 239 million, or 4.5 percent of GDP, compared with K 292 million, or 6.9 percent of GDP, in 1983. Within these totals, external interest payments will increase. Net of these payments, the deficit will be reduced from K 239 million in 1983 to K 111 million, or from 5.6 percent of GDP to 2.1 percent of GDP. The reduction will be achieved through a combination of measures to reduce real expenditures and to raise revenue.

Revenue and grants are programmed to increase by about 18 percent to K 1,223 million, slightly below the increase in the previous year. Nontax revenue is estimated to increase by K 45 million principally on account of dividends from the Bank of Zambia (K 12 million), increase in the import levy (K 10 million), mining license fees (K 12.0 million) and interest on loans and investments (K 8.0 million), while grants are programmed to increase by K 11 million. Tax measures estimated to yield K 46 million were introduced in the 1984 budget with the aim of replacing revenue lost due to the shrinking of the bases of dutiable imports and company income resulting from the foreign exchange constraint. These include increases in excise taxes on soft drinks, cigarettes, alcoholic beverages, and petroleum products (totaling K 27 million), a new procedure requiring the purchase of licenses prior to prospecting or mining aimed at the increased exploitation of emeralds (K 10 million), new taxes on imported capital goods (K 8 million), and increases in sales and miscellaneous taxes (K 1 million). Subsequently, further tax measures are being taken to ensure that the program's overall fiscal targets are attained. Effective August 1, 1984 the basis for taxing imports is being changed from f.o.b. to c.i.f. and a new minimum rate of import duty of 10 percent is being introduced for all items other than petroleum, government imports, and certain items exempt by law. These changes are estimated to yield about K 67 million on a full-year basis, and K 27 million during the remainder of 1984. In addition, institutional changes include the creation of a new revenue unit within the Ministry of Finance, and recruitment of staff for the customs and excise and income tax departments to improve the efficiency of tax administration. Measured as a proportion of GDP, Zambia's tax yields remain high in comparison with other sub-Saharan African countries.

Total expenditure and net lending are programmed to rise by 9.2 percent to K 1,462 million, substantially below the expected increase in prices. Personal emoluments are budgeted to increase by 11 percent on account of wage drift of about 6 percent and a modest increase in salaries for the lowest paid workers, that will add about 5 percent to the total wage bill. The salary increase applies only to workers earning at most K 7,540 per year, and ranges from 11 percent for the lowest paid workers to 1 percent for those at the upper limit. As in 1983, there will be no general wage increase; during the two-year period 1983-84, the wage bill will rise by 23 percent, compared with an expected increase in consumer prices of about 50 percent for the same period. Regarding the level of employment, current and new vacancies will be filled only in the Ministries of Health, Education, and Agriculture as well as certain revenue collecting departments in the Ministry of Finance. The Government is fully aware of the need to contain, and if possible reduce the level of public sector employment in view of Zambia's economic circumstances. To this end a comprehensive review of employment is being undertaken, to be completed prior to the 1985 budget, with particular emphasis on the Ministries of Health, Education, and Youth and Sports. Recurrent departmental charges are budgeted to rise by 5 percent, and within this limit efforts will be made to provide adequately for the recurrent cost of ongoing development projects. The provision for subsidies will rise by only K 9 million to K 91.6 million, which represents a substantial reduction in real terms. This will be achieved through further substantial price increases for maize and fertilizer, as detailed in subsection 4 below. Transfer payments will be reduced by 15 percent compared with the 1983 outturn by strictly limiting the operating costs of decentralized public agencies.

With respect to interest and amortization payments for debt service, the Government's request for debt relief from official and commercial creditors will also reduce the burden on the government budget. Nevertheless, because of the carry-over of payments from the 1983 debt rescheduling, there will be a substantial increase in government interest and amortization payments compared with payments made in 1983, which will lead to an expected negative flow of external net financing of K 13 million. To ensure that the Government remains current on its domestic currency payments to the Bank of Zambia for external debt service, regardless of the availability of foreign exchange, a blocked account has been established at the Bank of Zambia, into which payments will be made each month so that the full year's debt service will have been paid into the account by year-end. The program provides for capital expenditure (including net lending) of K 150 million which is confined mainly to the rapid completion of ongoing projects of a productive nature. This amount compares with an original 1983 program amount of K 190 million, and estimated actual outlays of K 153 million. Domestic nonbank financing of the budget deficit is expected to be K 78 million, a sharp reduction from the exceptionally high level of 1983 and in keeping with trends for this item over several years. In combination, the above measures will enable the Government to contain bank financing of the budget deficit to K 175 million.

The programmed level of expenditure represents a further substantial adjustment, in continuation of the progress made in 1983. For the period 1980-82, current expenditure (excluding interest payments) had averaged almost 30 percent of GDP. In 1983 this proportion was reduced to 25 percent of GDP, and the 1984 program provides for a further reduction to about 20 percent of GDP. The adjustment is particularly marked in the area of subsidy payments, which for 1980-82 averaged 4.6 percent of GDP, were reduced to 2 percent of GDP in 1983, and are budgeted at 1.7 percent of GDP for 1984. It will be essential to maintain the program's expenditure and overall budgetary targets, and, in the event of a shortfall in revenue or any unanticipated expenditure overruns, the Government is committed to the introduction of further compensatory fiscal measures. The Government is also committed to remain current on all its payments obligations. In addition, the Government has requested technical assistance from the Fund in the areas of budgeting and expenditure control, and a technical assistance mission on this subject has already visited Zambia.

3. Monetary policies

The program provides for continued cautious monetary policies with a view to containing the pressures on domestic prices and additional strains on the demand for foreign exchange through excessive credit creation. As noted above, the increase in credit to Government will be limited to K 175 million, an increase of 8 percent; the improved financial position of the mining company has eliminated the need for it to seek domestic financing from the Bank of Zambia to cover operating losses. Thus the program is able to provide for an increase of 20 percent in credit to the nongovernment sector, compared with 16 percent in 1983, within a ceiling of an 11 percent increase in the net domestic assets of the banking system. The increase in nongovernment sector credit is estimated to be adequate in view of the projected levels of real and nominal GDP growth and the impact of the program's pricing policies for the agricultural and manufacturing sectors, which are the major users of credit. Taking account of expected external developments, an increase of 15 percent in broad money is anticipated, compared to the projected growth in nominal GDP of 25 percent.

Despite the increases introduced in 1983, interest rates in Zambia remain negative in real terms. Therefore, to provide further incentives for domestic savings, restrain demand, and improve the allocation of credit, all interest rates have been adjusted further by an average of 2 percentage points, effective May 16, 1984. These increases include an increase of two percentage points in the maximum lending rate to 15 percent, which considerably widens the band of interest rates on commercial bank lending. Commercial banks will thus have more flexibility in setting interest rates for different types of loans, which will enable lending policy to reflect the relative riskiness of alternative loans. The authorities are also considering possible measures to ensure adequate provision of loans to the agricultural sector.

4. Supply oriented policies

The program for 1984 assumes no increase in real GDP, although nominal GDP is expected to rise by 25 percent, reflecting further increases in producer and consumer prices, as noted below, and the impact of exchange rate changes on the domestic cost of production inputs.

Copper output is expected to decrease by some 8 percent, reflecting production difficulties in the early part of the year, and low rainfall during the 1983/84 growing season will prevent any substantial increase in agricultural output despite improved incentives. Increased credit availability and improved efficiency in the allocation of scarce foreign exchange resources may lead to some offsetting increase in manufacturing and commerce.

In view of the limited remaining life of Zambia's mineral reserves and the uncertain future demand for copper, the program seeks to continue the process of providing a basis for the diversification of the economy through improved incentives for agriculture and increased efficiency in manufacturing. This should facilitate a resumption of a reasonable level of economic growth when external conditions permit. In support of this objective, producer prices for 1983/84 were raised by amounts ranging from 12 percent to 42 percent. For maize, Zambia's basic staple, the increase amounted to 32 percent, from K 18.50 to K 24.50 per 90 kg/bag. These price increases are being reflected in higher consumer prices, as noted below. On May 1, 1984 new producer prices were announced for the 1984/85 crop year with increases averaging 21 percent, including a further increase of 16 percent in the price of maize to K 28.32 per bag, in order to continue to ensure adequate financial incentives for crops for domestic consumption. The authorities are cooperating closely with the World Bank on formulating medium-term policies for the agricultural sector, including appropriate producer prices, and the World Bank is processing an Agriculture Sector Rehabilitation credit. Policy measures to improve medium-term performance have already been agreed, particularly in the areas of marketing, distribution, and the pricing of services and inputs, as well as incentives to producers. These policies will also enhance productivity by expanding the current research and extension services to small-scale and emergent farmers and by gradually introducing competition in the marketing of agricultural goods. It is also intended to give high priority to imports of agricultural inputs such as feed supplements, since shortages of these items have seriously impaired agricultural output over the past several years. Measures are also being taken to improve the availability and efficient operation of the system of agricultural credit. The Zambian Agricultural Development Bank has been instituted and has commenced operations. In this regard, the Government intends to review the role of the Agriculture Finance Company with a view to its abolition, so as to rationalize the provision of agricultural credit in the country.

The Government is continuing its efforts, initiated in the context of the 1983 program, to reduce costs and increase managerial efficiency in state enterprises, coordinated by the parastatal holding company (ZIMCO). These efforts, in conjunction with price decontrol, have already restored profitability in many ZIMCO subsidiaries and reduced losses in others. Furthermore, the World Bank has prepared an industrial sector report which outlines possible policy reforms in that sector.

