NOT FOR PUBLIC USE

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 83/63

10:00 a.m., April 18, 1983

J. de Larosière, Chairman

Executive Directors	Alternate Executive Directors
A. Alfidja	
	C. Taylor
J. de Groote	
	A. Le Lorier
	J. Delgadillo, Temporary
	C. Dallara
	T. Alhaimus
A. H. Habib	
	T. Yamashita
	G. W. K. Pickering, Temporary
A. Kafka	C. Robalino
G. Laske	
G. Lovato	
	A. S. Jayawardena
Y. A. Nimatallah	S. El-Khouri, Temporary
	T. de Vries
A. R. G. Prowse	
G. Salehkhou	O. Kabbaj
	E. I. M. Mtei
M. A. Senior	S. E. Conrado, Temporary
	A. Lindø
	Zhang X., Temporary

L. Van Houtven, Secretary
J. A. Kay, Assistant

Also Present
African Department: J. B. Zulu, Director; R. J. Bhatia, Deputy Director; O. B. Makalou, Deputy Director; N. Abu-zobaa, M. W. Bell, E. L. Bornemann, F. d'A. Collings, C. Enweze, U. R. Gunjal, R. L. Sharer, W. J. Shields, M. Sidibé. Asian Department: E. Gurgen. Exchange and Trade Relations Department: W. A. Beveridge, Deputy Director; S. Mookerjee, Deputy Director; M. Guitian, S. Kanesa-Thasan. External Relations Department: G. P. Newman. Legal Department: G. P. Nicoletopoulos, Director; W. E. Holder. Fiscal Affairs Department: W. R. Mahler, Jr. Research Department: W. C. Hood, Economic Counsellor and Director; G. I. Brown, K.-Y. Chu, N. M. Kaibni, A. Salehizadeh. Personal Assistant to the Managing Director: N. Carter. Advisors to Executive Directors: A. A. Agah, E. A. Ajayi, C. J. Batliwalla, M. A. Janjua, P. Kohnert. Assistants to Executive Directors: H. Arias, L. Barbone, R. Bernardo, J. Bulloch, M. Camara, G. Ercel, C. Flamant, I. Fridriksson, M. Hull, J. M. Jones, J. A. K. Munthali, V. K. S. Nair, Y. Okubo, J. Reddy, C. A. Salinas, J. Schuijer, H. Suzuki, P. S. Tjokronegoro, J. C. Williams.

1. ZAMBIA - 1982 ARTICLE IV CONSULTATION; STAND-BY ARRANGEMENT, AND USE OF FUND RESOURCES - COMPENSATORY FINANCING FACILITY

The Executive Directors considered the staff report for the 1982 Article IV consultation with Zambia and Zambia's request for a stand-by arrangement for one year in an amount equivalent to SDR 211.5 million (EBS/83/67, 3/30/83; Cor. 1, 4/4/83; and Sup. 1, 4/15/83). They also had before them a paper on a request expected to be received from Zambia for a purchase equivalent to SDR 97.2 million under the compensatory financing facility (EBS/83/70, 3/31/83), and a report on recent economic developments in Zambia (SM/83/50, 3/10/83).

The Chairman invited the Executive Directors to take a decision of principle with respect to a purchase transaction under the compensatory financing facility for which a request was expected in due course. The formal decision would be taken on a lapse-of-time basis when the outcome of a Paris Club meeting to reschedule the debts of Zambia--now arranged for May 13 and, if necessary, May 14, 1983--was known. An authenticated request for the purchase had not yet been received.

Mr. Mtei made the following statement:

> I would like to express the appreciation of my Zambian authorities to the staff for the papers produced in connection with the 1982 Article IV consultations and the request for a stand-by arrangement, as well as the request for a drawing under the compensatory financing facility. As the papers indicate, the discussions with the staff took place against a background of a difficult economic situation characterized by declining output, fiscal imbalances and considerable pressure on the balance of payments reflecting the continuous deterioration in Zambia's terms of trade and general unfavorable conditions in the world economy.
>
> For the past several years the Zambian authorities have been aware that the economic problems facing the country required sustained corrective measures. Accordingly, the Government initiated a medium-term adjustment program that was supported by an extended arrangement approved by the Board on May 8, 1981. Directors will recall that the objectives of the program were to increase the level and diversify the structure of production, reduce the budgetary deficit, and move toward a sustainable balance of payments position in the medium term. Most of the program's fiscal targets were achieved in 1981, the first year of the program. Producer prices were also increased for the 1981/82 crop year, while increases were initiated for a wide variety of consumer products, including maize, sugar, and bread. Interest rates were raised during the early part of 1981, and ceilings on commercial bank lending were established. Despite these initial efforts, progress under the program became increasingly difficult largely as a result of another sharp decline in the price of copper, the major source of foreign

exchange earnings. In these circumstances, the balance of payments came under severe pressure, and the mounting losses of the mining industry had to be financed through increased borrowing from the domestic banking system. Hence, domestic credit and external payments arrears exceeded their ceilings. Consequently, the program became inoperative and was later canceled. Meanwhile, real GDP stagnated, reflecting the decline in the mining sector and the slowdown in manufacturing activities.

The economic situation remained difficult in 1982, with further stagnation in real GDP reflecting a substantial decline in value added in the agricultural sector as well as the underutilization of industrial capacity due to the shortage of imported essential inputs brought about by the acute foreign exchange shortage. Industries that processed locally produced agricultural products were also adversely affected by the decline in agricultural output. The budgetary position worsened, with the deficit in relation to GDP increasing from 15 per cent in 1981 to 18.5 per cent in 1982. It is to be noted, however, that a substantial portion of total expenditure went to settle domestic arrears, which, if excluded, would have resulted in a budgetary deficit of 13.8 per cent of GDP. The balance of payments remained under severe strain, although the current account deficit is projected to decline to 17.3 per cent from 21 per cent in 1981. At the end of 1982, commercial payments arrears stood at SDR 666.3 million, while arrears on external public and publicly guaranteed debt have been estimated at SDR 222 million.

In light of the seriousness of the situation and in consultation with the staff, the Zambian authorities have put in place a new stabilization program aimed at arresting the financial decline and providing a basis for an eventual economic recovery. In support of this program, they are requesting a one-year stand-by arrangement with the Fund in the amount of SDR 211.5 million.

The Zambian authorities are aware of the fact that a sustainable economic recovery will have to put greater emphasis on diversification so as to reduce the country's heavy reliance on copper exports and thereby lessen the vulnerability of the economy to adverse developments in the international copper market. In this connection, priority is being given to development of the agricultural and manufacturing sectors. With regard to agriculture, efforts are being directed at increasing production of foodcrops for domestic consumption as well as traditional export crops such as tobacco, groundnuts, and cotton. A project for developing cashew nut production is being implemented, while steps are being taken to explore the possibility of expanding coffee production. In the spirit of diversification into agriculture and as an incentive to farmers, producer prices for the 1982/83 season were increased by between 13 per cent and 42 per cent for maize, tobacco, and rice. Prices for groundnuts and cotton were also raised by 12 per cent to 14 per cent. In setting prices for the 1983/84 season, the authorities will take account of increases in input costs such as fertilizer.

In the manufacturing sector, efforts are being directed at improving industrial incentives, and a study to this effect is being prepared with assistance from the World Bank. At the same time, the decision to liberalize prices for a broad range of commodities should also encourage industrial production. While endeavoring to diversify the economic base of the country, the authorities are also making efforts to improve efficiency in the copper industry. Accordingly, the mining companies were merged early last year in order to minimize costs, and the Government intends to monitor the operations of the new company much more closely. Further measures to reduce the wage bill were taken in November 1982, while production is being increased in order to generate more revenue.

The principal aim of fiscal policy is to achieve a substantial reduction in the overall budget deficit through firm restraint on expenditure and the introduction of new revenue measures. As regards expenditure, there will be no increase in wages for public sector employees, while recruitment into the civil service will be restricted to replacement of essential technical personnel. Subsidies will be reduced by K 44 million in FY 1983 as a result of increases in the prices of fertilizer and maize meal to be effective from May 1, 1983. My authorities have delayed announcement of these measures ahead of this date to avoid speculative and panic buying and stocking.

On the revenue side, there have been sharp increases in excise and sales taxes for a wide range of products and a 4 per cent tax on all mineral export proceeds was introduced on April 1, 1983. A number of fees and stamp duties have also been raised, and new road tolls were introduced. Reflecting these developments, the budget deficit is expected to decline to 5.6 per cent of GDP in 1983 from 13.8 per cent the previous year.

The authorities have adopted a cautious approach in the implementation of monetary policy consistent with the expected improvement in the budgetary position and the financial situation of the mining company. Hence the increase in money supply is expected to be limited to 13.9 per cent in 1983, compared with 34.3 per cent in 1982. Most interest rates were increased early this year in order to mobilize savings and improve the allocation of resources. The maximum lending rate is now set at 13 per cent compared with 12 per cent the year before. It is to be noted that the Government intends to keep interest rate policy under review.

The Zambian kwacha was devalued by 20 per cent in terms of the SDR on January 7, 1983. Although this is expected to have positive effects on the balance of payments, the country's external payments position is expected to remain difficult in 1983. The authorities have therefore in addition declared their intention to maintain a flexible exchange rate to ensure a competitive rate for the Zambian kwacha and for this purpose are seeking technical assistance from the Fund. Nevertheless, the medium-term outlook for Zambia's balance of payments will depend crucially on the future course of the price of copper, which, in the past year, has registered a substantial decline and has been the major factor for the decline in export earnings. The Board is aware of the fact that in connection with this evident shortfall in export earnings and the acute external payments position of Zambia, the authorities have requested a purchase under the compensatory financing decision as shown in EBS/83/70. In view of the tight foreign exchange situation, I request that the Board consider Zambia's request favorably, since delay can only aggravate the problem and possibly even adversely affect the implementation of the program. As the staff indicates, the shortfall in export earnings of SDR 97.2 million is reversible, as postshortfall projections show some recovery. The balance of payments need is clearly established, and the test of cooperation is evident from the implementation of the program.

Debt service has continued to place a severe strain on Zambia's balance of payments, and the authorities are seeking relief through rescheduling of debts owed to both official creditors and commercial banks as part of their adjustment program. It is my hope that the Fund and the international community will appreciate this situation and facilitate early positive arrangements.

The Zambian authorities are determined to implement all the measures specified under the program. Recognizing that there had been some administrative weaknesses that had caused failures of previous programs, they have introduced far-reaching institutional changes to ensure implementation.

Mr. Taylor stated that he could support the proposed decision concluding the Article IV consultation with Zambia and the request for a stand-by arrangement. He was in broad agreement with the staff appraisal in EBS/83/67. In general, the adjustment strategy seemed appropriate, particularly the aim of diversifying exports away from dependence on copper and cobalt, and encouraging agricultural development. However, a number of the assumptions were optimistic, and the projections underlying the fiscal and balance of payments targets and the debt relief aims were distinctly ambitious; it would require a massive effort by the Zambian authorities to meet all the objectives in the program.

