FOR AGENDA

EBS/83/67 & Corr. 1

CONFIDENTIAL

March 30, 1983

To: Members of the Executive Board

From: The Secretary

Subject: Zambia - Staff Report for the 1982 Article IV Consultation and Request for Stand-By Arrangement

Attached for consideration by the Executive Directors is the staff report for the 1982 Article IV consultation with Zambia and its request for a stand-by arrangement equivalent to SDR 211.5 million. Draft decisions appear on page 35.

This subject will be brought to the agenda for discussion on a date to be announced.

Att: (1)

CONFIDENTIAL

INTERNATIONAL MONETARY FUND

ZAMBIA

Staff Report for the 1982 Article IV Consultation and Request for Stand-By Arrangement

Prepared by the African Department and the Exchange and Trade Relations Department

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

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

March 29, 1983

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I. Introduction

The 1982 Article IV consultation discussions with Zambia were held in Lusaka during the periods November 8-23, 1982 and January 31-February 10, 1983. The Zambian representatives included Mr. N. Mundia, Prime Minister, and Minister of Finance since January 13, 1983; Mr. B.R. Kuwani, Governor of the Bank of Zambia; and other senior officials concerned with economic and financial matters. The mission head also met with President Kenneth Kaunda. The staff representatives were Messrs. E.L. Bornemann (head), W.J. Shields (both of AFR), W. Mahler (FAD), U. Gunjal (AFR), T. Hatayama (ETR), and Mrs. C. Smith and Miss M. Duane (secretaries-AFR). Mr. N. Sangare, Executive Director, participated in some of the discussions during the first mission.

Concurrently, discussions were held with the Zambian authorities on a stabilization program covering the year 1983. In the attached letter dated February 25, 1983, the Zambian Government requests a one-year stand-by arrangement in the amount of SDR 211.5 million (100 per cent of quota) in support of this program; this request and the accompanying Memorandum on the Economic and Financial Policies of Zambia are set out in Appendix II. Of the amount of SDR 211.5 million requested under the stand-by arrangement, SDR 67.8 million would be from the Fund's ordinary resources and SDR 143.7 million from borrowed resources. As of February 28, 1983, the Fund's total holdings of Zambian kwacha amounted to SDR 758.4 million, or 358.6 per cent of quota. Purchases scheduled under the stand-by arrangement and the concurrent CF request, together with repurchases scheduled during the program period, are set out in Table 1. If the full amount of the stand-by arrangement is purchased, the Fund's total holdings of Zambia's currency would rise to SDR 963.4 million at the end of March 1984, or 455.5 per cent of the present quota. Zambia's new quota will be SDR 270.3 million. A waiver of the limitation in Article V, Section 3(b)(iii) of the Articles of Agreement will be required.

The last Article IV consultation discussions with Zambia were held in Lusaka during the period August 5-17, 1981. The staff report (SM/81/196) and the report on recent economic developments (SM/81/208) were considered by the Executive Board on November 18, 1981. A summary of Zambia's relations with the Fund is provided in Appendix III. A summary of Zambia's relations with the World Bank Group is provided in Appendix IV. Zambia continues to avail itself of the transitional arrangements of Article XIV.

II. Background to the Discussions

Zambia's economic performance in recent years has been unsatisfactory. Real GDP declined over the five-year period 1977-81 at an average annual rate of almost 2 per cent (Table 2), with the consequence that real per

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

(In millions of SDRs)

	1983				1984
	April	May-June	July-Sept.	Oct.-Dec.	Jan.-March
Purchases					
Stand-by arrangement	31.5	45.0 1/	45.0	45.0	45.0
Ordinary resources	19.1	20.4	20.5	7.8	--
Borrowed resources	12.4	24.6	24.5	37.2	45.0
CFF	97.2	--	--	--	--
Repurchases					
Credit tranches	3.1	25.0	25.0	21.9	18.8
CFF	--	6.1	--	--	--
Oil	--	0.7	--	--	--
Net purchases	125.6	13.2	20.0	23.1	26.2
Total Fund holdings of Zambian kwacha (cumulative)					
In millions of SDRs	880.9	894.1	914.1	937.2	963.4
As per cent of quota	416.5	422.6	432.2	443.1	455.5

Source: IMF, Treasurer's Department.

1/ Based on April performance criteria and satisfactory completion of the review of the program with the Fund by end-June 1983.

Table 2. Zambia: Selected Economic and Financial Indicators, 1977-82

(In per cent, unless otherwise indicated)

	Period average 1977-81	1979	1980	1981	1982 Prel.
Real GDP growth rate	-1.9	-9.6	4.1	-0.7	--
Consumer prices 1/	13.8	10.1	11.7	12.9	12.7
Final consumption/GDP	80.4	76.2	81.4	88.8	85.3
Investment/GDP	21.7	14.6	23.5	21.0	23.6
National savings/GDP	16.0	18.7	9.8	2.6	...
Budget deficit/GDP (cash basis)	12.1	11.7	11.5	15.2	18.5
Current account balance/GDP 2/	-9.2	5.2	-12.2	-20.9	-17.3
Overall balance (in millions of SDRs)3/	-163	173	-213	-327	-552
Terms of trade	-9.3	15.7	-19.3	-6.9	-22.9
External debt/GDP 4/	70.1	61.4	67.4	89.7	...
External debt service/Exports of goods and nonfactor services 4/	26.4	21.2	28.0	34.3	50.4
External commercial payments arrears (in millions of SDRs)	...	350	461	500	669
Net domestic assets of the banking system 5/ 6/	33.3	4.8	37.0	46.4	63.0
Claims on Government (net) 5/	25.7	9.9	26.7	18.1	46.6
Credit to private sector including central bank claims on mining companies 5/	5.4	8.7	2.7	28.7	14.2
Broad money	10.1	30.2	9.0	7.9	34.3

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

1/ Weighted average of low-income (70 per cent) and high-income (30 per cent) indices.

2/ Including official transfers.

3/ Excluding valuation adjustments on official gold holdings.

4/ Including the Fund but excluding external payments arrears.

5/ Relative to the stock of broad money outstanding at the beginning of the period.

6/ Excluding the counterpart of gold revaluations and SDR allocations.

capita income declined on average by about 5 per cent per annum. The decline in real GDP was heavily influenced by a marked decline in real value added of the mining sector, which accounts for around 30 per cent of real GDP. This decline resulted from a decrease in mineral production, reflecting the advanced age of mining operations in Zambia and related problems, such as declining copper grades of the underground ore bodies, as well as the sharp fall in world market prices of copper relative to the prices of inputs to the mining sector. Other sectors of economic activity stagnated on balance during the past five years, in part as a result of an almost constant shortage of foreign exchange, which, for example, inhibited imports of raw materials, spare parts, and capital equipment for the manufacturing sector. However, there were substantial year-to-year fluctuations in output, particularly in the agricultural sector, where recurring droughts, such as those in 1979 and 1981, have compounded other problems, including previously inadequate financial incentives, to prevent any sustained improvement in this sector. Agriculture and manufacturing are the two principal productive sectors after mining, and each accounts for around 11 per cent of ral GDP.

Concurrent with the decline in overall economic activity, the internal and external financial imbalances worsened markedly. This can be traced in part to the sharp reduction in Zambia's external terms of trade, which occurred initially in 1974/75, when the world market price of copper fell to one half of its then current level (Chart 1). Zambia is dependent on copper for some 90 per cent of export receipts, and, as a consequence, the purchasing power of Zambia's exports also fell by about 50 per cent from the previous level. Despite a recovery in the price of copper to close to its pre-1975 peak by early 1980, sharply escalating import prices kept the purchasing power of Zambia's exports at the same reduced level throughout the years after 1975 (Chart 1). Moreover, the recovery in copper prices was short-lived, and since early 1980 the price has declined substantially; in 1982 the world market price averaged US$0.67 per pound, or close to the average price prior to and between the two boom cycles of 1973/74 and 1979/80. This latest decline was matched by a dramatic fall in the price of cobalt, which is Zambia's second most important export and accounts for an additional 4 per cent of export receipts, from US$25 per pound in 1980 to a current price of about US$6 per pound. Thus, although the increase in import prices moderated from earlier years, there was a further sharp decline in the purchasing power of Zambia's exports after 1980.

The decline in Zambia's terms of trade has contributed to a sharp deterioration in the balance of payments since 1979, when higher prices of copper and cobalt resulted in surpluses on both the current account and the overall balance. In 1980 and 1981 substantial deficits were recorded on both the current account and the overall balance of payments (Table 3). The current account deterioration reflected both a decline in export receipts

CHART 1

ZAMBIA

MARKET PRICE AND PURCHASING POWER OF COPPER EXPORTS, 1965-82

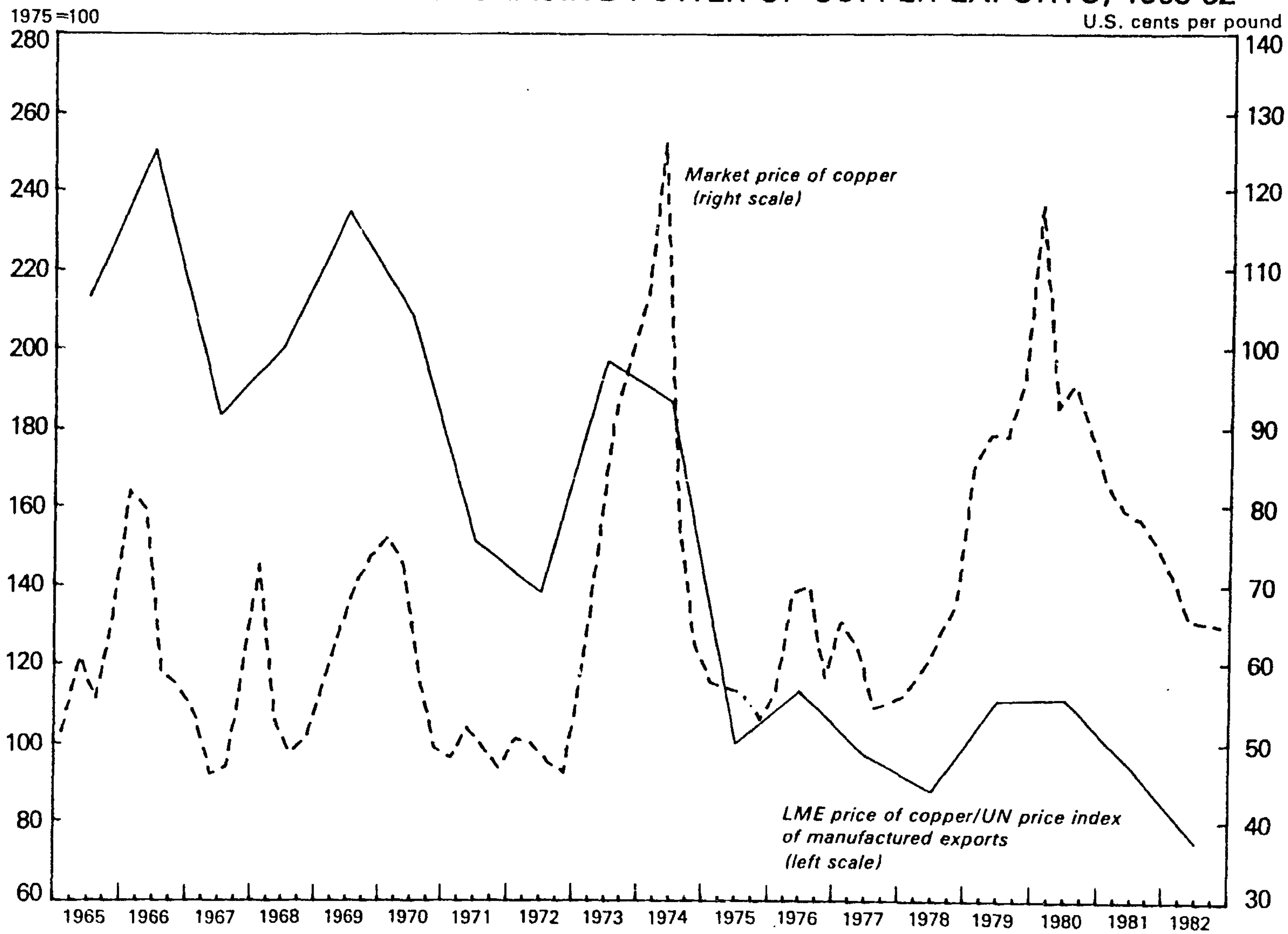

Table 3. Zambia: Balance of Payments, 1978-83

(In millions of SDRs)

	1978	1979	1980	1981	1982 Prel.	1983 Proj.
Exports, f.o.b.	649	1,092	1,023	833	844	963
Imports, c.i.f.	-617	-735	-1,017	1,050	-962	-841
Trade balance	32	357	-6	-217	-118	122
Services and unrequited transfers (net)						
Investment income	-109	-97	-163	-178	-226	-217
Other services	-64	-71	-129	-148	-131	-111
Private transfers	-85	-86	-94	-100	-104	-75
Government transfers	20	27	26	23	36	43
Total	-238	-227	-360	-403	-425	-360
Current account	-206	130	-354	-620	-543	-238
Nonmonetary capital (net)						
Government	53	134	100	251	42	-43
Mining companies	-15	-23	26	85	96	36
Other (including errors and omissions)	-39	-83	--	-58	-147	-50
Total	-1	28	126	278	-9	-57
SDR allocation	--	15	15	15	--	--
Valuation adjustment 1/	--	--	--	47	25	--
Overall balance	-207	173	-213	-280	-527	-295
Financing						
Use of Fund resources (net)	149	73	6	312	-52	150
Purchases	(149)	(99)	(50)	(359)	(34)	(264)
Repurchases	(--)	(-26)	(-44)	(-47)	(-86)	(-114)
Payments arrears (decrease -)	102	-145	110	39	447	-228
Debt relief	--	--	--	--	--	373
Other foreign assets (net) (increase -)	-44	-101	97	-71	132	--
Memorandum items:						
Gross international reserves (at end of period) 2/	39.2	60.7	61.3	36.2	38.3	...
In weeks of imports, c.i.f.	3.3	4.3	3.1	1.8	1.9	...