The authorities intend to review the policy proposals with the Bank staff at an early stage and to request financial support from the Bank in this area. In addition, a study funded in part by the World Bank is under way to review and suggest measures for rationalizing operations at NCZ, Ltd., the domestic fertilizer plant, and an agreement has recently been concluded with bilateral donors for its rehabilitation. Moreover, efforts are already underway to increase output and reduce losses, mainly through improved technical and managerial performance as well as increased prices. Also in conjunction with the World Bank the Government is reviewing the operations of Zambia's petroleum refinery, to determine the possibilities for converting production so that output can better satisfy domestic needs and foreign exchange requirements can be reduced. These and other reforms are aimed at strengthening ZIMCO's ability to contribute to the government budget, through improved efficiency and pricing reforms that allow cost recovery plus a reasonable profit that reflects the cost of capital for competing objectives.

The Government remains committed to its declared policy of economic pricing throughout the economy to avoid the emergence of losses in the private and parastatal sectors. To this effect, effective April 11, wholesale prices for petroleum products were increased by an average of 35 percent (with larger increases for kerosene and diesel), so as to pass through the rise in import prices, to eliminate outstanding losses at ZNEL, and to encourage conservation of fuel. These increases are in addition to those introduced in January 1984 for aviation fuel and a variety of other products. Moreover, petroleum prices will continue to be adjusted in line with changes in costs. In addition, ZIMCO raised the domestic price of beer by K 0.08 per bottle on top of the K 0.02 per bottle rise in excise tax approved in the 1984 budget. Further, to preserve the financial viability of NAMBOARD and limit budgetary subsidies for maize and fertilizer, the following price increases have been approved:

(i) Consumer prices for maize meal products will be increased by 21.7 percent, or K 6.5 per 90 kg/bag, effective July 1, 1984 reflecting transport and processing costs and the rise in producer prices to K 24.50 per bag for 1983/84.

(ii) NAMBOARD's sale price for fertilizer was raised by 11 percent, effective May 1, 1984, from K 24.10 per 50 kg/bag to K 26.75 per 50 kg/bag, equivalent to K 533 per ton.

The Government remains committed to the policy of wage restraint. In addition to the wage and employment policies for government employees noted above, the Government will use its majority shareholding in the parastatal sector to implement cautious policies for both wage increases and employment throughout the public sector. It will also instruct the Prices and Incomes Commission to apply strict guidelines in reviewing wage agreements during 1984.

5. Performance criteria

The stand-by arrangement includes the following performance criteria, with the quantitative ceilings being specified in Table 9:

(i) Ceilings on the net domestic assets of the banking system;

(ii) Subceilings on net claims on Government by the banking system;

(iii) Ceilings on Bank of Zambia claims on ZCCM;

(iv) Reduction in commercial payments arrears through cash payments;

(v) Elimination of arrears under debt rescheduling agreements;

(vi) Limits on new government or government-guaranteed borrowing on commercial terms with maturity of more than 5 and up to 12 years;

(vii) A prohibition on such borrowing with maturities of more than 1 and up to 5 years;

(viii) A prohibition on such borrowing of up to and including one year maturity, except for trade credit or bridge financing;

(ix) The usual understandings with respect to the trade and payments;

(x) A review of the stand-by arrangement to be completed by end-September 1984 and prior to the second purchase. The review will deal in particular with external debt rescheduling, exchange rate policy, and budgetary developments;

(xi) A review to be completed by end-March 1985, which would include understandings on quantitative ceilings and on budgetary and other policies for 1985.

V. Medium-Term Outlook

The staff has attempted to project Zambia's balance of payments and external debt service for the period 1984-89, as shown in Tables 10, 11 and 12. The projections indicate that Zambia's external position will remain extremely difficult throughout the period, with a need for further debt rescheduling on generous terms in each year. The projections are based on the assumptions that the thrust of adjustment policies that were pursued in 1983 and are to be continued under the proposed 1984 program will be maintained over the medium term. Real GDP is projected

Table 9. Zambia: Performance Criteria for 1984

	1983 Dec. actual	1984 July	1984 Sept.	1984 Dec.
		Proposed ceilings 1/		
		(In millions of kwacha)		
Net domestic assets	3,231.1	3,444.5 2/	3,500.5 2/	3,579.0 2/
Claims on Government (net)	2,098.5	2,211.0 2/	2,238.5 2/	2,273.5 2/
Bank of Zambia claims on ZCCM	165.5	165.5	165.5	165.5
		(In millions of SDRs)		
Cumulative reduction in commercial payments arrears through cash payments 3/	597.0	6.0	13.0	20.0
Arrears under debt rescheduling agreements 4/	38.0	...	...	...
New nonconcessional external borrowing contracted or guaranteed by Government (cumulative)				
1-12 years maturity	...	50	50	50
1-5 years maturity	...	--	--	--
1 year and under	...	--	--	--

Source: Appendix II.

1/ As defined in the Memorandum of Understanding between the Government of Zambia and the IMF, dated April 9, 1984.
2/ The ceilings will be reduced to the extent that the monthly payments into the blocked account for external debt service, as specified in the Memorandum of Understanding, are not made.
3/ The reduction applies to the end-March level of payments arrears which amounted to SDR 617 million, including those of ZCCM.
4/ Of the end-December 1983 amount, SDR 19 million was paid in January, and the balance will be liquidated during 1984. The phasing of the liquidation will be agreed during the first review of the program, following the meeting of the Paris Club scheduled for July 1984.

Table 10. Zambia: Medium-Term Balance of Payments, 1984-89

(In millions of SDRs)

	1984	1985	1986	1987	1988	1989
Exports, f.o.b.	765	942	1,213	1,398	1,426	1,498
Of which: copper	(638)	(812)	(1,073)	(1,249)	(1,311)	(1,372)
cobalt	(80)	(65)	(64)	(73)	(65)	(75)
Imports, c.i.f.	-688	-765	-807	-851	-910	-967
Trade balance	77	177	406	547	516	531
Services and unrequited transfers (net)	-374	-388	-403	-402	-399	-404
Of which: investment income 1/	(-253)	(-266)	(-279)	(-275)	(268)	(268)
Current account	-297	-211	3	145	117	127
Capital account 2/	44	10	-25	-52	-85	-114
Drawings	269	270	225	200	200	200
Amortization 1/	-225	-260	-250	-252	-285	-314
Debt service due on previously rescheduled debt	-202	-99	-98	-92	-55	-20
Overall balance before new debt relief	-455	-300	-120	1	-23	-7
Financing:						
Use of Fund resources (net)	74	21	-119	-186	-161	-100
Purchases	(148)	(115)	(30)	(...)	(...)	(...)
Repurchases	(-74)	(-95)	(-148)	(-186)	(-161)	(-100)
Cash reduction of arrears reduction -)	-38)					
Other foreign assets, net	)	279	239	185	184	107
Financing gap	419)					
Memorandum item:						
Copper price (U.S.$ per pound)	0.65	0.75	0.91	1.05	1.10	1.15

Sources: Data provided by the Zambian authrities; and staff estimates.

1/ Payments represent originally scheduled debt service.
2/ Includes errors and omissions.

Table 11. Zambia: Medium-Term Exports and Imports, 1984-89

(In millions of kwacha) 1/

	1984	1985	1986	1987	1988	1989
Exports						
Copper						
Volume (thousand tons)	530	580	620	620	620	620
Price						
US$/lb	0.65	0.75	0.91	1.05	1.10	1.15
K/t	2,508	2,894	3,511	4,051	4,244	4,437
Freight (K/t)	255	263	270	278	285	293
f.o.b. (K/t)	2,253	2,631	3,241	3,773	3,959	4,144
Value	1,194	1,526	2,009	2,339	2,455	2,569
Cobalt	149	121	120	136	121	141
Zinc/lead	55	82	92	82	20	5
Other	35	40	50	60	75	90
Total exports, f.o.b.	1,433	1,769	2,271	2,617	2,671	2,805
Imports						
Petroleum						
Volume (1981=100)	80	80	80	80	85	85
Price (1981=100)	170	172	174	176	178	180
Value	248	250	253	256	275	278
Fertilizer	55	30	20	10	--	--
Maize	24	--	--	--	--	--
Other						
Volume (1981=100)	62	72	74	76	78	80
Price (1981=100)	190	199	209	219	230	241
Value	765	934	1,008	1,085	1,169	1,257
Total imports, f.o.b.	1,092	1,214	1,281	1,351	1,444	1,535
Total imports, c.i.f.	1,289	1,433	1,511	1,594	1,704	1,811
Trade balance	144	336	760	1,023	967	994

Sources: Data provided by the Zambian authorities; and staff estimates.

1/ Assumes US$1 = K 1.75 and SDR 1 = US$1.07 throughout the period.

Table 12. Zambia: Medium-Term External Debt Service, 1984-89

(In millions of SDRs)

	1984	1985	1986	1987	1988	1989
1. International organizations	206	240	298	327	287	214
Principal	106	139	197	239	215	153
Of which: IMF	(74)	(95)	(148)	(186)	(161)	(100)
Interest	100	101	101	88	72	61
Of which: IMF	(58)	(58)	(56)	(43)	(27)	(17)
2. Debt service due on previously rescheduled debt	202	99	98	92	55	20
a. Paris Club creditors	89	57	53	49	34	20
Principal	(48)	(39)	(39)	(39)	(26)	(15)
Interest	(41)	(18)	(14)	(10)	(8)	(5)
b. Other creditors	113	42	45	43	21	--
Principal	(96)	(33)	(38)	(39)	(20)	(--)
Interest	(17)	(9)	(7)	(4)	(1)	(--)
3. Debt service not previously rescheduled	285	292	295	305	351	395
a. Paris Club creditors	106	100	102	113	130	137
Principal	(59)	(56)	(61)	(66)	(82)	(87)
Interest	(47)	(44)	(41)	(47)	(48)	(50)
b. Other creditors	179	192	193	192	221	258
4. Short-term debt	61	89	84	81	76	73
Principal	(--)	(31)	(29)	(28)	(26)	(25)
Interest	(61)	(58)	(55)	(53)	(50)	(48)
5. Total debt service	754	720	775	805	769	702
Memorandum items:						
Debt service ratio before rescheduling (in percent)						
Principal	62.3	43.6	37.8	35.4	32.8	27.2
Interest	29.3	25.5	21.2	18.3	17.6	16.7
Total (including IMF)	91.6 1/	69.1	59.0	53.7	50.4	43.9
Total (excluding IMF)	76.3 1/	54.4	43.5	38.5	38.1	36.6

Sources: Data provided by the Zambian authorities; and staff estimates.