He endorsed the authorities' intention to reduce the overall deficit to around 5.5 per cent of gross domestic product, Mr. Taylor went on. He agreed with the staff regarding budgetary policy, although the 25 per cent projected rise in revenue looked ambitious. He particularly commended the authorities for their emphasis on completing ongoing capital projects. Past performance had been disappointing in some respects in the budgetary field, and he encouraged the authorities to improve expenditure control and revenue collection. He strongly welcomed their commitment not to resort to supplementary allocations. On a technical point, it seemed that companies in Zambia were able to carry forward operating losses, setting them against tax liability for a considerable period ahead. In the circumstances, that provision might be overgenerous, and an adjustment of the corporate tax system to limit the extent to which companies could carry forward their losses might be useful. He did however welcome the decision to impose a tax on mineral export proceeds.

In monetary policy, Mr. Taylor stated, he welcomed the deceleration in the projected growth in broad money aggregates, which were now set to rise by only just over half the estimated increase in nominal GDP. However, with the rate of inflation projected to double to some 25 per cent in 1983, real interest rates would apparently be substantially negative for at least part of the year; he was therefore pleased that the authorities and the staff had agreed to look at the matter at the time of the review in June 1983.

For countries that had been caught up in a wave of inflation, Mr. Taylor considered, there was always the problem of knowing whether to raise interest rates sharply and run the risk of encouraging expectations that inflation would not decline, or to accept the disadvantage that if nominal interest rates were kept low, real interest rates might well become heavily negative with poor effects on domestic savings, which were in any event particularly low in Zambia. Perhaps the lesson was that interest rate policy should be made more flexible so that short-term movements in adjustment would have a less pervasive effect on longer-term expectations than they had traditionally had.

The system of extensive price controls, taken together with a general weakness of wage restraint, had resulted in unsustainably high levels of consumption, Mr. Taylor considered; he therefore welcomed the announcement of the general decontrol of wholesale and retail prices. In that connection, he would welcome an explanation of the role played by ZIMCO in setting prices. Given the country's external constraints, it would be important for internal prices, including the prices charged by public enterprises, to respond rapidly to local cost developments. It would also be necessary for producer prices to continue to convey significant market-related incentives.

He welcomed the moves being made to reduce labor costs in the mining sector, although he hoped that the measures would not reduce productivity, Mr. Taylor said.

In the external sector, the objective of reducing the deficit on the current account of the balance of payments by almost 10 per cent of GDP in 1983 was certainly ambitious, Mr. Taylor considered. The projected export recovery was, however, relatively modest, assuming as it did a reasonably cautious upward move in the price of copper during 1983 and a slight improvement in copper output. Much of the responsibility for improving the current account therefore lay with imports, which were to be reduced sharply for the second year running. He wondered therefore whether the economy could absorb such a large further reduction in imports without some impairment of the productive base. It seemed evident that much better export performance would be essential in later years if economic growth was to be restored. The devaluation of the kwacha by 20 per cent in January 1983 had been about the right order of magnitude, especially as a component of the overall package. However, if export incentives were to be maintained, the exchange rate would have to be managed more flexibly. Smaller and more frequent adjustments would avoid both an erosion of competitiveness and political difficulties associated with major devaluations. He therefore strongly endorsed the staff appraisal.

The success of the program would heavily depend on Zambia's gaining substantial debt relief in the forthcoming rescheduling operations, Mr. Taylor maintained. Active cooperation between Zambia and its creditors would be of the utmost importance. Leaving aside the vast bulk of commercial payments arrears, the 1983 financing gap could be reduced to manageable proportions through the Paris Club, provided that short-term debt was rolled over as well. He did however worry that the staff's assumptions regarding the remainder of the capital account were rather optimistic. It seemed clear that persistent financial pressures would continue to be a feature of the situation, even if the outcome of the rescheduling negotiations were quite favorable. In the circumstances, what was needed was not only further debt relief beyond 1983 but also an increase in longer-term aid efforts. He therefore welcomed the involvement of the World Bank in planning Zambia's structural adjustment policies, and he noted that steps were being taken to reconvene the consultative group for Zambia later in the year. He hoped that the next Article IV consultation with Zambia would be held not later than the middle of 1984.

Regarding the request for a purchase under the compensatory financing facility, Mr. Taylor remarked that Zambia seemed to meet all the conditions. The data were up to date, the shortfall was entirely price related, and the member was largely a price taker in world markets. The price projections were crucial to the size of the shortfall, and he wondered whether the price of copper would indeed rise by 24 per cent in 1984. It was true that copper prices were exceptionally low, but there was still a question of how strong the cyclical upswing might be, and whether substitutes for copper might affect prices in the medium term. In addition, nickel seemed to be on the way to becoming a substitute for cobalt.

However, of more importance was the fact that management had been suggesting that approval of the compensatory financing request--which still had to be made formally--should be conditional on the outcome of the Paris Club meeting to be held in May 1983, Mr. Taylor said. His chair naturally recognized the need of the Fund to be reasonably assured of a member's ability to repurchase its drawings under the compensatory financing facility in due course. When the Executive Board had approved an earlier compensatory financing drawing from Zambia in December 1982 (EBM/82/159), his chair has been among those expressing concern about Zambia's ability to repurchase and had gone on to argue the need for an adjustment program to tackle Zambia's balance of payments deficit. Since then, the Zambian authorities had agreed on a program with the Fund, a meritorious step that deserved support in the form of a stand-by arrangement.

Ordinarily, Mr. Taylor continued, it would be thought that such an arrangement, particularly in combination with prior measures, would be a sufficient reassurance, even though the compensatory financing request that was expected would go well beyond 50 per cent of quota. Nevertheless, management had taken the view that the present case was not ordinary. For one thing, the feasibility of the program would depend on the response by creditors in May 1983. Second, the implementation of the previous program had been disappointing in some respects. The usual way of dealing with such concerns was to provide for an early review of a country's progress under a stand-by arrangement, and to make subsequent drawings under the stand-by program conditional on further understandings if needed. Indeed, that approach had been taken on the present occasion: of the SDR 211 million to be made available under the stand-by arrangement, the great bulk was to be conditional on the successful outcome of debt relief and on progress toward the elimination of subsidies, among other policy steps. Such an arrangement seemed to be entirely reasonable and prudent.

Another problem in the present instance was that the request for compensatory financing was relatively large compared with the stand-by arrangement, especially for one for which the financing was not yet fully secured, Mr. Taylor stated. In the circumstances, Executive Directors would have to ask themselves whether suspending action on the compensatory drawing until after the meeting of the Paris Club was reasonable. It was true that if the timetable were adhered to, the Paris Club would meet on May 13, 1983, less than a month hence. On the other hand, Zambia was desperately short of foreign exchange, and the devaluation of the kwacha had taken place three months previously. There was also the wider issue of whether it was in the spirit of the decision providing for the compensatory financing of export fluctuations to make a drawing conditional, even if only on an informal basis. He knew of no precedents allowing a compensatory financing to be drawing being withheld temporarily from a country that had agreed on a stand-by arrangement with the Fund. In cases where the arguments were fairly finely balanced, it was normal to give the member the benefit of the doubt. In the present instance, the Executive Board would be withholding funds from the member for a few weeks, and the authorities had indicated that they could accept the proposal.

All in all, Mr. Taylor went on, it would be appropriate to defer to the wishes of management. A great deal depended on the full implementation of the program and the cooperation of creditors. Delaying disbursement might help to bring the parties together for a cooperative debt rescheduling. Nevertheless, his support for the proposed procedure would be given on the understanding that the drawing could take place promptly after the Paris Club on a lapse-of-time basis. Then there was the question whether the outcome of the Paris Club meeting would be satisfactory; if it were not, would the paper have to be brought back to the Executive Board? While he could see that it would be perfectly feasible to bring the matter back to the Board, he hoped that there would be no need to do so. For the time being, he would support management's proposal on the understanding that the procedure would be an exception, and that members having agreed on their adjustment program with the Fund would normally be able to expect to use their drawing rights promptly under the compensatory financing facility if the relevant criteria had been met.

Mr. Lovato commented that the Zambian economy was in a critical position, and that the restoration of medium-term viability would be a serious challenge. The authorities were confronted not only with the task of overhauling the financial structure of the country in the short run but also with the need to diversify away from the mining sector into other activities capable of replacing the role of copper. The stand-by arrangement that the authorities had requested could be only a first step in what would have to be a broad structural effort.

He would have liked to see a more detailed discussion of what was needed to reorient the economy of Zambia toward the agricultural sector, Mr. Lovato went on. It seemed clear from SM/83/50 that agriculture in Zambia was still subject to the vagaries of weather owing to the lack of irrigation; as a consequence, pricing policies aimed at fully reflecting costs--which had in fact apparently been followed by the authorities much more closely than in other countries--would probably not by themselves be sufficient to stimulate a switch from one productive sector to another. There seemed to be a possibility of contradiction between the needs of the short-term stabilization program and those of medium-term structural reform. The staff had in fact indicated that the main positive effect of the recent exchange rate depreciation was likely to be the compression of imports. Another general theme in the staff papers was that imports had been at such a low level as to have caused shortages of needed inputs. Thus, one of the consequences of the exchange rate action might have been to delay the more fundamental structural adjustment by making it more difficult to bring about the necessary investment in the agricultural sector. However, the authorities seemed to have little choice but to accept the proposed financial package.

The uncertainty of the situation was compounded by a lack of knowledge regarding the extent of debt relief, while the prospects for a recovery in the price of copper were far from good, Mr. Lovato noted. He had however been impressed by the measures that the authorities had already agreed to, and he hoped that it would be possible to implement them fully. The authorities would however be facing a difficult task: the revenue effort would have to be substantial and require strong political backing; the incomes policy, which envisaged a reduction in real wages of some 27 per cent, would be difficult to carry out. He had therefore been pleased to hear that some allowance would be made for moderate increases in the incomes of the poorest workers, to prevent consumption from falling below minimum acceptable levels.

As for monetary policy, the authorities clearly intended that it should remain appropriately restrictive, and the devaluation should help to ease the tensions generated by the extension of credit to the mining corporation, Mr. Lovato considered. On the whole, the Zambian authorities seemed to have committed themselves to a strong adjustment effort that would require the support of the international community if it was to be successful. He could therefore support the proposed decision on the stand-by arrangement.