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

1/ Reflecting changes in the valuation of gold.

2/ Excluding gold.

and a marked expansion in imports and in net service payments, particularly in 1980. The sharp increase in imports was partly attributable to adverse import price developments, including the higher cost of petroleum products, but also to an increase in the volume of all import categories. Service payments were higher on account of investment income, but also because of higher payments for foreign travel, overseas education, and port charges. In 1981 the current account deficit reached SDR 620 million, equivalent to 20.9 per cent of GDP. Net capital inflows improved in 1980 and 1981, but were only sufficient to finance some 40 per cent of the current account deficits. As a consequence, the overall balance of payments deficit continued to increase to SDR 327 million in 1981, equivalent to 11 per cent of GDP.

The deterioration in Zambia's external accounts since 1979 resulted in a significant expansion in external indebtedness and a further accumulation of external payments arrears. Public and publicly guaranteed debt, including to the Fund, rose sharply during 1980-81 to reach SDR 2.7 billion at the end of 1981, equivalent to 90 per cent of 1981 GDP, while associated amortization and interest payments increased to 34 per cent of that year's exports of goods and nonfactor services. Net use of Fund resources in 1981 was SDR 312 million (147 per cent of quota), which was almost sufficient to finance the overall balance of payments deficit of SDR 327 million. In addition, there was a renewed accumulation of external commercial payments arrears, which rose to SDR 500 million at the end of 1981, equivalent to 60 per cent of 1981 export receipts.

Domestic economic conditions during the period 1980-81 also had an adverse impact on the balance of payments. In particular, final consumption expenditure increased significantly from an already high level, rising to almost 89 per cent of GDP in 1981, despite the decline in real per capita income and in the real output of goods and services. This sharp increase in consumption expenditure undoubtedly contributed to the marked expansion in imports and net service payments. Taking into account the rate of inflation in consumer prices, it is estimated that final consumption also increased in real terms from the level prior to 1979. As a consequence, national savings declined dramatically in both 1980 and 1981, and represented only 2.6 per cent of GDP in the latter year. At the same time, total investment increased from its low level in 1979, and was largely financed externally through the expanding current account deficit and consequent external indebtedness.

Fiscal policy contributed to the expansion in domestic demand throughout the 1977-81 period, with the overall budget deficit as a share of GDP averaging about 12 per cent. During the 1977-81 period, the government expenditure to GDP ratio averaged 38 per cent, while the revenue to GDP ratio averaged 26 per cent. This budgetary imbalance was partly the result of insufficient control over expenditures, compounded by the sluggish growth in revenue, following the virtual disappearance of taxes on copper as a major revenue source. Total expenditure rose by 38 per cent during 1980-81, which was twice the rate of increase of nominal GDP, as the reduced levels of capital expenditure were more than offset by a nearly 50 per cent increase in current outlays. The increase in current outlays was broadly distributed, but the biggest increases were for defense and government personnel. Control over expenditures improved in 1981 when subsidies for maize and fertilizer were reduced sharply to 1979 levels and the growth in other nondefense expenditure heads slowed, but the restraint was achieved in part through the accumulation of domestic arrears. Aided by significant new revenue measures, revenue increased by 34 per cent between 1979 and 1981. Including the extraordinary military expenditure recorded in 1981, which was financed externally, the overall deficit was K 463 million (Table 4), equivalent to 15 per cent of GDP, for which domestic bank financing was K 164 million, or 5 per cent of GDP.

The large budget deficits experienced in recent years, as well as the rapid increase in demand for credit by the private sector, particularly the mining company, which since 1981 has had to finance substantial operating losses as a result of depressed export prices for copper and cobalt, led to a sharp expansion in domestic credit. In both 1980 and 1981 net domestic assets of the banking system rose by over 20 per cent, or at approximately double that rate when measured relative to the stock of broad money at the beginning of the period. Because of the large balance of payments deficits, however, broad money increased only modestly in these years. Reflecting the expansionary domestic policies outlined above, inflation accelerated from 10 per cent in 1979 to just under 13 per cent in 1981. However, this 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.

III. Implementation of the Extended Arrangement in 1981

On May 8, 1981 the Executive Board approved an extended arrangement in the amount of SDR 800 million, equivalent to 378.25 per cent of Zambia's quota. This arrangement was in support of a three-year program aimed at restoring financial balance and increasing the rate of growth of the economy through diversification away from the dominant mining sector toward other economic activity, in particular agriculture. The centerpiece of the financial program for 1981, the first year of the three-year program, was a significant improvement in fiscal performance. This was to be achieved by a substantial increase in revenues, notwithstanding the expected disappearance of revenues from the mining sector, and a reduction in recurrent expenditures largely through a substantial decline in subsidies and defense expenditure. As a consequence, both the overall budget deficit and required

Table 4. Zambia: Central Government Finance, 1979-83

(In millions of kwacha)

	1979	1980	1981	1982 Preliminary	1983 Budget	1983 Program
Revenue and grants	620.6	791.4	834.1	880.6	1,163.2 1/	1,101.7 1/
Tax revenue	518.5	684.5	732.9	766.1	1,000.9	945.9
Nontax revenue and grants	102.1	106.9	101.2	114.5	162.3	155.8
Total expenditure and net lending	922.6	1,168.2	1,277.7	1,324.2	1,378.8	1,329.7
Current expenditure	771.3	1,045.5 2/	1,148.6	1,108.2	1,145.4	1,139.7
Personal emoluments	170.2	213.6	273.0	290.0	285.4	304.5 3/
Recurrent departmental charges	160.7	193.5	230.6	286.7	286.4	286.4
Subsidies	105.3	213.7	110.4	126.8	82.8	82.8
Constitutional and statutory	270.1	337.1	444.2	285.7	334.0	309.2
Interest payments	(103.3)	(126.8)	(117.7)	(131.2)	(171.8)	(147.0)
Other 4/	(166.8)	(210.3)	(326.5)	(154.5)	(162.2)	(162.2)
Other payments 5/	65.0	87.4	90.4	133.0	156.8	156.8
Capital expenditure	88.7	161.3	119.3)		)	)
Net lending	62.6	-38.6	9.8)	216.0	) 233.4	) 190.0
Payment of past arrears	...	...	19.0	153.0	--	--
Overall deficit (-), cash basis	-302.0	-343.8	-462.8	-596.9	-215.6	-228.0
Financing	302.0	343.8	462.8	596.9	215.6	228.0
External (net)	137.9	141.9	247.4	74.2	-9.1	19.9
Gross borrowing	(180.3)	(178.1)	(278.6)	(152.2)	(80.5)	(80.5)
Amortization	(42.4)	(36.2)	(31.2)	(78.0)	(89.6)	(60.6)
Domestic nonbank (net)	17.9	41.7	52.0	28.7	73.1	58.1
Domestic bank (net)	63.3	221.8	163.8	455.8	150.0	150.0
Other	82.6	-61.6	-0.4	38.2	1.6	--
Memorandum item:						
Estimated reduction in payments as a result of debt rescheduling	...	...	...	...	...	161.2
Interest	(...)	(...)	(...)	(...)	(...)	(51.7)
Amortization	(...)	(...)	(...)	(...)	(...)	(109.5)

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

1/ The authorities estimate that the new revenue measures will increase revenue by K 146.8 million in 1983, while the staff estimate is K 23.5 million less. In the staff estimate 11/12ths of the official estimate is used for the revenue from measures introduced effective January 29 and 8/12ths of the official estimate for revenue from the mineral export tax which is to be introduced with effect from April 1. The staff estimate of revenue from imports is lower by K 31.5 million because imports are assumed to decline by 20 per cent in real terms compared to 1982. In addition, the staff estimate for grants is lower by K 6.5 million.

2/ Includes identified increase in arrears of K 33 million (See footnote to Table 10, SM/83/50).

3/ The staff estimate is higher by K 19.9 million because the budget figure appears to be an underestimate.

4/ Primarily defense expenditure on wages and goods and services.

domestic bank financing were to be reduced significantly to 7.1 per cent of GDP and to no more than K 150 million (equivalent to 4.1 per cent of projected GDP), respectively. In support of budgetary restraint, there was to to be a substantial liberalization in pricing policy toward greater flexibility and more "economic pricing" through the establishment of a Prices and Incomes Commission, which also was to develop guidelines for wage and salary increases in order to align future increases more closely with gains in productivity. Taken together, these measures were expected to allow a revitalization of economic activity in the parastatal and private sector and a return to modest growth in real GDP. The financial program was to be supported by a range of supply-oriented policies, both through the Government's capital budget, which was to be determined in the framework of a three-year investment program, and through improved price and taxation incentives for agriculture as well as for the manufacturing sector. These measures were expected to strengthen the balance of payments over the medium-term, although the position in 1981 was projected to remain difficult, with a modest improvement in the current account deficit to 9.8 per cent of GDP and in the overall deficit to SDR 152 million. After taking account of the use of Fund resources as scheduled under the program, there was expected to be a reduction in outstanding external payments arrears of SDR 100 million during 1981.

In the event, implementation of the program became increasingly difficult during 1981, in part as a result of a more severe decline than projected in copper and cobalt prices (Table 5). Performance criteria at the end of June 1981 could not be met because of a rapid expansion in the budget deficit, and associated bank financing, during the first four months of the year, and the inability to reduce external payments arrears to the program target (Table 6). Budgetary performance improved in the second half of the year, however, and the end-September ceilings on net claims of the banking system on the Government and total domestic credit were respected. However, the deteriorating balance of payments position made it difficult for the target on external payments arrears to be achieved, and, in recognition of this, the Executive Board approved a waiver of the end-September ceiling and modified the end-December ceiling to permit a reduction of SDR 62 million in outstanding arrears over 1981, rather than the original target of SDR 100 million. The economic and financial situation deteriorated markedly during the fourth quarter of 1981, in particular as the mining companies sought additional bank financing to cover large operating losses caused by weakening export prices. Demand for credit was also strong in the agricultural sector as a result of a record maize crop in 1981. There was a sustained effort by the authorities to restrain government expenditures during the fourth quarter of 1981, but the end-December ceiling on net claims on the Government was not met, while the ceiling on overall domestic credit was exceeded by a substantial margin. Moreover, the modified ceiling on external payments arrears was

Table 5. Zambia: Implementation of the 1981 Financial Program

Assumptions/Targets	Program	Actual
Real GDP growth (per cent)	5.0	-0.7
Nominal GDP growth (per cent)	20.0	2.1
Consumer prices (per cent)	14-16	12.9
Final consumption/GDP (per cent)	77.4	88.8
Investment/GDP (per cent)	21.9	21.0
Current account deficit/GDP (per cent) 1/	9.8	20.9 2/
Overall balance (million of SDRs)	-152	-327 3/
External commercial payments arrears outstanding (million of SDRs)	399	500
Overall budget deficit (cash basis)		
In millions of kwacha	260.5	462.8
As per cent of GDP	7.1	15.2 4/
Revenue/GDP (per cent)	23.4	27.4 5/
Expenditure/GDP (per cent)	30.5	42.0 6/
Expansion in domestic credit (per cent) 7/	30.2	46.1
Expansion in net claims on Government (per cent) 7/	16.5	17.4
Expansion in credit to private sector, including central bank claims on mining companies (per cent) 7/	11.8	28.7
Increase in 1980/81 agricultural producer prices (per cent)	15	15
Copper exports (tonnes)	600,000	552,000
Export price of copper (US$/lb.)	0.93	0.79
Export price of cobalt (US$/lb.)	21.6	9.7

Sources: EBS/81/91, April 20, 1983; and staff estimates.

1/ Including official transfers.
2/ 17.3 per cent relative to originally projected GDP.
3/ Excluding valuation adjustments on official gold holdings.
4/ 12.6 per cent relative to originally projected GDP.
5/ 22.7 per cent relative to originally projected GDP.
6/ 34.8 per cent relative to originally projected GDP; includes extraordinary military expenditure of 6 per cent of GDP recorded in 1981.
7/ Relative to broad money outstanding at the beginning of the period, and as defined under the program.

Table 6. Zambia: Quantitative Performance Criteria Under the Extended Arrangement in 1981 1/

(At end of period)

	1980	1981 Mar.	June	Sept.	Dec.
		(In millions of kwacha)			
Total domestic credit of the banking system					
Ceiling		1,930.0	1,999.0	2,094.0	2,134.0
Actual	1,859.7	1,957.9	2,013.7	2,079.5	2,288.9
Claims on Government (net) of the banking system					
Ceiling 2/		1,420.0	1,454.4	1,489.4	1,521.4
Actual	1,354.4	1,458.5	1,478.2	1,485.7	1,523.7
Bank of Zambia credit to mining companies					
Ceiling		61.4	61.4	61.4	61.4
Actual	61.4	61.4	65.4	61.4	61.4
		(In millions of SDRs)			
Outstanding external payments arrears					
Ceiling 3/	...	500.0	455.0	410.0	399.0
Adjusted ceiling 4/	...	500.0	479.0	447.0	447.8
Actual	461.0	544.6	529.0	566.5	500.6
New external borrowing directly undertaken or guaranteed by the Government in the maturity range of: 5/					
1-10 years					
Ceiling		----------	----------	----------	350.0
Actual		11.2	11.2	11.2	90.7
1-5 years					
Ceiling		----------	----------	----------	150.0
Actual		--	--	--	--

Sources: EBS/81/91; and data provided by the Zambian authorities.

1/ Based on the definitions included in the program (see EBS/81/91, Supplement 2).
2/ Includes additional bank financing of K 17 million in respect of wage increases granted in 1980 but paid in 1981.
3/ The original ceiling of SDR 361.0 million at end-December 1981 was modified to SDR 399.0 million (see EBS/81/220).
4/ Adjusted in accordance with EBS/81/91 for 75 per cent of the shortfall in export receipts.

exceeded by a wide margin, even after adjustment for 75 per cent of the shortfall in export receipts during the fourth quarter as provided under the extended arrangement. The end-December ceilings on Bank of Zambia credit to the mining companies and new external borrowing were met.