1/ Including the elimination of arrears of SDR 38 million under 1983 debt rescheduling agreements.

to grow only moderately throughout the period, by not more than 2-3 percent per annum, which would imply some reduction in real per capita incomes.

Export prospects are mainly determined by the projected world market price of copper which will continue to account for some 85-90 percent of Zambia's exports notwithstanding the adoption of policies geared toward export diversification in the medium term. Nonmineral exports will rise sharply, but, in view of their present level of only about SDR 20 million, they will have relatively little impact on total exports during the next five years. Based on available forecasts, the projections assume that the copper price will rise gradually to US$1.15 per pound by 1989, a total increase of about 75 percent over the five-year period. Export volumes are projected to recover to 580,000 tons in 1985, about the level achieved in 1983, and beyond that will be boosted by completion of the Tailings Leach project. This is projected to add some 40,000 tons to exports each year beginning in 1986 through the reprocessing of past wastes from which the copper could not be extracted. Noncopper exports will stagnate over the period, as the growth of nontraditional exports will be offset by a steady decline in exports of cobalt, zinc, and lead as reserves are depleted.

Regarding imports, in view of the continuous tight external position, the program projects an annual volume growth of about 3 percent (excluding oil, fertilizer, and maize), which should be considered at best as a bare minimum in view of the impact of the present foreign exchange constraint on production and the projected annual rate of real economic growth. However, the medium-term projections do not include allowance for additional imports resulting from additional donor support to Zambia, following the May 1984 meeting of the Consultative Group, as noted above. Oil import volumes are projected to be unchanged for the period 1984-87 and only 6 percent higher for 1988-89, reflecting conservation efforts, particularly by the mining industry, while maize and fertilizer imports are projected to taper off after the present year and be eliminated by 1988.

The export and import projections result in a steadily improving trade surplus, and, as services and unrequited transfers (including interest payments) will be virtually unchanged, the current account balance also improves, from a negative position of SDR 297 million in 1984 to a surplus of SDR 127 million by 1989. However, gross drawings on capital account are projected to decline from SDR 269 million in 1984 to SDR 200 million for 1987-89. The capital inflows are projected on a conservative basis in view of Zambia's existing debt burden. Also, no allowance is made for additional medium-term capital inflows resulting from the recent Consultative Group meeting. In any event, these may not improve Zambia's overall balance of payments position since they are likely to be related to the financing of additional imports. No further use of Fund resources beyond the present arrangement is included.

Total debt service due (including end-1983 arrears of SDR 38 million) remains above the amounts available throughout the period, leading to a financing gap before debt rescheduling and any allowance for reduction in arrears. However, the financing gap declines gradually from SDR 419 million in 1984 to SDR 184 million in 1988 and SDR 107 million in 1989. For 1984 the financing gap exceeds the total amount of debt service due on debts which have not been rescheduled previously. It will therefore be necessary to seek a rescheduling of obligations falling due on debts that have already been rescheduled. Furthermore, the projections exclude additional cash payments resulting from rescheduling agreements concluded in 1984 and beyond.

Zambia's external position will thus remain extremely difficult throughout the period, even with a seriously constrained volume of imports and appropriate debt rescheduling. Furthermore, the country will remain critically dependent on developments in world copper markets. The projections also include the assumption of no further use of Fund resources beyond the presently requested arrangement, leading to a very substantial net outflow of resources to the Fund for the period 1986-89. However, as noted above, Zambia's request for additional assistance from the international donor community in the context of the recent Consultative Group meeting was favorably received. Also, as Zambia regains the confidence of the international financial community through sustained adjustment efforts, capital flows could be more favorable than assumed, which would relax somewhat the constraint exercised by the external position on medium-term growth and development.

VI. Staff Appraisal

Zambia made significant progress toward adjustment in implementing the 1983 program. The kwacha was repegged to an unannounced basket of trading partner currencies and depreciated by more than 40 percent vis-à-vis the SDR, and by 16 percent in real effective terms between January 1983 and January 1984. As a result, the mining company has returned to profitability despite low world copper prices, and many of Zambia's agricultural products are now competitive, either for export or for import substitution. Fiscal performance also improved considerably, with the central government budget deficit declining to 6.9 percent of GDP. The substantial adjustment reflected an increase of 20 percent in government revenues, despite the stagnant economy, and a 4 percent decrease in total expenditure. The authorities also succeeded in reducing the growth in the net domestic assets of the banking system from 75 percent of broad money at the end of the previous year to 23 percent, while the percentage increase in net government credit fell from 50 perecent of broad money to just under 9 percent. Consequently, Zambia was able to make three of the four purchases under the 1983 stand-by arrangement.

However, there was a serious decline in export proceeds from earlier projections as the price of copper was 5 percent below the level anticipated in the program, and the export volume was 7 percent less, reflecting mainly the adverse effects on production of the foreign exchange shortage. This was the major reason why Zambia incurred arrears under its 1983 debt rescheduling agreements and failed to reduce its external commercial payments arrears through cash payments by SDR 30 million. Therefore, the final purchase under the program could not be made.

Zambia's balance of payments situation has become increasingly precarious. Copper prices remain substantially below earlier projections; the average price for 1984 is now expected to be almost 40 percent below the level anticipated at the time of formulating the 1983 program. Consequently, the country's foreign exchange reserves are depleted, consisting only of minimal working balances. Most important, the external debt service burden, including the arrears on 1983 recheduling agreements and amounts that will be due in 1984, will equal about 90 percent of exports of goods and services in 1984. In addition, outstanding commercial external payments arrears, though somewhat lower than at the end of 1982 equal about 90 percent of 1984 exports.

In view of the continued weakness in the copper price and the heavy debt service obligations, Zambia will need very substantial debt relief in 1984, and over a further number of years, in support of its efforts to reduce its external financing gap. It will be essential for Zambia to reach agreement with its creditors on rescheduling not only the bulk of all external maturities falling due in 1984, but also the outstanding arrears arising from its 1983 rescheduling agreements if Zambia's external financial position is to be viable during the program period. Nearly 70 percent of the debt service payments due in 1984, excluding the amounts due to international organizations and short-term debt, are on account of official creditors. The Zambian authorities have already contacted the Paris Club and other creditors for this purpose. The Paris Club is tentatively scheduled to discuss Zambia's request for debt relief by mid-July, and in accordance with Paris Club requirements, the Zambian authorities expect to apply the same terms as are agreed with the Paris Club to official creditors who are not Paris Club members. In these circumstances, the staff should be able to determine from the results of the Paris Club meeting whether the estimated external financing gap in 1984 will be financeable. The proposed stand-by arrangement will not become effective until the forthcoming Paris Club meeting and until the Fund finds that the balance of payments gap is fully financeable.

The Government of Zambia recognizes the severity of the situation and has introduced a further adjustment program aimed at stabilizing the country's external situation and continuing the effort toward economic recovery. The measures include continuation of a flexible exchange rate policy through regular monitoring and periodic adjustments. As a result of this policy, the exchange rate of the kwacha has been depreciated by a further 12 percent in the first five months of 1984. Continued application of a flexible exchange rate policy should preserve the competitive position Zambia achieved during 1983 for a wide variety of its agricultural products, thereby encouraging the diversification of Zambia's economy away from its heavy dependence on copper production. It should also provide added incentives for manufacturing that draws on domestic inputs to production. Together with further cost reduction measures, this policy will also strengthen the finances of the mining company, thereby allowing it to sustain its investment efforts and achieve a recovery in production.

Continued efforts aimed at restraining domestic consumption through a further reduction in the overall budget deficit, appropriate price and incomes policies, and tight monetary policies are also essential elements of the adjustment program. Fiscal policy in particular represents a key element in this process. Because of the limited opportunities for increasing revenue over the foreseeable future, continued restraint in expenditure is essential for strengthening fiscal performance and limiting the Government's recourse to domestic bank financing. The program provides for continuing limits on personnel expenditures and a further reduction in the real level of subsidy payments. The recent decision to grant a wage increase to lower level civil servants was probably inevitable in view of recent and prospective increases in consumer prices, but any slippage from the program's ceiling on personnel emoluments, or overruns in any other area of expenditure, will require the Government to take offsetting measures to ensure that the overall fiscal targets are attained. The authorities have agreed to monitor developments in this area closely in cooperation with the Fund staff. As part of the effort, the authorities will conduct a study of employment levels throughout Government, with the aim of preventing further increases in 1985. The program provides for the elimination of arrears under 1983 debt rescheduling agreements. In addition, the Government has established a blocked deposit account into which monthly payments will be made by the Treasury, in respect of its current external debt service to ensure that the Government remains current at least in its domestic currency payments, irrespective of the amount of new debt relief and the availability of foreign exchange; this should contribute to more orderly financial management.