He had no major problem with the staff projections or with the calculation of the shortfall for the request under the compensatory financing facility, Mr. Lovato stated. There was no doubt that the shortfall was beyond the control of the authorities, and he would therefore support the purchase by the Zambian authorities. He wished however to express both reservations and concern about the procedure that it was proposed to follow. The compensatory financing decision made no mention of a possible withholding of disbursements once the three conditions for eligibility--existence of a shortfall, circumstances beyond the control of the authorities, and cooperation with the Fund--were established. Moreover, in a recent discussion on external debt problems (EBM/83/57-58) there had been support by Executive Directors for the idea that stand-by arrangements should be timed to reflect the progress of discussions in the Paris Club. Nevertheless, Executive Directors had made no mention of a similar treatment of requests for drawings under the compensatory financing facility.

It was true that a rather similar procedure had been followed for Sudan, Mr. Lovato went on. However, in that case, the test of cooperation had been defined as agreement on a stand-by arrangement, and it had been agreed that there should be no disbursement from the stand-by arrangement until agreement had been reached in the Paris Club. In other words, the subordination of disbursements under the compensatory financing facility to an agreement on rescheduling had been only indirect. On the other hand, in the present instance, although the program provided for a review of the progress of rescheduling, it would become effective upon approval, thus making it difficult to say that the Zambian authorities were not cooperating with the Fund. The matter raised by management was clearly a major policy issue, and he was rather disturbed that such a proposal had been made to Executive Directors without prior discussion. If the Executive Board did agree to adopt the proposed procedure for the compensatory financing purchase, he would consider it an exceptional and ad hoc event, which should not be repeated in the future until the Executive Board had reviewed the substance of the compensatory financing decision.

Mr. Laske stated that he welcomed the conclusion of a one-year stand-by arrangement between the Zambian authorities and the Fund. He would also support the proposed decision, although he did so with some uneasiness because of the precarious balance of payments position for

1983 and for future years, and because of the unknown amount of potential debt relief. The adjustment measures to which the Zambian authorities had committed themselves were impressive, and the objectives of the program were ambitious indeed. To reach their targets, the authorities would have to implement the program in full, with more determination and perseverance than they had shown in connection with the extended arrangement canceled in 1982.

It was true that unfavorable exogenous influences had played a large part in the failure of the extended arrangement, Mr. Laske conceded. Nevertheless, closer adherence to the policies outlined in the earlier program would have prevented the damage from becoming as large as it eventually had been. In particular, he regretted the long delay in adjusting the exchange rate, a delay that had caused the authorities to lose control not only of the operating losses of the mining companies but also of credit expansion. Similarly, the delay had prevented any effective restraint on the demand for foreign exchange. While the projections offered by the staff seemed to imply that the 20 per cent devaluation of January 1983 would be sufficient, imports could be held at a reasonable level only by imposing heavy restrictions. It still remained to be seen whether the exchange rate readjustment had been large enough to discourage foreign travel and a desire for education abroad. Because of such uncertainties, he attached great importance to the comprehensive review that was to be concluded before the second disbursement under the stand-by arrangement could be released.

All the projections given by the staff had been based on two assumptions, namely, that there would be an increase not only in the volume of copper production but also in the world market price for copper, and that there would be a rather favorable outcome to the rescheduling of debt in both the public and the private sector, Mr. Laske commented. If the debt rescheduling did not produce the desired result, the whole program would be thrown out of balance.

Management had proposed that Executive Directors should approve the request for a drawing under the compensatory financing facility only in principle, Mr. Laske noted; they were to delay formal approval until the result of the debt rescheduling was known. Similarly, the phasing of the stand-by arrangement had been planned in such a way that very little would be available in the early stages. Although those procedures provided some safeguard for the revolving character of the Fund's resources--about which Executive Directors had raised great concerns when discussing the previous request under the compensatory financing facility in December 1982--his authorities were uneasy about the growing number of Fund programs for which external financing was not secured at the time that the Executive Directors were asked to approve an arrangement. They would much prefer procedures under which Executive Board approval would be sought only after debt rescheduling had been completed or the first disbursement under an arrangement was held up until after rescheduling took place.

In view of the particularly tight balance of payments situation in Zambia, Mr. Laske concluded, he would expect the program to be comprehensively reviewed if debt rescheduling fell short of the assumptions made by the staff, and that any disbursements after the first one would be halted. With those provisos, he could agree with the proposed procedure for handling the request for a purchase expected to be received under the compensatory financing facility. He would also approve the draft decision concluding the Article XIV consultation.

Mr. Alfidja remarked that the staff paper for the request by Zambia and Mr. Mtei's statement had given considerable insight into the serious financial imbalances facing the Zambian authorities both at home and abroad. Like all primary producing countries, Zambia had been beset by a substantial deterioration in its terms of trade, which had been one of the major reasons for the deterioration of the balance of payments from a surplus of SDR 173 million in 1979 to a deficit of SDR 213 million in 1980. The price of copper, which accounted for 86 per cent of Zambia's export receipts, had fallen by 18 per cent in 1982. Similarly, between 1981 and 1982 the price of cobalt, which represented 7 per cent of Zambia's export receipts, had declined by 76 per cent. Any country was bound to be profoundly affected by events of such magnitude.

Zambia's external reserves were so low as to reflect a critical external financial position, Mr. Alfidja went on. While the staff seemed to think that in 1983 there would be large increases in both the volume and the price of copper and cobalt exports, the estimates seemed to be on the rather optimistic side as the projected improvement in sales was predicated largely on an uncertain recovery in the world economy. In the fiscal area, the overall budget situation had shown deficits for the past five years, partly because of the weakening of world copper prices, which had caused a sharp decline in revenue from mineral taxation. Although the authorities had taken steps to increase revenues, the attempts to match total revenue with total expenditure had proved beyond their strength. The difficulties had indeed become so severe that the authorities had become unable to complete the program that they had adopted with Fund support in mid-1981.

He welcomed the policies that the authorities had adopted for bringing about a substantial reduction in both internal and external financial balances, Mr. Alfidja stated. On the external front, they had taken a major step in January 1983 in devaluing the kwacha by 20 per cent as a means of reducing imports and curtailing invisible payments abroad, such as those for overseas travel and education. He hoped that the devaluation, together with other external measures, would help to reduce the deficit in the overall balance of payments to an amount that could be financed from available external resources, including those from the Fund. He also welcomed the determination of the authorities to improve public finances, including the financial position of the mining companies. It was encouraging to note that the authorities wished to move away from the domination of the mining sector toward diversified economic activity in the agricultural and manufacturing sectors, and to bring about the change by raising agricultural producer prices and rationalizing the manufacturing sector itself.

However, the success of the program would also depend considerably on the outcome of an agreement between the authorities and their creditors for rescheduling a large proportion of debt service obligations, and for consolidating and rescheduling outstanding external payments arrears, Mr. Alfidja considered.

The steps that the authorities were taking to bring about economic and financial recovery justified assistance from the Fund, Mr. Alfidja stated. He would therefore support both the request for a stand-by arrangement and that for a purchase under the compensatory financing facility. Zambia's need had been clearly demonstrated, and its willingness to continue to cooperate with the Fund was not in doubt. Consequently, while he understood the reason for which management had proposed the deferment of a drawing under the compensatory financing facility, he agreed with both Mr. Taylor and Mr. Lovato in their observations on that point.

Miss Le Lorier commented first on the amount of the stand-by arrangement being requested by Zambia. When an arrangement replaced a previous one that had been canceled because of the nonobservance of performance criteria, it was quite frequent for the second arrangement to be smaller than the first. At the same time, it was likely that the balance of payments need of the country concerned would have become larger rather than smaller. In considering the amount to be made available, the staff normally referred to the track record of the country, which might not always have implemented the policy measures that it had undertaken, and to the degree of conditionality, which was often less severe under the new arrangement, as a means of taking into account shortcomings under the previous one. Such considerations did not seem to be fully applicable to Zambia.

The external environment had played a prominent role in the deterioration of Zambia's economic performance, Miss Le Lorier considered. In 1981 total exports had fallen short of the original forecast by SDR 230 million, and in 1983 the world copper price had fallen to half the 1978-81 level and 15 per cent below the 1981 level. The objectives of the proposed stand-by arrangement were ambitious, even though they might be necessary in present circumstances. She saw little difference in the degree of conditionality between the previous extended arrangement and the proposed stand-by arrangement. In those circumstances, an amount of more than 100 per cent of quota could have been considered, even though the volume of kwachas held by the Fund and of Zambia's projected debt service ratio had to be taken into account.

As to the program itself, Miss Le Lorier commented that while the policy actions would certainly have the desired effect over the longer run, like Mr. Lovato she wondered whether in the short run there would not be some conflict between the objectives pursued. For instance, the improvement of the fiscal situation was obviously a cornerstone of the program; on the other hand, it might well conflict with the much-needed improvement in the financial position of the mining company. She was rather concerned by the creation of the new 4 per cent tax on mineral exports just at the time when the mining company appeared to be engaged in a major effort to restore its financial situation. It would be unfortunate if the mining company were led to discharge its new tax obligation by borrowing from the banking system, and she would welcome a comment by the staff.

As to the medium-term scenario, it would have been helpful to have a more detailed account of the sensitivity of the current account of Zambia to an improvement in the terms of trade, Miss Le Lorier observed. Like Mr. Lovato, she felt that the level of imports for 1983-86 would be much constrained by the debt service payments; such a situation was not obviously compatible with the general objective of diverting the economy away from the mining sector, and more particularly with the aim of increasing manufacturing output.

As to the performance criteria, the provisions regarding external commercial payments arrears were rather ambiguous, Miss Le Lorier stated. On page 19 of EBS/83/67, the staff had stated that the program provided for a reduction of SDR 100 million in external commercial payments arrears, a minimum SDR 30 million of which was to be through cash payments, with the balance through rescheduling of outstanding arrears. She had understood that there was an agreement not to set any performance clause on the outcome of rescheduling negotiations with respect to outstanding arrears. In the circumstances, she would appreciate some elaboration on the meaning of paragraph 19 of the memorandum by the Zambian authorities and of Attachment II to the letter of intent with respect to performance on external payments arrears. While she could support the proposed decisions, she would associate herself with the remarks by Mr. Taylor and Mr. Lovato.

What was actually happening in the present instance, Miss Le Lorier suggested, was perhaps that the Executive Directors were approving a stand-by arrangement earlier than would have been acceptable in principle, rather than delaying a request for a drawing under the compensatory financing facility. However, she did have great conceptual difficulties with the idea of relating the future ability of a country to repurchase its purchase under the compensatory financing facility to the outcome of a Paris Club held in the year of purchase. The ability of a country to repurchase its drawing under the compensatory financing facility had little, if anything, to do with the outcome of rescheduling negotiations, which bore on debt service payments due four years prior to the repurchase. She was therefore uncomfortable with any direct or indirect linkage between a purchase under the compensatory financing facility and the outcome of deficit rescheduling negotiations. Consequently, in practice, the accent should be placed more on prior action relating to the stand-by arrangement than on anything else. She could accept the proposed decision under the compensatory financing facility provided that it remained an isolated exception.