In reviewing fiscal performance under the program, two special factors need to be considered; these are extraordinary military purchases and the accumulation of arrears. Official data for 1981 include extraordinary expenditure for imports of military equipment (equivalent to about 6 per cent of GDP) and a matching official capital inflow; at least part of these purchases may have occurred in earlier years. Thus, although the data in Table 5 show the budget deficit increasing to 15.2 per cent of GDP in 1981, compared with the target of 7.1 per cent, this increase reflects the recording of the extraordinary military expenditure as well as the lower than projected increase in nominal GDP. The increase in net claims of the banking system on the Government in 1981 (under the program definition) was K 152.3 million, which was only slightly above the program target. However, there was a substantial increase in domestic arrears which was not consistent with the program objectives. While the precise amount of the increase in total arrears in 1981 is not available, it is estimated that there was a substantial increase in that year, and somewhat smaller increases in earlier years. In 1982 there was a payment of arrears totaling K 153 million (equivalent to about 5 per cent of the estimated GDP). Excluding the extraordinary military expenditure recorded in 1981, the overall budget deficit in 1981 is estimated at K 280 million, compared with the program target of K 260.5 million.

The implementation of the nonfiscal elements in the 1981 program was also disappointing. Although agricultural producer prices and a fairly wide range of consumer prices were raised during the first half of the year, progress toward greater flexibility and "economic pricing" was not sustained, in part because the Prices and Incomes Commission did not become operational as envisaged under the program. Implementation of the capital budget was also disappointing, while many other supply-oriented policies were only partially implemented or not at all. Interest rates were raised in March 1981 as a part of the medium-term program. As it became clear that the program's original economic and financial targets could not be achieved, the extended arrangement was canceled, effective July 3, 1982.

IV. Economic Developments in 1982

Faced with a continuing fall in copper and cobalt prices, and the absence of restraint on central government operations unlike in the previous year, the economic and financial situation in Zambia deteriorated further in 1982. Real GDP is estimated to have stagnated again as a result of lower export prices and the acute foreign exchange shortage. In addition, agricultural output declined in 1982 because of below-normal rainfall in many parts of the country, particularly in the important crop areas in the Southern Province. The maize crop (the staple food crop) was insufficient to meet domestic demand, and maize imports had to be resumed in the latter half of the year. By contrast, mineral production recovered, with the output of refined copper rising to 587,000 tons from 557,000 tons in 1981. In spite of the critical foreign exchange situation, and disappointing agricultural output, supplies of consumer goods within the country appear to have remained relatively satisfactory during 1982, with most essential commodities available at official prices. This was achieved by the accumulation of further commercial payments arrears, the nonpayment of external public debt service, and recourse to costly short term trade finance.

The balance of payments worsened in 1982. The realized export price of copper declined by 18 per cent, while the price of cobalt fell by 30 per cent. However, an increase in the volume of copper as well as cobalt shipments raised export receipts marginally, while imports declined due to the acute shortage of foreign exchange; there was a further increase of over 5 per cent in net service payments, primarily due to rising interest payments on external debt. As a result, the current account deficit is estimated to have narrowed to SDR 543 million in 1982, equivalent to 17.3 per cent of GDP. At the same time, net capital inflows are estimated to have declined sharply from SDR 278 million in 1981 to a net outflow of SDR 9 million. Consequently, the overall deficit widened to SDR 552 million before taking account of valuation changes on official gold holdings. In contrast with 1981, there were net repayments to the Fund totaling SDR 52 million in 1982. After taking account of these repayments, the overall deficit was financed by an increase of SDR 169 million in external commercial payments arrears, the incurrence of arrears on external public debt, and a rise in reserve-related liabilities. At the end of 1982 commercial payments arrears stood at SDR 669.3 million, equivalent to 79 per cent of 1982 export receipts; arrears on external public and publicly guaranteed debt have been estimated at SDR 222 million. In addition, the mining company accumulated SDR 56.5 million in overdue payments to overseas suppliers of goods and services.

Budgetary performance deteriorated in 1982, both in relation to the 1981 outturn and the original budgetary goal, and on a cash basis the deficit rose to K 597 million, or 18.5 per cent of GDP. However, K 153 million (5 per cent of GDP) of total outlays was due to the settlement of domestic arrears previously accumulated. Total expenditure rose by 4 per cent, as capital outlays and net lending nearly doubled to K 216 million, largely due to budgeted increases in net lending to the public enterprises. Current expenditure declined by 3 per cent. Excluding the extraordinary military outlays from the 1981 data, current expenditure in 1982 rose by about 14 per cent, with increases in all categories of current expenditure. Subsidies increased as a result of a delay in the approval of the price increases for maize and fertilizer assumed in the budget, and in the case of fertilizer, a smaller price increase than assumed in the budget. Reflecting the stagnation in economic activity, revenue increased by less than 6 per cent, despite higher excise duties, acceleration of company income tax payments, and the imposition of a special equity levy on public enterprises which do not make profits, and hence pay no corporate income tax to the budget. External financing of the deficit declined, and domestic bank financing nearly tripled to K 456 million, or about 14 per cent of GDP.

The decline in metal prices during 1982 resulted in the mining company 1/ incurring substantial operating losses. After a loss of K 173.6 million in the 1981/82 trading year (April 1-March 31), the company incurred a loss of K 151 million during the first nine months of the 1982/83 trading year, despite the implementation of a range of cost-saving and additional revenue measures which achieved cash savings of K 167 million during this period. Initially, the company financed these losses through borrowing from the domestic banking system as well as externally. However, in 1982 there was limited scope for additional borrowing from these sources, partly because the domestic banking system was fully lent after the sharp rise in credit during the latter half of 1981, and the company had to borrow K 113.5 million directly from the Bank of Zambia. As a consequence of the increased demand for bank financing of the budget deficit and the mining sector, domestic credit creation accelerated during 1982. Net domestic assets of the banking system are estimated to have increased by over 27 per cent, compared with an increase of 23 per cent in 1981; measured against the stock of broad money outstanding at the beginning of the period, the increase in net domestic assets was 63 per cent in 1982 compared with 46 per cent in 1981. In contrast to the restraint exercised in 1981, monetary policy largely accommodated the increasing credit demands in 1982, with the growth in broad money accelerating to 34 per cent over the year, compared with only 8 per cent for 1981. Inflation was little changed from 1981 at about 13 per cent, reflecting in part the widespread price controls, which continued through 1982 and resulted in substantial delays in the approval of applications for price increases.

V. Report on the Discussions and Financial Program for 1983

The 1982 Article IV consultation discussions were held together with the negotiations toward a new stand-by arrangement. The discussions reviewed in depth economic and financial developments during 1981 and 1982, as well as the causes underlying the authorities' inability to implement the extended arrangement after 1981, which were outlined in

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1/ On April 1, 1982, the two mining companies (Nchanga Consolidated Copper Mines, Ltd., and Roan Consolidated Mines, Ltd.) were merged to form Zambia Consolidated Copper Mines, Limited (ZCCM). The background to the merger is discussed in SM/83/50, Zambia--Recent Economic Developments, Section I.3 (b).

the previous sections. The discussions also provided a framework for the staff to reassess earlier recommendations for a financial recovery program to be supported by use of Fund resources 1/. Following these, and subsequent negotiations during February 1983, the Zambian authorities requested Fund support for a financial recovery program for 1983, the principal elements of which are set out in the attached Memorandum on the Economic and Financial Policies of Zambia (Appendix II).

1. Objectives and assumptions

The major objective of the program that has been adopted by the Government is a substantial reduction in the serious financial imbalances facing Zambia, both internally and externally. Externally, the program aims at reducing the overall deficit in 1983 to a level that could be financed from available external resources, including the Fund. Since projected export receipts and capital inflows are insufficient to finance essential imports and meet scheduled debt service during the year, the program assumes the consolidation and rescheduling of Zambia's external debt service as well as external payments arrears. Domestically, the focus of the program is on a marked improvement in public finances as well as the financial position of the mining company. The authorities realize that a significant improvement in all of these critical areas must occur before there can be a sustained recovery in overall economic activity. At the same time, the authorities recognize that a beginning must be made toward the diversification of economic activity away from the dominant mining sector. Within the available resources, the program provides further incentives in this regard, in particular through enhanced producer price incentives for agriculture as well as increased price flexibility and improved efficiency in manufacturing.

The major assumptions underlying the program's projections as well as the principal elements of the program are summarized in Table 7. Crucial to the success of the program is the assumed world market price for copper, which has been conservatively projected to average US$0.76 per lb. in 1983; during the first two months of 1983 the price has improved to average US$0.73 per lb. A modest increase in refined copper production and sales has also been assumed, reflecting in part improved profitability of the mining company and the continued implementation of cost-saving measures in the mining sector. Nevertheless, because of an expected poor agricultural crop in 1983 as a result of low rainfall, and a continuing critical shortage of foreign exchange resources, real GDP is projected to remain stagnant in 1983. The GDP deflator should rise sharply, however, as a result of the various measures adopted under the program, in particular the devaluation and price decontrol.

1/ Missions visited Zambia in December 1981 and April 1982 to discuss the possible use of Fund resources under a new one-year arrangement.

Table 7. Zambia: Summary of Financial Program, 1983

	1981 Actual	1982 Est.	1983 Program
Assumptions			
Real GDP growth (per cent)	-0.7	--	--
Nominal GDP growth (per cent)	2.1	6.0	27.0
Change in terms of trade (per cent)	-6.9	-22.9	2.7
Copper exports:			
Volume (thousand tons)	552	604	615
Price (US$/lb.)	0.79	0.68	0.76
Targets			
Current account deficit including grants:			
In millions of SDRs	620	543	238
As per cent of GDP	20.9	17.3	7.4
Overall deficit (millions of SDRs)	280	527	295
External commercial payments arrears (end of period--millions of SDRs)	500.6	669.3	569.3
Budget deficit (cash basis)			
In millions of kwacha	462.8	596.9	228.0
As per cent of GDP	15.2	18.5	5.6
Total revenue and grants/GDP (per cent)	27.4	27.3	26.9
Tax revenue/GDP (per cent)	24.1	23.8	23.1
Expenditure and net lending/GDP (per cent)	42.0	41.5	32.4
Domestic bank financing/GDP (per cent)	5.4	14.2	3.7

Principal elements

External

Devaluation of the kwacha by 20 per cent in terms of the SDR, effective January 7, 1983 and flexible exchange rate policy during program.
A 13 per cent reduction in imports and a 15 per cent decline in net service payments and a 14 per cent increase in exports to achieve the targeted current account deficit.
A minimum cash reduction in external commercial payments arrears of SDR 30 million.

Fiscal

Restraint of total expenditure and a 25 per cent increase in revenues to achieve targeted reduction in the budget deficit.
New tax measures equivalent to 3 per cent of projected GDP.
Reduction in budgetary subsidies by K 44 million to K 83 million.
No net increase in government employment.
No general wage increase for government employees.
No extrabudgetary or supplementary expenditure and improved fiscal management.

Prices and incomes

General price decontrol and increased flexibility to set prices at economic levels.
Increases in the selling prices of maize meal and fertilizer.
Full pass-through to domestic prices of higher import costs following devaluation.
Wage increases to be limited to 5 per cent, except at lower-paid levels.

Mining industry

Copper production to increase by up to 30,000 tons annually.
Further reduction of 200 in expatriate labor force and a reduction by 4 per cent in local payroll as of April 1, 1983.
Continued implementation of other administrative and technical cost saving measures.

Other

Interest rate increases (announced January 7).
Restrictions on contracting or guaranteeing of nonconcessional debt.

2. External policies

As noted earlier, Zambia's balance of payments is highly sensitive to fluctuations in the world market price of copper. The program assumes an average world market price of US$0.76 per pound during 1983, as well as a slight improvement in the output of refined copper to 615,000 tons. Based on these assumptions, there will continue to be a critical shortage of foreign exchange resources, however, and the program includes the following measures to ensure that imports and essential service payments will not exceed available export receipts and external financing in 1983. On January 7, 1983, the Zambian kwacha was devalued by 20 per cent in terms of the SDR, and is now pegged to the SDR at a rate of K 1 = SDR 0.781049. Since the prices of Zambia's principal exports are set in internationally competitive markets, there is not expected to be any immediate improvement in foreign exchange receipts as a result of the devaluation. However, the sharply increased costs of imports and payments for services is expected to lead to a marked decline in import volume as well as in certain invisibles, such as overseas travel and education. Moreover, taken together with the cost-cutting measures being implemented, the devaluation will facilitate the financial viability of the mining sector, and allow a redirection of the industry's financial resources toward much needed rehabilitation and investment in capital equipment, which will support the projected modest expansion in copper production and exports. Finally, recent decisions on pricing policy (outlined below) have reinforced the effects of the devaluation and are projected to result in further restraint on particular import categories such as petroleum products.

The Zambian authorities are reviewing current arrangements for the determination of the exchange rate. The present system has necessitated sizeable, discrete adjustments in the rate at infrequent intervals, involving substantial political and social costs which have tended to delay the decision-making process. This contrasts with the frequent, and often sharp, fluctuations in Zambia's external terms of trade. In order to manage the exchange rate better so that it will adjust quickly in response to changed external circumstances, the authorities are considering adopting more flexible arrangements, including a change in the peg to a different currency basket, leading to smaller but more frequent adjustments in the exchange rate. During the comprehensive review of progress under the program, to be completed before end-June 1983 (see section 7 below), the implementation of the new flexible exchange rate policy will be assessed, and understandings will be reached with the Fund on this subject.

