

**FOR
AGENDA**

EBS/83/176

CONFIDENTIAL

August 18, 1983

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

Attached for consideration by the Executive Directors is a paper on the mid-term review of the stand-by arrangement for Zambia. A draft decision appears on pages 22 and 23.

It is proposed to bring this subject to the agenda for discussion on Friday, September 16, 1983.

If Executive Directors have technical or factual questions relating to this paper prior to the Board discussion, they should contact Mr. Bornemann, ext. (78181), or Mr. Sharer, ext. (73717).

Att: (1)

INTERNATIONAL MONETARY FUND

ZAMBIA

Mid-Term Review of the Stand-By Arrangement

Prepared by the African Department

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

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

August 17, 1983

I. Introduction

On April 18, 1983 the Executive Board approved Zambia's request for a one-year stand-by arrangement 1/ in the amount of SDR 211.5 million (100 percent of quota). Zambia made an initial purchase of SDR 31.5 million under the arrangement, but the stand-by arrangement requires that subsequent purchases be subject to completion of a mid-term review of performance under the program, including understandings with the authorities on performance criteria for the period June-December 1983. The review is to focus on exchange rate and interest rate policies, as well as progress on debt rescheduling, budgetary performance, credit policies, and prices and incomes policies.

As of July 31, 1983, the Fund's holdings of Zambia's currency, the kwacha, subject to repurchase amounted to SDR 631.4 million, or 298.5 percent of quota. If the balance available under the stand-by arrangement is purchased, this amount would rise to SDR 739.5 million, or 349.6 percent of quota; excluding purchases under the CFF, the corresponding amounts would be equivalent to 208.4 percent and 259.5 percent of quota, respectively. The proposed revised phasing of the arrangement 2/ and the total outstanding use of Fund credit are shown in Table 1.

The attached letter (Appendix III) from the Prime Minister and Minister of Finance to the Managing Director, dated August 16, 1983, reviews developments since the beginning of the program period and indicates the areas

1/ EBS/83/67, March 30, 1983.

2/ The purchase that was subject to the April/May performance criteria has been rephased.

Table 1. Zambia: Proposed Schedule of Purchases and Repurchases, 1983-84

(In millions of SDRs)

	1983				1984
	April	May- June	July- Sept.	Oct.- Dec.	Jan.- March
<u>Purchases</u> ^{1/}					
Stand-by arrangement	31.5	--	45.0	67.5	67.5
Ordinary resources	19.1	--	20.4	27.8	--
Borrowed resources	12.4	--	24.6	39.7	67.5
CFF	--	97.2	--	--	--
<u>Repurchases</u>					
Credit tranches	3.1	25.0	25.0	21.9	18.8
CFF	--	6.1	--	--	--
Oil	--	0.7	--	--	--
<u>Net purchases</u>	<u>28.4</u>	<u>65.4</u>	<u>20.0</u>	<u>45.6</u>	<u>48.7</u>
<u>Total Fund holdings of</u> <u>Zambian kwacha (cumulative)</u>					
In millions of SDRs	783.7	849.1	869.1	914.7	963.4
As percent of existing quota (excluding CFF)	370.5 (323.5)	401.5 (311.4)	410.9 (320.8)	432.5 (342.4)	455.5 (365.4)
As percent of new quota (SDR 270.3 million) (excluding CFF)	289.9 (253.2)	314.1 (243.7)	321.5 (251.1)	338.4 (267.9)	356.4 (285.9)

Sources: IMF, Treasurer's Department; and staff projections.

^{1/} Proposed revised phasing of purchases; previously there were to have been four equal quarterly purchases of SDR 45 million beginning May-June 1983.

in which additional adjustment efforts are being made. ^{1/} The background to the present program is summarized in Section II of this paper; performance and prospects are reviewed in Section III; policies for the remainder of 1983 are set out in Section IV; and the staff appraisal and the proposed decisions are set forth in Section V. Summaries of Zambia's relations with the Fund and the World Bank Group are shown in attached Appendices I and II.

The staff will remain in close contact with the Zambian authorities, and a staff team is expected to visit Lusaka in November 1983 to review the initial budget proposals for 1984 and to initiate preliminary discussions on a program that could be supported by further use of Fund resources during 1984.

The Zambian authorities have submitted a request to the Fund for a Resident Representative to be stationed in Lusaka.

II. Background

The one-year program adopted for 1983 aims primarily at substantially reducing the serious internal and external financial imbalances facing Zambia, and thereby establish conditions that would permit a sustained recovery in overall economic activity when external conditions improve. The program also seeks to promote diversification of economic activity away from the dominant mining sector. Economic and financial indicators for recent years and the program's targets for 1983 are summarized in Table 2.

As part of the program the Zambian authorities devalued the kwacha by 20 percent against the SDR in January 1983. At the same time, the Government announced a general decontrol of wholesale and retail prices, following which prices for a wide range of commodities were increased. Effective May 1, 1983, substantial price increases for maize meal products (30 percent) and fertilizer (60 percent) were effected, consistent with the reduced provision for subsidies in the 1983 budget. The Government also announced that as a general guideline wages should not rise by more than 5 percent (with no general salary increase for government employees); however, low-income earners could obtain a somewhat higher increase due to the substantial increases in prices of basic commodities. In addition, interest rates were

^{1/} A staff team that carried out the discussions in Lusaka during June 7-24 that provided the basis for the mid-term review was composed of Messrs. Bornemann (head), Rothman, and Sharer, all of the African Department, Mr. Mahler (FAD), Mr. Hatayama (ETR), and Miss Simpson (secretary-AFR). Additional discussions with Zambian delegations took place in Washington during July 14-21 and August 8-10.

Table 2. Zambia: Selected Economic and Financial Indicators, 1980-83

	1980	1981	1982	1983	
				Program	Revised
(Annual percent changes, unless otherwise specified)					
National income and prices					
GDP at constant prices	3.0	-1.8	4.6	--	--
GDP deflator	12.5	4.0	1.3	25-30	25-30
Consumer prices	11.7	14.0	12.5	25-30	25-30
External sector					
Exports, f.o.b. (millions of SDRs)	1,023	833	844	963	943
Imports, c.i.f. (millions of SDRs)	1,017	1,050	962	841	786
Non-oil imports, c.i.f. (millions of SDRs)	839	839	763	660	642
Export volume	-6.6	-3.8	16.1	1.8	1.5
Import volume	18.3	-3.2	-13.6	-17.0	-25.0
Terms of trade (deterioration, -)	-19.3	-6.9	-21.4	2.7	2.7
Nominal effective exchange rate (depreciation, -) <u>1/</u>	-2.1	1.6	-2.8	...	...
Real effective exchange rate (depreciation, -) <u>1/</u>	-3.5	5.5	1.4	...	...
Government budget					
Revenue and grants	27.5	5.4	5.6	25.1	22.2
Total expenditure <u>2/</u>	26.6	9.4	3.6	0.4	-9.0
Money and credit					
Domestic credit <u>3/</u>	27.8	46.7	64.8	24.4	23.7
Government <u>3/</u>	25.1	18.1	50.0	11.4	13.4
Money and quasi-money (M2)	9.0	7.9	33.8	13.9	12.5
Velocity (GDP relative to M2)	3.3	3.1	2.5	2.7	2.8
Interest rate (maximum lending rate, percent per annum)	12.0	12.0	12.0	13.0	13.0
(In percent of GDP)					
Central government budget deficit					
Including official transfers	11.5	15.2	18.5	5.6	5.7
Excluding official transfers	12.3	15.9	19.2	6.3	6.4
Domestic bank financing	7.0	5.4	15.2	3.7	4.3
Foreign financing	4.7	8.1	2.3	0.5	0.3
Gross domestic investment	23.5	21.0	23.6	...	...
Current account deficit					
Including official transfers	12.2	20.9	17.3	7.4	6.5
Excluding official transfers	13.1	21.7	18.4	8.8	7.8
External debt <u>4/</u>	67.4	89.7	80.2	...	...
Debt service ratio <u>5/</u> (before relief)	28.0	34.3	50.7	53.3	54.1
Interest payments <u>5/</u> (including Fund charges)	10.7	11.5	19.8	18.1	17.5
(In millions of SDRs, unless otherwise specified)					
Overall balance of payments	-213	-280	-527	-295	-270
Gross official reserves (weeks of imports)	3.1	1.8	1.9	...	...
External payments arrears	461	501	669	569	579

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

1/ Import weighted and adjusted for relative consumer prices.

