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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 90/109
and Correction 1

10:00 a.m., July 10, 1990

R. D. Erb, Acting Chairman

Executive Directors	Alternate Executive Directors
	Z. Iqbal, Temporary
	A. Raza, Temporary
	C. Enoch
C. S. Clark	
Dai Q.	
T. C. Dawson	
	J. Prader
E. T. El Kogali	L. B. Monyake
	M. J. Shaffrey, Temporary
	M. Hepp, Temporary
	G. García, Temporary
	C. Schioppa, Temporary
	S. K. Fayyad, Temporary
M. Fogelholm	
	O. Kabbaj
	B. Goos
J. E. Ismael	
	L. M. Piantini
	J.-F. Cirelli
	J. K. Orleans-Lindsay, Temporary
G. A. Posthumus	
K. Yamazaki	

L. Van Houtven, Secretary and Counsellor
M. J. Miller, Assistant

Corrected: 8/2/91

Also Present

IBRD: S. Denning, H. Messenger, Africa Regional Office. African Department: M. Touré, Counsellor and Director; E. L. Bornemann, Deputy Director; K. B. Dillon, S. N. Kimaro, A.-D. Riess. Asian Department: H. E. Jakubiak. Exchange and Trade Relations Department: L. A. Whittome, Counsellor and Director; J. T. Boorman, Deputy Director; J. Berg, H. M. Flickenschild, G. R. Kincaid. Fiscal Affairs Department: J. Baldet. Legal Department: H. Elizalde. Secretary's Department: C. Brachet, Deputy Secretary; A. Tahari. Treasurer's Department: J. E. Blalock, W. L. Coats, Jr., Z. Farhadian-Lorie, P. Fontana, P. R. Ross. Western Hemisphere Department: J. Ferrán, Deputy Director. Office of the Managing Director: E. A. Milne. Advisors to Executive Directors: M. Eran, K.-H. Kleine, P. O. Montórfano, B. S. Newman, P. Péterfalvy. Assistants to Executive Directors: S. T. Allouba, B. A. Christiansen, B. R. Fuleihan, J. Gold, M. A. Hammoudi, K. Ichikawa, A. Iljas, K. Kpetigo, J. A. K. Munthali, J.-P. Schoder, G. Serre, D. Sparkes.

1. ZAMBIA - REVIEW OF ECONOMIC AND FINANCIAL PROGRAM EXCHANGE SYSTEM; AND OVERDUE FINANCIAL OBLIGATIONS - REVIEW FOLLOWING DECLARATION OF INELIGIBILITY

The Executive Directors considered staff papers on the first review of Zambia's economic and financial program for 1990 (EBS/90/120, 6/22/90; and Sup. 1, 6/26/90) and the further review of Zambia's overdue financial obligations to the Fund following the declaration of its ineligibility to use the general resources of the Fund effective September 30, 1987 (EBS/90/126, 7/5/90).

The staff representative from the African Department stated that the recent disturbances in Zambia had been triggered by the large increases in the price of maize meal. The price of 25 kilograms of roller meal--the lowest quality meal--had been raised from K 82 to K 198. In response, the Zambian Government had announced on the previous Friday an increase in the monthly maize meal coupon for low-income families. The coupon had been increased from K 21 to K 30 on June 19, and had been raised in the previous week to K 42, or the equivalent of about US$1 at the second window exchange rate. The staff estimated the budgetary cost of the new increase at about 0.2 percent of GDP, which was well within the margin of error of the staff's forecast for the budget. The Government remained committed to meeting the fiscal targets of the program.

The Government, at the highest levels, had indicated to the staff its full continued commitment to the program, the staff representative stressed. The date of the follow-up meeting of the Consultative Group for Zambia, which had previously been scheduled for July 24, 1990, had been advanced to July 20, 1990.