In addition, the Zambian authorities have adopted a number of institutional arrangements to strengthen the foreign exchange allocation system. The role of the Ministerial Foreign Exchange Committee will be changed to concentrate on policy matters rather than the day-to-day management of foreign exchange and the approval of import licenses. A new technical committee of officials will now be in charge of foreign exchange allocations, and import licenses will be issued strictly in accordance with the available foreign exchange resources as notified by the Bank of Zambia on the basis of a monthly foreign exchange budget. Another important measure in this area is the recently announced decontrol of emerald mining. This measure will allow Zambian nationals to possess emeralds legally, which was prohibited in the past and led to illegal and clandestine activities in this area. All sales of emeralds will have to be made to the Reserve Minerals Corporation (RMC) at the equivalent of the international price of emeralds. Through the injection of foreign capital and management, RMC will also take a leading role in emerald mining in a few restricted areas. These measures are expected to expand existing trade through official channels and, over time, to increase foreign exchange receipts.

As a result of these, as well as the domestic financial measures outlined below, the current account deficit is projected to narrow markedly in 1983 to SDR 238 million (7.4 per cent of projected GDP) from SDR 543 million in 1982 (17.3 per cent of GDP) (Table 3). Export receipts are projected to increase by 14 per cent, largely reflecting the projected 12 per cent increase in the price of copper, while imports and net service payments are estimated to decline by over 13 per cent, almost entirely as a result of the lower volume of imports as well as service payments other than scheduled interest payments on external debt. Because of higher amortization payments on external debt during 1983, but also reduced external borrowing by the Government and the mining company, an increase in net capital outflows to SDR 57 million is envisaged. Nevertheless, the overall balance of payments deficit is projected to be almost halved in 1983 to SDR 295 million.

Even with this significant improvement in the balance of payments expected under the program, it would not be possible to finance the projected overall deficit from available resources, including the proposed net use of Fund resources. Thus, the Zambian authorities have announced their intention to seek a consolidation and rescheduling of scheduled debt service and accumulated external payments arrears. A request has been forwarded to the Paris Club, and approaches have been made to other creditors, including commercial banks. A meeting of the Paris Club is expected to be held soon after Executive Board consideration of Zambia's request for a stand-by arrangement. In the meantime, scheduled repayments of principal and most interest payments have been suspended, with the exception of certain international organizations such as the Fund and the World Bank. It is not possible to indicate precisely at this time what amount of debt relief will be provided during 1983. However, it has been assumed that debt relief equivalent to SDR 373 million would be forthcoming. This includes estimated relief of SDR 195 million in respect of scheduled debt service amounting to SDR 345 million in 1983 (excluding multilateral agencies) and

SDR 178 million through the consolidation and rescheduling of outstanding external arrears, particularly on public sector debt service. Debt relief of this amount would be sufficient to finance the uncovered gap after net use of Fund resources. In view of the critical importance of debt relief to the program, the Zambian authorities will give the highest priority to this matter, and will review with the Fund progress in this area during the mid-term review.

The program also contains restrictions on the contracting or guaranteeing of new external debt on nonconcessional terms. No new debt will be contracted or guaranteed with an original maturity of 1-5 years, nor will there be additional short-term debt under one-year maturity except for trade financing. The contracting or guaranteeing of nonconcessional debt with an original maturity of 1-10 years is otherwise limited to SDR 100 million over the program. The program also provides for a reduction of at least SDR 100 million in external commercial payments arrears, a minimum SDR 30 million of which is to be through cash payments, with the balance through rescheduling of outstanding arrears. The remaining reduction of SDR 78 million in arrears envisaged during 1983 will be in respect of arrears on public debt.

In view of Zambia's difficult foreign exchange situation, the authorities are not yet in a postion to relax existing restrictions on imports for balance of payments purposes, and on payments and transfers for current international transactions, except through the programed reduction in external payments arrears. The authorities are reviewing the 10 per cent levy on sales of foreign exchange for private overseas travel, which was introduced as part of the 1982 budget, so as to eliminate early the resulting multiple currency practice.

3. Fiscal policies

Fiscal policies will provide a major part of the domestic adjustment under the program. The 1983 budget, which was presented to Parliament on January 28, 1983, provides for a significant reduction in the overall deficit through firm restraint on all expenditures as well as additional revenue measures. The budget, as well as the program projections which reflect the staff's detailed review of the original budget provisions, are shown in Table 4. The program projects an overall deficit of K 228 million, equivalent to 5.6 per cent of projected GDP, compared with a 1982 deficit (excluding the payment of accumulated domestic arrears) of K 444 million, or 13.8 per cent of GDP. The program includes a 3 per cent increase in recurrent expenditure and a 12 per cent decrease in capital expenditure, both of which will result in significant reductions in real terms. Given the expected 27 per cent increase in nominal GDP, total expenditure as a percentage of GDP would decline by 9 percentage points. At the same time, new revenue measures are expected to yield an additional K 123 million during 1983 (3 per cent of GDP), which will almost offset the low buoyancy of revenue which is projected as a result of the stagnation in imports and the specific rather than ad valorem nature of excise duties. Total revenue is projected to increase by 25 per cent. The budget provision for capital expenditure has been reduced substantially in 1983 to more closely reflect available resources. This is to be achieved by concentrating expenditure on the completion of ongoing projects. Moreover, for several years actual capital expenditure has been significantly less than budgeted, because of inadequate external resources as well as difficulties in project implementation, and in 1983 this is expected to recur, with actual expenditure (including net lending) estimated at K 190 million, compared with the budget provision of K 233 million. Although the projected decline in foreign financing will mean that the budget will be financed largely through the domestic banking system, recourse to bank financing will be limited to K 150 million in 1983, equivalent to 3.7 per cent of projected GDP, significantly below domestic bank financing during 1982.

A large part of government expenditure is for personal emoluments and other wages. The 1983 budget provides for no general wage increase for government employees and a freeze on the total number of government employees. New recruitment will be restricted to the replacement of essential technical personnel, and only those vacant posts in revenue-raising agencies will be filled. Nevertheless, the wage bill will increase modestly by 6 per cent in 1983, reflecting the final adjustment of wages for lower-paid employees, as announced earlier by the Government, and normal increments. Subsidies will be reduced from K 126.8 million to K 82.8 million under the 1983 budget as a result of the increases in the prices of fertilizer and maize meal, which will be announced by May 1 (paragraph 15 of the Memorandum). Finally, debt relief is expected to lead to a considerable reduction in external interest (and amortization) payments, although the exact contribution cannot be accurately estimated at this time. The Government will not permit any extrabudgetary or net supplementary expenditures during the program.

A major contribution to the additional revenue projected in the budget will come from a new 4 per cent tax on all mineral exports, which will be effective April 1. This tax is designed to ensure a continuous, even if modest, revenue flow from the mining sector, which is Zambia's principal economic resource at present, but which under the existing tax system could utilize previous losses to offset income tax liabilities for a number of years following a return to profitability. Other new revenue measures include sharp increases in excise duties on beer, cigarettes, petroleum products, and soft drinks (Table 8). The sales tax has been raised on a wide range of products and its coverage extended, as have import duties on capital goods and raw materials. In addition to these measures introduced with effect from the announcement of the budget, the Government has introduced legislation to sharply raise various fines, licenses, fees, and stamp duties, and to introduce a road toll on major roads, with effect from April 1.

Table 8. Zambia: Quantitative Impact of Discretionary Revenue Measures Under the Financial Program, 1983

(In millions of kwacha)

	Impact in 1983
Introduction of Mineral Export Tax (April 1, 1983)	30.0
Increase in excise duties on petroleum products, tobacco, beer, soft drinks, and sugar	77.5
Increase in coverage and rates of sales tax	4.6
Increase in coverage and rates of import duties	10.5
Increase in license fees and fines	0.7
Total	123.3

In the attached Memorandum the Government outlines a number of measures to improve efficiency of both expenditure control and revenue collection. It is essential that a better framework for fiscal management be established if the targets of the program are to be achieved. The authorities are aware that a sustained management effort will be required to ensure satisfactory implementation of the 1983 budget, and that a more careful monitoring of budgetary developments will be required to detect and respond to any shortcomings in budget developments.

4. Prices and incomes policies

If the exchange rate and budgetary adjustments outlined above are to lead to a sustained reduction in the existing financial imbalances, it is essential that they be supported by appropriate prices and incomes policies. The extensive price controls and general lack of wage restraint which existed in previous years have resulted in unsustainably high levels of consumption and contributed to the marked deterioration in the balance of payments and the budget. The Government has recently taken a number of major decisions which should assist in establishing appropriate prices and incomes policies.

On December 29, 1982 the general decontrol of wholesale and retail prices was announced 1/. Only three commodities (maize meal, candles, and wheat flour and bread) will continue to be categorized as essential, with price increases subject to prior government approval. The prices of all other commodities can be determined by the enterprises concerned, subject only to ex post review by the Prices and Incomes Commission, which has become operational; the commission's structure and role are described in paragraph 16 of the Memorandum. In practice, the prices of products of parastatal enterprises will be subject to approval by the Board of Directors of ZIMCO, the overall parastatal holding company. Following this decision, the prices of a wide range of commodities, including such sensitive products as rice, sugar, cooking oil, beer, soap, and washing powders, were raised by up to 28 per cent, effective January 8, while the prices of various petroleum products were raised at the same time as the increased excise duties were announced in the budget. These increases also reflected the initial effects of the devaluation on the cost of imported raw materials. Consistent with the policy of economic pricing, and in order to achieve the budgetary objective of reducing subsidies in 1983, the prices of maize meal products and fertilizer will be raised on May 1 by an average of 32 per cent and 62 per cent, respectively, as detailed in paragraph 15 of the Memorandum.

The Prices and Incomes Commission is also expected to develop an appropriate incomes policy to guide future wage negotiations. In addition to the decision not to provide a general wage increase for government employees in 1983, the Government announced at the time of the devaluation of the kwacha that, as a general guideline, wages should not rise by more than 5 per cent in 1983. This policy will not preclude somewhat higher increases for lower-paid workers in view of the particularly sharp increases in the prices of many basic commodities which took place during early 1983. The Government will use its majority shareholding in the parastatal sector to implement this general guideline, and recognizes that it is imperative to restrain wage increases in the mining sector so that the projected financial benefits to the industry of the exchange rate adjustment will be realized.

5. Monetary policies

A major element of the Government's financial recovery program is that the sharp reductions in the previous financial imbalances stemming from public finances and the mining sector will make possible the revitalization of economic activity in the other sectors. Following the devaluation, and

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1/ A few prices outside the retail sector are still covered by existing legislation and are subject to controls, such as electricity tariffs, hotel rates, and producer and input prices in agriculture.

assuming that the export prices and other assumptions in the program are realized, it is projected that the financial position of the mining company will substantially improve during the program period, and no further recourse to the banking system to finance operating losses is envisaged. Under the program there will be no additional credit to the mining sector from the Bank of Zambia. Credit to the private sector is programed to increase by 19 per cent during 1983 (Table 9), which should be sufficient to accommodate any expansion in economic activity after taking account of recent cost and price increases. As already noted, the increase in net credit to the Government by the domestic banking system will not exceed K 150 million in 1983. As a result, there will be a moderate expansion of 11 per cent in total domestic credit during 1983, and, after allowing for the loss in net foreign assets as a consequence of the projected balance of payments deficit, broad money is estimated to increase by 14 per cent, about half the projected increase in nominal GDP. The increases in domestic credit and money projected under the program will be substantially less than those recorded in 1982, and are consistent with a restrictive monetary policy.

The authorities increased interest rates effective January 7, 1983, as a part of the program's monetary policies. Most interest rates have risen, with the overdraft and maximum lending rate now set at 13 per cent, compared with the previous rates of 9.5 per cent and 12 per cent, respectively. Deposit rates were also increased by up to one percentage point to 8 per cent in the case of savings accounts, and now range from 5.5 per cent to 10 per cent, depending on the maturity of the deposit. The Bank of Zambia's rediscount rate was raised from 7.5 per cent to 10 per cent, while the Treasury bill rate was increased from 6 to 7.5 per cent. Interest rate policy will continue to be reviewed under the program.

6. Development policies and medium-term outlook

The major elements of the Government's program in 1983 are aimed at restraining overall demand to available resources and at restoring financial stability to the economy. The Government remains committed, however, to the restoration of sustained economic growth, and recognizes that this can only be achieved in the medium term through diversification of the economy away from the traditional mining sector, whose remaining life is around 30 years. The major economic alternatives to mining are agriculture and manufacturing based particularly on local raw materials. The financial incentives for agriculture have been improved significantly during recent years, both through higher producer prices and lower taxation. The Government's objective is to set producer prices that are approximately at world price equivalents. Producer prices were raised by between 13 per cent (maize and tobacco) and 42 per cent (rice) for the current 1982/83 season. In establishing prices for the coming 1983/84

Table 9. Zambia: Monetary Survey and Changes, 1979-83

	1979	1980	1981	1982	1983 Proj. Jan. 1/	1983 Proj. Dec.
	(In millions of kwacha; end of period)					
Net foreign assets	642.2	-860.2	-1,147.4	-1,402.4	-1,753.0	-1,881
Monetary authorities	(-320.8)	(-370.5)	(-660.2)	(-646.8) 2/	(-808.5)	(-1,152
Banking system	(37.7)	(-17.4)	(25.5)	(-70.1)	(-87.6)	
Payments arrears	(-359.1)	(-472.3)	(-512.7)	(-685.5)	(-856.9)	(-728
Net domestic assets	1,514.6	1,822.5	2,243.7	2,859.9	2,859.9	3,170
Claims on Government (net)	(1,108.9)	(1,330.7)	(1,494.5)	(1,950.3)	(1,950.3)	(2,100
Credit to private sector	(478.1)	(500.4)	(760.3)	(899.6) 2/	(899.6)	(1.070
of which: Bank of Zambia claims on mining companies	(76.0)	(57.0)	(57.0)	(160.5)	(160.5)	(160
Other assets (net)	(-72.4)	(-8.6)	(-11.1)	(10.0)	(10.0)	(.
Assets = Liabilities	872.4	962.3	1,096.3	1,457.5	1,106.9	1,289
Broad money	832.2	907.1	978.7	1,314.3	1,314.3	1,497
Money	(513.3)	(509.4)	(561.4)	(688.1)	(688.1)	(.
Quasi-money	(318.9)	(397.7)	(417.3)	(626.2)	(626.2)	(.
SDR allocation	40.2	55.2	70.0	70.0	87.5	87
Revaluation of official gold holdings 3/	--	--	47.6	73.2 2/	73.2	73
Revaluation gains/losses (-) 4/	--	--	--	--	-368.1	-368
	(In annual percentage changes)					
Net domestic assets	2.1	20.3	23.1	27.5		1(
Claims on Government (net)	6.1	20.0	12.3	30.5		
Credit to the private sector	13.1	4.7	51.9	18.3		1'
of which: Bank of Zambia claims on mining companies	-33.3	-25.0	--	181.6		
Broad money	30.2	9.0	7.9	34.3		1

Sources: Bank of Zambia, Quarterly Financial and Statistical Review; and staff estima

1/ Adjusted for devaluation of the kwacha by 20 per cent in terms of the SDR, effecti January 7, 1983.
2/ Provisional.
3/ Official gold holdings were revalued at market-related prices on December 31, 1981 198[illegible].
4/ Includes valuation losses on net foreign assets, including gold holdings and payme [illegible] and SDR allocation.

season, the authorities will also take into account recent price increases for inputs such as fertilizer. In the manufacturing and commercial sectors, the parastatal holding company ZIMCO is coordinating a broad effort to reduce costs and improve managerial efficiency. This has already resulted in the improved profitability of several companies, particularly in the industrial group. The IBRD is assisting ZIMCO's efforts through an industrial incentives study currently under preparation.