2/ Includes net lending but excludes payment of past arrears.

3/ As a percentage of money and quasi-money at the beginning of the period.

4/ Inclusive of use of Fund credit, but excluding commercial payments arrears.

5/ In percent of exports of goods and nonfactor services.

increased significantly, with commercial banks' maximum lending rates being raised to 13 percent, and the minimum rate on deposits of over 12 months being raised to 9 percent.

Under the program the external current account deficit of the balance of payments was to be narrowed markedly to 7.4 percent of GDP (from 17.3 percent in 1982), and the overall deficit was to be limited to SDR 295 million before debt rescheduling. External commercial payments arrears were expected to be reduced by at least SDR 100 million, with a minimum of SDR 30 million to be effected through cash payments. The Zambian authorities also announced their intention to seek a consolidation and rescheduling of external debt service payments and accumulated arrears. The authorities also took a number of fiscal actions aimed at reducing the budget deficit to 5.6 percent of GDP (from 18.5 percent in 1982). To attain this target, new revenue measures were enacted and total expenditure and net lending were to be virtually unchanged in nominal terms, implying a substantial reduction in real terms.

In view of the scarcity of foreign exchange and unfavorable prospects in agriculture, the program projected no growth in real output in 1983, although, as a result of the exchange rate and price actions, the growth in nominal GDP was projected to accelerate to about 27 percent. Despite higher tax payments, the financial position of the mining company (ZCCM) was expected to improve, as a result of the exchange rate action and the continued implementation of a major plan to reduce costs. In addition to the above actions, a new committee of senior government officials was instituted to monitor and oversee implementation of the Government's economic program.

III. Performance Under the Program

A list of measures under the 1983 financial program and the status of their implementation is provided in Table 3. Despite implementation of most of the measures envisaged under the program, external and domestic financial prospects for 1983 are less favorable than anticipated at the inception of the program. Due to a number of factors elaborated below, the program's performance criteria for April/May for banking system net credit to Government and external arrears were not observed (Table 4).

Regarding the balance of payments, revised projections indicate that the current account and overall payments deficits will be somewhat lower than previously envisaged, being constrained by a lack of foreign exchange (Table 5). Exports in the first five months of 1983 were lower than projected, due in large part to a disruption of shipments on the TAZARA railroad, leading to a buildup of copper stocks. A significant portion of

Table 3. Zambia: Summary of Financial Program, 1983

	1983	
	Program	Revised
<u>Assumptions</u>		
Real GDP growth (percent)	--	--
Nominal GDP growth (percent)	25-30	25-30
Change in terms of trade (percent)	2.7	2.7
Copper exports:		
Volume (thousands tons)	615	600
Price (US\$/lb.)	0.76	0.76
<u>Targets</u>		
Current account deficit including grants:		
In millions of SDRs	238	207
As percent of GDP	7.4	6.5
Overall deficit (millions of SDRs) ^{1/}	100	60
External commercial payments arrears (end of period; millions of SDRs)	569.3	579.3
Budget deficit		
In millions of kwacha	228.0	234.0
As percent of GDP	5.6	5.7
Domestic bank financing/GDP	3.7	4.3
<u>Principal elements</u>		<u>Status of Implementation</u>
<u>External</u>		
Devaluation of the kwacha by 20 percent in terms of the SDR, effective January 7, 1983, and flexible exchange rate policy during program.		New exchange arrangement implemented July 6; additional 5 percent depreciation as of August 9.
A 13 percent reduction in imports and a 14 percent increase in exports to achieve the targeted current account deficit.		Based on revised data, imports are now estimated to decline by 25 percent, and exports are to rise by 12 percent.
A minimum cash reduction in external commercial payments arrears of SDR 30 million.		To be effected in the second half of 1983.
<u>Fiscal</u>		
Restraint of total expenditure and a 25 percent increase in revenues.		Total expenditures are now estimated to decline by 9 percent and revenues to rise by 22 percent. This is to be achieved by additional fiscal measures described in the letter of intent, notably a doubling of the minerals tax to 8 percent and cuts in current and capital expenditures.

^{1/} After debt relief.

Table 3 (continued). Zambia: Summary of Financial Program, 1983

New tax measures equivalent to 3 per- cent of projected GDP.	Implemented
Reduction in budgetary subsidies by K 44 million to K 83 million.	Implemented
No net increase in government employment.	Implemented
No general wage increase for government employees.	Implemented
No extrabudgetary or supplementary ex- penditure and improved fiscal manage- ment.	Being implemented
<u>Prices and incomes</u>	
General price decontrol and increased flexibility to set prices at economic levels.	Implemented
Increases in the selling prices of maize meal and fertilizer.	Implemented
Full pass-through to domestic prices of higher import costs following devalua- tion.	Implemented
Wage increases to be limited to 5 per- cent, except at lower-paid levels.	Maximum average wage increases to be limited to 10 percent.
<u>Mining industry</u>	
Copper production to increase by up to 30,000 tons annually.	Likely to be realized
Further reduction of 200 in expatriate labor force and a reduction by 4 per- cent in local payroll as of April 1, 1983.	Implemented
Continued implementation of other administrative and technical cost saving measures.	Implemented
<u>Other</u>	
Interest rate increases (announced January 7).	Implemented
Restrictions on contracting or guaranteeing of nonconcessional external debt.	Implemented

Table 4. Zambia: Quantitative Performance Criteria, 1982-83

	1982	1983				
	Dec. Actual	April Ceiling	April Actual	July Proposed ceilings	Oct. Proposed ceilings	Dec. Proposed ceilings
	(In millions of kwacha)					
Net domestic assets <u>1/</u>	2,933.0	3,063.9	2,972.8	3,117.8	3,221.2	3,243.0
Claims on Government (net) <u>2/</u>	1,983.4	2,058.4	2,110.1	2,158.4	2,158.4	2,158.4
Bank of Zambia claims on ZCCM <u>3/</u>	160.5	170.5	170.5	170.5	170.5	170.5
	(In millions of SDRs)					
Commercial payments arrears <u>4/</u>	669.3	669.3	<u>5/</u> 686.5	<u>5/</u> 669.3	654.3	639.3
Arrears under debt rescheduling agreements	--	...	--	--	--	--
New external borrowing contracted or guaranteed by Government (cumulative)	...	100.0	--	100.0	100.0	100.0
1-10 years maturity	...	--	--	--	--	--
1-5 years maturity	...	--	--	--	--	--

Source: Letter of Intent.