The Deputy Director of the Exchange and Trade Relations Department stated that there was a change in the proposed decision. An inconsistency had crept in between the staff appraisal and the draft decision regarding the exchange restrictions for which the staff was recommending Board approval. Since the authorities had expressed their intention to move away from the present dual exchange market toward a unified one over the course of the program, the staff was advising that that exchange restriction be approved. However, in the draft decision, the approval encompassed the restriction evidenced by external payments arrears. The staff was not recommending that the latter restriction be approved, and therefore the phrase to that effect should be deleted from the text of the decision.

Mr. El Kogali made the following statement:

> During the Executive Board's discussion in March on Zambia's economic and financial program for 1990, Directors were generally supportive of the overall adjustment strategy, and welcomed the authorities' decision to set, in a number of key areas, more ambitious targets than those in the policy framework paper. The

Zambian authorities, together with the staff, have since assessed the progress being made under the program, and are generally satisfied with the overall performance. All the quantitative bench marks--except those on arrears and international reserves--were observed, or missed by a slight margin.

When the program was launched in 1989, the authorities were under no illusion that the wide-ranging reforms that they had embarked upon would be smooth and easy. The unfortunate civil disturbances in the last week of June, which once again involved the loss of life, were highly regrettable, and served as a harsh reminder of the problems of maintaining the political consensus for adjustment. The authorities have been categorical in stating that they will stay the course and adhere to the program, which offers the only chance for sustainable growth in the medium term. With the benefit of hindsight, however, the authorities are now taking steps to accelerate the work of the joint committee of Zambian officials and donor representatives to implement a social action program in order to ameliorate the cost of adjustment on the most vulnerable groups.

The authorities consider it important to proceed with the adjustment process also because of the delicate financing package which the authorities, together with the management and staff of the Fund, are trying to put together for 1990, as shown in the staff report. Although the financing gap re-emerges in 1991 and in subsequent years, the program for the year under review has been fully funded. The bulk of this financing will come from external bilateral and multilateral sources, including Paris Club rescheduling at the meeting which is to take place this Thursday. On their part, the Zambian authorities have sought to further demonstrate their commitment to the program by making a contribution toward closing the financing gap from their own limited resources through the copper price contingency mechanism. The need for prompt financial assistance in adequate amounts cannot be overemphasized. It will be essential to the success of the program that both project finance and the balance of payments support be disbursed on a timely basis.

The lower real GDP growth now expected for 1990 gives cause for serious concern, particularly since maize production, the country's main staple crop, has been adversely affected by unfavorable weather conditions. In the present circumstances, when the subsidy on cornmeal was being progressively reduced, Zambia could ill afford shortages in maize. However, thanks to the very large stocks accumulated last year, the supply situation is expected to remain relatively normal, and should not be a source of further inflationary pressures. In this connection, the authorities are making considerable progress in reducing the rate of inflation from

154.3 percent in 1989 to an estimated 50 percent in 1990, but this would fall short of the original target of 40 percent. In the event, both the growth and inflation targets have been revised, taking into account these latest developments.

This less favorable outlook for production and prices does not reflect policy slippages. Indeed, economic and financial policies remain broadly unchanged. In particular, the authorities have reaffirmed their intention to pursue tight fiscal and monetary policies, in line with the original objectives of the program. The Bank of Zambia is continuing to exercise monetary restraint as planned. To avoid disruptions in this year's maize marketing season, while limiting the expansion of domestic credit, special arrangements have been provided for crop credit. Also, outstanding crop credit that has not been cleared from last season by the cooperatives will be liquidated through exports of some of the maize stocks.

The authorities recognize that the realization of the fiscal objectives would be crucial to the success of monetary policy in containing domestic demand and inflation. Accordingly, the target for the fiscal deficit (excluding foreign grants and foreign interest) remains virtually unchanged at 3.0 percent of GDP, in comparison with the original program projection of 2.9 percent. The overall strategy is to regain most of the lost ground which may have occurred through delays in the implementation of certain measures. As the brunt of fiscal adjustment was to be borne by revenue increases, the strong performance of revenue to date gives confidence that the original program objectives would be met, although a minor modification of the benchmark on domestic revenue for end-June was deemed necessary to reflect a temporary delay in implementing the now mandatory dividend on parastatals.