The recent decision to increase retail prices of petroleum and other essential commodities reflects the willingness of the authorities to pass on the effects of currency adjustment and the increase in producer prices to consumers. Despite political difficulties, the policy of economic pricing policies will be reinforced, not only to strengthen the financial position of the private and parastatal sectors but also to restrain consumption, generate funds for investment, and improve the allocation of resources. As in 1983, pricing policies will be accompanied by an incomes policy aimed at preserving the benefits of depreciation of the exchange rate and aligning future wage increases more closely with gains in productivity. The decision not to grant a general salary increase to government employees, with the exception of the limited increase for lower-level workers, will contribute to this effort. The authorities will also need to resist firmly the likely wage pressures from other sectors of the economy.

The Government will supplement the above measures with comprehensive policy reforms designed to facilitate diversification and growth in the nonmining sectors of the economy. To this end, the Government has been cooperating closely with the World Bank in formulating its public expenditure plans and its proposals for policy reform that were submitted to the Consultative Group meeting, with particular emphasis on the agricultural sector and the mining sector, in the context of the recently approved World Bank loan for export rehabilitation and diversification. These policy reforms were well received by Zambia's donors at the recent Consultative Group meeting. The Governnment plans to expand this cooperation into other important areas.

Medium term balance of payments projections show that even with a steady but slow recovery in the copper price, and the continued application of strong adjustment policies Zambia's external position will remain serious. Even without providing for a cash reduction in commercial arrears, financing gaps are expected in each year, requiring exceptional external assistance, including generous debt relief. This bleak outlook, however, is based on cautious estimates of the copper price and of official capital flows. A one cent U.S. dollar gain in the price of copper per pound would make a difference of SDR 11 million to exports, and official capital inflows could be higher on account of the revival of the Consultative Group arrangement. Even so, it is clear that the authorities need to implement very stringent adjustment policies not only to restrict domestic consumption but also to diversify the economy through prompt and appropriate investments and adjustment of the exchange rate, as well as of domestic factor and product prices.

The authorities have demonstrated a keen awareness of their problems and willingness to implement strong adjustment measures, as is evidenced by actions under the last as well as the new program. Another encouraging development hs been the increased involvement of the World Bank in expanding its loan operations in Zambia and in sponsoring the recent Consultative Group meeting, after an interruption of six years. During that meeting the World Bank endorsed Zambia's development strategy and the priorities incorporated in its capital expenditure program. However, the Zambian authorities will not be able to continue their adjustment policies without a successful and generous rescheduling of their external debt and payments arrears, and increased official assistance, both of which are dependent on Zambia having a stand-by arrangement with the Fund. In light of all these considerations, the staff feels that Zambia deserves continued Fund support for its adjustment efforts. However, the level of Fund support will also need to be limited because of the unfavorable balance of payments outlook for the medium-term as well of the relatively high level of outstanding use of Fund resources. Therefore, the proposed stand-by arrangement is limited to an annual access of 47.5 percent of quota. If the full amount of the stand-by arrangement were purchased, outstanding Fund use under tranche policies would rise from 180 percent of quota to 221 percent. Purchases under the arrangement would be made in eight nearly equal installments, subject to frequent reviews of the program to ensure the implementation of adequate adjustment policies.

Zambia's exchange system involves restrictions on payments and transfers for current international transactions subject to approval under Article VIII, including those related to imports, travel, medical and educational expenditures, and dividends and profits, as well as restrictions evidenced by external payment arrears, as described in SM/84/125. All of these restrictions are subject to approval under Article VIII. Two multiple currency practices arising from (1) the 10 percent levy on sales of foreign exchange for private overseas travel, and (2) the counterpart deposit requirement against commercial payments arrears are also subject to approval under Article VIII. The staff welcomes the authorities' intention to liberalize the exchange system as the balance of payments position permits, and progressively reduce the level of outstanding external payments arrears. In the meantime, the staff recommends the approval of all restrictions on current payments and the multiple currency practice described in (2) above until June 30, 1985, or the next Article IV consultation, whichever is earlier. The staff urges that the multiple currency practice described in (1) above be eliminated by removing the tax from the exchange system.

It is expected that the next Article IV consultation discussions with Zambia be held on the standard 12-month cycle.

Proposed Decisions

In view of the foregoing, the following draft decisions are proposed for adoption by the Executive Board:

(i) 1984 Consultation

1. The Fund takes this decision relating to Zambia's exchange measures subject to Article VIII, Sections 2 and 3, and in concluding the 1984 Article XIV consultation with Zambia, in the light of the 1984 Article IV consultation with Zambia conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. Zambia's exchange system remains highly restrictive. In the context of the program supported by a stand-by arrangement, the authorities intend to pursue the policies that will permit a progressive reduction in external payments arrears and facilitate other steps toward a more liberal exchange system. In the circumstances of Zambia, the Fund grants approval for the restrictions on payments and transfers for current international transactions, including the restriction evidenced by external payments arrears, and a multiple currency practice arising from the existing counterpart deposit scheme for external payments arrears as referred to in SM/84/125 until June 30, 1985, or the next Article IV consultation, whichever is the earlier. The Fund urges the authorities to eliminate a multiple currency practice arising from the 10 percent levy on the sale of foreign exchange for private overseas travel.

(ii) Stand-By Arrangement

1. The Government of Zambia has requested a stand-by arrangement for a period ending April 30, 1986 in an amount equivalent to SDR 225 million.

2. The Fund approves the stand-by arrangement attached to EBS/84/135, subject to paragraph 3 below, and waives the limitation in Article V, Section 3(b) (iii).

3. The stand-by arrangement set forth in EBS/84/135 shall become effective on the date on which the Fund finds that satisfactory arrangements have been made with respect to the financing of the estimated balance of payments deficit in 1984, but provided that such finding shall not be made later than July 31, 1984.

ZAMBIA - Stand-By Arrangement

Attached hereto is a letter and annexed Memorandum dated June 1, 1984 from the Minister of Finance of Zambia requesting a stand-by arrangement and setting forth: (a) the policies and objectives that the authorities of Zambia intend to pursue for the period of this stand-by arrangement; and (b) understandings of Zambia with the Fund regarding reviews that will be made of progress in realizing the objectives of the program and of the policies and measures that the authorities of Zambia will pursue for the remaining period of this stand-by arrangement.

To support these objectives and policies, the International Monetary Fund grants this stand-by arrangement in accordance with the following provisions:

1. For the period from the effective date of this arrangement until April 30, 1986, Zambia will have the right to make purchases from the Fund in an amount equivalent to SDR 225 million, subject to paragraphs 2, 3, 4, and 5 below, without further review by the Fund.

2. (a) Purchases under this arrangement shall not, without the consent of the Fund, exceed the equivalent of SDR 30.0 million until August 15, 1984, SDR 55.0 million until November 15, 1984, SDR 80.0 million until February 15, 1985, SDR 109.0 million until May 15, 1985, SDR 138.0 million until August 15, 1985, SDR 167.0 million until November 15, 1985, and SDR 196.0 million until February 15, 1986.

(b) None of the limits in (a) above shall apply to a purchase under this stand-by arrangement that would not increase the Fund's holdings of Zambia's currency in the credit tranches beyond 25 percent of quota or increase the Fund's holdings of that currency resulting from purchases of borrowed resources beyond 12.5 percent of quota.

3. Purchases under this stand-by arrangement shall be made from ordinary and borrowed resources in the ratio of 1:1, provided that any modification by the Fund of the proportions of ordinary and borrowed resources shall apply to amounts that may be purchased after the date of modification.

4. Zambia will not make purchases under this stand-by arrangement that would increase the Fund's holdings of Zambia's currency in the credit tranches beyond 25 percent of quota or increase the Fund's holdings of that currency resulting from purchases of borrowed resources beyond 12.5 percent of quota:

(a) During any period in which the data at the end of the preceding period indicate that

(i) the limit for increases in external commercial payments arrears described in paragraph 7 and Attachment I of the annexed Memorandum, or

(ii) the limit for arrears under debt rescheduling agreements described in paragraph 7 and Attachment I of the annexed Memorandum, or

(iii) the limit on total net domestic assets described in paragraph 20 and Attachment I of the annexed Memorandum, or

(iv) the limit on net credit to the Government described in paragraph 20 and Attachment I of the annexed Memorandum, or

(v) the limit of Bank of Zambia credit to ZCCM described in paragraph 19 and Attachment I of the annexed Memorandum has not been observed or,

(b) If Zambia fails to observe the limits on the contracting of new public and publicly guaranteed foreign indebtedness described in paragraph 8 of the attached Memorandum, or

(c) After August 15, 1984, until the first review contemplated in paragraph 6 of the attached letter is completed or while the performance criteria established pursuant to that review are not being observed, or

(d) After February 15, 1985, until the second review contemplated in paragraph 6 of the attached letter is completed and suitable performance criteria for the period of the program after 1984 have been established, or while such performance criteria, having been established, are not being observed, or

(e) During the entire period of this stand-by arrangement, while Zambia has any overdue financial obligations to the Fund, or if Zambia

(i) imposes or intensifies restrictions on payments and transfers for current international transactions, or

(ii) introduces or modifies multiple currency practices, or

(iii) concludes bilateral payments agreements that are inconsistent with Article VIII, or

(iv) imposes or intensifies import restrictions for balance of payments reasons.

When Zambia is prevented from purchasing under this stand-by arrangement because of this paragraph 4, purchases will be resumed only after consultation has taken place between the Fund and Zambia and understandings have been reached regarding the circumstances in which such purchases can be resumed.

5. Zambia's right to engage in the transactions covered by this stand-by arrangement can be suspended only with respect to requests received by the Fund after (a) a formal ineligibility, or (b) a decision of the Executive Board to suspend transactions, either generally or in order to consider a proposal made by an Executive Director or the Managing Director formally to suppress or to limit the eligibility of Zambia. When notice of a decision of formal ineligibility or of a decision to consider a proposal is given pursuant to this paragraph 5, purchases under this arrangement will be resumed only after consultation has taken place between the Fund and Zambia and understandings have been reached regarding the circumstances in which such purchases can be resumed.