1/ Defined as the difference between net foreign assets including external commercial payments arrears and money plus quasi-money, but excluding revaluation gains or losses due to exchange rate adjustments or on account of official gold holdings, and the counterpart of SDR allocations. Net domestic assets comprise claims on the Government, credit to the private sector, Bank of Zambia claims on ZCCM, and other assets (net).

2/ Claims on Government (net) is defined as the sum of all holdings of government securities and loans or advances to the Government by the Bank of Zambia and the commercial banks less all deposits of the Government held with these banks, plus the net use by the Government of any local currency related to past or future purchases from the Fund.

3/ Bank of Zambia credit to ZCCM is defined as direct lending by the Bank of Zambia as well as commercial bank loans refinanced partly or wholly by the Bank of Zambia.

4/ Defined as in the Bank of Zambia statement of Commercial Banks' Foreign Exchange Requirements on the last Friday of the month.

5/ End-May.

Table 5. Zambia: Balance of Payments, 1981-83

(In millions of SDRs)

	1981	1982	1983	
			Program	Revised
Exports, f.o.b.	833	839	963	943
Imports, c.i.f.	-1,050	-1,049	-841	-786
Trade balance	-217	-210	122	157
Services and unrequited transfers (net) <u>1/</u>				
Investment income	-178	-226	-217	-221
Other services	-148	-131	-111	-111
Private transfers	-100	-104	-75	-75
Government transfers	23	36	43	43
Total	-403	-425	-360	-364
Current account	-620	-635	-238	-207
Nonmonetary capital (net) <u>1/</u>				
Government	242	126	-43	19
Mining company	85	96	36	36
Other <u>2/</u>	-96	-169	-50	-80
Total	231	53	-57	-63
SDR allocations	15	--	--	--
Valuation adjustment <u>3/</u>	47	21	--	--
Overall balance, before debt relief	-327	-561	-295	-270
Debt relief on principal and interest during the year	--	--	195	210
Overall balance, after debt relief	-327	-561	-100	-60
Financing:				
Use of Fund resources (net)	312	-52	150	128
Purchases	(359)	(34)	(264)	(242)
Repurchases	(-47)	(-86)	(-114)	(-114)
Payments arrears (decrease -)	39	447	-228	-270
Debt service	(--)	(222)	(-128)	(-180)
Of which: cash payment	(--)	(--)	(-20)	(-38)
Commercial	(39)	(225)	(-100)	(-90)
Of which: cash payment	(--)	(--)	(-30)	(-30)
Rescheduling of arrears	--	--	178	202
Debt service	(--)	(--)	(108)	(142)
Commercial	(--)	(--)	(70)	(60)
Other foreign assets, net (increase -)	-24	166	--	--

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

1/ Includes scheduled debt service payments.

2/ Includes errors and omissions.

3/ Revaluation of Bank of Zambia holdings of gold.

copper exports has been redirected through southern routes, though at higher cost, and the TAZARA line is again operating so that stocks are being gradually reduced. Nevertheless, it is now estimated that copper exports, which account for about 90 percent of total exports, will be about 2.5 percent less in volume terms than projected under the program; world copper prices during the period January-July 1983 have averaged slightly over 75 U.S. cents per pound, approximately in line with the program's forecast of 76 cents per pound. In addition, initial cash payments for the settlement of arrears under the debt rescheduling arrangements are likely to be higher than estimated earlier. As a result, less foreign exchange is expected to be available for imports in 1983. Imports are now forecast to be some 25 percent below their 1982 level in SDR terms, compared with a 13 percent reduction initially envisaged with consequent adverse effects on both industrial activity and the government budget. ^{1/} Net services and transfers are expected to be in line with previous projections, and the current account deficit is thus expected to be SDR 207 million, compared with SDR 238 million forecast earlier. The overall deficit, after debt relief, is projected at SDR 60 million, compared with SDR 100 million initially envisaged. The overall deficit as well as a reduction of K 68 million in payments arrears through cash payments will be financed through net purchases from the Fund. Payments arrears will be reduced by a further SDR 202 million as part of the debt rescheduling arrangements.

The actual budget deficit for 1982 turned out to be about K 700 million, or about K 110 million (3.4 percent of GDP) higher than was estimated at the time the program for 1983 was formulated (Table 6). This higher deficit resulted mainly from a large supplementary budget in December 1982, a purpose of which was to clear outstanding domestic arrears. Moreover, as the supplementary budget was approved only very late in 1982, there was an extraordinarily large float at end-1982, totaling about K 129 million, as payments were not debited to the Government's account with the Bank of Zambia until early 1983. The extraordinary element in the end-1982 float is estimated at about K 60 million. As a result of this float, the program's end-April ceiling on net bank credit to the Government was exceeded, with such borrowing amounting to K 127 million through the first four months of 1983, compared with K 75 million provided for the period in the program. Based on the revised 1982 budget data and available information on developments during the first four months of 1983, new budgetary projections have been prepared. Mainly due to a large shortfall in revenue of some K 80 million associated with lower levels of imports and industrial activity, these projections suggest that, in the absence of additional fiscal measures, the overall budget deficit would amount to about K 345 million, or 8.4 percent of GDP, compared with the program's initial target of K 228 million, or 5.6 percent of GDP. Taking account of revised financing projections and the impact

^{1/} Based on revised 1982 data, the program's initial import level would have implied a 20 percent reduction in imports.

Table 6. Zambia: Central Government Finance, 1981-83

(In millions of kwacha)

	1981	1982		1983		
		Prelim.	Actual	Program <u>1/</u>	Revised proj. <u>2/</u>	Revised program <u>3/</u>
Revenue and grants	834.1	880.6	869.0	1,101.7	1,020.7	1,061.9
Tax revenue	732.9	766.1	743.3	945.9	887.1	903.7
Nontax revenue and grants	101.2	114.5	125.7	162.3	155.8	158.2
Total expenditure and net lending	1,277.7	1,324.2	1,424.4	1,329.7	1,365.9	1,295.9
Current expenditure	1,148.6	1,108.2	1,195.9	1,139.7	1,175.9	1,155.5
Personal emoluments	273.0	290.0	292.2	304.5	306.7	304.5
Recurrent departmental charges	230.6	286.7	300.4	286.4	300.4	300.4
Subsidies	110.4	126.8	126.4	82.8	82.8	82.8
Constitutional and statutory	444.2	285.7	335.3	309.2	329.2	322.1
Interest payments	(117.7)	(131.2)	(149.8)	(147.0)	(167.0)	(159.9)
Other <u>4/</u>	(326.5)	(154.5)	(186.5)	(162.2)	(162.2)	(162.2)
Other payments <u>5/</u>	90.4	133.0	141.6	156.8	156.8	145.7
Capital expenditure <u>6/</u>	119.3)		100.9)			
Net lending	9.8)	216.0	127.6)	190.0	190.0	140.4
Payment of past arrears	19.0	153.0	153.0	—	—	—
Overall deficit (-)	-462.8	-596.9	-708.4	-228.0	-345.2	-234.0
Financing	462.8	596.9	708.4	228.0	345.2	234.0
External (net)	247.4	74.2	129.5	19.9	28.5	13.6
Gross borrowing	(278.6)	(152.2)	(193.0)	(80.5)	(89.1)	(62.5)
Amortization	(31.2)	(78.0)	(63.5)	(60.6)	(60.6)	(48.9)
Domestic nonbank (net)	52.0	28.7	38.8	58.1	58.1	105.4
Domestic bank (net)	163.8	455.8	488.9	150.0	318.6	175.0
Other	-0.4	38.2	51.2	--	-60.0	-60.0
Memorandum item:						
Estimated reduction in payments as a result of debt rescheduling	...	...	...	161.2	165.0	165.0
Interest	(...)	(...)	(...)	(51.7)	(40.9)	(40.9)
Amortization	(...)	(...)	(...)	(109.5)	(124.1)	(124.1)

Sources: Ministry of Finance, Financial Reports (Annual), 1979-81; Estimates of Revenue and Expenditure, 1983; data provided by the Zambian authorities; and staff estimates.