Mr. Lindå remarked that the staff had clearly described the severe economic difficulties facing Zambia. It was impossible to escape the conclusion that external developments were mainly responsible for the country's difficult circumstances. Zambia's dependence on a single export commodity, one prone to wide fluctuations in price, made Zambia all the more vulnerable to outside disturbances. Since Zambia had accepted an extended arrangement with the Fund two years previously, developments had turned out to be much worse than envisaged at the time, and it was therefore only correct to deal with the present situation by prompt and decisive action. In the circumstances, the program submitted to the Executive Board seemed to represent an important step in the right direction. However, the 5 per cent average annual decline in real per capita income during 1977-81 and the size of the present imbalances were bound to make adjustment to a sustainable external position very painful.

Fiscal policy had correctly received high priority, and the adjustment objective was large indeed, Mr. Lindå remarked. Expenditure would have to be curtailed, and the authorities should be urged to place heavy emphasis on expenditure control. The projected improvement in the current account was a substantial one, but it was to be brought about partly at least through a sharp reduction in imports. In that connection, he wished to inquire whether the contraction of imports in 1982 and 1983 would have long-term consequences for domestic production, and whether it would not entail a serious scarcity of consumer essentials. The pricing policy that the authorities had adopted would have a major effect on the future development of the economy. The export sector needed to be diversified, and adequate incentives would have to be provided to promote the development of new industries. The staff had rightly stated that the medium-term payments outlook would depend crucially on the future course of copper prices. If the world economic recovery did not materialize and if copper prices rose more slowly than expected, still greater adjustment would be required, and Zambia might find it difficult to reach its objectives.

The program contained the essential elements for reducing the imbalances in the Zambian economy, Mr. Lindå remarked. In those circumstances, he could support the proposed decisions.

Mr. Dallara stated that he was in broad agreement with the staff appraisal and could support the proposed decisions on the request for a stand-by arrangement and on the Article IV consultation. He commended the authorities for the courageous program to which they had agreed; if fully implemented, it should significantly reduce existing financial imbalances in the economy.

Commenting on Zambia's fiscal policy, Mr. Dallara remarked that the objective of reducing the overall debt to 5.6 per cent of GDP was an ambitious undertaking. He strongly urged the authorities to persevere in implementing the required policies, with respect both to expenditure restraint and control and with respect to revenue raising. It was particularly important to keep expenditure within agreed limits. He welcomed the plan for cutting the cost of subsidies by 34.7 per cent, a critical element in controlling overall expenditure. If only because appropriate action on subsidies would contribute to eliminating distortions in the economy, he looked forward to the planned increases in the prices of fertilizer and maize meal on May 1, 1983. It would also be necessary to maintain strict control over personnel-related expenditures, and he welcomed the authorities' intention not to permit any extrabudgetary or net supplementary expenditures during the program. The introduction of discretionary revenue measures represented a serious effort, for which the authorities deserved commendation.

Appropriate pricing policies would also be necessary to restrain domestic consumption and improve the overall allocation of resources, Mr. Dallara considered. The decontrol of wholesale and retail prices, announced in December 1982, and the subsequent price changes for a range of particular commodities, were welcome. Future price adjustments should reflect economic factors and should be made in a timely manner so as to minimize distortions. He noted the authorities' commitment to pursuing an economic pricing policy in spite of what the staff referred to as considerable opposition. The authorities should continue on their course with perseverance if their adjustment effort was to succeed in laying the foundation of broad-based and sustainable development. He had noticed, as had Mr. Taylor and others, that the Board of Directors of ZIMCO was to approve price changes for the products of parastatal enterprises. He would appreciate hearing from Mr. Mtei or the staff the particular considerations that would underlie ZIMCO's actions in that field. He also wished to emphasize the need for an incomes policy that would link future wage increases to gains in productivity.

In the external field, Mr. Dallara commended the authorities for their decision to devalue the kwacha by 20 per cent in SDR terms in January 1983, although he had not been convinced that the devaluation had been sufficient. In that connection, he noted that the staff considered that Zambia's exchange and trade system was highly restrictive and that a reduction of arrears was an important element in the program. He therefore wondered whether a larger devaluation in the exchange rate might not be called for to bring about a gradual reduction in restrictions, as well of course as the adjustment in the current account, both short term and long term. The authorities should adopt policies that would allow them to adjust the rate quickly and flexibly, and he would like to see action in that field at the time of the mid-term review. He had noticed the institutional changes that had been designed to strengthen the foreign exchange allocation system, but he did wonder whether a more market-sensitive allocation procedure could be introduced.

Regarding Zambia's balance of payments, Mr. Dallara observed that it was evident that Zambia would require debt relief from both official and private creditors. The scale of the financing needed to provide debt relief appeared to be consistent with past Paris Club and commercial bank practices, although there were a number of uncertainties. Table XXI of Appendix II to SM/83/50 showed that roughly half the debt outstanding to foreign governments at the end of June 1982 had been owed to countries that did not participate in the Paris Club. He hoped that the staff or Mr. Mtei could provide additional information on the status of discussions with those governments, together with any indications that they might have received on the prospects that the rescheduling would be comparable to that which the authorities intended to seek from Paris Club creditors.

More generally, Mr. Dallara observed, his authorities would have preferred a rather more detailed presentation of the debt service obligations of Zambia for 1983, to enable them more easily to evaluate the request for debt relief from the Paris Club. Zambia's medium-term prospects were crucially dependent on movements in copper prices and on improvements in the efficiency and productivity of the existing mines. The recent merger to form Zambia Consolidated Copper Mines was a welcome step toward the reduction of unnecessary duplication. He encouraged the new company to adopt such additional measures as might be required to improve its overall financial position. Table 11 seemed to show that the price of copper was expected to rise consistently during the four years beginning in 1983. He wondered whether such an assumption was not rather optimistic, and whether it would not be prudent for the authorities to take into account the possibility that there might be a cyclical downturn sometime during the four years.

The uncertainties concerning the future suggested that the authorities would have to undertake continuous adjustment, and at some point in the near future perhaps even stronger adjustment than presently planned, Mr. Dallara went on. Second, the authorities should place high priority on reserve increases in the years ahead. He had made the same point in connection with a number of other programs, as it was particularly important that current adjustment efforts should include provisions for an increase in reserves whenever practical. He could understand that it would be difficult for the authorities to make plans to increase reserves in the coming months. Nevertheless, in the longer term reserves had to have great priority. Indeed, in making a presentation to the Paris Club the authorities might wish to consider including a scenario combining debt relief, extraordinary assistance, and Fund resources in such a way as to allow at least a minimum of reserve reconstitution.

Clearly, there was a need to diversify export earnings away from the mining sector and toward agriculture and manufacturing-based products, Mr. Dallara stated. He commended the authorities for setting producer prices that were on a level with those elsewhere in the world, and he would like to hear the staff or Mr. Mtei comment on the general adequacy of the existing price structure.

He had some concern about the policies in other fields, Mr. Dallara went on. He had not obtained from the staff paper any clear sense of the authorities' investment program, or of their strategy for the medium term. Presumably some of the information he would have welcomed was contained in the memorandum on development objective policies that had recently been agreed between the Zambian authorities and the World Bank. He would welcome any information that Mr. Mtei or the staff could provide.

He was rather disappointed that the authorities had not devised a detailed investment plan, Mr. Dallara observed. While there were references in the staff papers to work proceeding between the World Bank staff and the authorities in connection with the preparation of an investment plan, he was rather uncomfortable with the slow pace envisaged. At the time of the extended arrangement in 1981, an operational investment plan had been the centerpiece of the program. While there were understandable reasons for putting the priority elsewhere, there was no less need to devise an investment plan providing a framework for addressing Zambia's problems. He encouraged the authorities to work with the World Bank staff and the Fund staff to develop an investment plan that could provide the basis for World Bank and donor support.

Taking up the request for a drawing under the compensatory financing facility, Mr. Dallara stated that he could support the decision to approve a drawing under the compensatory financing facility in principle, pending a satisfactory outcome of the Paris Club meeting and the implementation of the pricing measures promised for May 1, 1983.

As to the technical aspects of the request under the compensatory financing facility, Mr. Dallara remarked that there was certainly a balance of payments need. Moreover, that the shortfall was largely beyond the control of the authorities seemed clear. He had been rather disturbed by the impact of past pricing and the lack of satisfactory pricing policies for cobalt; however, since cobalt had represented only 3.7 per cent of exports in the shortfall years, the point was not a major consideration.

Regarding the rest of cooperation and issues related to the timing of the drawing, Mr. Dallara stated that he could understand the concerns of Mr. Mtei and of other Executive Directors, since the authorities had made a strong adjustment effort and they appeared to have met the conditions for a drawing under the compensatory financing facility.

Nevertheless, Mr. Dallara stated, the need to safeguard the revolving nature of the Fund's resources was paramount. There were uncertainties concerning the financing of the program, and the need for additional pricing measures on May 1, 1983. Zambia had had difficulty in meeting its repurchase obligations, and its performance had not been wholly satisfactory. In those circumstances, there were some questions as to whether the Fund could have reasonable assurances that its resources would be repaid on schedule. The compensatory financing drawing was a significant portion of the total conditional financing that the Fund was providing, and it could be argued that more certainty was required regarding the prospects for repayment for compensatory financing purchases than for stand-by arrangements. The Fund had a number of opportunities to monitor and review developments under a stand-by program and to assure itself that the Fund's resources were being properly safeguarded. Moreover, the Fund only disbursed its resources progressively as the program proceeded. For a compensatory financing drawing, on the other hand, the Fund had to decide at the start that its resources would be safeguarded.

Some Executive Directors had considered that Zambia had met the requirements for a compensatory financing drawing while others, including himself, had doubted whether the Fund's resources were being adequately safeguarded, Mr. Dallara noted. The dichotomy suggested that there might be fundamental questions whether the decision establishing the facility as it now stood was consistent with the requirement of the Articles that the Fund "will establish adequate safeguards for the temporary use of the general resources of the Fund." He looked forward to examining that question in connection with the forthcoming review of the compensatory financing facility.

Mrs. Zhang said that she could fully support the request by Zambia for a stand-by arrangement as well as its request for a purchase under the compensatory financing facility. The shortfall was largely attributable to circumstances beyond the control of the authorities, and it was clearly temporary. She therefore wondered whether it would be appropriate to make the disbursement of compensatory financing conditional on the outcome of the Paris Club meetings.

Mr. Prowse commented that the present discussion showed the value of bringing all issues affecting a given country to the Executive Board at one time. The procedure followed had been productive, and he would like to see it applied on other similar occasions.

To say that Zambia was facing a financial crisis of serious proportions was an understatement, Mr. Prowse went on. Not only was the external situation not viable, but national income had been declining severely for several years and would no doubt decline again in 1983. It would be worth considering how the economy had been allowed to decline to that state. In the present circumstances, he saw only positive benefits from the approval of the stand-by arrangement, the drawing under the compensatory financing facility, and approval of the existing multiple currency practices.