It is also essential that the mining sector continue to improve efficiency and reduce costs. The merger on March 31, 1982 of the two mining companies to form Zambia Consolidated Copper Mines, Ltd. (ZCCM) provided the first step toward improving efficiency and avoiding duplication in certain important cost categories such as capital expenditure, administration, and stores holdings. Although the full effects of the benefits of the merger will only be realized over several years, the company has established an integrated administration and is actively implementing the reorganization. In response to the continuing decline in world metal prices, and the resulting losses incurred by ZCCM, in May 1982 the company announced a comprehensive plan to reduce costs and raise additional revenues. This plan included measures to raise annual production by 30,000 tons through the redirection of mining operations toward higher-grade ore deposits; a review of proposed capital expenditure and purchase commitments for stores and spare parts that had been developed independently by the two former companies; measures to reduce actual inventories of supplies and spare parts through better management procedures; reduction in labor costs by a decline of 500 in the expatriate labor force through nonrenewal of contracts and a decline in the local labor force through attrition, as well as strict limitations on overtime and other personnel expenditures; a reduction in the stocks of refined copper in transit; and other administrative and technical savings. These measures were reinforced in specific areas in November 1982, including a further reduction by 200 in the expatriate labor force and a targeted 4 per cent reduction in the local Zambian payroll from the level on April 1, 1983.

The original plan is budgeted to save the company K 277 million in 1982/83 and a further K 50 million in 1983/84, while the measures adopted in November are budgeted to lead to additional cash savings of K 97 million in 1983/84. Overall progress with the cost-savings plan to date has been better than budgeted, with gross cash savings of K 307 million achieved during the nine months ended December 1982. Unfortunately, during the same period sales proceeds were K 140 million less than budgeted due to poor metal prices, so that the net benefit to the company's cash flow was only K 167 million. Savings in excess of the budgeted level have been achieved in most individual cost categories, with only production and actual stores holdings worse than expected. The shortfall in production was largely the result of an accident at the Nkana smelter in November, which temporarily interrupted smelting and refining operations; full operations have now been restored, and monthly production in January again exceeded 50,000 tons of refined copper. Actual inventories have not been reduced as quickly as planned because of the dual effect of significant savings in the consumption of materials but continued deliveries of stores under past purchase commitments, which by necessity have a large lead time because of Zambia's landlocked position. However, purchase commitments have been reduced below the budgeted level, and greater reductions in actual inventories are expected in the coming months as deliveries under past purchase commitments end.

Despite this encouraging progress, the company incurred an overall loss of K 151 million during the nine months ended December, largely because of depressed revenues. For 1982/83 as a whole, a loss of K 145 million is currently projected (Table 10), excluding substantial balance sheet losses as a result of the recent devaluation of the kwacha. However, the devaluation will lead to a significant improvement in ZCCM's financial position in 1983/84, and the company estimates the net benefit to the profit and loss account will be K 186 million, after taking into account the cost-savings measures outlined above. It is currently projected that ZCCM will incur a modest loss after tax in 1983/84, largely as a result of the new mineral tax, which is estimated to cost the company K 54 million; after taking into account capital expenditure and borrowing, as well as other factors affecting cash payments and receipts, a positive cash flow is forecast for 1983/84. The company is committed to improving the efficiency of its operations further and can be expected to adopt additional measures that may be necessary to improve its overall financial position.

The medium-term balance of payments outlook for Zambia depends crucially on the future course of copper prices. Tentative balance of payments projections and a projected external debt profile for Zambia up to 1986 are set out in Table 11. The projected export receipts are based on world market copper prices assumed under the program for 1983 and currently projected by the Fund's Commodities Division for 1984, with modest price increases thereafter. The scenario in the table indicates that the current account deficit could be reduced substantially if there continues to be restraint on imports as well as on net service payments other than scheduled interest on external debt. Net capital inflows excluding any debt relief, are projected to improve modestly over the four-year period due to increased long-term borrowing by the Government and the mining sector, particularly from the World Bank Group, for capital rehabilitation and in support of economic diversification. The overall balance of payments is thus projected to register a slight surplus in 1986. After taking account of the proposed stand-by arrangement and scheduled repurchases to the Fund but excluding further debt rescheduling as well as further reductions in external payments arrears, the uncovered financing gap would decline to about SDR 100 million in 1985-86.

Scheduled debt service payments, including to the Fund and those estimated to result from new borrowing, remain large throughout the period up to 1986. Total payments rise from just under SDR 600 million in 1983 to

Table 10. Zambia: ZCCM, Consolidated Profit and Loss Account, 1980/81-1983/84 1/

(In millions of kwacha)

	1980/81	1981/82	1982/83 Proj.	1983/84 Proj.
Sales	1,093.3	977.1	999.2	1,341
Of which: copper	(968.8)	(867.5)	(908.0)	(1,221)
Cost of sales	1,082.7	1,007.7	1,055.1	1,207
Profit/loss (-) on sales	85.6	-105.6	-55.9	134
Other costs 2/	51.3	65.3	84.7	131
Profit/loss (-) before taxation	34.3	-170.9	-140.6	3
Profit/loss (-) after taxation 3/	56.5	-173.6	-145.0	-55 4/
Memorandum item:				
Cash flow (outflow -)	-91.6	-132.7	14.5	43

Source: Zambia Consolidated Copper Mines, Ltd.

1/ The ZCCM fiscal year is April 1-March 31.
2/ Primarily interest costs.
3/ Including taxation recoverable from the carry-back of losses against profits for the previous year.
4/ Including payment of the new 4 per cent minerals tax to take effect April 1, 1983.

Table 11. Zambia: Medium-Term Balance of Payments and External Debt Outlook, 1982-86

	1982 Prel.	1983 Projected	1984 Projected	1985 Projected	1986 Projected
	(In millions of SDRs)				
Exports, f.o.b.	844	963	1,177	1,468	1,589
Imports, c.i.f.	-962	-841	-906	-1,117	-1,223
Trade balance	-118	122	271	351	366
Invisibles (net)	-425	-360	-368	-383	-393
Of which: investment income 1/	(-226)	(-217)	(-225)	(-230)	(-235)
Current account	-543	-238	-97	-32	-27
Capital (net) 1/ 2/	16	-57	-15	25	55
Overall balance	-527	-295	-112	-7	28
Financing					
Use of Fund resources (net)	-52	150	-29	-95	-134
Purchases	(34)	(264)	(45)	(--)	(--)
Repurchases	(-86)	(-114)	(-74)	(-95)	(-134)
Payments arrears (decrease -)	447	-228)			
Other (net) (increase -) 3/	132	373)	141	102	106
Debt service					
Scheduled payents on existing debt	341	383	403	397	367
Estimated payments on new borrowings 4/	--	10	73	105	218
Payments to the Fund 5/	135	174	150	172	211
Total	476	567	626	674	796
	(In per cent)				
Debt service ratio 1/					
Total	50.4	53.3	48.3	43.3	47.1
Excluding the Fund	36.1	37.0	36.7	32.2	34.6
Memorandum item:					
Market price of copper (US$/lb.)	0.67	0.76	1.05	1.15	1.25

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

1/ Prior to debt rescheduling.
2/ Includes SDR allocation, valuation adjustments associated with gold revaluation, and errors and omissions.
3/ Includes debt relief in 1983.
4/ Assumes a grace period of 3.5 years, repayments in 4 years thereafter in equal instailments, and an interest rate of 10 per cent.
5/ Includes proposed stand-by arrangement.

almost SDR 800 million by 1986, with the debt service ratio declining only modestly over the period from 53.3 per cent in 1983 to a projected 47.1 per cent in 1986. Continuing debt service obligations of this magnitude will place a severe strain on Zambia's balance of payments, even after allowing for the projected increase in export receipts and continuing restraint on imports. The estimated debt relief in 1983 is expected to reduce the debt service ratio in that year to 36 per cent. It is likely, therefore, that Zambia will need to seek further debt relief after 1983, in order to mitigate the effects on the balance of payments of the large debt service payments.

7. Performance criteria and review

The proposed stand-by arrangement includes as performance criteria ceilings on net domestic assets, net credit to the Government (both of the banking system), Bank of Zambia credit to the mining company (ZCCM), external commercial payments arrears, and the contracting or guaranteeing of new nonconcessional debt in the maturity range of 1-10 years, as specified in Table 12. The ceilings for June, September, and December are indicative and will be reviewed during a mid-term review in the light of the effects of debt rescheduling on the budget and the balance of payments, actual and prospective copper prices, and the seasonal credit needs of the agricultural sector on the basis of the 1983 agricultural crop. The usual performance criteria relating to the exchange and payments system will apply.

As mentioned above, there will be a comprehensive review of progress with the Fund under the program by end-June 1983, and prior to the purchase based on the April ceilings. In particular, this review will require understandings to be reached with the Fund on performance criteria for the remaining period of the program, as well as on exchange rate and interest rate policies. Other topics of the review will include progress on debt rescheduling, budgetary performance, credit policies, and prices and incomes policies.

8. Relations with the World Bank

Over the past years the Bank has been extending a number of IBRD loans and IDA credits to different economic sectors within Zambia; the current status of these loans and credits is shown in Appendix IV. More recently, the Bank and the Zambian Government have reached agreement on a Memorandum on Development Objectives and Policies, which sets out a framework for structural adjustment over the next several years. Within this framework, the Bank is assisting the Government with a number of detailed studies, including a forward budgeting study (with Fund technical assistance), an

Table 12. Zambia: Quantitative Performance Criteria for 1983 1/

(End of period, except as otherwise specified)

	1982 Prov. actual	1983 April	1983 June 2/	1983 Sept. 2/	1983 Dec. 2/
		(In millions of kwacha)			
Net domestic assets of banking system	2,859.9	2,990.8	3,045.8	3,115.8	3,170.8
Net claims on Government of banking system	1,950.3	2,025.3	2,055.3	2,075.3	2,100.3
Bank of Zambia credit to ZCCM	160.5	170.5 3/	170.5	165.5	160.5
		(In millions of SDRs)			
External commercial payments arrears 4/	669.3	669.3 5/	589.3	579.3	569.3
New external borrowing contracted or guaranteed by the Government (cumulative):					
1-10 years maturity	...	___	___	___	100
1-5 years maturity	...	___	___	___	--

Source: Appendix II.

1/ For precise definitions see Attachments I and II to Appendix II.
2/ Indicative and subject to review by mid-1983.
3/ Estimated actual.
4/ Incorporates a minimum cash reduction of SDR 30 million and a reduction through debt relief of SDR 70 million assumed to be implemented by end-June but subject to the review of progress on debt rescheduling.
5/ Excluding increases on account of interest on overdue payments pending rescheduling.

energy sector assessment, and an industrial incentives study, which are expected to identify detailed areas for future cooperation between Zambia and the Bank. In addition, the Bank has recently completed an appraisal and suggestions for strengthening the Planning Division of the Ministry of Agriculture and Water Development and has initiated an agricultural export and import substitution strategy study. The IBRD has also been discussing for some time a copper sector rehabilitation loan of about US$70 million, which would enable the importation of essential capital equipment and spare parts for the mines. Technical discussions have reached an advanced stage, and the loan is expected to be presented to the Bank Board during the coming months. The IFC has recently approved an investment of US$30 million, as part of a US$250 million investment by a consortium, for a Tailings Leach Stage 3 Project which will increase finished copper production by about 35,000 tons per annum when operational.

The Zambian authorities have requested the Bank to chair a meeting of the Consultative Group for Zambia, which has met only once in 1978. A number of preparatory steps will have to be completed prior to the meeting, including the preparation of a suitable investment program by the Zambian Government; as these preparations are likely to be time consuming, the meeting is unlikely to take place until some time in late 1983. A Bank economic mission currently in Zambia to clarify some issues related to the Memorandum mentioned above and to hold preliminary discussions on the forward budgeting study will also review with the Government the preparations needed for this meeting.

VI. Staff Appraisal

For a number of years Zambia has incurred major financial imbalances, stemming mainly from a prolonged decline in its terms of trade and the inability to adjust economic and financial policies to curtail real expenditures, especially on consumption, in line with the lower level of real income. Under the medium-term program introduced in 1981, which was supported by an extended arrangement with the Fund, encouraging progress was made for some time to redress the situation. However, much lower than expected export prices for copper and cobalt, combined with insufficient program implementation in the latter part of 1981, made it impossible to achieve the original program targets, and the extended arrangement was canceled in July 1982.