- 1/ The program differed somewhat from the government budget, as noted in EBS/83/67.
2/ With no additional measures.
3/ Including effect of additional measures.
4/ Primarily defense expenditure on wages and goods and services.
5/ Mainly transfers.
6/ Net of capital receipts from parastatals.

of the extraordinarily large float, in the absence of additional measures bank credit to Government would amount to about K 319 million, compared with the program's indicative limit of K 150 million.

The monetary impact of the higher-than-anticipated increase in credit to the Government through April was offset by slack demand for private sector credit, which actually declined by 2 percent, reflecting both seasonal factors and the tight foreign exchange position, and a decline in other domestic assets (net). Overall net domestic assets increased by only K 40 million through April, compared with the program's ceiling of K 131 million. Combined with the impact of a continued decline in net foreign assets, this led to a decline of almost 3 percent in broad money (Table 7).

In view of further strains on the foreign exchange position, in early 1983 the Zambian authorities canceled all outstanding import licenses and implemented a new quarterly foreign exchange budgeting system to establish better balance between the issuance of import licenses and estimated foreign exchange availability. Nevertheless, due to technical delays in processing foreign exchange allocations by commercial banks, the program's end-May ceiling for commercial external payments arrears was exceeded by SDR 17 million; however, by June 10 these arrears had been reduced to a level SDR 8 million below the end-May ceiling, and at end-June they were SDR 9 million below the end-May ceiling.

Considerable progress has been made in the area of debt rescheduling. Negotiations under the aegis of the Paris Club took place on May 14 and 16, which resulted in an agreement by official creditors to provide debt relief somewhat more extensive than envisaged earlier: the agreement provided for (1) a rescheduling of arrears outstanding at the end of 1982 over five years with no grace period, with payments to be made in 10 equal semiannual installments beginning December 31, 1983; ; and (2) a rescheduling of 90 percent of current maturities, with the remaining 10 percent to be paid in 5 equal annual installments beginning December 31, 1983. The grace period for the payment of the rescheduled maturities will run until December 31, 1988 and the repayment period (for 10 equal and successive semiannual payments) until June 30, 1993. ^{1/} Negotiations with creditor commercial banks on term debt have reached an advanced stage, although it is possible that the terms will be less favorable than previously envisaged, with somewhat larger initial cash payments than estimated earlier. At the same time, bilateral contacts have been initiated with non-OECD creditor governments, most of which have given indications of a willingness in principle to reschedule, including a favorable initial response from the two largest creditors.

^{1/} For further details see SM/83/106, May 26, 1983.

Table 7. Zambia: Monetary Survey, 1981-83

(In millions of kwacha; end of period)

	1981	1982		1983		December Projection
		Prov.	Actual	March	April	
Net foreign assets	-1,195.1 <u>1/</u>	-1,402.4	-1,484.6	-1,547.8	-1,736.6	-2,317.2
Monetary authorities	(-707.9) <u>1/</u>	(-646.8)	(-729.2)	(-742.7)	(-941.0)	(-1,257.7)
Banking system	(25.5)	(-70.1)	(-69.9)	(-65.6)	(-57.2)	(-102.2)
Payments arrears	(-512.7)	(-685.5)	(-685.3)	(-739.5)	(-738.4)	(-957.3)
Net domestic assets	2,291.4 <u>1/</u>	2,859.9	2,933.0	2,941.1	2,972.8	3,243.0
Claims on Government (net)	(1,494.5)	(1,950.3)	(1,983.4)	(2,064.6)	(2,110.1)	(2,158.4)
Credit to private sector	(760.3)	(899.6)	(905.4)	(889.7)	(884.5)	(1,040.4)
Of which: Bank of Zambia						
claims on mining companies	57.0	160.5	160.5	170.5	170.5	170.5
Other assets (net)	(36.6) <u>1/</u>	(10.0)	(44.2)	(-13.2)	(-21.8)	(44.2)
Assets = Liabilities	<u>1,096.3</u>	<u>1,457.5</u>	<u>1,448.4</u>	<u>1,393.3</u>	<u>1,236.2</u>	<u>925.8</u>
Broad money	978.7	1,314.3	1,309.2	1,277.9	1,274.8	1,472.5
Money	(561.4)	(688.1)	(682.2)	(631.8)	(635.7)	(...)
Quasi-money	(417.3)	(626.2)	(627.0)	(646.1)	(639.1)	(...)
SDR allocation	70.0	70.0	70.0	70.0	70.0	102.3
Revaluation of official gold holdings <u>2/</u>	47.6	73.2	69.2	69.2	69.2	69.2
Revaluation gains/losses (-) <u>3/</u>	--	--	--	-23.8	-177.8	-718.2

(In annual percentage changes)

Net domestic assets	25.7	27.5	28.0			10.6
Claims on Government (net)	12.3	30.5	32.7			8.8
Credit to the private sector	51.9	18.3	19.1			14.9
Of which: Bank of Zambia claims on mining companies	(--)	(181.6)	(181.6)			(6.2)
Broad money	7.9	34.3	33.8			12.5

Sources: Bank of Zambia, Quarterly Financial and Statistical Review; data provided by the Zambian authorities; and staff projections.

1/ Revised.

2/ Official gold holdings were revalued at market-related prices on December 31, 1981 and 1982.

3/ Includes valuation losses on net foreign assets, including gold holdings and payments arrears, and SDR allocation. Data for March and April are cumulative totals (starting January 7, 1983) for Bank of Zambia foreign assets and liabilities thus far revalued, including Fund accounts, and losses in respect of arrears payments.

In summary, payments in respect of debt service and payments arrears in 1983 are expected to be SDR 399 million, compared with SDR 564 million originally falling due; the revised debt service ratio is estimated to be 38.2 percent of exports of goods and services, compared with 54.1 percent based on the scheduled payments.

Regarding the exchange rate, with effect from July 6, 1983 the Zambian kwacha has been unlinked from the SDR and pegged to a new basket of currencies reflecting Zambia's trade with its major trading partner countries. The composition of the basket will be reviewed periodically to reflect changes in Zambia's trade structure. This is intended to provide greater flexibility in the determination of the exchange rate in an effort to keep the kwacha in close alignment with Zambia's relative competitive position. On the day of the change in exchange arrangements, the Zambian kwacha was depreciated by one percent vis-a-vis its intervention currency, the U.S. dollar, and the authorities have continued to manage the rate flexibly; by August 9, 1983, a depreciation of 5 percent had taken place vis-a-vis the rate against the SDR prior to the change in exchange arrangements.