Nevertheless, Mr. Prowse considered, his authorities believed that the problems of Zambia were due not entirely to adverse external factors but also in part to faulty domestic policy. Very strong adjustment measures were required, and he believed that they were about to be put in place. The heart of the problem was the reliance on copper, which represented some 86 per cent of Zambia's exports. Moreover, the life of the mines was limited, and diversification was therefore of overriding importance. He agreed with Mr. Dallara about the need to treat the investment program and restructuring with great urgency. As diversification would be the most important adjustment measure, he agreed with earlier speakers--notably Mr. Taylor, Miss Le Lorier, and Mr. Lovato--on the need to ensure that imports of vital investment machinery and raw materials were sufficient to sustain the restructuring and the growth of the diversified sectors. He wondered whether the staff could say whether a debt service ratio of 50 per cent of export earnings was compatible with the restructuring of the economy and the maintenance of adequate growth. The answer to the question was important because it was bound to impinge on any agreement that might be reached regarding rescheduling and the reduction of arrears. It was always possible to endanger the longer-term outcome if the shorter-term proposals were too severe.

On the domestic side, Mr. Prowse went on, the budget deficit for 1982 had equaled 19 per cent of GDP, the current account deficit had equaled 17 per cent of GDP, and the external debt service ratio had been in excess of 50 per cent of exports. The proposed measures on the budget side seemed remarkable, and should be supported. There were several restraints on expenditure; the authorities were also making a notable revenue effort. Although he had had some worry, like Miss Le Lorier, about the effect of the export tax on the mineral industry, the tax was probably a major source of new revenue.

He welcomed the intended reduction in subsidies and the decision to decontrol the retail and wholesale price structure, Mr. Prowse went on.

Commenting on the domestic situation, Mr. Prowse noted that broad money had grown by 30 per cent in 1979 and 34 per cent in 1982, although there had been major reductions in 1980 and 1981. Taking the past four years together, consumer prices had risen by between 11 per cent and 12 per cent a year. The staff had not commented on the apparent inconsistency between such a comparatively low rate of inflation with such a relatively high rate of increase in the volume of broad money. He had found interesting the one statement by the staff that the apparently modest response of inflation to domestic credit expansion was due in part to the effects of extensive price controls and subsidies, particularly on items of importance to low-income consumers. Typically, Executive Directors would not wish to see the effects of credit expansion being constrained by extensive price controls and subsidies. The implication of the staff statement seemed to be that the reduction of subsidies and the removal of price controls would allow some latent inflation to flourish.

On the external side, Mr. Prowse stated that he welcomed the proposed reduction in arrears, and the proposed rescheduling, simply hoping that the very short-term effects would not be too severe. With only two weeks' worth of imports in its external reserves, Zambia did not have much scope for reducing arrears.

The dominating feature of the external field in Zambia in recent times had been the devaluation of the kwacha, Mr. Prowse noted. It was important to bear in mind that Zambia was a price taker and could therefore not expect to increase its external receipts by its own actions on the value of its currency. If the devaluation was to be successful as a means of reducing imports, the price effect would have to be allowed to flow through to the economy. In other words, price increases would make themselves felt more rapidly in the absence of price controls and subsidies. He was not however as confident as others that the effects of the devaluation would be wholly beneficial. In particular, the price effect would be severe for wage earners, whose real income had been greatly cut in recent years. However, in view of the loss of income to the nation through the decline in the terms of trade, there was no option but to reduce wages.

Commenting on the proposed decision under the compensatory financing facility, Mr. Prowse stated that he would support the decision. The decline in earnings was beyond the control of the authorities; cooperation was evident in the agreement for the stand-by arrangement; and there was no question Zambia had a balance of payments need. He was uneasy at the proposal to make the drawing conditional and he wished to be assured that the language of the decision as it stood was sufficient to support the proposed procedure. While the Fund and the authorities of any given country could agree on whatever purchase timetable seemed appropriate, the proposed decision seemed to contain entirely standard language that did not indicate that the purchase would be conditional on further procedures. He wondered whether, instead of using moral suasion with the Zambian authorities not to request a drawing until other procedures had taken place, the staff would do better to include appropriate language in the decision itself.

After all, Mr. Prowse recalled, the purpose of the compensatory financing facility was to alleviate immediate problems arising from the shortfall of export income. The purpose of the compensatory financing procedure was to enable the purchase to be made rapidly once the shortfall became evident; indeed it allowed for the estimation of data to provide for that purpose. It would therefore be a departure from the fundamental concept of the compensatory financing facility to propose that a drawing should be made conditional on further factors. He could agree with what Mr. Taylor had said about the compensatory financing drawing, but he would like to know what would happen if the Paris Club meeting turned out to be unsatisfactory. He found it disconcerting that nothing had been said by the staff about the Fund's actions in those circumstances. For his part, he would prefer the decision establishing the compensatory financing facility to be implemented as written, meaning that the drawing should be available once the decision was taken. He hoped that the procedure proposed for the drawing under the compensatory financing facility would be regarded as entirely exceptional. Nevertheless, the layout of the staff papers, and particularly the contents page of the base document, had been helpful.

Mr. Pickering remarked that over the past two years the economic performance of Zambia had been adversely affected both by unfavorable external factors and by poorly constructed policy initiative. During 1982, the economic and financial situation had deteriorated significantly; the supply of consumer goods had been maintained only through the accumulation of commercial payments arrears, the nonpayment of debt services, and recourse to costly short-term borrowing. He therefore welcomed the program of corrective policy measures to be undertaken in conjunction with the disbursement of Fund resources under a one-year stand-by arrangement. He was in full agreement with much of the staff's analysis and with most of the comments made by other Executive Directors, particularly Mr. Taylor, on Zambia's objectives, and on the external and domestic measures taken by the authorities.

Regarding prices and incomes policy, Mr. Pickering said that he commended the authorities for their initiatives in the past few months. Nevertheless, although some decontrol of prices had already been initiated, he would join others in placing particular emphasis on the further price measures expected on May 1, 1983. The provision that there should be no general wage increase for government employees in the 1983 budget--apart from an adjustment for some normal increment of about 6 per cent--and that there should be a freeze on government hiring seemed broadly appropriate, given the lack of control in that field in the past few years. On the external side, he endorsed the movement toward flexibility in setting the exchange rate initiated in January 1983; but he urged the authorities to become more flexible with a view to improving competitiveness and reducing further the level of imports. The adoption of new institutional arrangements to strengthen the allocation of foreign exchange and import licenses through a new technical committee of officials would imply that some simplification of the existing system had taken place. However, he looked forward to a fuller assessment of the new system and to some explanation of its functioning as part of the forthcoming mid-term review. As to the planned reduction in commercial and official arrears, he placed particular emphasis on strict observance of the program targets in view of Zambia's poor track record in meeting the conditions of some earlier bilateral rescheduling arrangements.

He supported the decision relating to the stand-by arrangement and the conditional approval of the drawing under the compensatory financing facility, Mr. Pickering remarked. The sequence of resource allocation from the Fund was rather unusual; however, it did provide an innovative agenda that supported corrective action by the Zambian authorities while safeguarding the effective use of Fund resources. He joined other Executive Directors in noting that such arrangements should clearly be used only in exceptional circumstances. However, experience during the past year indicated that there were benefits in the Fund's being innovative in designing country programs. With increasing frequency, members seemed to be facing exceptional circumstances by earlier Fund standards.

An improvement in Zambia's domestic financial position and its balance of payments position would require full support by both creditors and aid donors, Mr. Pickering considered. Furthermore, the extent of the deterioration in the past few years had been so great that only a program as ambitious as the one submitted to the Executive Board would represent a step in the right direction. Strenuous efforts would have to be made by the Zambian authorities not only in the coming year but in the medium term as well.

Mr. de Vries stated that he could support both decisions on the basis outlined by the Chairman at the beginning of the meeting. The economic position in Zambia was serious, in part because the earlier extended arrangement had not been successful. The extent of the problem could be seen from the fact that in the past few years both the budget deficit and the current account deficit had been in the range of 15-20 per cent of gross domestic product, while the debt service ratio had been in excess of 50 per cent of export earnings. Although a number of major measures had already been taken, the situation was so unstable that it seemed likely that a program covering a considerable number of years would be required. The proposed cuts in the domestic budget were quite drastic; he only hoped that they would be fulfilled. Prices had been increased, and subsidies would be reduced. Nevertheless, like others, he hoped that the authorities would introduce even more price flexibility as a means of alleviating the budget deficit.

Insofar as the exchange rate was concerned, Mr. de Vries welcomed the devaluation that had already taken place, although he noted that many restrictions still remained. He would prefer to see greater exchange rate flexibility, leading to less abrupt changes than in the past. As it was, such items as travel abroad, education and medical services obtained outside the country were being subsidized by overvaluing the kwacha, and then the authorities were providing export subsidies for certain commodities to make them competitive. The incentives were therefore pulling in different directions and canceling one another out. While a number of short-term measures had been taken, there had been little progress on a medium-term investment program, and the staff had given a rather poor idea of the authorities' intentions. It would be useful if the authorities would come up with more precise ideas in that field.

As to the proposed drawing under the compensatory financing facility, Mr. de Vries noted that Zambia was a price taker, and that from that standpoint he had no difficulty with the drawing. He also had less difficulty with the proposed procedures than some other speakers. One of the principles governing the operations of the Fund was the revolving character of its resources. The procedures proposed by management were designed to make some resources of the Fund available to Zambia earlier than could have been done if strict order had been followed. Consequently, since the Fund was acting for the benefit of Zambia, and the Zambian authorities had agreed to the procedures, he saw no difficulty with them. The alternative would have been to wait until the country had been able to find the needed resources and a realistic financing program was available. His only problem was to know what the legal status would be if the Executive Board adopted a decision in principle at the present meeting. There was no doubt that the wise husbandry of the Fund's resources was one of the main functions of the Executive Board. It was in accordance with that precept that he could accept the procedures proposed by management.

In conclusion, Mr. de Vries noted that a continuous effort would be required of the Zambian authorities for several years to come, an effort that would need to be supported by both creditors and donors. At the same time, Mr. Mtei had assured Executive Directors that the Zambian authorities had introduced institutional changes in order to ensure that the program agreed with the Fund would be implemented.

Mr. Kafka stated that he supported the staff appraisal in the consultation paper and the request for a stand-by arrangement. Like Miss Le Lorier, he wondered why the assistance offered in conjunction with an ambitious adjustment program could not have been somewhat larger.

