

DOCUMENT OF INTERNATIONAL MONETARY FUND AND NOT FOR PUBLIC USE

EBS/84/135
Supplement 2

CONFIDENTIAL

July 20, 1984

To: Members of the Executive Board
From: The Acting Secretary
Subject: Zambia - Stand-By Arrangement

Attached is the text of the decision approving a stand-by arrangement for Zambia, adopted by the Executive Board at Meeting 84/110 (7/18/84), together with the text of the arrangement. The effective date of the stand-by arrangement will be set in a further decision dealing with the arrangements referred to in paragraph 3 of the attached decision.

Att: (2)

INTERNATIONAL MONETARY FUND

Zambia - Stand-By Arrangement

Executive Board Decision - July 18, 1984

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, Sup. 2 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, Sup. 2 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 reduction 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 announced 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

	<u>1983</u> <u>Dec.</u> actual	<u>1984</u> <u>July</u> <u>Sept.</u> <u>Dec.</u> Proposed ceilings <u>1/</u>		
<hr/>				
		<u>(In millions of kwacha)</u>		
Net domestic assets	3,231.1	3,444.5 <u>2/</u>	3,500.5 <u>2/</u>	3,579.0 <u>2/</u>
Claims on Government (net)	2,098.5	2,211.0 <u>2/</u>	2,238.5 <u>2/</u>	2,273.5 <u>2/</u>
Bank of Zambia claims on ZCCM	165.5	165.5	165.5	165.5
		<u>(In millions of SDRs)</u>		
Cumulative reduction in commercial payments arrears through cash payments <u>3/</u>	597.0	6.0	13.0	20.0
Arrears under debt reschedul- ing agreements <u>4/</u>	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.