6. Purchases under this stand-by arrangement shall be made in the currencies of other members selected in accordance with the policies and procedures of the Fund, and may be made in SDRs if, on the request of Zambia, the Fund agrees to provide them at the time of the purchase.

7. The value date of a purchase under this stand-by arrangement involving borrowed resources will be determined in accordance with Rule G-4(b) of the Fund's Rules and Regulations. Zambia will consult with the Fund on the timing of purchases involving borrowed resources in accordance with Rule G-4(d).

8. Zambia shall pay a charge for this arrangement in accordance with the decisions of the Fund.

9. (a) Zambia shall repurchase the outstanding amount of its currency that results from a purchase under this stand-by arrangement in accordance with the provisions of the Articles of Agreement and decisions of the Fund, including those relating to repurchases as Zambia's balance of payments and reserve position improves.

(b) Any reductions in Zambia's currency held by the Fund shall reduce the amounts subject to repurchase under (a) above in accordance with the principles applied by the Fund for this purpose at the time of the reduction.

(c) The value date of a repurchase in respect of a purchase financed with borrowed resources under this stand-by arrangement will be normally either the 6th day or the 22nd day of the month, or the next business day if the selected day is not a business day, provided that repurchase will be completed not later than seven years from the date of purchase.

10. During the period of the stand-by arrangement Zambia shall remain in close consultation with the Fund. These consultations may include correspondence and visits of officials of the Fund to Zambia or of representatives of Zambia to the Fund. Zambia shall provide the Fund, through

reports at intervals or dates requested by the Fund, with such information as the Fund requests in connection with the progress of Zambia in achieving the objectives and policies set forth in the attached letter and annexed Memorandum.

11. In accordance with paragraph 7 of the attached letter, Zambia will consult the Fund on the adoption of any measures that may be appropriate at the initiative of the Government or whenever the Managing Director requests consultation because any of the criteria in paragraph 4 above have not been observed or because he considers that consultation on the program is desirable. In addition, after the period of the arrangement and while Zambia has outstanding purchases in the upper credit tranches, the Government will consult with the Fund from time to time, at the initiative of the Government or at the request of the Managing Director, concerning Zambia's balance of payments policies.

Office of the Minister
Ministry of Finance
P.O. Box 50062
Lusaka

Lusaka, June 1, 1984

Mr. Jacques de Larosière
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mr. de Larosière:

Zambia's economy has suffered major economic reversals over the last decade, in large part because of the international economic recession and a continuous decline in the terms of trade; the real purchasing power of Zambia's exports has fallen by 75 percent since the mid-1970s. In addition, mining production, which represents roughly 30 percent of Zambia's real output and provides virtually all of its export earnings, has decreased significantly, while production in other sectors has stagnated since the end of the 1970s because of the severe shortage of foreign exchange. Real GDP per capital has consequently fallen, and domestic supply has been maintained only through increasing external indebtedness and the accumulation of substantial commercial payments arrears.

In its continuing efforts to stem the effects of external economic difficulties on Zambia's economy, the Government of Zambia has undertaken a series of adjustment proposals supported by Fund resources, the most recent being the one-year stand-by arrangement approved on April 18, 1983. Under this last arrangement, the Government has taken a variety of measures aimed at restoring financial stability and achieving a sustainable balance of payments position over the longer term. In addition, the Government obtained a substantial rescheduling of its external debt in 1983.

Although Zambia made important strides in addressing its economic problems under the 1983 adjustment program, the country's financial position remains precarious. In particular, external prospects are less favorable than envisaged. For 1983, exports amounted to SDR 853 million compared to an estimate of SDR 963 million at the time of formulating the programme. As a consequence of this shortfall, Zambia could not meet its obligations under 1983 debt rescheduling agreements, and there was a carryover of part of these obligations into 1984. Furthermore, 1984 export prospects have also deteriorated, and total receipts are now projected to be only SDR 765 million, some SDR 412 million below the forecast for 1984 made at the time of formulating the 1983 programme. Because of these two factors, Zambia's external debt service obligations for 1984 are projected to be slightly more than the total value of export earnings (before taking account of any further rescheduling). Before taking account of any debt rescheduling for 1984, there would be an unfinanced payments gap of the order of SDR 419 million. Projected 1984 imports will be 11 percent below the level of 1983 in nominal SDR terms which follows a reduction of more than 25 percent during 1983. Any further reduction could bring about a sharp drop in economic activity with consequent loss of domestic revenues and foreign exchange earnings.

On account of these developments we have requested additional debt relief from our creditors for 1984 and have also asked for further assistance from donor countries in the context of the IBRD Consultative Group meeting. Moreover, Zambia must take additional strenuous measures to assure its economic viability and to aim toward an ultimate resolution of the country's external financial condition. We are therefore adopting a further comprehensive set of measures, and request that the Fund, in support of the Government's continuing efforts toward financial recovery, approve a new stand-by arrangement covering the period until the end of April, 1986 in the amount of SDR 225 million (83 percent of Zambia's present quota).

The economic and financial policies that have been adopted under the programme to be supported by a new stand-by arrangement are described in the accompanying "Memorandum on Economic and Financial Policies of Zambia." This memorandum states the programme's primary objectives, the policy measures taken to achieve them, and the quantitative ceilings and targets to be established for domestic credit, external debt, and external arrears. Moreover, these efforts will be continued in 1985, when further adjustment efforts will clearly be essential.

We intend to review the programme's progress with the Fund for the first time before end-September 1984, in particular the status of debt rescheduling arrangements, other external developments, budgetary performance, exchange rate policy, and will reach such understandings as are necessary. We will carry out with the Fund a second review before end-March 1985 to discuss the annual programme for 1985, and will reach understandings on performance criteria for the remaining period of the arrangement, including the dates of further reviews.

The Government believes that the policies and measures set forth in the attached memorandum represent continued major steps toward the restoration of economic stability, but it will take whatever additional measures that might become necessary to achieve this purpose. Zambia will consult with the Fund in accordance with the Fund's policy and will provide the Fund staff with all relevant information in regard to monitoring the progress made under this adjustment programme.

Sincerely,

/s/

L.J. Nwananshiku, MP
Minister of Finance

cc: His Excellency the President,
State House,
LUSAKA

Memorandum on the Economic and Financial Policies of Zambia

1. The Government of Zambia has adopted an economic adjustment program for 1984-85 aimed at continuing the progress made during 1983 toward restoring financial stability and achieving a sustainable balance of payments position. As in 1983, the program's broad objectives are to strengthen the finances of the public and mining sectors, to reduce the immediate burden of external debt obligations through the consolidation and rescheduling of existing payments schedules and the reduction in commercial payments arrears, and to establish the conditions necessary for a viable payments position over the longer term. To achieve these objectives, the Government has adopted the comprehensive set of policies described in this memorandum. These policies are aimed at creating conditions for the growth of exports through diversification while containing domestic demand, particularly consumption expenditure, to a level consistent with available resources. To this end, the Government will continue its efforts to provide adequate economic incentives for agriculture and the production of domestically manufactured exports; to enhance the international competitiveness of the economy; and to introduce measures aimed at raising productivity, particularly in the mining sector.

I. External policies

2. Despite the measures undertaken during 1983, Zambia's balance of payments position remains precarious. Copper prices have remained low, averaging only about US$0.65 a pound during the first four months of 1984. Furthermore, production difficulties in the early part of the year, reflecting mainly the shortage of foreign exchange, are expected to limit output to about 530,000 metric tons in 1984, some 7.8 percent below the 1983 level. Thus total export receipts are expected to decline by a further 10 percent to SDR 765 million from the already depressed level of SDR 853 million attained in 1983. Even with 1984 imports reduced by 11 percent in nominal terms to SDR 688 million, nearly 35 percent below the 1982 level in nominal terms, Zambia's current account deficit before debt rescheduling is estimated to reach SDR 297 million, compared to the 1983 level of SDR 273 million. Although this represents substantial improvement compared with earlier years, the reduced volume of imports is already having serious adverse consequences, and we believe that any further reduction would lead to a vicious downward spiral of falling output and export earnings. Furthermore, Zambia's heavy debt repayment obligations make these current account deficits unsustainable. Even in 1983, we were unable to discharge fully our obligations to official and commercial creditors, and partly as the result of the carryover of SDR 144 million of these obligations (including agreements not concluded by year-end), our debt service obligations for 1984 are estimated to be SDR 792 million, equivalent to 104 percent of exports. Consequently,

the Government of Zambia has adopted the following measures to reduce the balance of payments deficits and will be seeking additional debt relief on appropriate terms.

3. A flexible exchange rate policy will remain central to our adjustment strategy. It will continue to be used to maintain the financial viability and operating efficiency of the mining sector to promote export diversification, and to achieve a better balance between the supply and demand for resources. Since January 6, 1983, when the Government began the most recent series of currency adjustments, and end-April 1984, the Zambian kwacha has depreciated approximately 45 percent relative to the U.S. dollar. This depreciation was initiated by a 20 percent devaluation relative to the SDR, after which the kwacha was delinked from the SDR, pegged to an unannounced basket of currencies, and a policy of floating followed. With this depreciation, the kwacha has now reached a value at which mining operations are profitable and there is adequate financial incentive for the production of a substantial number of agricultural goods, both for export and for import substitution. The Zambian authorities will continue to monitor exchange rate developments during the program period to ensure the continued profitability of mining operations and preserve the incentives for economic diversification achieved during 1983. In pursuing this exchange rate policy, we will monitor the situation on a monthly basis and make such adjustments as needed. The Government will also examine with the Fund exchange rate policy during each review of the program, and will reach such understandings as are necessary.