In the first quarter of 1983 the consumer price index rose by about 9.5 percent, reflecting the depreciation of the kwacha and the general decontrol of wholesale and retail prices. On May 1, the index is estimated to have risen by a further 2 percent due to the sharp increase in the price of maize on account of the reduced subsidy. For the year as a whole, consumer prices are expected to rise by 25-30 percent. In view of the impact of these increases, particularly on the lower paid workers, wage guidelines were issued providing for a maximum average increase of 10 percent in the wages and salaries of nongovernment employees, compared with the program's initial intention of 5 percent. However, the guideline represents a maximum increase, and it is expected that actual increases will be lower in many cases. As envisaged in the program, no general salary increases were granted to government employees.

For the 1982/83 crop season, agricultural producer prices were raised, on average, by about 15 percent. The increases had a favorable impact on output; despite poor weather conditions marketed agricultural production is expected to be higher than in the previous crop year. Producer price increases for the 1983/84 season were recently announced, and for maize, soya beans, wheat, and groundnuts these averaged almost 22 percent, which is estimated to be sufficient to offset the adverse impact of the increase in the fertilizer price.

IV. Prospects and Policies for the Remaining Program Period

During the remainder of the program period the Zambian authorities intend to continue their policy of fiscal restraint and to adhere broadly to the program's initial budgetary targets. Accordingly, the authorities have already enacted, on July 22, 1983, a doubling of the existing minerals export tax from 4 to 8 percent, which is expected to increase receipts by K 29 million. Tax collection efforts on account of domestic goods and services and nontax revenue are also being stepped up, and are expected to raise additional revenue of K 12 million. In addition, a number of measures are being taken to contain expenditure. Capital outlays and net lending will be reduced by about K 50 million, through a scaling back of outlays on a number of projects that have been identified in the capital budget and stepped-up capital receipts from parastatals, whose financial position has improved significantly following the price decontrol enacted earlier in the year. Recurrent spending will be lowered through reduced transfer payments, savings in government interest payments, and lower personnel costs. In total, recurrent outlays will be reduced by K 20 million.

Altogether, these actions are expected to contain the overall budget deficit on a commitment basis to about K 234 million, or 5.7 percent of GDP, compared with the original program target of K 228 million, or 5.6 percent of GDP. However, taking into account the large carry-over of payments from 1982, on a cash basis the deficit would be in the order of K 290 million. To finance the increase in the cash deficit, the authorities expect to raise additional nonbank domestic financing, mainly from the Zambia State Insurance Company and the Zambia National Provident Fund. As a result, bank borrowing by the Government will be limited to K 175 million, including the impact of the extraordinarily large carry-over of 1982 expenditures, compared with the program's original indicative target of K 150 million. The authorities are committed to meeting these targets while avoiding a repetition of the situation in 1982, when a large carry-over of expenditures occurred, resulting in an increased bank financing requirement in the following year. This point will be taken into account during a review with the Fund scheduled to be completed no later than February 15, 1984. The authorities are aware that further adjustment measures will be needed in 1984, and they intend to discuss budgetary policies for 1984 with the Fund staff at an early date in connection with the review mentioned above.

For the remainder of 1983 the authorities intend to continue to maintain a restrictive monetary policy. The expansion in domestic credit will be kept moderate, but the authorities will continue to aim at a shift in the composition of bank credit toward the private sector. Thus, while

the increase in net credit to the Government will decelerate sharply, a pickup in private sector credit is expected, especially to finance the agricultural sector. Nevertheless, reflecting the very slack demand in the early part of 1983, credit to the private sector for all of 1983 is now targeted to increase by 15 percent, compared with the earlier projection of 19 percent. Bank of Zambia credit to ZCCM will not increase above its April level. Overall, net domestic assets are now envisaged to rise by 11 percent through 1983, equivalent to the program's initial projection. Taking into account the revised projected movement in net foreign assets, broad money would increase by 12.5 percent in 1983, or slightly less than anticipated earlier. This compares with a projected increase in nominal GDP of about 27 percent.

In early January 1983, as part of the program, significant increases in interest rates were effected. Already during the January-April period there was a marked change in the composition of broad money toward quasi-money, with the share of quasi-money in broad money rising from 48 percent to 52 percent. In addition, as noted above, private sector demand for credit has been weaker than expected. In view of these developments, the authorities do not expect to make any further changes in the interest rate structure for the remainder of the year.

For 1983/84 (April-March) ZCCM's budget calls for further cost-cutting measures, amounting to about K 150 million, after savings of K 356 million realized in 1982/83. These savings would be effected mainly in the areas of purchasing (including contractual services through increased use of the company's own resources), personnel and a further deferral of capital spending. These savings plus a higher level of proceeds from copper shipments are projected to result in a profit for ZCCM (Table 8), even after allowance is made for the recent increase in the minerals export tax rate. This compares with a modest loss projected early in 1983.

Regarding external developments, the authorities have already introduced a more flexible exchange rate policy, as noted above. For the remainder of the year they intend to maintain a rate consistent with the objectives of the program, with particular attention given to the implications of new wage agreements for the cash flow and profitability of the mining company and aggregate domestic demand. In addition, despite the somewhat tighter foreign exchange position, the authorities intend to maintain the program's initial targets for a reduction in external arrears through net cash payments. Furthermore, they will not permit any arrears to arise under debt rescheduling agreements.

Revised medium-term balance of payments and external debt projections for the period 1983-87 are set forth in Table 9. As indicated in the table,

Table 8. Zambia: ZCCM, Consolidated Profit and Loss Account, 1980/81-1983/84 1/

(In millions of kwacha)

	1980/81	1981/82 Revised	1982/83		1983/84	
			Proj.	Actual	Orig. proj.	Rev. proj. <u>2/</u>
Sales	1,093.3	974.7	999.2	969.8	1,341.0	1,522.0
Of which: copper	(968.8)	(867.7)	(908.0)	(867.8)	(1,221.0)	(1,389.0)
Cost of sales	1,082.7	1,080.3	1,055.1	1,047.1	1,207.0	1,269.0
Profit/loss (-) on sales	85.6	-105.6	-55.9	-77.3	134.0	253.0
Other costs <u>3/</u>	51.3	36.1	84.7	49.6	131.0	116.0
Profit/loss (-) before taxation	34.3	-141.7	-140.6	-126.9	3.0	137.0
Profit/loss (-) after taxation <u>4/</u>	56.5	-148.0	-145.0	-134.8	-55.0 <u>5/</u>	27.0 <u>6/</u>

Sources: Zambia Consolidated Copper Mines, Ltd.; and staff projections.

1/ The ZCCM financial year is April 1-March 31.

2/ Projections of ZCCM adjusted by staff.

3/ Primarily interest costs.

4/ Including taxation recoverable from the carry-back of losses against profits for the previous year.

5/ Including payment of the new minerals tax effective April 1, 1983.

6/ Adjusted for the increase in the minerals tax rate enacted July 22, 1983.