On the expenditure side, the authorities have taken steps to exercise stricter control, prompted by the expansion of budgetary authorizations that were running ahead of cash outlays. First, biweekly reports on these fundings are being submitted to senior officials in the Ministry of Finance and the National Economic Monitoring and Implementation Committee to initiate prompt action whenever deemed necessary. Second, direct intervention will be made by the Ministry of Finance to limit cash outlays to within prescribed or authorized amounts. It should be noted that the recent wage increase awarded to civil servants was considered necessary to help stem the drain of qualified staff from Government; the high rate of inflation experienced in recent years has seriously eroded purchasing power.

Efforts to reform parastatals are already under way, with the decision taken by the Government to partially privatize the state enterprises. To this effect, 40 percent of the shares in public utilities and services, and up to 49 percent in the mining, industrial, and commercial ventures will be sold to the private sector. Meanwhile, the Government is awaiting a World Bank mission to review the performance of the remainder of the public enterprises not covered by an earlier mission.

In the external sector, progress has been made in implementing the dual exchange rate system, with the official rate being devalued substantially since a year ago. As stated in the policy framework paper, the objective is to promote a realignment of relative prices so as to diversify exports away from copper while reducing import dependency. The authorities are actively examining possible areas of diversification so as to induce or promote new investment in those particular sectors. They would benefit from any advice from the Fund or other competent organizations like the World Bank in this regard. In the meantime, the exchange rate action already implemented is being supported by price liberalization measures, as well as a phased introduction of an open general license system for imports. The target date for shifting most of the imports to the open general license has been moved to end-December 1990, from July 31, mainly because of revised expectations on donor assistance.

In conclusion, I would like to emphasize that Zambia is facing a very difficult period in its implementation of the adjustment program and in its efforts to normalize relations with its creditors, including the Fund. The present situation is being aggravated by progressive erosion in per capita incomes and the attendant deterioration in living standards. In these circumstances, special financial assistance in adequate amounts would be helpful to introduce urgently the social action program currently being considered by the authorities and representatives of donor agencies. This direct safety net provision will be particularly important if the social and political consensus is to be sustained over the whole period of the proposed rights accumulation arrangement, as reflected in the decision contained in the supplement to the staff paper, and crucial to the normalization of relations with the Fund. The authorities need every encouragement to remain steadfast with the adjustment program.

I have no difficulty with the decision relating to the overdue financial obligations to the Fund. It is significant to note that the authorities have resumed payments to the Fund in line with their intention to submit a request for a rights accumulation arrangement. A total amount of SDR 7.2 million has been paid to the Fund since the last review in March. Of this total, SDR 6.1 million is to meet obligations falling due beginning this month. I have every hope that the Board will endorse Zambia's program as meeting the standards for programs supported by enhanced structural adjustment facility or upper credit tranche arrangements. The procedures and criteria for monitoring the program are already in place. In the light of the commitment demonstrated by the authorities, even under difficult circumstances, I would urge Directors to adopt the proposed draft decisions.

Mr. Enoch made the following statement:

I very much welcome this discussion of the first review of Zambia's economic and financial program for 1990. Zambia seems, overall, to be maintaining the momentum of the reform efforts which it began a year ago. Last summer, when the Board discussed Zambia's policy framework paper (EBM/89/128, 9/15/89), the country's poor track record on previous programs caused doubts to be expressed that the authorities would stick to their agreed objectives. By the time the 1990 program was approved last spring, however, there was considerably more credibility in the authorities' commitment. This credibility has now been enhanced further overall. The report on the first review indicates that, by and large, progress has been fairly good, although arrears to the international financial institutions have continued to mount. The staff report shows that all but two of the quantitative benchmarks and three of the structural benchmarks have been either met or missed by small margins, and bad weather is reported to be partly responsible for the rather disappointing growth of GDP. Nevertheless, in addition to Zambia's failure to remain current on its payments to the Fund, there are some worrying signs of slippages, which need to be dealt with decisively if the program is to remain on track. The staff appraisal covers most of these, so I will highlight only some of the most important areas.