Both the balance of payments and the fiscal situation continued to worsen in 1982, as the terms of trade deteriorated further and adequate adjustment measures were not taken. Reflecting the unfavorable world market conditions, the financial position of the mining company deteriorated further, requiring large amounts of commercial and central bank financing to cover its operating losses. Zambia now faces a financial crisis of serious proportions: the shortage of foreign exchange is critical, outstanding external payments arrears, including for the first time arrears on public debt, are very large, and access to foreign borrowing is extremely limited.

The Government of Zambia recognizes the seriousness of the situation and has recently taken a number of measures in order to arrest the financial decline and to provide a basis for an eventual economic recovery, in support of which it has requested support from the Fund. These measures include a 20 per cent devaluation of the kwacha in SDR terms, which should assist in improving the balance of payments as well as the financial position of the mining company. To preserve these gains, it will be necessary to adopt a more flexible exchange rate policy in order to avoid the past delays in exchange rate adjustment which resulted in large, discrete changes at infrequent intervals. A more flexible exchange rate policy would also assist with the objective of strengthening the country's competitiveness thereby enhancing the necessary process of diversification away from Zambia's dependence on the mining sector. In particular, this should enable a sustained improvement in domestic financial incentives for agriculture as well as provide increased opportunities for manufacturing activities which emphasize the use of domestic raw materials. At the same time, the successful efforts undertaken so far to reduce costs and improve efficiency in mining operations will have to be pursued with determination in order to maximize output and revenues from this sector.

Of particular importance for the success of the program are the measures aimed at restraining domestic consumption, which had risen to an unsustainably high level, through a reduction in the overall budget deficit, supporting prices and incomes policies, and cautious monetary policies. Budgetary policy is a key element in this adjustment process. In this context, sustained restraint on expenditure is the most essential factor to strengthen government finances. Specifically, this requires firm control of personnel expenditure, timely price actions to reduce budgetary subsidies, and firm expenditure controls, as well as adequate monitoring mechanisms to prevent expenditure from exceeding the approved 1983 appropriations. This will be particularly difficult in an election year and in a period of rapidly rising prices, but success in this area is crucial for the overall stabilization effort.

The decision of the Government to decontrol prices at the wholesale and retail levels reflects the determination of the authorities to face economic realities. Despite considerable opposition, the policy of "economic pricing" should be pursued, in order to strengthen the financial position of the private and parastatal sector, to restrain consumption and restore savings, and to improve the allocation of resources. It will have to be accompanied by an appropriate incomes policy aimed at preserving the beneficial financial effect of the devaluation and aligning future wage increases more closely with gains in productivity. The announced general guideline to limit wage increases in the private and parastatal sector to 5 per cent during 1983 will have to be implemented with determination.

In view of the magnitude of the external imbalance and Zambia's scheduled debt service obligations, estimated at 53 per cent of receipts from exports and services in 1983, the necessary adjustment cannot be achieved by domestic efforts alone. It is thus essential for Zambia to reach an early agreement with its creditors on rescheduling a large part of the payments falling due, as well as on a consolidation and rescheduling of outstanding external payments arrears. As part of the comprehensive review to be completed before the end of June, progress in this area will be assessed. In view of this, the initial purchase on approval of the stand-by arangement has been scaled down, and in addition, the purchase linked to performance criteria for end-April 1983 will depend on the satisfactory conclusion of this review.

Although the existing foreign exchange situation does not permit a significant easing of restrictions, other than the programed reduction in external payments arrears, the authorities should take steps to reduce the reliance on restrictive practices as the balance of payments improves. In particular, the continued reduction in external payments arrears through rescheduling and cash payments is essential to a strengthening of external confidence and improvement of Zambia's creditworthiness. Restrictions on payments and transfers for imports; travel, medical, and educational expenditures; and dividends and profits, as well as payments arrears on current international transactions are subject to approval under Article VIII. In view of the authorities' intention to eliminate them as soon as the balance of payments situation permits, the staff recommends their approval until June 30, 1984, or the next Article IV consultation, whichever comes first. The multiple currency practice arising from the existing 10 per cent levy on sales of foreign exchange for private overseas travel should be removed early. In the meantime, a temporary approval of this practice until the completion of the mid-term review is recommended.

The staff believes that the policies set forth in the attached letter of February 25, 1983, requesting a stand-by arrangement in the amount equivalent to SDR 211.5 million, represent an important step toward strengthening Zambia's domestic financial position and balance of payments and merit Fund support. However, strenuous and prolonged efforts will be required over a period of several years, which will need also to be supported by creditors and donors.

Proposed Decisions

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

I. 1982 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.

II. 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 1983.

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

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

ZAMBIA - Stand-By Arrangement

Attached hereto is a letter and annexed Memorandum dated February 25, 1983 from the Prime Minister and Minister of Finance of Zambia requesting a stand-by arrangement and setting forth: (a) the policies and objectives that the authorities of Zambia intend to pursue for the period of this stand-by arrangement; and (b) understandings of Zambia with the Fund regarding a review that will be made of progress in realizing the objectives of the program and of the policies and measures that the authorities of Zambia will pursue for the remaining period of this stand-by arrangement.

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

1. For a period of 12 months from   1983, Zambia will have the right to make purchases from the Fund in an amount equivalent to SDR 211.5 million, subject to paragraphs 2, 3, 4, and 5 below, without further review by the Fund.

2. (a) Purchases under this arrangement shall not, without the consent of the Fund, exceed the equivalent of SDR 31.5 million until June 15, 1983, SDR 76.5 million until August 15, 1983, SDR 121.5 million until November 15, 1983, and SDR 166.5 million until February 15, 1984.

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

3. Purchases under this stand-by arrangement shall be made from ordinary resources until purchases reach the equivalent of SDR 8,780,728, then from ordinary and borrowed resources in the ratio of 1:1.2, until purchases under this arrangement reach the equivalent of SDR 138,557,813; and then from borrowed resources only provided that any modification by the Fund of the proportions of ordinary and borrowed resources shall apply to amounts that may be purchased after the date of modification.

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

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

(i) the target for reduction in external payments arrears described in paragraph 19 and Attachment II of the annexed Memorandum, or

(ii) the limit on total net domestic assets described in paragraph 17 and Attachment I of the annexed Memorandum, or

(iii) the limit on net credit to the Government described in paragraph 17 and Attachment I of the annexed Memorandum, or

(iv) the limit of Bank of Zambia credit to ZCCM described in paragraph 17 and Attachment I of the annexed Memorandum
has not been observed or,

(b) After June 15, 1983, until the review contemplated in paragraph 4 of the attached letter is completed and suitable performance criteria have been established, or while such performance criteria, having been established, are not being observed, or

(c) If Zambia fails to observe the limits on the contracting of new public and publicly guaranteed foreign indebtedness described in paragraph 20 of the attached Memorandum, or

(d) If Zambia

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

(ii) introduces or modifies multiple currency practices, or

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

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

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

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

Zambia and understandings have been reached regarding the circumstances in which such purchases can be resumed.

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

7. The value date of a purchase under this stand-by arrangement involving borrowed resources will be normally either the 15th day or the last day of the month, or the next business day if the selected day is not a business day. Zambia will consult with the Fund on the timing of purchases involving borrowed resources.

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

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

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

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

10. During the period of the stand-by arrangement Zambia shall remain in close consultation with the Fund. These consultations may include correspondence and visits of officials of the Fund to Zambia or of representatives of Zambia to the Fund. Zambia shall provide the Fund, through reports at intervals or dates requested by the Fund, with such information as the Fund requests in connection with the progress of Zambia in achieving the objectives and policies set forth in the attached letter and annexed Memorandum.

11. In accordance with paragraph 5 of the attached letter, Zambia will consult the Fund on the adoption of any measures that may be appropriate at the initiative of the Government or whenever the Managing Director requests consultation because any of the criteria in paragraph 4 above

have not been observed or because he considers that consultation on the program is desirable. In addition, after the period of the arrangement and while Zambia has outstanding purchases in the upper credit tranches, the Government will consult with the Fund from time to time, at the initiative of the Government or at the request of the Managing Director, concerning Zambia's balance of payments policies.

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

Lusaka, February 25, 1983

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

Dear Mr. de Larosière:

In March 1981 the Government of Zambia adopted a medium-term adjustment program covering the three-year period 1981-83, which was supported by an extended arrangement in the amount of SDR 800 million approved by the Fund on May 8, 1981. The principal objectives of the program were to promote the resumption of a modest rate of economic growth through the stimulation and diversification of economic activity, to restore domestic financial equilibrium, particularly in public and parastatal enterprises' finances, and to achieve a sustainable external position over the period of the program. Implementation of the medium-term program began in early 1981. The 1981 budget included a number of measures to raise additional revenues and contain, or actually reduce, expenditures in order to achieve a sharp reduction in the overall deficit and the use of domestic bank financing. Despite setbacks during the year, particularly in respect of revenues due to stagnation in economic activity, most of the program's fiscal targets were achieved. Action on domestic pricing policy was also initiated with the approval of substantial increases in producer prices for the 1981/82 crop year, and in the final consumer prices for a wide variety of products including maize meal products, sugar products, and bread. Interest rates were raised in March 1981, and ceilings placed on lending by commercial banks to ensure compliance with the overall credit ceilings established under the extended arrangement.

Notwithstanding these actions, progress during 1981 became increasingly difficult as exogenous factors deteriorated. In particular, a sharp decline in the price of copper resulted in increasingly severe pressure on the balance of payments and mounting losses by the mining companies, which had to be financed largely through the domestic banking system. The balance of payments deficit widened sharply from that targeted in the program. The deficit was financed by purchases of SDR 359.3 million from the Fund, which included the SDR 300 million available in the first year of the extended arrangement and a drawing of SDR 59.3 million under the Fund's compensatory financing facility, and a further increase in external payments arrears.

As a consequence, not all performance criteria at the end of December 1981 could be met, and in the cases of domestic credit and external payments arrears the relevant ceilings were exceeded. Moreover, despite a sizable increase in value added by the agricultural sector reflecting a record crop for maize (the staple food item), real GDP stagnated in 1981, compared with a growth target of 5 per cent in the extended arrangement, as a result of a sharp decline in the mining sector and stagnation in manufacturing and commerce.

In the light of actual and prospective developments in the international economy, it became apparent that the objectives of the extended arrangement could no longer be achieved in the program period, and the arrangement was cancelled on July 3, 1982. The most urgent task now facing the Government is to halt the severe deterioration in the internal and external imbalances which has occurred in 1982. Externally, the prospective balance of payments gap in 1983 is of a magnitude that clearly cannot be financed from available sources, and, consequently, additional corrective measures have been taken. Even with the successful implementation of these measures, there is expected to be little improvement in the Zambian economy in the immediate future, and the balance of payments will continue to record a sizable deficit. Accordingly, we request that the Fund, in support of the Government's financial recovery program, approve a one-year stand-by arrangement in the amout of SDR 211.5 million.

The economic and financial policies that have been adopted under the program to be supported by a new stand-by arrangement are described in the attached "Memorandum on the Economic and Financial Policies of Zambia". The Memorandum sets out the principal objectives of the program, the supporting policy measures that have been implemented, and performance criteria for the budget, credit, external debt and external payments arrears for April 1983. In view of the importance of external debt relief to the successful implementation of the program, we have already initiated contacts with our creditors. We intend to review with the Fund progress under the program, including in particular progress toward debt rescheduling, wage restraint and price policy, budgetary performance, and the generation of new external assistance before the end of June, and to reach understandings with the Fund on performance criteria for the remaining period of the program, as well as on the exchange rate and interest rate policies.

The Government believes that the policies and measures set forth in the attached Memorandum are important steps to achieve the objectives of the program, but will take any further measures that might become necessary for this purpose. Zambia will consult with the Fund in accordance with the policies of the Fund, and will provide the Fund staff with all relevant information in connection with the progress being made in achieving the program's objectives.

Yours faithfully,

/s/

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

cc: His Excellency the President,
State House,
LUSAKA

Memorandum on the Economic and Financial Policies of Zambia

1. The principal objectives of the financial recovery program that has been adopted by the Government are to restore financial stability in the economy, particularly in public finances and the mining sector, to consolidate and restructure existing payment schedules for outstanding external debt as well as external payments arrears, and to halt the deterioration in the balance of payments and contain the overall deficit to a level that can be financed from available external resources. In order to achieve these objectives the Government has adopted a comprehensive set of policies which are outlined in detail in this memorandum. These policies are aimed primarily at the reduction of domestic demand, particularly consumption expenditure which has continued at a high level in real terms during recent years despite a decline in the real output of goods and services. However, the Government remains committed to the restoration of economic growth through structural diversification of the economy, and to the need to achieve balance of payments viability over the medium term. In this regard, the Government will be guided by the need to provide adequate economic incentives for production in agriculture and of locally manufactured exports, to enhance the international competitiveness of the economy, and to implement measures aimed at raising productivity in the mining sector over the medium term.

2. Economic activity has stagnated over the past three years, in part reflecting the adverse international economic environment. It is projected that real GDP will not record significant growth in 1983. Agricultural output is expected to remain below normal because of inadequate rainfall in many parts of the country in the last two years, which has necessitated substantial imports of maize (the staple food item). Value added by the mining sector is expected to be little changed with copper production being maintained at a level of about 615,000 tons. A continued scarcity of foreign exchange resources and the reduction in real disposable income resulting from implementation of the program will inhibit expansion in manufacturing output and commercial activities. Prices are expected to rise rapidly as a result of measures taken by the Government, with consumer prices projected to increase by around 25 per cent on an annual basis in 1983, compared with an estimated increase of 15 per cent in 1982.