Table 9. Zambia: Medium-Term Balance of Payments and External Debt Outlook, 1983-87

	1983	1984	1985	1986	1987
	(In millions of SDRs)				
Exports, f.o.b.	943	1,143	1,336	1,465	1,593
Imports, c.i.f.	-786	-864	-951	-1,047	-1,151
Trade balance	157	279	385	418	442
Invisibles (net)	-364	-456	-457	-438	-413
Of which: investment income <u>1/</u>	(-221)	(-313)	(-314)	(-295)	(-270)
Current account	-207	-177	-72	-20	29
Capital (net) <u>2/</u>	-63	-119	-58	-53	-29
Overall balance, before debt relief	-270	-296	-130	-73	--
Debt relief of principal and interest during the year	210	--	--	--	--
Overall balance, after debt relief	-60	-296	-130	-73	--
Financing:					
Use of Fund resources (net)	128	-6	-95	-151	-203
Purchases	(242)	(68)	(--)	(--)	(--)
Repurchases	(-114)	(-74)	(-95)	(-151)	(-203)
Payments arrears (decrease -)	-270	) 302	225	224	203
Other (net) (increase -) <u>3/</u>	202)			
<u>Debt service</u>					
Original maturities on existing debt	388	388	402	373	328
Estimated payments on new borrowings	11	37	66	83	95
Payments to the Fund	165	137	152	198	235
Total, before rescheduling	564	562	620	654	658
Debt relief (relief -)	-210	--	--	--	--
Debt service arising from re-scheduling of 1983 maturities and arrears	45	113	98	90	85
Total, after rescheduling	399	675	718	744	743
	(In percent)				
Debt service ratio <u>4/</u>					
Before debt relief	54.1	45.6	42.9	41.4	38.4
Of which: excluding the Fund	(38.3)	(34.4)	(32.4)	(28.9)	(24.7)
After debt relief	38.2	54.7	49.7	47.1	43.4
Of which: excluding the Fund	(22.4)	(43.6)	(39.1)	(34.6)	(29.7)
<u>Memorandum item:</u>					
Market price of copper (US\$/lb)	0.76	0.90	1.05	1.15	1.25

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

1/ Includes interest on rescheduled debt for future years.

2/ Includes service payments arising from rescheduling, SDR allocation, valuation adjustment associated with gold revaluation, and errors and omissions.

3/ Represents rescheduling of arrears for 1983, and uncovered gaps for the period 1984-87.

4/ Vis-à-vis exports of goods and services.

the medium-term outlook remains difficult, particularly on account of the heavy debt burden and prospects for copper prices, which are unlikely to return to the peak levels of earlier years. After taking account of disbursements under the current stand-by arrangement and of scheduled repurchases from the Fund, but excluding any further debt rescheduling, reductions in non-Paris Club related external payments arrears, or further use of Fund resources, there would be an uncovered financing gap of about SDR 300 million in 1984, declining to about SDR 200 million by 1987. The authorities are aware of the consequent need to intensify their adjustment efforts over the medium term, and expect to request further debt rescheduling as well as continued use of Fund resources to support these efforts. Under such a scenario Zambia would be able to make net repurchases from the Fund beginning no later than 1986.

The stand-by arrangement includes as quantitative performance criteria ceilings on net domestic assets and on net credit to the Government (both of the banking system); Bank of Zambia credit to ZCCM; external commercial payments arrears; and the contracting or guaranteeing of new nonconcessional debt in the maturity range of 1-10 years. An additional performance criterion covers arrears under debt rescheduling agreements. The proposed quantitative performance criteria are set forth in Table 4. Further purchases under the arrangement will be contingent on the observance of these performance criteria. In addition, the purchase related to the October performance criteria will be subject to a review of the appropriateness of exchange rate policy, as noted in paragraph 8 of the attached letter, and the purchase related to the December performance criteria will be subject to a review of budgetary policies for 1984, as noted in paragraph 10 of the attached letter.

V. Staff Appraisal and Proposed Decision

Under the present stand-by arrangement, the Zambian authorities have made substantial progress in implementing adjustment measures. These have included importantly a significant depreciation of the kwacha and the adoption of a more flexible exchange rate policy, an upward adjustment in interest rates, a wide range of tax increases, sizable increases in the retail prices of maize and fertilizer and agricultural producer prices, and a general decontrol of wholesale and retail prices. There has also been a vigorous and successful effort to reduce costs in the important mining sector. Moreover, there has been a consolidation and rescheduling of external debt service payments and accumulated arrears with Paris Club creditors, and the authorities are currently at an advanced stage of discussing rescheduling terms with commercial banks and non-OECD bilateral creditors.

Despite the satisfactory pace of policy implementation, Zambia's foreign exchange and domestic financial prospects for 1983 are less encouraging than envisaged earlier in the year. Disruptions of copper shipments plus higher initial cash payments associated with debt rescheduling are the principal reasons for a downward revision in the available foreign exchange for imports, which will have further adverse repercussions on industrial production and the budget. Reflecting the financing constraint, both the current account and overall balance of payments deficits are now projected to be smaller than envisaged at the inception of the program. The new quarterly foreign exchange budgeting system has improved the coordination in the issuance of import licenses and available foreign exchange. The program's end-May ceiling on external commercial payments arrears was exceeded, mainly for technical reasons relating to the commercial banks, but subsequently such arrears have declined so that by end-June they were SDR 9 million below the end-May ceiling. Moreover, the authorities still intend to effect the initially targeted cash reduction in commercial payments arrears.

Regarding the budget, a large shortfall in revenue from the level originally projected has emerged, associated mainly with lower levels of imports and industrial activity. Combined with the carry-over of uncleared checks linked to the supplementary budget of late 1982, this has led to higher-than-foreseen government recourse to domestic bank financing in the early part of the year and to a deterioration in fiscal prospects for the year as a whole. Thus the program's end-April ceiling on net banking system credit to Government was exceeded, and, in the absence of additional actions, both the budget deficit and net bank financing would have expanded appreciably above the initial targets. However, in recognition of the necessity for fiscal restraint, the Zambian authorities have implemented policy changes and have undertaken other measures to contain the budget deficit and government bank financing to Je lose to the initial targets.

Some measures will lessen the bank financing requirement through the obtaining of additional financing from parastatal enterprises, whose finances have been substantially improved by the price decontrol effected earlier in the year. There are also a number of measures in the areas of revenue and expenditure, notably the doubling of the minerals export tax and curtailment of recurrent and capital outlays, which should favorably affect future budgetary projections. Moreover, consistent with the Zambian authorities' determination to achieve a continuous improvement in the fiscal area, they will review the policy content of the 1984 budget with the Fund at an early stage.

Despite the larger-than-planned government recourse to the banking system in early 1983, overall credit expansion was very moderate, reflecting weak demand emanating from the private sector. Even with the anticipation of a pickup in private sector credit during the second half of the year and higher government bank borrowing than initially projected, overall credit expansion and monetary growth are envisaged to approximate the initial targets, and continue to be substantially below the projected growth of nominal GDP.

In the area of wage policy, the authorities have, as intended, not granted any general increases to government employees. However, for nongovernment employees wage awards are likely to exceed the program's initial average limit of 5 percent. The authorities are nevertheless committed to minimizing the effects of the larger awards on Zambia's export position and aggregate domestic demand. Thus in recent weeks the exchange rate of the kwacha has moved downward, and the staff has been assured that the authorities will continue to maintain a rate consistent with the objectives of the program. In addition, the Zambian authorities will maintain close contact with the Fund regarding the appropriateness of the rate.

The staff believes that the policy initiatives and other measures set forth in the attached letter of August 16, 1983 are consistent with strengthening Zambia's balance of payments and domestic financial positions as envisaged under the current program, and thus merit continued Fund support. Nevertheless, despite the considerable adjustment effort undertaken in 1983, the medium-term balance of payments outlook remains extremely difficult. Therefore, as emphasized earlier in the year, prolonged and intensified efforts will be required of the Zambian authorities, and creditors and donors will have to be even more forthcoming, if Zambia is to achieve medium-term domestic and external financial viability. In this context it will be important for Zambia to maintain close collaboration with the World Bank staff in preparing for a consultative group meeting, under the auspices of the World Bank, which is expected to be held early in 1984.