On fiscal policy, I welcome the expectation that the original revenue benchmark for the second half of 1990 will be met. Rapid expansion of the open general license system will be the key, as revenues depend to a large extent on import duties. But the expenditure side is more worrying. The high level of budget authorizations in the first quarter may cause problems in the future, requiring increased bank financing of the deficit and making it more difficult for the authorities to hit their inflation target. I welcome the information that the authorities have now taken measures to bring expenditure back on track; it is important that no further slippages occur. In this connection, while I agree that the civil service should be paid more in return for productivity gains, it seems unfortunate that its recent wage award--amounting to 1.1 percent of GDP--was not offset by cuts in manning levels. Moreover, I note that spending overshoots took place in so-called constitutional and statutory expenditures, which include military spending. This points to a clear need for a thorough review of expenditure priorities, cutting out prestige and other nonproductive spending. The World Bank is likely to have an important role in this area.

Meanwhile, in order to meet the fiscal targets, the authorities have introduced drastic reductions in the maize subsidies. While these reductions should have helpful allocative results over the medium term, they have generated considerable domestic opposition. The authorities' adherence to their policies is a commendable sign of their commitment to reform, and augur well for their perseverance through the remainder of the program. However, the one-off recapture of capital gains from the sales of maize stocks is an essentially temporary solution, and the authorities will need to find further savings to meet the expanded wage bill in future years.

The stance of monetary policy seems broadly in line with the program, although the authorities need to free interest rates so that they can reach levels that are positive in real terms. This would help control credit, dampen inflationary pressures, and encourage domestic savings. I also agree with the staff that more careful attention needs to be given to the impact of commercial arrears and the effect on liquidity of excess copper earnings. I would be grateful if the staff could comment further on the authorities' handling of cooperatives' arrears, particularly the Bank of Zambia's agreement to rediscount new crop credits, and whether, in view of the reduced 1990 maize crop, this solution could stoke up inflationary pressures by compromising the Government's tight monetary policy.

Zambia's external policies are being adjusted far too cautiously. The target date for the open general license system expansion has been put back in the light of expectations about donor flows, although I am unsure as to precisely why, in the present circumstances, expansion has to be tied to the disbursement of donor support. Also, although the path for exchange rate unification remains as before, the target date is still far off; this chair has argued in previous discussions for a more ambitious timetable. The significant divergence between the second window and parallel market rates suggests that the time is now approaching when a marked adjustment in the second window rate should be considered, to avoid the need for an even sharper adjustment later on. I had also hoped that tariff reform could be pursued more rapidly than is now envisaged, so as to give the necessary boost to revenues. Overall, it seems that the Zambian authorities are still far too dirigiste in their external policies. I would be interested to hear whether policy measures so far taken have yet had any effect on nontraditional exports.

The autonomy of much of the parastatal sector continues to be a cause for concern. Purchases of vehicles by Zambia Consolidated Copper Mines Ltd. (ZCCM) have not been consistent with Zambia's benchmarks on incurring new medium-term debt. After the criticism at the meeting of the Consultative Group for Zambia of the authorities' attitude toward parastatal reform, some partial privatization of the sector is now promised. This is welcome, but it is not clear that it goes far enough. The authorities are still unwilling to allow majority foreign ownership or majority domestic private sector participation. The need for fuller liberalization, including full privatization of profitable enterprises, is urgent as a means of enhancing private sector confidence, economizing on scarce administrative resources in the public sector, generating budgetary revenues, and contributing to external debt reduction. The marketing of maize continues to be handled very inefficiently, with private traders unable to take part. No further progress has been made with the removal of fertilizer handling subsidies, beyond a government commitment to phase them out by 1993. The authorities should push ahead more urgently to open these important areas to private competition.