He also supported the proposed drawing under the compensatory financing facility, Mr. Kafka went on. He did however have profound concerns regarding the unusual procedure proposed by the staff and management in respect of the compensatory drawing. He supported the statements by Mr. Taylor and others to the effect that the procedure must remain an exception. He took the line put forward by Mr. Lovato, that a disbursement under the compensatory financing facility should not be withheld if it could be shown that the country was suffering from a shortfall and balance of payments need, and if the requirement of cooperation was met. That the requirement of cooperation was met did not have to be supported by the existence of a stand-by or extended arrangement. What was implied was that, for a purchase going beyond 50 per cent of quota, the member should cooperate with the Fund where appropriate to solve its balance of payments problems. Like Miss Le Lorier, he wondered whether debt rescheduling was necessarily related to a member's ability to repay its drawing under the compensatory financing facility. In principle, since drawings under that facility were made available in consideration of a temporary shortfall, there should be some automaticity, since there was a good chance that the circumstances that had led to the request for the drawing would be reversed.

Mr. Jayawardena stated that he was in agreement with the staff appraisal relating to the stand-by arrangement and strongly supported the proposed decision. As to the proposed drawing under the compensatory financing facility, the request would meet all the requirements of the decision and could therefore be supported. However, he shared the views of earlier speakers who had questioned the wisdom of deferring drawing until debt rescheduling arrangements had been completed. Indeed, he wondered whether matters of expediency should dictate a deviation from a point of principle. Countries whose export earnings were volatile due to violent fluctuations in the prices of primary products were not expected to react by taking measures detrimental to international trade. Instead, when export prices were expected to recover cyclically or when export shortfalls were deemed to be purely temporary, the Fund would make resources available to compensate the shortfall. Hence, the question of a country's ability to repurchase did not arise. Indeed, the intricate method by which the export shortfall was computed ensured that the upturn in prices would help to bring about a repurchase. It did not seem possible to defer compensation of an export shortfall, which was expected to reverse itself, on the grounds that a country had not completed rescheduling arrangements. The whole matter was too serious to be treated as an exception, as some speakers had proposed. As things now stood, Zambia's drawing on the compensatory financing facility would depend on the outcome of a debt rescheduling negotiation that was to take place one month hence. Would the drawing be denied if the debt rescheduling negotiations failed to come out satisfactorily?

In view of the size of Zambia's debt and the Fund's holdings of Zambian kwacha, equal to SDR 758 million, he wondered whether the proposed purchase of SDR 97.2 million could be considered very large, Mr. Jayawardena remarked. He doubted whether the present proposal for a deferred drawing under the compensatory financing facility was legal. Moreover, Fund members had an expectation of making a drawing under that facility when sudden and temporary export shortfalls occurred. If the Fund were to make an exception in the present case, it might be deemed to be signaling to debt-ridden countries that if they were unable to arrange a satisfactory repayment scheme, access to the compensatory financing facility would not be available, and that, therefore, they were free to impose trade and exchange restrictions. The whole topic of the compensatory financing facility ought to be discussed at some time in the near future.

Meanwhile, he had reservations about the contemplated deferment of the drawing by Zambia, Mr. Jayawardena said. The only way out of the situation that he could see was to ask the Government of Zambia to request a drawing under the compensatory financing facility later. If the Government did not wish to do so, the Fund seemed to be obliged to allow the authorities to make a purchase as soon as the Executive Board approved.

Mr. El-Khouri commented that the Zambian economy was heavily dependent on the mining sector, which accounted for about one third of GDP and generated virtually all export earnings. The sharp decline in the prices of copper and cobalt that had occurred during the past two years had led to a considerable weakening of the economy. That was accompanied by the pursuit of expansionary domestic financial policies, thus leading to a further deterioration in the economic and financial imbalances in the country. The authorities had more recently adopted a stabilization program in support of which they were requesting a stand-by arrangement with the Fund, and he supported the request. The authorities had already taken a number of important corrective measures that were to be commended. Those measures included the decision in late 1982 to decontrol prices at the wholesale and retail level, various measures to boost government revenues and to restrain budget expenditures, and a significant devaluation of the exchange rate.

He agreed with the staff, Mr. El-Khouri stated, that the adjustment policies must be implemented firmly, so that the gains achieved could be preserved. In particular, there was a need for the continued pursuit of an economic pricing policy. As the authorities had already demonstrated their ability and a willingness to adjust, he hoped that the program review scheduled for June 1983 would be concluded successfully.

Table 11 of EBS/83/67 showed that the external payments situation of Zambia would remain difficult over the medium term and was highly sensitive to changes in the price of copper, Mr. El-Khouri observed. The authorities ought to adopt policies to insulate the economy from such fluctuations as much as possible. He therefore hoped that they would put in place a medium-term adjustment program that would stress economic diversification in addition to the pursuit of prudent domestic financial policies.

The request for a purchase under the compensatory financing facility met all the requirements of the decision, Mr. El-Khouri considered. The balance of payments need was obvious; the shortfall was well established and based on actual data; and the principle of cooperation was met by the adoption of a stabilization program. He was therefore glad that the request for a drawing under the compensatory financing facility had been returned to the agenda. As he understood that Mr. Mtei and management had agreed that the drawing under the compensatory financing facility should be made later, he could accept the procedure of the delayed purchase, although with reluctance. That procedure should be considered an exception, acceptable only because of the circumstances involved.

Mr. Alhaimus commented that the program under consideration was both strong and ambitious; he had however been encouraged by Mr. Mtei's statement that the authorities were determined to implement all the measures contained therein. He supported both the decision on the stand-by arrangement and the proposed decision for a drawing under the compensatory financing facility, although he had reservations about making the drawing under the compensatory financing facility conditional on the outcome of the Paris Club meeting.

Mr. Dallara noted that a number of Executive Directors were unhappy because, although the proposed request for a drawing under the compensatory financing facility would meet all the requirements, the Fund was not intending to provide resources immediately. The same Executive Directors had remarked that a request for a drawing under the compensatory financing facility was related to temporary shortfalls in export earnings, thus automatically assuring the Fund, to some extent, that repayment would be possible. He noted that an obligation under the previous compensatory financing drawing by Zambia in May 1978 would be coming due on May 1, 1983, and he hoped that payment would be made. Unfortunately, the compensatory financing facility was not being operated in a way that was totally consistent with the original intentions of the facility. Shortfalls had not always been temporary, as could be seen from the fact that Zambia was requesting a new compensatory financing drawing at the very time when it was making repayments to the Fund.

Moreover, Zambia had obligations to the Fund as the result of earlier drawings under the credit tranches, Mr. Dallara noted, a point that raised questions in his mind about whether there had been adequate safeguards for some resources made available to Zambia. The principle of the temporary use of Fund resources was under strain at the present time because members with substantial obligations to the Fund were finding themselves in serious difficulties. The temporary nature of Fund financing was becoming more and more difficult to ensure, and many Executive Board members were unwilling to support any innovative procedures for ensuring that the Fund would in fact be repaid. In the circumstances, he could only propose that Executive Directors review the decision on the compensatory financing facility to ensure that its operations were consistent with the need to safeguard the Fund's resources.

Miss Le Lorier recalled that she had suggested that it would have been conceivable to follow an alternative procedure, namely, to delay the effective approval of Zambia's request for a stand-by arrangement. She had not wished to imply that her chair would have preferred delaying the decision on the stand-by arrangement. Mr. Dallara's observations prompted her to note that the existence of several temporary shortfalls in a given country, one after the other, did not mean that the shortfalls were not temporary; what it seemed to show was that raw material prices were extremely volatile.

Mr. Habib stated that he would support both the decision on the stand-by arrangement and that for the proposed drawing under the compensatory financing facility. He also had misgivings about the proposed procedure for the drawing under the compensatory financing facility. The matter was too important to be dispensed with as an exception. In that connection, he fully shared the views put forward by Mr. Jayawardena. He for one would have liked to see the Zambian authorities request a compensatory financing drawing later rather than at present, if it was necessary to defer one of the drawings.

Mr. Conrado stated that he could support the proposed decisions. However, he wished to express concern for the procedure being proposed for the compensatory financing drawing. Clearly, the request met all the conditions and should therefore be treated normally. The purpose of the compensatory financing facility was to deal with temporary shortfalls in exports, thus precluding any phasing or increased conditionality. In any event, the present case should not be considered a precedent.

The staff representative from the African Department recalled that a number of Executive Directors had commented that the program was quite ambitious, particularly in respect of balance of payments and fiscal adjustments. The staff would agree with that assessment, but Zambia was facing a difficult situation both externally and internally, and a large adjustment was therefore needed. The authorities would have to bring considerable dedication to the stabilization effort, and the staff did not believe that the way would be easy. There was, however, no alternative.

Taking up some of the more detailed comments by Executive Directors, the staff representative noted that one speaker had remarked that tax losses could be carried over from one year to the next for a long period. The main beneficiary of that provision was the mining industry. It was true that the arrangement was generous, and that was one of the reasons why the staff felt that the proposed mineral tax would be useful. The bill was also a response to a situation in which the Government, which had invested considerable sums in the mining industry, was so far receiving no return whatsoever. In view of the difficult budget position, it was important that the Government should begin to obtain at least a modest return on investment even if the export tax did put some additional burden on the mining industry.

Discussing the role of ZIMCO in the price setting policy, the staff representative remarked that in the past there had been a two-tier price control system. First, prices had been set by ZIMCO, a government-owned holding company in charge of the whole industrial and commercial sector. On top of that, for the past few years the Government had exercised price control directly. With the introduction of the new decontrol measures, he understood that the role of making sure that price increases were not excessive would remain entirely with the Board of ZIMCO, and that ZIMCO would examine all requests carefully to see that they were correct. During January and February 1983, a large number of prices in industries controlled by ZIMCO had risen by up to 30 per cent, an indication that the new procedures were working.

A number of Executive Directors had observed that imports were expected to decline in 1983 and had asked whether the decline would have an adverse impact on the economy, the staff representative recalled. The staff did indeed believe that there would be some adverse effect on the economy, but, in view of the shortage of external reserves and the balance of payments forecasts, the staff could see no way in which a reduction of imports could be avoided. After all, Zambia had no external reserves and could undertake no further short-term borrowing. It was important to stress that the mining sector in Zambia did require regular flows of imports. If it proved impossible to maintain such flows, the ability of the mining company to produce would be affected, even though the Government was giving the highest priority to the needs of the company. Some of the other needs of the economy probably would not always be met.

A number of speakers had commented on the need for diversification into agriculture, the staff representative observed. The staff could agree that there was such a need, but in the present circumstances, given the foreign exchange crisis, the highest priority surely had to be setting the country's financial house in order. Once the authorities had done that, they would find it far easier to concentrate on diversification efforts. The World Bank, which had agreed on a memorandum of development policy objectives with the authorities in Zambia, was involved in a number of studies in the agricultural and industrial sectors that should in due course lead to a sound investment program. Unfortunately, the time required was rather long, but the World Bank was prepared to call a consultative group meeting on Zambia in due course, meaning by the end of 1983. It would have been preferable for the consultative group and the Paris Club to meet at the same time and for the investment program to be introduced forthwith. The staff had however believed that in view of the urgency of the adjustment effort some matters would have to be left for later.