4. The exchange rate adjustments achieved to date have substantially improved the financial position of the mining sector. During 1983, the mining company (ZCCM) was able to maintain its financial position despite the drop in copper prices and a shortfall in output. Current projections indicate that the company will generate an operating profit and positive cashflow, given current projections of output and world prices. Nevertheless, a number of cost-saving measures have been identified that can further increase efficiency and provide an added financial margin in the event that copper prices or production fall below current projections. These measures, which include foreign exchange savings from increased domestic value added, are estimated to save about K 50 million during 1984, and will supplement the more than K 150 million in savings achieved through the cost reduction programs of 1982 and 1983. The Government of Zambia will monitor the implementation of these measures and, in cooperation with ZCCM management, prepare further measures as needed to ensure their success. In August 1983, the Government also initiated a program whereby ZCCM could retain 25 percent of its foreign exchange earnings for its own use. In January 1984 this amount was raised to 35 percent to ensure the efficient operations of the company. This measure has eased the foreign exchange constraint on ZCCM's productive capacity. In addition, the Government and ZCCM have been collaborating with the World Bank in formulating medium-term policies for the mining sector.

In support of these policies, in March 1984 the Bank approved an export rehabilitation and diversification loan amounting to US$75 million as part of a US$300 million rehabilitation project cofinanced by the EEC and the African Development Bank.

5. We also intend to increase export earnings through improved exploitation of emeralds and other precious minerals, which in the past has been elusive. To achieve this, licenses for prospecting are being sold for mineral exploitation throughout the Republic of Zambia. In addition, the Reserved Minerals Corporation (RMC) has become a buying and marketing agency for emeralds, offering competitive world prices. Where it acts as a marketing agency it will pay back to producers 90 percent of export proceeds in domestic currency, with 10 percent held in foreign exchange to the account of the producer, to be used for imports in accordance with regular import licensing regulations. RMC will also participate in mining, alone or in collaboration with others. In addition, foreign-owned companies are being invited to participate in the industry, in partnership with RMC, and one such company has recently been incorporated in collaboration with outside investors.

6. During 1983, the Government introduced several administrative reforms designed to support its external policies. Among the most important was a new foreign exchange allocation system designed to improve the procedure for issuing import licenses, balance the issuance of licenses with available foreign exchange, and enable the Government to direct foreign exchange resources to priority areas, particularly export promotion. During 1984 we will strive to improve the new system of foreign exchange budgeting. Further administrative measures have also been taken to support export diversification and other external policies. In particular, in February 1984, a scheme was introduced whereby nonmineral exporters are allowed to retain for their own use 50 percent of export proceeds through their commercial banks. The exporter can then use these receipts for imports subject only to regular import licensing. The Government is also endeavoring to reduce administrative bottlenecks in respect of exports. In addition, effective April 1, 1984 the Government has established preferential tax treatment of profits from nontraditional exports.

7. During 1983 the Government of Zambia succeeded in reducing the country's external commercial payments arrears by SDR 15 million and SDR 50 million through refinancing and cash payments, respectively. In addition, a further reduction of SDR 63 million is estimated to have been realized in respect of outstanding arrears denominated in kwacha, as a result of the depreciation of the kwacha during 1983. Additional reductions have resulted from the agreement with the Paris Club in May 1983; however, the magnitude of such reduction can be worked out only when the relevant data on commercial arrears covered by that agreement becomes available. Including this component the total of external commercial payments arrears, as at the end of 1983 is estimated at SDR 597 million, of which SDR 26 million represented arrears of the mining company. In view of the extreme shortage of foreign exchange,

reductions in external payments arrears through cash payments beyond those under debt rescheduling agreements will need to be relatively limited. Between end-March 1984 and end-1984, such recduction will amount to a minimum of SDR 20 million (see Attachment I). This reduction will also be over and beyond the reduction in the SDR value of arrears which are denominated in kwacha that would result from any further depreciation of the kwacha during 1984.

Regarding external payments arrears on debt service, as explained above, arrears of SDR 38 million on rescheduled debt arose at the end of 1983. The Government also intends to eliminate the external debt arrears through additional debt rescheduling and cash payments, and to remain current on its obligations after a forthcoming Paris Club meeting in 1984.

8. Given Zambia's existing large debt burden and the uncertain export prospects, the Government will continue to follow a very cautious foreign borrowing policy in 1984, particularly on loans involving commercial terms. The contracting or guaranteeing of new external borrowing on commercial terms by the Government with an original maturity of more than five years and up to 12 years will be limited to SDR 50 million under the program. No debt on commercial terms will be contracted or guaranteed with an original maturity of more than one year and up to five years. Total outstanding short-term debt of up to and including one year's maturity, other than trade-related credits and bridging loans, will not be allowed to increase during 1984. These limits do not apply to refinancing/restructuring loans in the context of debt restructuring arrangements envisaged in 1984. The Government also will seek to utilize more concessional sources of finance, including the World Bank group and individual aid donors, and is committed to fully supporting those loans, such as the export rehabilitation loan and the proposed agriculture and industrial sector loans, which can be expected to enhance the economy's productive capacity.

9. Under the chairmanship of the World Bank, the Consultative Group for Zambia met in Paris on May 22-24, 1984. At this meeting, the Government of Zambia presented to the international donors community its development strategy, and outlined a number of economy-wide and sectoral policy reforms. There was general agreement among the participants with the Government's proposed policies for the future, which involve mainly diversification of the economy away from mining by emphasizing agriculture, rehabilitation of the capital base, increased capacity utilization and efficiency of enterprises, changed incentives to promote efficiency and favor exports, and a shift from direct intervention and control toward establishing an environment conducive to greater private participation and initiative. The Government presented the group with an expenditure program for 1984-86 totalling US$1.7 billion in line with the policies mentioned above. The World Bank and the donors endorsed the priorities incorporated in the expenditure program.

The external capital requirements presented to the meeting involved a total for new commitments of US$1.5 billion. The donor community represented at the meeting was asked to commit US$400 million per year of this, half of which should be in the form of quick disbursing assistance; such a level of commitment would be 30 percent higher in nominal terms than that of 1980-82. In his concluding statement, the Chairman noted that the response of the donors was gratifying, and that he had hopes that the aid target could be reached.

10. Zambia is not yet in a position to relax existing restrictions on imports for balance of payments purposes, and on payments and transfers for current international transactions, except through the programmed reduction in payments arrears. During the period of the proposed stand-by arrangement, it is the Government's intention not to introduce or modify any multiple currency practices nor to impose new, or intensify existing restrictions on payments and transfers for current international transactions.

11. Even after taking account of the effect of the foregoing measures and likely capital inflows, Zambia will not have enough available foreign exchange receipts in 1984 to permit full payment of scheduled debt service on public and publicly guaranteed external debt. Scheduled debt service, including to the IMF and other multilateral institutions, is provisionally estimated to be SDR 792 million in 1984, equivalent to 104 percent of exports. As noted earlier, this includes SDR 144 million in carryover of amounts due on 1983 maturities, of which SDR 38 million was arrears to Paris Club members on rescheduling agreements signed by year-end and SDR 106 million was estimated to be payable on agreements that had not been concluded. Consequently, the Government of Zambia will seek a further consolidation and rescheduling of external debt service and accumulated external payments arrears, in addition to that obtained during 1983. Our request for additional debt relief has already been forwarded to the Paris Club. Further, we intend to seek debt relief from other official creditors as well as from commercial lenders on terms comparable to those requested from the Paris Club. It is not yet possible to indicate the precise amount of debt service relief that can be obtained in 1984. However, it is expected that the requested additional debt rescheduling will lead to significant savings in foreign exchange during the program period, and that further assistance will be received from donors following the Consultative Group meeting. Together with the measures adopted under the program, and taking account of the amount of the access to financing resources requested from the Fund, we believe these factors will eliminate the prospective unfinanced balance of payments gap for 1984. In view of the critical importance of debt relief to the program, the Zambian authorities are giving the highest priority to efforts in this direction, and will cooperate closely with the Fund staff and review with the Fund progress on rescheduling during the first review referred to in the covering letter.

The Zambian authorities recognize that debt rescheduling provides only temporary relief to the balance of payments, and is not a substitute for efforts to attain medium-term balance of payments viability.

II. Economic Policies

12. Because of the limited remaining life of our mineral reserves and the uncertain future demand for copper, the Government is committed to continuing the diversification of the economy through improved incentives for agriculture and increased efficiency in manufacturing. In support of this objective, producer prices for 1983/84 were raised by amounts ranging from 12 percent to 42 percent. For maize, Zambia's basic staple, the increase amounted to 32 percent, from K 18.50 to K 24.50 per 90 kg/bag. These price increases are being reflected in higher consumer prices as noted in paragraph 18 below. Furthermore, new producer prices have already been annouced for the 1984/85 crop year with increases averaging 21 percent, and including a further increase of 16 percent in the producer price for maize to K 28.32 per 90 kg/bag. These increases will continue to ensure adequate financial incentives for crops for domestic consumption and for export. We are also cooperating closely with the World Bank on formulating medium-term policies for the sector, and the World Bank is processing an Agriculture Sector Rehabilitation credit. We have already agreed on policies to improve medium-term performance, together with a timetable for implementation. These policies apply particularly to the areas of marketing, distribution, and the pricing of services and inputs, as well as incentives to producers, and will also enhance productivity by expanding the current research and extension services to small-scale and emergent farmers, and by introducing competition in the marketing of agricultural goods. The import licensing committee has also been directed to give high priority to imports of agricultural inputs such as feed supplements, since shortages of these items have seriously impaired agricultural output over the past several years. Measures are also being taken to improve the availability and efficient operation of the system of agricultural credit. The Zambian Agricultural Development Bank has been instituted, and has commenced operations. In this regard, the Government intends to review the role of the Agriculture Finance Company so as to rationalize the provision of agricultural credit in the country.