The staff paper draws attention to the social costs of adjustment. In view of recent events in Zambia, this focus is timely. While the most vulnerable are protected by the maize meal coupon system, and adjustment policies are tilting the terms of trade in favor of the rural sector, where most of the poor live, economic reforms will inevitably bear harshly on a large section of the population. Rapid implementation of a social action program is very important, although it will need to be carefully targeted to have the proper effect, to win a consensus in favor of seeing through Zambia's difficult program of adjustment.

With respect to the outlook for the balance of payments and the financing requirement, I see that the current account outlook is largely unchanged from that in the staff paper of March 1990. The financing plan, and the timetable for the rights accumulation program, seem generally appropriate. I very much hope that rights accumulation can begin before January 1991, perhaps as soon as World Bank lending begins in October or November 1990. I welcome the flexibility the World Bank has shown in agreeing to provide larger resources to Zambia than had been programmed.

The next few months are crucial. The Zambian authorities must make full payments from July 1, and must accord preferred status to international financial institution creditors, something that they have failed to do in the first half of the year. I am somewhat reassured by the payments they have made to cover the obligations for the current month. The authorities need also to work closely with the Fund in preparing next year's budget, and in agreeing a second-year policy framework paper. I hope that a copper contingency mechanism can be included, so that the allocation of any copper revenue windfalls can be determined in advance. In response, the Paris Club should agree to as comprehensive a deal as possible, and donors also need to play their part, through flexible and timely disbursement of their commitments. The United Kingdom is prepared to support Paris Club rescheduling on the basis of the Fund-monitored program, and also to postpone moratorium interest due on newly consolidated debt. I hope that Zambia's other creditors will be prepared to be equally flexible in attempting to close the 1990 financing gap and to ensure a good start to the program. Such a response would clearly be no more than a logical consequence of the assurances given regarding the new arrears strategy at the meetings of the Interim Committee in May.

In conclusion, I urge the Zambian authorities to stay the course. Adjustment will inevitably be a painful process, but restructuring of the economy is vital given Zambia's diminishing copper reserves. The rights approach will give Zambia a one-off opportunity to clear its arrears with the Fund. The authorities must build on their achievements under their Fund-monitored program so far, and adhere fully to their commitments on both performance and payments, so that they can soon begin accumulating rights, and work with donors and creditors toward restoring Zambia to full participation in the international financial community. I can support the proposed decisions, with the amendment proposed by the Deputy Director of the Exchange and Trade Relations Department.

Mr. Fogelholm made the following statement:

The Zambian authorities have made considerable and, indeed, commendable efforts in initiating an economic restructuring process under a comprehensive adjustment program, with reasonably satisfactory results to date. My authorities concur with the staff's view that the slightly modified program to be reviewed today meets the requirements of the Fund's upper credit tranche conditionality. Hence, they endorse the staff's recommendation that the Fund monitor the program, and the intention of the Managing Director to recommend a rights approach arrangement for Zambia at a later stage, provided that performance under this program has been satisfactory and that a new program--meeting the same standards--has been adopted.

In addition, the staff recommends that "...when considering the rights accumulation arrangement, the Board take into account Zambia's performance under the current program in determining both the length of the arrangement and the appropriate front-loading of rights to be granted immediately upon approval." We can support this approach, but would like to emphasize that the amount of front-loading should reflect the amount of prior actions. In making this evaluation, measures undertaken during the 1990 program implementation could, of course, be taken into account. I would also like to stress how important it is that Zambia honor its commitment to stay current with the Fund with regard to obligations falling due from July 1 and thereafter.

I will not further address the issue of Zambia's overdue obligations to the Fund, since I concur with the conclusions drawn by the staff, and can approve the proposed decision as amended by the Deputy Director of the Exchange and Trade Relations Department. I am also in broad agreement with the staff's assessment of the economic program for the remainder of 1990, and can, therefore, limit myself to a few remarks.