3. The balance of payments will remain under severe pressure in 1983. The price of copper, which accounts for almost 90 per cent of Zambia's export receipts, is expected to average 76 U.S. cents per pound compared with an average world market price of 67 U.S. cents per pound in 1982. Demand for cobalt, Zambia's other major export item accounting for a further 4 per cent of export receipts, will continue to be depressed as a result of international economic conditions, and the average price is expected to be around US$6 per pound. Without additional restraint on imports and payments for services, therefore, the current account deficit could reach a level not substantially different from that in 1982, when it continued to widen to SDR 543 million, equivalent to 17 per cent of estimated GDP.

The overall deficit in 1982 was SDR 527 million, and was financed largely by a further increase in external commercial payments arrears of SDR 169 million, as well as new arrears on external public and other debt provisionally estimated at SDR 278 million. Since external payments arrears have had undesirable consequences for Zambia's international creditworthiness, and additional external funds of the magnitude required are unlikely to be forthcoming, the Government has adopted the following measures in order to reduce the balance of payments gap to a magnitude that can be financed from available sources, while also providing for some reduction in external arrears.

4. On January 7, 1983, the Zambian kwacha was devalued by 20 per cent in terms of the SDR; the kwacha is now pegged to the SDR at a rate of K 1 = SDR 0.781049. While the nature of Zambia's principal exports, and especially the fact that their prices are set in internationally competitive markets, preclude an immediate improvement in foreign exchange receipts as a result of the devaluation, the increased cost of imports and payments for services will act to restrain the level of imports and thereby benefit the balance of payments. In particular, imports of goods for which existing supplies within Zambia are adequate, or which can be produced domestically with a real saving in foreign exchange, are projected to decline in volume following the devaluation. Payments for services, in particular overseas travel and educational expenses which increased sharply in recent years, are expected to decline. It should be emphasized that devaluation of the kwacha is expected to stimulate the diversification of economic activity in the medium term, especially toward production for export. In particular, it is hoped that by offsetting a part of the substantial cost disadvantage that exists in the production of nonmineral exports, such as tobacco and cotton lint, production of these and other products can be stimulated so that exports become more diversified and less dependent on one or two metals.

5. The Zambian authorities will closely monitor exchange rate developments during the program period. In particular, because of the severe economic and social costs of infrequent and large adjustments of the exchange rate, the authorities are considering proposals which would allow greater flexibility in the determination of the rate. The Government will reach understandings with the Fund on exchange rate policy by the time of the mid-term review of the program referred to in paragraph 4 of the covering letter.

6. A number of institutional measures have been implemented in support of the exchange rate adjustment, which are aimed at strengthening the foreign exchange allocation system. New arrangements for the allocation of foreign exchange and import licenses have been adopted. The new arrangements differ from earlier procedures in that while previously the Ministerial Foreign Exchange Committee met almost weekly to approve import licenses, the present procedures will only require a Ministerial Committee to meet quarterly to receive reports from a technical committee of officials,

who will be responsible for the issue of import licenses strictly in accordance with the available resources as notified by the Bank of Zambia on the basis of a monthly foreign exchange budget. In accordance with the priority listing established for all import and service payments, the Government will continue to restrict official travel abroad. It is the Government's intention that such permission will be given only when the purpose is of clear benefit to Zambia.

7. A potentially important contribution to overcoming the serious balance of payments difficulties faced by Zambia will be the recently announced decontrol of emerald mining, and the strengthening of the Reserve Minerals Corporation (RMC) through the injection of foreign capital and management. Decontrol will allow Zambian nationals to legally possess emeralds, although mining will be subject to the granting of a license and all sales will have to be made to RMC at the equivalent of the international market price. The Corporation also will take a leading role in mining in certain restricted areas. These measures are expected to expand and redirect existing trade in emeralds through official channels, and, over time, to increase substantially foreign exchange receipts.

8. Even after taking account of the effect of the foregoing measures in terms of savings in foreign exchange, there will be insufficient foreign exchange receipts in 1983 to meet essential import and service payments and also permit full payment of scheduled debt service on public and publicly guaranteed external debt. Debt service, including to the IMF and other multilateral institutions, is provisionally estimated to be SDR 567 million in 1983, equivalent to 53 per cent of exports of goods and nonfactor services. Consequently, the Government has decided to seek a consolidation and rescheduling of Zambia's external debt service and accumulated external payments arrears. A request has been forwarded to the Paris Club, and approaches have been made to other creditors. It is not yet possible to indicate with precision the amount of relief from debt service payments which can be obtained in 1983. However, it is expected that debt rescheduling will enable significant savings in foreign exchange during the program period, which together with the other measures adopted under the program should close the unfinanced balance of payments gap in 1983. In view of the critical importance of debt relief to the program, the Zambian authorities are giving the highest priority to efforts in this direction, and will review with the Fund progress on rescheduling during the mid-term review referred to in the covering letter. The Zambian authorities recognize that debt rescheduling provides only temporary relief to the balance of payments, and should not be allowed to weaken efforts at attaining medium-term balance of payments viability.

9. The exchange rate adjustment that has been announced will improve significantly the financial position of the mining sector, and thereby contribute to the restoration of domestic financial stability. The financial position of Zambia Consolidated Copper Mines, Ltd. (ZCCM), which is responsible for most mining activity in Zambia, has deteriorated sharply

as a result of depressed metal prices and weak demand for cobalt. In the 1981/82 financial year (April-March) there was a loss of K 173.6 million. In response to this loss and the further decline in metal prices during 1982, ZCCM has adopted a comprehensive plan aimed at reducing costs, increasing productive capacity, and improving efficiency in the mining sector. The merger of Nchanga Consolidated Copper Mines, Ltd. and Roan Consolidated Mines, Ltd. to form ZCCM was the first step under this plan. The merger is expected to lead to significant savings in costs over the coming years, particularly as a result of the reduction in administrative overhead and improved efficiency in management. The cost saving measures adopted during 1982 included the redirection of mining operations toward higher grade ore sources, which is expected to raise annual production by about 30,000 tons; a review of capital expenditure and purchase commitments for stores and spare parts that had been adopted independently by the two former companies in order to rationalize combined operations; reduction in labor costs through a reduction by 700 in the expatriate labor force, about 500 of whom have been discharged through nonrenewal of contracts, a decline of at least 4 per cent in the local work force through natural wastage, and strict limitations on overtime and other personnel expenditures; as well as other technical and administrative savings. These measures were budgeted to yield savings of K 277 million in 1982/83, and progress during the nine months ended December 1982 indicates gross savings of K 307 million, which, despite lower sales proceeds because of weakening metal prices, was nevertheless in excess of budget. Despite this encouraging progress, it is forecast that ZCCM will incur a further loss of K 145 million in 1982/83 (excluding balance sheet losses due to the recent devaluation). The devaluation will lead to a significant improvement in ZCCM's financial position in 1983/84, however, and it is estimated that the net benefit of the devaluation to the mining company will be K 186 million. After allowing for the new mineral export tax of 4 per cent which is expected to cost the company K 54 million, and continued cost savings, it is currently projected that ZCCM will incur a modest loss in 1983/84.

10. Because of the limited remaining life of the mines, the Government is committed to continuing diversification of the economy through improved incentives for agriculture and increased efficiency in the manufacturing sector. Agricultural producer prices have been increased for the 1982/83 crop, with individual increases ranging between some 13 per cent for maize and tobacco and 42 per cent for rice. In addition, new producer prices have been introduced for traditional crops, such as cassava and millet, in order to encourage production by small-scale farmers. The medium-term objective continues to be to obtain producer prices that are approximately at world price equivalents. In setting the producer prices for 1983/84, due account will also be taken of the increases in input costs, in particular of fertilizer. In the manufacturing and commercial sectors there has been a substantial effort coordinated by the parastatal holding company (ZIMCO) to reduce costs and improve managerial efficiency. This has been partly responsible for the improved profitability of many individual companies, particularly in industry. This effort is being assisted by an industrial incentives study undertaken by the IBRD. The IBRD also has assisted the Government in developing its energy policy through an energy sector

assessment, including studies on the oil refinery and on improving efficiency of existing coal mining operations. The Government is committed to a policy of maximum utilization of domestic energy resources, particularly hydro-electricity which is abundant in Zambia.

11. If the exchange rate adjustment is to be effective, both in restraining imports and alleviating the short-term financial position of the mining sector, it will need to be supported by appropriate fiscal, prices and incomes, and monetary policies. A major part of domestic adjustment under the program will fall on fiscal policy. The principal aim of the 1983 budget as presented to Parliament on January 28, is to achieve restraint on consumption expenditure and make available the resources necessary for an adequate level of capital investment and productive expenditure. The containment of recurrent and capital expenditure and substantial new revenue measures will minimize recourse to bank borrowing, which rose sharply to an unsustainable level in 1982. The 1983 budget projects an overall deficit of K 228 million, compared with a 1982 deficit presently estimated at K 444 million, excluding the payment of domestic arrears of K 153 million. The overall budget deficit in 1983 is equivalent to about 6 per cent of projected GDP, compared with a 1982 deficit (excluding the payment of domestic arrears) equivalent to 14 per cent of estimated GDP. Compared with the estimated outcome in 1982, the new budget provides for a 3 per cent increase in recurrent expenditure and a 12 per cent decrease in capital expenditure, both of which will result in significant reductions in expenditure in real terms. Personal emoluments and wages account for a large part of government expenditure, and the new budget provides for no general increase in wages for government employees. However, the wage bill will rise by 6 per cent, reflecting mainly the last of three annual wage adjustments accepted and announced earlier by the Government, which aimed at substantial increases for those employees in the lowest part of the salary scale. A careful enumeration of regular government employees and of temporary and contract employees was made as of December 1982, and the budget provides for a freeze on the total number of government employees in 1983. New recruitment will be restricted to the replacement of essential technical personnel who leave the public service, and the only unfilled posts which may be filled are those in the revenue-raising agencies. Retiring employees in the clerical scales will not be replaced, and temporary and contract employees will not be renewed. An instruction embodying the above provisions has been issued to the Public Service Commission. The provision for subsidies has been reduced from K 127 million in 1982, excluding the payment of arrears of K 29 million, to K 83 million in the 1983 budget, as a result of the price increases for maize and fertilizer set out in paragraph 15 below. All other discretionary categories of current expenditure have been restrained in order to achieve the overall fiscal target. In addition, the proposed debt rescheduling is expected to make a considerable contribution to the reduction in recurrent expenditure for external interest, even after allowing for the effect of the devaluation. The budget estimate for capital expenditure (including net lending) is K 233 million, which is a significant reduction from the 1982 budget provision of K 308 million. However, for a number of years, actual

capital expenditure has been significantly less than what is provided for in the budget, and it is estimated at K 190 million for 1983, compared with K 216 million in 1982. The budget estimate requires K 100 million in domestic financing, which the Government firmly intends will not be exceeded during 1983.

12. The 1983 budget includes new revenue measures estimated to yield revenue of K 123 million, which is equal to about 3 per cent of projected 1983 GDP. The principal contribution to this increase will come from a new 4 per cent tax on mineral exports, which will be effective from April 1, and is designed to ensure a continuous contribution to government revenues by the mining sector. The Government has made a substantial investment in the mining sector which accounts for around 30 per cent of real economic activity, but has received no revenue from the corporate income taxes on this sector during the past two years, because low metal prices have resulted in corporate losses. Moreover, because of the structure of the tax system in Zambia which allows a company to carry forward losses indefinitely, revenue would not be forthcoming through existing taxes for several years following a return to profitability by the company. In order to both curtail consumption and to increase revenue the 1983 budget sharply increased excise duties on beer, cigarettes, petroleum products and soft drinks, and also increased the sales tax rate on many products and increased its coverage. There was also an increase in both the coverage and the rate of the import duty on capital goods and raw materials. In addition, the Government plans to introduce legislation to take effect from April 1, to sharply increase various fines, licenses, fees and stamp duties and to introduce a road toll on major roads. The decontrol of prices is expected to result in a significant increase in revenue as a result of an increase in corporate profits and, consequently, corporate income tax payments. After taking into account the limited amount of net external financing, nonbank domestic borrowing, and likely debt relief, recourse to bank financing will be restricted to K 150 million, compared with K 456 million (including the settlement of domestic arrears) in 1982.

13. There will be a substantial effort to improve the efficiency of both revenue collection and expenditure control, which is expected to contribute toward containing the budget deficit and to establish a better framework for fiscal management. Tax administration will be improved through a variety of measures which include the placement of additional customs officials and officers who audit income tax accounts and nontax collections. There will be an increase in the number of motor vehicles necessary to facilitate investigation and collection efforts. A major effort is to be made by the Ministry of Finance to collect revenues from those agencies which have failed to remit revenue receipts collected by them. As regards expenditures, the use of commitment registers will be reinforced and will be monitored by the Ministry of Finance on a monthly basis. Separate accounts for authorized capital expenditure and recurrent expenditure have been established for each ministry at the Bank of Zambia, which has been instructed by the Minister of Finance not to permit overdrafts on any ministry's account at the Bank. The Government will not permit any extra-budgetary or net supplementary expenditures during the program.

14. In support of the program for financial recovery, the Government has taken a number of measures aimed at establishing an appropriate prices and incomes policy. At the time of the exchange rate adjustment, the Government announced as a general guideline that wages should not rise by more than 5 per cent in 1983. This does not preclude somewhat higher increases for lower-income earners in view of the particularly sharp price increase for many essential commodities early in 1983. The Government will use its majority shareholding in the parastatal sector to implement this guideline, particularly for the mining company, for which it is imperative that wage increases are not excessive if the projected financial benefits of the exchange rate adjustment are to be realized.