In view of the foregoing, the following draft decision is proposed for adoption by the Executive Board:

1. Zambia has consulted the Fund in accordance with paragraph 4 of the stand-by arrangement for Zambia approved by Decision No. 7383-(83/63), adopted April 18, 1983, and the fourth paragraph of the letter of February 25, 1983, attached to the stand-by arrangement for Zambia (EBS/83/67, Supplement 1) in order to review progress under the program and to reach understandings with the Fund on performance criteria for the remaining period of the program, as well as on exchange rate and interest rate policies.

2. The letter of the Prime Minister and Minister of Finance dated August 16, 1983, shall be attached to the stand-by arrangement for Zambia and the letter from the Prime Minister and Minister of Finance dated February 25, 1983 shall read as supplemented and modified by the letter of August 16, 1983.

3. (a) Purchases under this arrangement shall not, without the consent of the Fund, exceed the equivalent of SDR 76.5 million until November 30, 1983, and SDR 144 million until February 15, 1984.

(b) None of the limits in (a) 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.

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 target for reduction in external payments arrears described in paragraph 4 and Attachment I of the annexed letter, or

(ii) the understanding concerning arrears under debt rescheduling agreements described in paragraph 4 and Attachment I of the annexed letter, or

(iii) the limit on total net domestic assets described in paragraph 11 and Attachment I of the annexed letter, or

(iv) the limit on net credit to the Government described in paragraph 11 and Attachment I of the annexed letter, or

(v) the limit of Bank of Zambia credit to ZCCM described in paragraph 11 and Attachment I of the annexed letter

has not been observed, or

(b) After November 30, 1983, until the review contemplated in paragraph 8 of the attached letter is completed, or

(c) After February 15, 1984, until the review contemplated in paragraph 10 of the attached letter is completed.

Staff contacts:

The 1982 Article IV consultation discussions were held in Lusaka in November 1982 and January-February 1983. Use of Fund resources missions visited Zambia in December 1981, April and November 1982, and February and June 1983. Zambian delegations held discussions at the Fund in January and September 1982 and in July and August 1983.

Zambia: Financial Relations with the World Bank Group

A. IBRD/IDA operations (as of June 30, 1983)

(In millions of U.S. dollars)

	<u>Disbursed</u>		<u>Undisbursed</u>	
	<u>IBRD</u>	<u>IDA</u>	<u>IBRD</u>	<u>IDA</u>
Agriculture (incl. industrial forestry)	35.19	4.04	11.97	27.46
Education	62.59	1.15	5.69	23.85
Industrial and development finance	25.46	--	9.21	--
Power	236.87	--	4.08	--
Program lending	42.50	--	--	--
Technical assistance (incl. petroleum exploration)	1.66	1.07	4.94	8.23
Telecommunications	26.73	--	5.27	--
Transportation	53.33	12.91	30.12	13.34
Urban	<u>20.00</u>	<u>--</u>	<u>--</u>	<u>16.00</u>
Total	504.33	19.17	71.28	88.88
of which has been repaid	160.61	--		
Total now outstanding	343.72	19.17		

(In millions of U.S. dollars)

B. IFC investments
(as of June 30, 1983)

<u>Disbursed</u>	<u>Undisbursed</u>
28.5	34.0

Sources: IBRD and IFC.

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

Lusaka, August 16, 1983

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

Dear Mr. de Larosière:

1. Under the provisions of the stand-by arrangement approved by the Fund's Executive Board on April 18, 1983, at mid-term the Government is to review with the Fund progress under the program, including in particular progress toward debt rescheduling, the generation of new external assistance, wage restraint and price policy, and budgetary performance, and to reach understandings with the Fund on performance criteria for the remaining period of the program, as well as on exchange rate and interest rate policies. The Government has recently discussed these areas with the Fund staff, and in the light of these discussions intends to pursue further policy initiatives, including necessary adaptations of the program, as described below.

2. Despite the implementation of most of the measures envisaged under the program, including importantly an initial depreciation of the kwacha by 20 per cent, upward adjustments in interest rates, a wide range of tax increases, substantial increases in the prices of maize and fertilizer, general decontrol of wholesale and retail prices, and a consolidation and rescheduling of external debt service payments and accumulated arrears, the foreign exchange and domestic financial prospects for 1983 are less favorable than anticipated at the inception of the program.

3. Regarding the balance of payments, export receipts in the first five months of 1983 were lower than projected, due in large part to a disruption of shipments on the TAZARA railroad, leading to a buildup of copper stocks. Although TAZARA is again operating, a significant portion of copper exports is being redirected through an alternative route, which is more costly. Stocks are being gradually reduced, but it is now estimated that the volume of copper exports will be 2.5 per cent less than projected earlier; world copper prices have been approximately in line with the initial forecast. Considerable progress has been made in the area of debt rescheduling, and relief provided by the Paris Club in May was somewhat larger than envisaged earlier. Nevertheless, cash payments in 1983 associated with rescheduling are likely to be higher than foreseen.

As a result of these factors, as well as a downward revision of other capital flows, less foreign exchange will be available for imports. In SDR terms, imports are now forecast to be some 25 per cent below their 1982 level, compared to a 20 per cent reduction previously envisaged, with a consequent additional adverse impact on both industrial activity and the budget. Revised projections now show a current account deficit of SDR 207 million, compared with a deficit of SDR 238 million forecast earlier. Financing constraints will contain the overall balance of payments deficit to about SDR 60 million, compared with SDR 100 million initially envisaged.

4. A new quarterly foreign exchange budgeting system has been implemented, with improved coordination in the issuance of import licenses and available foreign exchange. Nevertheless, due to technical delays on the part of commercial banks, the program's end-May ceiling for commercial payments arrears was exceeded. By June 10, however, arrears were SDR 7.9 million below the end-May ceiling. Moreover, for 1983 the Government remains committed to making a minimum cash reduction of SDR 30 million in respect of commercial payments arrears on the basis of the schedule set out in Attachment I, and will not permit any arrears to arise under debt rescheduling agreements. In addition, it is still intended that external arrears as a result of payments overdue to overseas suppliers of goods and services to the mining company (ZCCM) will not increase over 1983.

5. Concerning attempts to improve the efficiency and thus profitability of ZCCM, in 1982/83 (April-March) the company realized gross savings due to cost-cutting measures of K 356 million. As a result, and despite lower copper revenues than forecast, losses of ZCCM were actually less in 1982/83 than envisaged at the time of the adoption of the present program. For 1983/84, further savings will be effected, particularly in the areas of purchasing, personnel, and deferred capital outlays, which are expected to total about K 150 million. These savings plus a higher level of proceeds from copper are expected to lead to a profit for ZCCM, even if allowance is made for the new minerals tax, compared with a modest loss projected earlier in the year.

6. Upward adjustments of agricultural producer prices for the 1982/83 crop season have yielded substantial benefits. Despite less than favorable weather conditions, marketed agricultural production is expected to be higher than was obtained in the previous crop year. Producer prices have recently been reviewed, and for 1983/84 further increases have been announced for maize, soya beans, wheat, and groundnuts averaging about 22 per cent.

7. In the area of wage policy, as envisaged no general increases have been granted to government employees. However, due to rapid increases in consumer prices resulting from the depreciation of the kwacha, the general decontrol of wholesale and retail prices, and the substantial increase in the price of maize, wage guidelines have been issued providing for a maximum average increase of 10 per cent in the wages and salaries of nongovernment employees, compared with our initial intention of 5 per cent. Nevertheless, although the 10 per cent limit will be the maximum average award permissible, we expect that the actual increase will be lower in many cases.