It is clear from the medium-term outlook for Zambia, particularly when one looks at the developments in the external accounts, that the economy is extremely sensitive to outside disturbances. This makes it imperative that the authorities adhere to the announced program. Moreover, the economy's vulnerability to adverse exogenous shocks implies that the medium-term strategy should focus on a broadening and diversification of the production base, and thus aim at reducing the relative reliance on copper.

The fiscal policy constitutes a key area in the reform process. Thus, the expenditure slippages referred to in the paper regarding budgetary authorizations are indeed most worrisome. In order to establish the necessary control over fiscal developments, such slippages will have to be avoided by tightening budgetary discipline. The steps taken by the authorities in this area are welcome. I was also pleased to hear from the staff that the increase in the value of maize meal coupons will not have any major implications for budget targets. Likewise, I welcome the expressed commitment by the authorities to keep the program on track, despite the recent developments.

Stringent monetary policies are also important, and I am pleased to acknowledge that the Zambian authorities have already made some commendable progress in this area, particularly in reducing money growth. Because of the high rate of inflation, additional measures are necessary, and I believe that the authorities should be urged to use interest policy more actively, and to institute a positive real interest rate as soon as possible.

On the exchange rate reform, I can endorse the approach suggested in the paper, and would also join the staff in urging the authorities to accelerate the process as circumstances permit. Moreover, further delays in the tariff reform program should be avoided.

With regard to the parastatals and civil service reforms, I concur with the staff's view that it is important now to move from studies to action. This also applies to the marketing systems, where an ambitious and courageous restructuring is needed to improve the efficiency of marketing and to alleviate the pressures that the current system is placing on the budget.

The authorities are clearly confronting a very difficult task in restructuring and adjusting Zambia's economy, a process which undoubtedly will demand perseverance by the population at large. Hence, the establishment of a well-targeted social safety net would seem to be a prerequisite for the success of the reform efforts. This fact was underscored by the recent civil disturbances. Thus, I welcome the steps taken to speed up the implementation of such a social action program, and hope that donor assistance will materialize for this purpose.

Mr. Orleans-Lindsay stated that he welcomed the first review of Zambia's economic and financial program for 1990. He was pleased to note from the staff paper and from Mr. El Kogali's statement that Zambia's performance during the first quarter was generally satisfactory, with most of the quantitative benchmarks having been observed, and with the structural benchmarks for reviewing the performance of the parastatals and reforming the export licensing system having been met. That performance was all the more remarkable since Zambia was still confronted with administrative constraints. It was therefore understandable that there had been some slippages in macroeconomic performance, that the quantitative benchmarks on gross international reserves and on arrears--particularly to multilateral financial institutions--had been missed, and that the target dates for the full implementation of the open general license system and tariff reform could not be adhered to. In view of those developments and the ambitious targets that had been set originally under the program, he would go along with the proposal to modify the benchmarks for the subsequent reviews envisaged under the 1990 program.

At the time that the program was presented to the Board in March 1990 (EBM/90/30, 3/2/90), his chair, among others, had welcomed its general thrust and policy objectives, and had made extensive comments on the key areas in which he considered that the authorities needed to strengthen their adjustment efforts, Mr. Orleans-Lindsay went on. His view that the Zambian authorities needed to intensify those adjustment efforts in order to elicit donor support had not changed, and he was therefore impressed by the determination with which they were pursuing them. In that context, he would call on the international financial community to speed up the disbursement of its financial assistance to Zambia. In general, he was in agreement with the staff appraisal, and he endorsed the assessment that the 1990 program met upper credit tranche conditionality. Furthermore, he could go along with the recommendation that the Fund should monitor progress made by Zambia under the program, which would eventually evolve into a medium-term program supported by an arrangement under the rights approach.

He had noted in March that the financing gaps for Zambia's adjustment program for 1990 and beyond were substantial, and that exceptional efforts would be needed to close them, Mr. Orleans-Lindsay observed. He was encouraged to note that the gap for 1990 could be closed, and that part of the financing would come from Zambia's own resources. Indeed, it would be essential for the success of Zambia's program that the necessary financial support from donors and official creditors be disbursed as promptly as possible under the current program, and for subsequent ones.