Replying to Miss Le Lorier, who had inquired why the staff had decided that only 100 per cent of Zambia's quota would be made available under the stand-by arrangement, the staff representative explained that in the medium-term balance of payments scenario no provision had been made for any further Fund support beyond the present program. However, given the debt situation, together with the need to reduce arrears and provide additional imports, it was not unreasonable to believe that further recourse to the Fund would be needed in coming years. In those circumstances, it was only prudent to husband the use of the Fund's resources at present.

As to the sensitivity of Zambia's terms of trade to the medium-term outlook, the staff representative recalled that copper amounted to some 90 per cent of total exports, so that any discussion of the terms of trade would imply a discussion of the price of copper. Zambia's balance of payments and potential import growth were both highly sensitive to future price changes. If the copper price were less favorable than expected, there would be a considerable impact on import growth.

All the performance criteria for external arrears during the remainder of the program were still indicative, the staff representative from the African Department explained. The arrears performance criterion that was originally in the program for April 1983--implying no increase in arrears--had been shifted to the end of May 1983, reflecting the delay in disbursing the drawing under the compensatory financing facility. As a general guideline, it had been assumed that there would be a reduction of SDR 100 million in commercial arrears, of which some SDR 30 million would be in cash and SDR 70 million through rescheduling or consolidation. Whether such a course of action was feasible would only be known with accuracy once the debt rescheduling exercise had been concluded, and appropriate performance criteria would be stabilized during the June review.

Miss Le Lorier said that she had no objection to the indicative character of the performance criteria. However, only in the case of Uganda had the Fund set performance criteria for the reduction of arrears not only on cash payments but also on the outcome of rescheduling negotiations. Like a number of speakers, she regarded such a procedure as inappropriate because in practice it imposed an obligation not on the debtor country but on the creditors. While it was reasonable to express wishes regarding the outcome of rescheduling, it was not correct to set in advance a performance clause regarding it.

The staff representative from the Exchange and Trade Relations Department said that Miss Le Lorier was correct in feeling that performance criteria should not apply to the reduction of arrears through rescheduling. That had not been the intention of the staff. The performance test applied by the staff was to refer only to a reduction in arrears through cash payments. The figures for the estimated reduction of arrears through rescheduling were supposed to be indicative only.

The staff representative from the African Department added that, particularly in the case of rescheduling of commercial arrears, it was difficult to make advance estimates of how much rescheduling could actually take place. As to the status of the negotiations for official rescheduling, the procedure with the Paris Club had been set in motion, and the Zambian authorities had started discussions with the appropriate banks. He understood that the commercial banks were willing to act immediately after the Paris Club meeting. In addition, the Zambian authorities had been in contact with the governments holding a substantial volume of Zambian bilateral debt outside the Paris Club membership. It was his understanding that once the Paris Club had acted, rescheduling on rather similar terms and conditions would be accepted by the other countries.

The adjustments that had so far taken place in agricultural producers' prices had been a step in the right direction, the staff representative mentioned. It was difficult to say whether the actual prices were completely adequate. The World Bank would, among other things, be examining the need for additional incentives in the agricultural sector. In the past few years, there had been an effort to make agricultural production increasingly attractive, and the results so far had been encouraging. Unfortunately, in the past year or so, weather conditions had not been good. In the circumstances, the achievement of self-sufficiency in a number of basic foods had been an elusive goal.

Commenting on Mr. Prowse's observation that it seemed unlikely that a debt service ratio of 50 per cent of export earnings could be compatible with a satisfactory adjustment program, the staff representative agreed that the position was untenable. It was for that reason that Zambia was requesting debt relief, which would be required not only in 1983 but for a number of years to come. He also agreed with Mr. Prowse's interpretation of the relationship between the volume of money in circulation and the rate of price increase. As part of the program involved the decontrol of prices and the removal of subsidies, it did indeed seem likely that a certain amount of latent inflation would be coming to the surface. During 1983, price rises might be expected to amount to as much as 25 per cent, reflecting in part the delayed effects of the adjustment that the staff felt was necessary. The staff would also agree with the comments made by Mr. de Vries and others regarding the need for increased flexibility in the exchange rate system. The Zambian authorities had requested technical assistance from the Fund to help them in devising a system that would be more flexible and would avoid the need for frequent large adjustments, an unsatisfactory arrangement, especially in a country like Zambia that was subject to sudden movements in the terms of trade, primarily resulting from shifting copper prices.

Finally, the staff representative from the African Department explained that the legislation regarding the carrying over of losses was particularly beneficial to the mining companies. One of the purposes of the proposed mineral tax was to overcome the deficiencies of the present system. While from the outside it might seem possible simply to eliminate the privilege, in practice it would be comparatively difficult to do so. As matters now stood, the mining companies had accumulated such great losses that they would not be liable to taxes for at least another five or six years. The minerals export tax would be some compensation for the Government.

The staff representative from the Exchange and Trade Relations Department recalled that Miss Le Lorier had asked why the stand-by arrangement had been limited to 100 per cent of quota. First, Zambia's track record under the previous arrangement had been unsatisfactory. Second, the situation of Zambia had changed materially for the worse since the extended arrangement had been negotiated. The medium-term balance of payments and debt outlook had materially worsened since 1981, so that the need for structural adjustment stretched out over the medium term became even greater. While the present program called for substantial adjustment, it certainly did not address the structural problem adequately, as several Executive Directors had remarked. Third, the Fund's holding of Zambian kwachas were already quite substantial, amounting to some 360 per cent of quota. Even excluding past purchases under the compensatory financing facility, the figure would still be 311 per cent of quota. On the other hand, it was clear that Zambia would need to receive Fund support for several years ahead. In the circumstances, the staff had to be prudent in deciding on the amount of Fund support to be made available forthwith.

A number of speakers had commented that Zambia had not prepared an adequate investment program on which to base a medium-term structural adjustment policy, the staff representative stated. The staff had already said that the Zambian authorities had been in contact with the World Bank and were preparing a suitable investment program. Once the program was in place, it might be possible to consider an extended arrangement with larger amounts of Fund support.

Commenting on Mr. Prowse's question regarding the compatibility of a 50 per cent debt service ratio with structural adjustment, the staff representative from the Exchange and Trade Relations Department remarked that clearly the situation was untenable. It was indeed for that reason that debt rescheduling had been provided for in the program. However, debt relief would not represent a permanent solution to the country's balance of payments problem; it would only give some respite. The debt service payments would still have to be made with a time lag. In Zambia's situation, it was therefore essential for additional aid on concessional terms to be received. It was therefore quite important that the consultative group sponsored by the World Bank should meet without undue delay.

The staff representative from the Research Department referred to questions by Executive Directors regarding the price of copper. During the first three months of 1983, the price of copper had averaged 73 cents a pound, some 24 per cent higher than the price of 59 cents a pound recorded in June 1982. The price of 73 cents a pound was 9 per cent higher than the average for calendar year 1982 as a whole. In the first days of April 1983, copper prices had edged upward to between 74 cents and 75 cents a pound, which meant that the prices for the first three-and-a-half months of 1983 were consistent with the projection for Zambian copper of 76 cents a pound for the year as a whole. The price of 94 cents a pound projected for 1984 implied an increase of 24 per cent over the 1983 figure. If the prospects described in the World Economic Outlook papers were in fact realized, the estimate of 94 cents a pound might well turn out to have been conservative.

Mr. Prowse commented that the staff had said that if the debt relief operations went ahead as desired, the debt service ratio of Zambia would fall from 53.3 per cent to 36 per cent in 1983; such an outcome would be extremely beneficial. It was however clear that Zambia would require further debt relief after 1983. He wondered whether the coming discussions would cover the later period.

The staff representative from the African Department explained that it was his understanding that the Zambian authorities would request debt relief for perhaps two or even three years, and that they would provide information supporting that request. On the other hand, it was also his understanding that in the normal course of events the Paris Club would provide relief for only a single year, while offering a declaration of goodwill to consider further debt relief in coming years.

The staff representative from the Legal Department commented that he would treat the general observations of Executive Directors on the compensatory financing facility as views that would be more appropriately addressed in a review of the facility's procedures.

As to the nature of the decision that might be taken at the present meeting, the staff representative commented that there were three possible courses of action. The first was that proposed by the Managing Director, namely, that the Executive Board should take a decision in principle to the effect that a particular decision would be taken by the Executive Board at a later time when certain preconditions had been met. In the present situation, the preconditions would be the meeting of the Paris Club in three weeks or so. If that line were adopted, there would be no action at all at the present meeting on the proposed decision set out in EBS/83/70.

The second possibility, the staff representative from the Legal Department went on, would be, as Mr. Prowse had suggested, for the Executive Board to take a decision forthwith and to make that decision effective upon the occurrence of a later event. The decision to be taken would be that set out in EBS/83/70. There would be no need for any later action if the decision taken at the present meeting were worded appropriately, for instance, to say that the decision taken would come into effect after a given outcome of the Paris Club meeting. The third possibility would be that the Executive Board should take two separate decisions, as it had done on Sudan. In that case, the Executive Board would take a decision at the present meeting referring to later events; but it would require that, once the later events had occurred, the Executive Board would take a further decision. The Managing Director had chosen the first possibility, meaning that no decision at all would be taken at the present meeting on EBS/83/70. One reason for choosing that course would be that there was in fact no formal request for a purchase under the compensatory financing facility before the Executive Board at the present time.

Mr. Mtei stated that he was grateful to Executive Directors for the way in which they had responded to the request for a stand-by arrangement and for a purchase under the compensatory financing facility. Their comments would certainly be passed on to his Zambian authorities, who were deeply committed to implementing the agreements reached between them and the Fund. The authorities had already started to implement the agreed program, and they had taken action of an institutional nature to strengthen their hand, since they were aware that the previous arrangements had gone off track in part because of weaknesses in Zambia itself. Executive

Directors had clearly seen that the Zambian economy was greatly dependent on the vagaries of the copper market, and the authorities were determined to try to diversify into agriculture and manufacturing. Naturally, such a major change would take time, and the country was bound for some years to remain dependent on copper.

Regarding the outstanding external debt of Zambia, Mr. Mtei explained that his authorities had recently advised him that the arrears outstanding in respect of 1982--amounting to SDR 199 million--would be consolidated and their repayment would be rescheduled following successful conclusion of the Paris Club meeting. It was in fact hoped to reschedule SDR 126 million out of SDR 199 million in Paris.

As to the debt owed by Zambia to countries that were not members of the Paris Club, Mr. Mtei said that his authorities had been pleased with the response, particularly from China, to which a substantial debt was owed and was coming due in 1983. The Chinese authorities had agreed to reschedule that debt even without waiting for the Paris Club meeting. His authorities wished him to express their appreciation for the cooperative actions by China. They had also indicated that the other non-Paris Club creditors had said that they would follow in the steps of the Paris Club members in order to give Zambia some relief. He therefore hoped that Executive Directors would do whatever they could to facilitate agreement by the respective creditor representatives in Paris.