15. The Government remains committed to its declared policy of allowing economic pricing to function throughout the economy. In order to accelerate the implementation of this policy, on December 29, 1982 the general decontrol of prices was announced. The number of goods categorized under the Control of Goods Act as essential and requiring Cabinet approval for price increases was reduced to three (mealie meal, candles, flour and bread). The Government has allowed ZIMCO enterprises to increase the prices of their products subject only to approval by the Board of ZIMCO, with _ex post_ review by the Prices and Incomes Commission (see below). As a result, price increases were announced in early January 1983 for a wide range of commodities, including such basic commodities as rice, sugar, cooking oil, beer, soap, washing powders as well as all petroleum products. In most cases, the increased price reflects the initial effect of the recent devaluation, although further adjustments may be necessary at a later stage as the full effects of the devaluation flow through to the cost of imported inputs. Consistent with the policy of economic pricing, which includes the full pass-through of the effects of exchange rate adjustment, and in order to achieve the budgetary objective of limiting subsidies to K 83 million in 1983, the following price increases have been approved and will be announced before May 1, 1983:

(i) Consumer prices for maize meal products will be increased to allow the National Agricultural Marketing Board (NAMBOARD) and cooperative unions to increase the selling price of maize to millers from K 17 to K 22.48 per 90 kg bag, compared with the new producer price of K 18.30 per bag. All these price increases will take effect on May 1, 1983.

(ii) NAMBOARD's selling price of fertilizer will be raised from K 296 to K 479 per metric ton on May 1, 1983, which includes the required pass-through followng the recent exchange rate adjustment.

16. The Prices and Incomes Commission (PIC), which was established in 1981, will assume responsibility for the _ex post_ review of prices as well as the review and ratification of collective wage agreements. The PIC is set up as a semi-autonomous body, under the guidance of a Consultative Council of Prices and Incomes. With the assistance of a full-time secretariat, it will assume full powers in executing the Government's pricing policies.

The members of the Commission and of the Consultative Council have been appointed, and the secretariat is being provided with adequate and experienced staff. The Government's role will be to lay down, through the Consultative Council, the general principles and policy guidelines to be followed. The application of these guidelines is left to the PIC.

17. The program will provide for an increase in domestic credit sufficient to allow for an expansion in economic activity after taking into account the cost and price increases following the devaluation. The improved financial position of the mining company following devaluation should sharply reduce the need for the company to seek bank financing to cover operating losses, and there will be no additional Bank of Zambia credit to ZCCM during 1983. The increase in net credit of the banking system to the Government will not exceed K 150 million in 1983. There will be a modest expansion in domestic credit of no more than 11 per cent consistent with a restrictive monetary policy; taking into account the envisaged balance of payments deficit, the targeted increase in broad money under the program will be 12 per cent, far less than the projected increase in nominal GDP. Net domestic assets, net credit to the Government, and Bank of Zambia credit to ZCCM will not exceed the limits for April, June, September and December set out in Attachment I. The ceilings for June, September, and December are indicative and will be reviewed during the mid-term review in light of the results of debt rescheduling on the budget and the balance of payments, actual and prospective copper prices, as well as the seasonal credit needs of the agricultural sector on the basis of the 1983 agricultural crop.

18. The authorities have announced substantial increases in interest rates effective January 7, 1983 to reflect more closely actual and prospective economic conditions. The Bank of Zambia's rediscount rate was raised from 7.5 to 10 per cent. At the same time, the commercial banks' overdraft and maximum lending rates were raised to 13 per cent from the previous rates of 9.5 and 12 per cent, respectively. In order to provide additional incentives for savings through the banking system, deposit rates were also increased, with the savings account rate rising from 7 per cent to 8 per cent and the minimum rate on deposits of over 12 months rising from 8.25 to 9 per cent. The Treasury bill rate was increased from 6 to 7.5 per cent.

19. The measures which have been adopted as part of the Government's financial recovery program are projected to lead to a sharp reduction in the balance of payments deficit to a level which can be financed from available external resources and debt rescheduling. The current account deficit is estimated to narrow to about SDR 200 million before debt relief, equivalent to about 6.5 per cent of projected GDP (17 per cent in 1982), as a result of a 16 per cent decline in imports and a 15 per cent reduction in net service payments. An increase of 14 per cent in export receipts, largely as a result of the higher price for copper, will contribute to the projected decline in the current account deficit. Capital inflows are expected to decline substantially, leaving an overall balance of payments deficit of

SDR 263 million (before debt relief). In addition to a reduction in external payments arrears through debt rescheduling, the Government will make a minimum cash reduction of SDR 30 million in external commercial payments arrears of SDR 669.3 million outstanding at end-December 1982; this reduction will be achieved on the basis of the schedule set out in Attachment II, and will form part of an overall reduction in commercial payments arrears under the program of at least SDR 100 million from the level outstanding at the end of 1982. Furthermore, external arrears as a result of payments overdue to overseas suppliers of goods and services by ZCCM, which totaled SDR 56.5 million at the time of the devaluation, will not, as a minimum, increase over 1983. The resulting overall financing gap of SDR 491 million, which includes the consolidation and reduction of external commercial and public debt arrears, is expected to be met from net purchases from the Fund and debt relief.

20. Given Zambia's existing large debt burden and the uncertain export prospects, the Government will follow a very cautious foreign borrowing policy in 1983, particularly on loans involving commercial terms. The contracting or guaranteeing of new external borrowing by the Govenent with an original maturity of more than one year and up to 10 years will be limited to SDR 100 million under the program. Within this limit no debt will be contracted or guaranteed with an original maturity of more than one year and up to five years. The Government also intends not to engage in borrowings of less than one-year maturity except for trade financing. The Government also will seek to utilize more concessional sources of finance including the World Bank group and individual aid donors, and is committed to fully supporting these loans, such as the proposed copper sector rehabilitation loan under consideration by the World Bank, which can be expected to enhance the economy's productive capacity.

21. Zambia is not yet in a position to relax existing restrictions on imports for balance of payments purposes, and on payments and transfers for current international transactions, except through the programmed reduction in payments arrears. During the period of the proposed stand-by arrangement, it is the Government's intention not to introduce any multiple currency practices or impose new or intensify existing restrictions on payments and transfers for current international transactions. The authorities are reviewing the method of collection of the 10 per cent levy on sales of foreign exchange for private overseas travel, which was announced as a part of the 1982 budget, so as to eliminate the existing multiple currency practice.

Zambia: Proposed Credit Ceilings of the Banking System for 1983 1/

(In millions of kwacha at end of period)

	1982	1983			
	Provisional 2/	Apr.	June 3/	Sept. 3/	Dec. 3/
Net domestic assets 4/5/	2,859.9	2,990.8	3,045.8	3,115.8	3,170.8
Claims on Government (net) 5/6/	1,950.3	2,025.3	2,055.3	2,075.3	2,100.3
Bank of Zambia credit to ZCCM 7/	160.5	170.5	170.5	165.5	160.5

1/ Comprises the Bank of Zambia and all six commercial banks.
2/ To the extent that actual data differ from the provisional estimate, the ceilings will be adjusted accordingly.
3/ Indicative and subject to review under the program by mid-1983.
4/ Defined as the difference between net foreign assets including external commercial payments arrears and money plus quasi-money, but excluding revaluation gains or losses due to exchange rate adjustments or on account of official gold holdings, and the counterpart of SDR allocations. Net domestic assets include net claims on the Government, credit to the private sector, Bank of Zambia claims on ZCCM, and other assets (net).
5/ These ceilings will be reduced by the amount of any drawings by the Government on loans for balance of payments purposes, i.e., not directly the counterpart of expenditure items.
6/ Claims on Government (net) is defined as the sum of all holdings of government securities and loans or advances to the Government by the Bank of Zambia and the commercial banks less all deposits of the Government held with these banks, plus the net use by the Government of any local currency related to past or future purchases from the Fund.
7/ Bank of Zambia credit to Zambia Consolidated Copper Mines Ltd. is defined as direct lending by the Bank of Zambia as well as commercial bank loans refinanced partly or wholly by the Bank of Zambia. This ceiling will be lowered by any repayments made by ZCCM to the Bank of Zambia during 1983, other than those already included in the ceilings.

Zambia: Proposed Timetable for Reduction of External Commercial Payments Arrears in 1983 1/

(In millions of SDRs)

	1982	1983 Projection 3/			
	Dec. 2/	Apr.	June	Sept.	Dec.
Minimum cash reduction		--	10.0	10.0	10.0
Estimated reduction through rescheduling 4/		--	70.0	--	--
Total reduction (cumulative)		--	80.0	90.0	100.0
Limits on external commercial payments arrears outstanding 4/ (end of period)	669.3	669.3 5/	589.3	579.3	569.3

1/ As recorded by the Bank of Zambia as "Deposits in Forex Arrears" (Forex Requirements), including overdrawn amounts in respect of letters of credit and suppliers' credits not covered by a local currency deposit.
2/ SDR/K = 0.976311.
3/ SDR/K = 0.781049.
4/ Limits for June, September and December are indicative and subject to review following debt rescheduling which is presently assumed to be concluded by June 30.
5/ Excluding increases on account of interest on overdue import payments pending rescheduling.

Zambia: Relations with the Fund
(On February 28, 1983)

Date of membership	September 23, 1965
Quota:	SDR 211.5 million
Status:	Article XIV
Exchange system:	The Zambian kwacha is pegged to the SDR, with the present rate of K 1 = SDR 0.781049 having been maintained since Janury 7, 1983. The U.S. dollar is the intervention currency, and the Bank of Zambia's rates for the U.S. dollar are based on the U.S. dollar/SDR rate calculated by the Fund for the preceding day.
Fund holdings of Zambian kwacha:	SDR 758.4 million, or 358.6 per cent of quota, of which SDR 146.8 million (69.4 per cent) is under the credit tranches, SDR 99.4 million (47.0 per cent) under the CFF, SDR 0.7 million (0.3 per cent) under the oil facility, SDR 77 million (36.4 per cent) under the EFF, and SDR 223 million (105.4 per cent) under the Enlarged Access Policy.
SDR position:	Holdings are SDR 8,137 or 0.0 per cent of net cumulative allocation (SDR 68.3 million).
Gold distribution (four distributions):	65,043.532 fine ounces
Direct distribution of profits from gold sales (July 1, 1976-July 31, 1980):	US$12.07 million
Trust Fund Loan Disbursement (second period):	SDR 42.77 million
Technical assistance:	The Central Banking Department is currently providing a research advisor and an advisor to the Governor of the Bank of Zambia.
Staff contacts:	The 1982 Article IV consultation discussions were held in Lusaka in November 1982 and January-February 1983. Use of Fund resources missions visited Zambia in December 1981, April and November 1982, and February 1983. Zambian delegations held discussions at the Fund in January and September 1982.

Zambia: Financial Relations with the World Bank Group

A. IBRD/IDA operations (as of December 31, 1982

(In millions of U.S. dollars)

	Disbursed		Undisbursed	
	IBRD	IDA	IBRD	IDA
Agriculture (incl. industrial forestry)	34.35	3.56	12.81	2.44
Education	59.34	--	8.94	--
Industrial and development finance	24.94	--	10.16	--
Power	236.72	--	4.23	--
Program lending	42.50	--	--	--
Technical assistance (incl. petroleum exploration)	1.10	0.84	5.50	4.16
Telecommunications	25.68	--	6.32	--
Transportion	48.67	7.33	34.78	18.92
Urban	20.00	--	--	--
Total	493.30	11.73	82.74	25.52
of which has been repaid	146.55	--		
Total now outstanding	346.75	11.73		

B. IFC investments (as of February 28, 1983)

(In millions of U.S. dollars)

Disbursed	Undisbursed
28.5	34.0

Sources: IBRD and IFC.

ZAMBIA - Basic Data

Area, population, and GDP per capita

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

	1978	1979	1980	1981	1982 Est.
GDP (at factor cost)					
Total (in millions of kwacha)	2,203	2,571	2,978	3,040	3,221
Agriculture (per cent of total)	16	15	15	18	15
Mining (per cent of total)	13	18	16	7	6
Government (per cent of total)	16	15	15	17	19
Annual real rate of growth (per cent)	1.9	-9.6	4.1	-0.7	--
Investment as per cent of GDP (at market prices)	24	15	24	21	23
Prices (per cent change)					
GDP deflator	11.2	24.0	12.3	2.8	6.0
Cost of living (low income)	16.4	9.7	11.7	14.0	12.5
Government finance	(In millions of kwacha)				
Revenue	576	621	791	834	881
Current expenditure	580	771	1,013	1,168	1,180
Capital expenditure and net lending	199	152	122	129	298
Overall deficit (cash)	-203	-302	-344	-463	-597
External borrowing (net) as per cent of overall deficit	10	46	41	53	12
Domestic bank borrowing as per cent of overall deficit	46	20	68	35	78
Overall deficit as per cent of GDP	9	12	12	15	19
Money and credit	(Per cent change)				
Net domestic assets	17	2	20	23	27
Government (net)	34	6	20	12	30
Credit to private sector	-10	13	5	52	18
Money and quasi-money	-8	30	9	8	34

ZAMBIA - Basic Data (concluded)

	1978	1979	1980	1981	1982 Prel.
Balance of payments			(In millions of SDRs)		
Exports, f.o.b.	649	1,092	1,023	833	844
Imports, c.i.f.	-617	-735	-1,017	-1,050	-962
Trade balance	32	357	6	-217	-118
Net services and transfers	-238	-227	-360	-403	-425
Current account balance	-193	130	-354	-620	-543
Capital account (net)	-14	28	126	278	-9
Government	(53)	(134)	(100)	(251)	(42)
Mining companies	(-15)	(-23)	(26)	(85)	(96)
Other (including errors and omissions)	(-52)	(-83)	(--)	(-58)	(-147)
SDR allocation	--	15	15	15	--
Valuation adjustment	--	--	--	47	25
Overall surplus or deficit (-)	-207	173	-213	-280	-527
Current account balance as per cent of GDP	-9	5	-12	-21	-17
Gross official foreign reserves 1/ (end of period)	39	61	61	36	38
External public debt 2/					
Disbursed and outstanding (end of period)	1,223	1,638	1,943	2,025	2,128 3/
Debt service as per cent of exports of goods and nonfactor services 2/	28	18	23	27	36

1/ Excluding gold.
2/ Excluding the Fund.
3/ End-June.