13. A substantial effort coordinated by the parastatal holding company (ZIMCO) has also been underway to reduce costs and increase managerial efficiency at state enterprises. This effort, in conjunction with price decontrol begun in 1983, has already eliminated losses at many ZIMCO subsidiaries, and further steps toward rationalization are underway during the current program year. Furthermore, the World Bank has prepared an industrial sector report which outlines possible policy reforms in that sector. We will review the policy proposals with the bank staff at an early stage, and intend to request financial support from the Bank in this area. In addition, a study funded by the World

Bank is underway to review and suggest measures for rationalizing operations at NCZ, Ltd., the domestic fertilizer plant and an agreement has recently been concluded with bilateral donors for rehabilitation of the plant. Moreover, efforts are already underway to increase output and eliminate losses, mainly through improved technical and managerial performance, as well as increased prices. Also in conjunction with the World Bank, the Government is reviewing Zambia's petroleum refinery to determine the possibilities for converting production so that output can better satisfy domestic needs, and foreign exchange requirements can be reduced. Over the longer run, these and other reforms are aimed at strengthening ZIMCO's ability to contribute to the government budget, through improved efficiency and pricing reforms that allow cost recovery plus a reasonable profit that reflects the cost of capital for competing objectives.

III. Demand Management Policies

14. The program's external policies will be supported by appropriate demand management policies. The principal aim of budgetary policies for 1984 is to achieve restraint in public sector consumption, and to make the resources necessary for an adequate level of productive expenditure. To this end, total expenditure is programmed to rise by only 9 percent, substantially below the level of anticipated price increases. Within this total, priority will be given in recurrent expenditure to adequate funding of ongoing development projects. In addition, the Government has requested technical assistance in the area of budgeting and expenditure control from the Fund. A technical assistance mission has already visited Zambia, and we intend to review carefully its recommendations with a view to early implementation. With respect to revenue, while several new measures have been introduced, the most far-reaching changes are expected to come over the medium term through improvements in the area of tax administration, where the Government is undertaking extensive administrative reforms. These actions, combined with planned capital expenditure limited to completion of existing projects and rehabilitation of existing facilities, will result in a budget deficit of K 239 million compared to an estimated overall deficit of K 292 million in 1983. However, within this total, external interest payments will rise sharply; net of payment of external interest, the overall deficit will be reduced to only K 111 million, compared to K 239 million in 1983. This represents a reduction equivalent to nearly four percentage points of GDP.

15. Compared with the estimated outcome in 1983 the new program provides for a 5 percent increase in recurrent departmental charges. Regarding expenditure for personal emoluments of civil servants, there will be an increase of 11 percent. Although, as in 1983, there will be no general salary increase in 1984, wage drift is expected to be about 6 percent.

In addition, in view of the rise in consumer prices of some 40 percent for 1983-84, it was necessary to give some modest increase in salaries to the lowest paid workers. The salary increase applies only to those workers earning less than 7,540 kwacha per year and ranges from 11 percent to the lowest paid workers to 1 percent for those at the upper limit. These salary increases will add 5 percent to the wage bill. Regarding the level of employment, existing vacancies and vacancies appearing in 1984 will not be filled except in the Ministries of Health, Education, and Agriculture, as well as in the Departments of Customs and Excise and Income Tax. In addition, the Government will make such adjustments in employment as needed to strictly observe the budgeted figure for personal emoluments in 1984. Moreover, the Government is fully aware that Zambia's economic circumstances do not permit continued growth in net government employment. A comprehensive review of employment throughout all ministries, with particular emphasis on the Ministries of Health, Education, and Youth and Sports, will therefore be undertaken with the aim of containing, and if possible reducing, the level of government employment in the 1985 budget. The provision for subsidies will rise from K 83 million in 1983 to K 92 million in the program, but entailing a significant reduction in real terms, and consequently there will be price increases for maize and fertilizer as set out in paragraph 18 below. Transfer payments will be reduced 15 percent from the 1983 level by strictly limiting the operating costs of decentralized public agencies. With respect to debt repayments, a blocked account has been established at the Bank of Zambia into which budgeted payments for debt service, in local currency, will be made on a regular basis, regardless of the amount of debt relief obtained and the availability of foreign exchange. The program estimate for capital expenditure (including net lending) is K 150 million and is confined mainly to the rapid completion of on-going projects of a productive nature.

16. Several new taxes were introduced in the 1984 budget, estimated to yield K 46 million, largely to replace revenue lost due to the shrinking of the bases of dutiable imports and company income resulting from the foreign exchange shortage. These include increases in excise taxes on soft drinks, cigarettes, alcoholic beverages, and petroleum products (totaling K 27.2 million), a new procedure requiring the purchase of licenses prior to prospecting or mining on any Zambian territory (K 10 million), new taxes on imported capital goods (K 7.5 million), and increases in sales and miscellaneous taxes (K 1.0 million). Subsequently, further tax measures have been taken to ensure that the program's fiscal targets are attained. Effective August 1, 1984, the basis for taxing imports will be changed from f.o.b. to c.i.f., and a new minimum rate of import duty of 10 percent will be introduced for all imports other than petroleum, government imports, and certain items exempt by law. These changes are estimated to yield K 67 million on a full year basis, and K 28 million during the remainder of 1984. In addition to efforts

to improve the administrative capacity of the tax system as outlined above, a new revenue unit has been established within the Ministry of Finance.

17. The Government considers it essential to maintain the program's budgetary targets. In the event that during the remainder of the year any shortfall in revenue emerges, or there are unanticipated overruns in some items of expenditure, the Government will introduce further compensatory fiscal measures to ensure that the annual targets are attained. Furthermore, the Government will remain current on all its payment obligations.

18. The Government remains committed to its declared policy of allowing economic pricing to function throughout the economy, following the general decontrol of prices introduced in the context of the 1983 program. To this effect, on April 10 ZIMCO increased prices for premium petrol, regular petrol, diesel, and kerosene, by K 0.21, K 0.19, K 0.16, and K 0.15 per liter, respectively, so as to pass through the rise in import prices, to eliminate outstanding losses at its domestic petroleum subsidiary (ZNEL), and to encourage conservation of fuel consumption. These increases are in addition to the increases introduced in January 1984 for aviation fuel and a variety of other products. Moreover, petroleum prices will continue to be adjusted in line with changes in ZNEL's costs and exchange rate movements. In addition, ZIMCO raised the domestic price of beer by K 0.08 per bottle, on top of the K 0.02 per bottle rise in excise tax, approved in the 1984 budget. Further, to preserve the financial viability of NAMBOARD, and limit the budgetary subsidies for maize and fertilizer to the stipulated level of K 37.1 million during 1984, the following price increases have been approved:

(i) Consumer prices for maize meal (roller meal) will be increased by K 6.50 per bag to K 36.45 per 90 kg/bag, effective July 1, 1984, reflecting the rise in producer prices to K 24.50 per bag for the 1983/84 season and the increase in transport and processing costs.

(ii) NAMBOARD's sales price for fertilizer was raised by 11 percent effective May 1, 1984, from K 24.10 per 50 kg/bag to K 26.75 per 50kg/bag, equivalent to K 533 per tonne.

19. *The Government remains committed to the policy of wage restraint.* In addition to the wage and employment policies for government employees noted above, the Government will use its majority shareholding in the parastatal sector to implement cautious policies for both wage increases and employment throughout the public sector. It will also instruct the Price and Incomes Commission to apply strict guidelines in reviewing wage agreements during 1984.

20. The program will provide for an increase in domestic credit sufficient to allow for a modest expansion in economic activity. Nevertheless, the overall stance of the monetary authorities will remain restrictive. The improved financial position of the mining company following the depreciation of the kwacha should sharply reduce the need for the company to seek bank financing to cover operating losses, and there will be no additional Bank of Zambia credit to ZCCM during 1984. In addition, the increase in net credit of the banking system to the Government will not exceed K 175 million in 1984. There will be an expansion of credit to the private sector of no more than 20 percent, and in consequence, we anticipate an increase in the net domestic assets of the banking system of about 11 percent. Taking account of the envisaged balance of payments deficit, the targeted increase in broad money under the program will be about 15 percent, far less than the projected increase in nominal GDP of 25 percent. Net domestic assets, net credit to the Government, and Bank of Zambia credit to ZCCM will not exceed the limits for July, September, and December 1984 set out in Attachment I. The ceilings for September and December will be re-examined during the first review in light of the results of debt rescheduling on the budget and the balance of payments, actual and prospective copper prices, as well as the seasonal credit needs of the agricultural sector on the basis of the 1984 agricultural crop. The ceilings for 1985 will be set during the review of the program in early 1985.

21. In January 1983 the Zambian authorities introduced substantial increases in interest rates to reflect more closely actual and prospective economic conditions. These covered the Bank of Zambia's rediscount rate, the rate on Treasury bills, the commercial banks' overdraft and maximum lending rates, and deposit rates for savings accounts. Despite these increases, interest rates remain negative in real terms. Therefore, to provide further incentives for domestic savings, restrain demand, and improve the allocation of credit, all interest rates have been adjusted further by an average of 2 percentage points, effective May 16, 1984. These increases include an increase of two percentage points in the maximum lending rates to 15 percent, which considerably widens the band of interest rates on commercial bank lending. Commercial banks will thus have more flexibility in setting interest rates for different types of loans, which will enable lending policy to reflect the relative riskiness of alternative loans. The Bank of Zambia is discussing with commercial banks the formulation of policies to facilitate adequate provision of loans to the agriculture sector.