Zambia's debts were quite large, amounting to the equivalent of SDR 270 million to Paris Club members alone in 1983 and to SDR 338 million in 1984, Mr. Mtei explained. The Zambian authorities hoped to obtain a breathing space of at least three years, during which the measures agreed with the staff, which they were forcefully implementing, would have time to take effect. The commercial banks had also indicated that they were awaiting the response of the Paris Club, and that they would take action immediately after the Club meeting. Commercial creditors to which Zambian purchasers were in arrears had already been in touch with the Zambian authorities and had in many cases agreed to convert their funds into equity capital or long-term loans to avoid making an immediate call on the resources of Zambia. Some of those resources would be placed in agricultural industries, and some of the measures being taken as part of the program were designed to ensure that the creditors would be able to invest their local funds in those industries for the time being.

The authorities would adjust the prices of fertilizer and maize meal on May 1, 1983, Mr. Mtei went on. They had indicated that it would not have been possible to announce those price adjustments earlier without bringing about speculative purchases and stockpiling.

The Zambian authorities had already carried out most of the difficult parts of the program, Mr. Mtei considered. They had reduced wages, increased prices, raised taxes, and devalued the currency. The benefits of those actions--which would mainly take the form of seeing factories and mines working to full capacity--had not yet come about, because of the delay in actions designed to facilitate the flow of resources into the economy. In the circumstances, it would be important for the Fund to take action as promptly as possible to help the authorities in Zambia.

Regarding a possible drawing under the compensatory financing facility, Mr. Mtei remarked, he had thought at first that the best procedure would be for the Executive Board to come to a decision at the present meeting in order to reduce to a minimum the time required for enabling Zambia to draw on the facility once satisfactory arrangements had been reached in Paris. He had however been encouraged by the response of the Board, and would welcome it if Executive Directors wished to take a decision in advance of the Paris Club meeting. He would like the Executive Directors to take the decision at the present meeting on the grounds that all the conditions had been met. He was unclear as to what would happen if no satisfactory agreement was reached in Paris. It was certainly important for the Zambian authorities that the Fund should make resources available to them at the time that could help them most.

He would convey the views of Executive Directors to the Zambian authorities, Mr. Mtei said. He was confident that they would find them most useful in trying to manage their economy, and particularly in implementing the agreement that had already been reached between Zambia and the Fund.

The Chairman commented that in proposing a decision in principle on the request for a drawing under the compensatory financing facility, he had not been trying to lay the foundations for a new procedure for compensatory financing drawings. The proper way of doing such a thing would have been to ask the Executive Board to discuss the facility as a whole. The procedure he had proposed was intended to respond to the rather exceptional circumstances of Zambia, and to combine pressure on the creditors and quick disbursement of the resources available under the compensatory financing facility with protection of the Fund's resources. Although by no means perfect, the solution that he had proposed had merit in the present circumstances, and he had been heartened to see that Board members, although some of them with reluctance, could accept it. The intention had not been to introduce delaying tactics. Now that the dates of the Paris Club meeting had been set for May 13 and perhaps May 14, the delay caused by the procedure that he had proposed was comparatively small. He was grateful to the Zambian authorities for the understanding that they had shown.

Mrs. Zhang remarked that in consideration of the external difficulties facing the Zambian authorities, her chair hoped that the Executive Board would consider and support Mr. Mtei's request that disbursement under the compensatory financing facility should be approved and become effective in time even should the outcome of the Paris meeting turn out to be somewhat unsatisfactory.

Mr. Mtei commented that although he and the Managing Director had agreed that there should be a deferment of any decision on the request for a drawing under the compensatory financing facility, his feeling was that the Executive Directors were not of the same mind.

Mr. Prowse explained that he would prefer the decision to be implemented as written. By that, he meant that he could accept the immediate release of the funds.

Mr. Alhaimus said that he had expressed reservations regarding tying a purchase under the compensatory financing facility to the decision that might be taken in a Paris Club meeting.

The Secretary reported that seven Directors would prefer immediate disbursement of the resources available under the compensatory financing facility, and that ten Executive Directors either supported or were prepared to go along with the approach suggested by the Chairman. The sense of the meeting was in favor of the latter.

Mr. Taylor remarked that the staff had put before Executive Directors some alternative methods of dealing with the situation. It had said that the first alternative was relevant because no formal request was before the Executive Board. What the Executive Board had been doing was to consider a request that might be presented and giving its approval in principle to that request. He would like to see the approval in principle recorded, perhaps in a sentence at the end of the summing up.

Mr. Mtei remarked that if Mr. Taylor was claiming that there was no formal request before the Executive Board, he could say that he had received from Lusaka a cable from the Governor of the Central Bank reading, "I shall be grateful if you can please help resolve the matter of the delayed drawing under the compensatory financing facility as this upsets our foreign exchange budget very seriously."

The staff representative from the Legal Department explained that, despite the communication received by Mr. Mtei, there was no formal request before the Executive Board. The relevant staff departments had confirmed an hour previously that no such request had been received.

Mr. Jayawardena remarked that he appreciated that the Managing Director had advanced consideration of Zambia's request in preparation for the meeting of the Paris Club, so that the Executive Board had considered a request for a stand-by arrangement which might normally have come later. However, if the outcome of the Paris Club meeting turned out to be less than was hoped for, he wondered whether the decision on the request for a drawing under the compensatory financing facility would be circulated for lapse-of-time approval in the usual way.

The Chairman replied that it would not be in the best interests of the country if he were to answer Mr. Jayawardena directly. He had however understood not only the sense of the meeting but what had been said by those who were less happy with the outcome. Management and staff would certainly do their best to ensure that the time until the meeting of the Paris Club was used to the best advantage of Zambia.

The Chairman then made the following summing up:

Executive Directors have indicated broad agreement with the views expressed in the staff appraisal in the report for the 1982 Article IV consultation, and they have approved Zambia's request for a stand-by arrangement. Directors noted that Zambia had incurred major financial imbalances for several years as a result both of a prolonged decline in its terms of trade and of the failure to adjust economic and financial policies to curtail real expenditures, especially on consumption, in line with the lower level of real income. Zambia's overwhelming dependence on copper was noted.

Directors expressed concern at the large budget deficits, which had continued to rise, primarily as a result of inadequate expenditure control, particularly for subsidies, and they underscored the contribution that expansionary fiscal policies had made to the deterioration in Zambia's financial and economic situation. Directors noted that efforts had been made to redress this situation during 1981 under the medium-term program supported by an extended arrangement with the Fund. Moreover, although some progress had been made under the program, the program targets had not been adhered to owing to the sharp fall in copper and cobalt prices, as well as to insufficient program implementation, and the extended arrangements had been canceled in July 1982.

In the absence of any adjustment program, Directors noted that the economic and financial situation had deteriorated markedly in 1982 and that it is now critical. Directors therefore welcomed the authorities' resolve to address the current situation and their adoption of a program for financial and economic recovery in Zambia. Directors agreed that it was essential to restrain domestic consumption, which was at an unsustainably high level, and that a substantial reduction in the overall budget deficit would be a key element in this process. Directors urged the authorities to exercise restraint on all categories of expenditure and to make a sustained effort to improve fiscal management. This would require great resolve and perseverance.

Directors welcomed the recent devaluation of the kwacha; they noted the support that it would provide for the measures aimed at improving efficiency as well as for the medium-term diversification of economic activity, but some doubt was expressed by some Directors whether the devaluation had been fully adequate. In view of the sharp fluctuations in Zambia's external environment, Directors urged the authorities to pursue a more flexible exchange rate policy that would ensure prompter and, if necessary, more frequent adjustments in the exchange rate as and when needed. Several Directors also noted that the exchange system was highly restrictive; they urged the Zambian authorities to reduce their reliance on these restrictive practices and to put more emphasis on a more market-related management of the exchange rate.

Directors welcomed the authorities' decision to decontrol prices and to allow enterprises to charge "economic prices" for their products. Together with the necessary wage restraint and cautious monetary policies adopted by the authorities, Directors believed that this decision would contribute significantly to the revitalization of economic activity.

Directors noted that Zambia was seeking multilateral debt relief under the Paris Club and that contacts with commercial banks and other creditors had been made by Zambia. They stressed that generous debt relief, as well as continuing flows of new aid, would be crucial in supporting the programmed improvement in the balance of payments. Directors looked forward to reviewing progress in this area during the June review of the stand-by arrangement as well as the other areas of the program.

Finally, a number of Directors stressed that, while the program was ambitious, it allowed for little, if any, margin of maneuver. Indeed, some of the program's assumptions--in particular, the forecast for world copper prices--might not necessarily materialize. Considering the critical economic and financial situation in Zambia, the authorities should stand ready to implement all necessary measures--particularly in the areas of the budget, the exchange rate, and pricing--where Zambia's past track record was disappointing, to achieve the objectives of the stand-by arrangement.

Looking further ahead, the authorities should urgently consider the medium-term priorities and policies for the rehabilitation and diversification of the economy. Several Directors stressed that, in cooperation with the World Bank, Zambia's investment program should be examined and reviewed as soon as practicable.

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

The Executive Board took the following decisions:

Decision Concluding 1982 Article XIV Consultation

1. The Fund takes this decision relating to Zambia's exchange measures subject to Article VIII, Sections 2 and 3, and in concluding the 1982 Article XIV consultation with Zambia, in the light of the 1982 Article IV consultation with Zambia conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. Zambia's exchange system remains highly restrictive. In the context of the program supported by a stand-by arrangement, the authorities intend to pursue the policies that will

permit a progressive reduction in payments arrears and facilitate other steps toward a more liberal exchange system. In the circumstances of Zambia, the Fund grants approval for the restrictions on making of payments and transfers for current international transactions referred to in SM/83/50 until June 30, 1984, or the next Article IV consultation, whichever is the earlier. The existing multiple currency practice, resulting from the levy on the sale of foreign exchange for private overseas travel, is approved until the completion of the mid-term review of the stand-by arrangement.

Decision No. 7382-(83/63), adopted
April 18, 1983

Stand-By Arrangement

1. The Government of Zambia has requested a stand-by arrangement in an amount equivalent to SDR 211.5 million for a period of 12 months beginning April 18, 1983.

2. The Fund approves the stand-by arrangement attached to EBS/83/67, Supplement 3.

3. The Fund waives the limitation in Article V, Section 3(b)(iii).

Decision No. 7383-(83/63), adopted
April 18, 1983

Use of Fund Resources - Compensatory Financing Facility

The Executive Board agreed to take a decision in principle along the lines set out in EBS/83/70. The formal request would be made available when it was received. The proposed decision would be circulated with the formal request for a decision on a lapse-of-time basis in due course.

APPROVED: September 16, 1983

LEO VAN HOUTVEN
Secretary