8. On July 6, 1983, the Bank of Zambia switched from pegging the kwacha to the SDR to pegging it to a currency basket more reflective of Zambia's trade pattern. This is intended to provide greater flexibility in the determination of the exchange rate. For the remainder of the year, it is intended to maintain a rate consistent with the overall objectives of the program, with particular attention given to the implications of new wage agreements for the cash flow and profitability of the mining company and aggregate domestic demand. We will review with the Fund the appropriateness of exchange rate policy no later than November 30, 1983.

9. The actual budget deficit for 1982 amounted to about K 700 million, or K 102 million (3.2 per cent of GDP) higher than was estimated at the time our financial program for 1983 was formulated. This higher deficit resulted mainly from a large supplementary budget in December, a purpose of which was to clear outstanding domestic arrears. Moreover, as the supplementary outlays occurred only very late in 1982, there was an extraordinarily large float at end-1982, as payments were not debited to the Government's account with the Bank of Zambia until early 1983. As a result of this float, the program's end-April ceiling on net bank credit to the Government was exceeded. Such borrowing amounted to K 127 million through the first four months of 1983, compared with K 75 million provided for in the program.

10. Based on the revised 1982 budget data and developments during the first four months of 1983, new budgetary projections have been prepared. Mainly due to a large shortfall in revenue associated with lower levels of imports and industrial activity, these projections suggest that, in the absence of additional fiscal measures, the overall budget deficit would amount to about K 345 million, compared with the program's initial target of K 228 million. However, the Government remains determined to impose fiscal restraint and has recently taken several measures to help contain the deficit, as indicated in Attachment II.

These include importantly a doubling of the existing minerals export tax from 4 to 8 per cent; additional tax collections on account of domestic goods and services and nontax revenue; and a number of measures to contain expenditure. The latter are in the areas of recurrent spending, including personnel costs, savings in government interest payments, and a reduction in transfer payments, and include also a scaling down of outlays on a number of projects which have been identified in the capital budget and stepped up efforts to recover past loans to public enterprises. In sum, these actions are expected to contain the deficit to about K 234 million, broadly in line with the original program estimate. Moreover, we will avoid a repetition of the situation in 1982, when a large carry-over of expenditure occurred, resulting in an increased bank financing requirement in the following year. In addition, we are aware that further adjustment measures will be needed in 1984, and we will review with the Fund budgetary policies for 1984 no later than February 15, 1984.

11. During the first four months of 1983, the growth in domestic credit was quite moderate (3.7 per cent). Although the Government's financing requirements were larger than initially envisaged, credit to the private sector actually declined. The latter reflected both the usual slack demand for agricultural credit during the early part of the year and a reduced demand for credit for imports associated with the shortage of foreign exchange. Through April, net domestic assets of the banking system rose by only K 40 million, and money plus quasi-money declined by 2.6 per cent. With the aim of maintaining a restrictive monetary policy, the expansion in domestic credit will be kept moderate for the remainder of 1983. For 1983 as a whole, the increase in net credit to the Government will not exceed K 175 million (including the impact of the extraordinarily large float at end-1982), compared with the initial indicative limit of K 150 million. On the other hand, reflecting the very slack demand in the early part of 1983, credit to the private sector for all of 1983 is now targeted to increase by 15 per cent, compared with the earlier projection of 19 per cent. Bank of Zambia credit to ZCCM will be contained at the present level of K 170.5 million. Overall, domestic credit is now anticipated to rise by 11 per cent through 1983, equal to the initially projected expansion. Taking into account the revised balance of payments projection, broad money would rise by 12.5 per cent in 1983, or slightly less than envisaged earlier, and considerably less than the projected increase in nominal GDP. Net domestic assets, net credit to the Government, and Bank of Zambia credit to ZCCM will not exceed the limits for July, October, and December 1983, set out in Attachment I.

12. In January 1983, substantial increases in interest rates were effected, with, for example, the commercial bank maximum lending rate raised

to 13 per cent and the minimum rate on deposits of over 12 months increased to 9 per cent. Already over the first four months of the year there was a shift in the composition of broad money toward quasi-money. Moreover, as indicated above, private sector credit demand has been weak. Therefore, no further changes in the interest rate structure are envisaged for the rest of 1983.

13. The Government reconfirms its intentions in other areas of economic and financial policy as described in the Memorandum on the Economic and Financial Policies of Zambia annexed to my letter of February 25, 1983. Furthermore, as noted in paragraphs 8 and 10 above, we will review with the Fund the appropriateness of the exchange rate by November 30, 1983 and budgetary policies for 1984 by February 15, 1984, and will reach such understandings as are necessary.

Yours faithfully,

/s/

Nalumino Mundia, MCC, MP
Prime Minister and Minister of Finance

cc: His Excellency the President,
State House,
Lusaka

Attachment I. Proposed Quantitative Performance Criteria
Attachment II. List of Additional Fiscal Measures

Zambia - Proposed Quantitative Performance Criteria

	1982	1983	1983		
	Dec.	April	July	Oct.	Dec.
	Actuals		Proposed ceilings		
	(In millions of kwacha)				
Net domestic assets <u>1/</u>	2,933.0	2,972.8	3,117.8	3,221.2	3,243.0
Claims on Government (net) <u>2/</u>	1,983.4	2,110.1	2,158.4	2,158.4	2,158.4
Bank of Zambia claims on ZCCM <u>3/</u>	160.5	170.5	170.5	170.5	170.5
	(In millions of SDRs)				
Commercial payments arrears <u>4/</u>	669.3	686.5	<u>5/</u> 669.3	654.3	639.3
Arrears under debt reschedul- ing agreements	--	--	--	--	--
New external borrowing contracted or guaranteed by Government (cumulative)	...	-----			100.0
1-10 years maturity	...	-----			
1- 5 years maturity	...	-----			--

1/ Defined as the difference between net foreign assets including external commercial payments arrears and money plus quasi-money, but excluding revaluation gains or losses due to exchange rate adjustments or on account of official gold holdings, and the counterpart of SDR allocations. Net domestic assets comprise claims on the Government, credit to the private sector, Bank of Zambia claims on ZCCM, and other assets (net).

2/ Claims on Government (net) is defined as the sum of all holdings of government securities and loans or advances to the Government by the Bank of Zambia and the commercial banks less all deposits of the Government held with these banks, plus the net use by the Government of any local currency related to past or future purchases from the Fund.

3/ Bank of Zambia credit to ZCCM is defined as direct lending by the Bank of Zambia as well as commercial bank loans refinanced partly or wholly by the Bank of Zambia.

4/ Defined as in the Bank of Zambia's statement of Commercial Banks' Foreign Exchange Requirements on the last Friday of the month.

5/ Actual end-May.

List of Additional Fiscal Measures

(In millions of kwacha)

Revenue

Raise minerals export tax to 8 per cent	28.8
Improved collections of beer tax	4.0
Improved collections of equity levy	6.0
Improved collections of interest due	2.4
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Total revenue increase	41.2

Expenditure

Reduced capital outlays	19.2
Increased capital receipts from parastatals	30.4
Reduced current expenditure	20.4
Of which: personal emoluments	(2.2)
transfers	(11.1)
interest payments	(7.1)
	<hr/>
Total expenditure reduction	70.0

Total fiscal measures 111.2