Zambia: Proposed Quantitative Ceilings and Targets for 1984

	1983 Dec. actual	1984 July	1984 Sept.	1984 Dec.
		Proposed ceilings 1/		
		(In millions of kwacha)		
Net domestic assets	3,231.1	3,444.5 2/	3,500.5 2/	3,579.0 2/
Claims on Government (net)	2,098.5	2,211.0 2/	2,238.5 2/	2,273.5 2/
Bank of Zambia claims on ZCCM	165.5	165.5	165.5	165.5
		(In millions of SDRs)		
Cumulative reduction in commercial payments arrears through cash payments 3/	597.0	6.0	13.0	20.0
Arrears under debt rescheduling agreements 4/	38.0	...	...	...
New nonconcessional external borrowing contracted or guaranteed by Government (cumulative)				
1-12 years maturity	...	50	50	50
1-5 years maturity	...	--	--	--
1 year and under	...	--	--	--

1/ As defined in the Memorandum of Understanding between the Government of Zambia and the IMF, dated April 9, 1984.

2/ The ceilings will be reduced to the extent that the monthly payments into the blocked account for external debt service, as specified in the Memorandum of Understanding, are not made.

3/ The reduction applies to the end-March level of payments arrears which amounted to SDR 617 million, including those of ZCCM.

4/ Of the end-December 1983 amount, SDR 19 million was paid in January, and the balance will be liquidated during 1984. The phasing of the liquidation will be agreed during the first review of the program, following the meeting of the Paris Club scheduled for July 1984.

ZAMBIA - Relations with the Fund
(As of May 31, 1984)

I. Membership Status

(a) Date of membership: September 23, 1965
(b) Status: Article XIV

A. Financial Relations

II. General Department (General Resources Account)

(a) Quota: SDR 270.3 million (previously SDR 211.5 million)
(b) Total Fund holdings of currency:
SDR 948.5 million (350.9 percent of quota)
(c) Fund credit: SDR 678.2 million (250.9 percent of quota)

Credit tranche--SDR 111.5 million (41.2 percent)
EFF--SDR 77.0 million (28.5 percent)
Enlarged access--SDR 299.2 million (110.7 percent)
CFF--SDR 190.5 million (70.5 percent)

(d) Reserve tranche position: None
(e) Current Operational Budget: Not included
(f) Lending to the Fund: None

III. Current Stand-by or Extended Arrangement and Special Facilities

(a) Current stand-by
(i) Duration: April 19, 1983-April 18, 1984
(ii) Amount: SDR 211.5 million
(iii) Utilization: SDR 144.0 million
(iv) Undrawn balance: SDR 67.5 million
(b) Stand-by and extended arrangements during last 10 years:
(i) First credit tranche purchase - one-year stand-by for 25 percent of quota, approved in May 1973;
(ii) One-year stand-by for 82 percent of quota, approved in July 1976;
(iii) Two-year stand-by for 177 percent of quota, approved in April 1978;
(iv) Three-year extended arrangement for 378 percent of quota, approved in May 1981 and canceled in July 1982;
(c) Special facilities in the past two years:
(i) Compensatory financing facility purchase for 16 percent of quota (SDR 34 million), approved in December 1982.
(ii) Compensatory financing facility purchase for 46 percent of quota (SDR 97.2 million), approved in principle April 18, 1983 and authorized May 18, 1983.

ZAMBIA - Relations with the Fund (concluded)
(As of May 31, 1984)

IV. SDR Department

(a) Net cumulative allocation: SDR 86.3 million
(b) Holdings: 249,451 (0.37 percent of net cumulative allocation)
(c) Current Designation Plan: Not included

V. Administered Accounts

(a) Trust Fund Loans
 (i) Disbursed SDR 42.77 million
 (ii) Outstanding SDR 42.77 million
(b) SFF Subsidy Account: None

VI. Overdue Obligations to the Fund: None

B. Nonfinancial Relations

VII. Exchange rate arrangement

The Zambian kwacha is pegged to an unannounced basket of currencies. The U.S. dollar is the intervention currency, and the Bank of Zambia's rates for the U.S. dollar are based on the U.S. dollar/SDR rate calculated by the Fund for the preceding day. As of May 31, 1984, the rate was K1 = US$0.5796.

VIII. Last Article IV consultation and stand-by review

The last Article IV consultation discussions were held in Lusaka during November 8-23, 1982 and January 31-February 10, 1983, with Board discussion on April 18, 1983. The last review (of exchange rate policy) under the present arrangement was held in Lusaka during November 22-December 7, 1983. The present Article IV consultation discussions were held in Lusaka during February 7-22, 1984.

IX. Technical Assistance

The Central Banking Department has furnished the Bank of Zambia with a Research Adviser (February 1983-February 1984), an economic adviser to the Governor (appointed October 1983), and an external debt adviser (appointed November 1983 for one year).

A technical assistance mission from the Fiscal Affairs Department visited Zambia March 25-April 9, 1984.

X. Resident Representative: A Fund resident representative has been stationed in Lusaka since November 1983.

ZAMBIA: Financial Relations with the World Bank Group

A. IBRD/IDA operations (as of February 29, 1984)

(In millions of U.S. dollars)

	Disbursed		Undisbursed	
	IBRD	IDA	IBRD	IDA
Agriculture (incl. industrial forestry)	37.44	4.64	9.72	49.26
Education	63.56	1.99	--	23.01
Industrial and development finance	108.89	--	2.78	--
Power, energy, and water supply	155.24	--	4.63	14.30
Program lending	42.50	--	--	--
Technical assistance (incl. petroleum exploration)	1.95	1.45	4.65	3.55
Telecommunications	28.54	--	3.46	--
Transportation	58.42	13.21	25.03	13.04
Urban	20.00	—	--	--
Total	516.54	21.29	50.27	103.16
of which has been repaid	172.09	--		
Total now outstanding	344.45	21.19		

B. IFC investments (as of February 29, 1984)

Disbursed	Undisbursed
57.8	33.2

Sources: IBRD and IFC.

Zambia: External Payments Arrears, 1982-March 1984

(In millions of SDRs)

	1982 December	1983 December	1984 March
Outstanding			
Commercial arrears	725	597	617
Pipeline	(669)	(571)	(591)
ZCCM	(56)	(26)	(26)
Arrears on debt	222	38	19
Total	947	635	636
Reduction from the previous level (reduction -)			
Commercial arrears		-128	20
Cash		(-50)	(44)
Refinancing/rescheduling		(-15)	(-15)
Kwacha depreciation		(-63)	(-9)
Arrears on debt		-184	-19
Cash		(38)	(-19)
Refinancing/rescheduling		(-222)	(--)
Total		312	1
Cash		-12	25
Refinancing/rescheduling		-237	-15
Kwacha depreciation		-63	-9

Sources: Data provided by the Zambian authorities.

ZAMBIA - Basic Data

Area, population, and GDP per capita

Area	290,410 square miles
Population: Total (1981)	6.0 million
Growth rate	3 percent
GDP per capita (1981)	SDR 492

	1979	1980	1981	1982	1983 Est.
Gross Domestic Product (GDP)		(In millions of kwacha)			
Total	2,647	3,013	3,449	3,564	4,206
Agriculture (percent of total)	15	14	16	14	14
Mining (percent of total)	18	16	14	11	16
Government (percent of total)	16	17	18	20	17
Annual real rate of growth (percent)	-7.7	3.6	4.7	-2.2	0.8
Investment as percent of GDP (at market prices)	14	23	20	17	15
Prices (percent change)					
GDP deflator	28.1	9.8	9.4	5.6	17.1
Cost of living (low income)	9.7	11.7	14.0	12.5	19.6
		(In millions of kwacha)			
Government finance (cash basis)					
Revenue and grants	621	791	833	868	1,037
Current expenditure	771	1,012	1,168	1,233	1,176
Capital expenditure and net lending	151	123	129	310	153
Overall deficit	-302	-344	-463	-674	-292
External borrowing (net) as percent of overall deficit	46	41	53	17	26
Domestic bank borrowing as percent of overall deficit	20	68	35	72	40
Overall deficit as percent of GDP	11	11	13	19	7
Money and credit		(Percent change)			
Net domestic assets	2	20	26	28	10
Government (net)	6	19	12	33	6
Credit to private sector (inc. mining)	13	5	52	19	14
Money and quasi-money	30	9	8	34	11

ZAMBIA - Basic Data (Concluded)

	1979	1980	1981	1982	1983 Prel.
Balance of payments			(In millions of SDRs)		
Exports, f.o.b.	1,092	1,023	833	839	853
Imports, c.i.f.	-735	-1,017	-1,050	-1,049	-775
Trade balance	357	6	-217	-210	78
Net services and transfers	-227	-360	-421	-405	-351
Current account balance	130	-354	-638	-615	-273
Capital account (net)	28	126	249	33	-43
Government	(134)	(139)	(242)	(109)	(11)
Mining companies	(-23)	(26)	(111)	(96)	(-7)
Other (including errors and ommissions)	(-83)	(-39)	(-104)	(-172)	(-47)
SDR allocation	15	15	15	--	--
Valuation adjustment	--	--	47	21	-8
Overall surplus or deficit (-)	173	-213	-327	-561	-98
Current account balance as percent of GDP	5	-12	-19	-18	-9
Gross official foreign reserves (end of period)	69	70	91	127	110
External public debt 1/					
Disbursed and outstanding (end of period)	1,638	1,943	2,025	3,184	...
Debt service as percent of exports of goods and nonfactor services 1/	18	23	34	50	36

1/ Excluding the Fund and short-term debt.