He supported the proposed draft decisions, with the amendments suggested by the staff, including the draft decision on overdue financial obligations.

Mr. Schioppa stated that he basically agreed with the staff's evaluation of Zambia's economic situation under the 1990 economic and financial program. Progress had been made in both the structural and macroeconomic fields, in spite of the poor agricultural output and the difficult balance of payment situation. However, the staff had highlighted a number of actual or potential developments which might be serious impediments to the achievement of the objectives that had been set for the remainder of the year. While he strongly encouraged the authorities to consider carefully all the points raised by the staff in its comprehensive report, he would also like to call the authorities' attention to two policy areas which he believed required strong and immediate action on their part. Those were the fiscal situation, and credit and monetary policy.

Regarding the fiscal situation, it was worrying that budgetary authorizations had been running above cash spending, which might have unwanted future effects on the cash deficit, Mr. Schioppa pointed out. He wondered if the staff could comment on whether the transition to the new budgetary procedures could be held responsible for the emergence of the problem. He would also appreciate knowing what steps, apart from limiting the pace of cash spending against the amounts already funded, the authorities intended to take to rectify the situation. It was clear that the authorities' effort to limit the pace of cash spending should be seen only as a temporary measure, and that more radical budgetary control measures might be needed to avoid further fiscal slippages.

On credit and monetary policy, the existence of large unpaid crop credits to banks on the part of farmers and cooperatives was a cause for serious concern, since central bank refinancing of such arrears might endanger the achievement of monetary targets, Mr. Schioppa continued. However, development for copper was reflected in neither the accumulation of foreign reserves--as programmed--nor in any substantial repayment to the Fund.

On fiscal policy, I welcome the fact that most revenue items performed well. It is disappointing, however, that the introduction of mandatory dividends on parastatals was postponed. In addition, I share the staff's concern about the overcommitment of expenditure in the first quarter. Unless necessary fiscal tightening is undertaken in the second half of the year, fiscal adjustment, which is of central importance to the program, will not be achieved. In addition, there is a clear need to establish firm control over funding, as well as the cash spending of every expenditure, in order to avoid the recurrence of such overspending.

On the monetary front, I welcome the tightening of monetary growth and credit supply, despite strong credit demand. This being said, I am somewhat concerned about underlying credit demand. If it is attributable to insufficient fiscal adjustment, fiscal tightening must be stepped up. Furthermore, I would appreciate the staff's elaborating on what is behind the higher than expected level of inflation.

These developments point to the need for stepped-up adjustment efforts during the second half of the year. By contrast, the revised program sets less ambitious targets for revenue and monetary expansion. It is not encouraging that consumption is projected to be maintained at a high level, despite the worrisome price developments. In this context, I would like to raise some questions about certain aspects of the program design.

On fiscal policy, I have some doubts about the sharp increase in the public wage bill at this critical juncture. While I note that the average wage increase is within the adjustment for inflation, any wage bill cost above the original projection should be offset by a reduction in public employment. I rather regret that the initiation of the civil service review came too late. I strongly encourage the authorities to accelerate civil service reform.

On the monetary front, it is essential for the authorities to achieve a positive real interest rate, and I welcome the authorities' firm commitment to do that. Also, the authorities need to make a prudent assessment before releasing additional crop credits.

On external policy, the staff is right to emphasize that elimination of administrative controls on the trade and exchange system is essential for export diversification. This is a formidable challenge in the face of the scarcity of foreign exchange. It should be completed in a timely manner, however, since the size of the external imbalance is already unsustainably high. While I believe that the differential between the second window rate and the parallel rate should be reduced as soon as possible, I can endorse the phase-in plan of the open general licensing system.

On structural policy, I encourage the authorities to proceed expeditiously with parastatal and agricultural market reforms. While progress is being achieved in maize handling subsidies, the fundamental inefficiency of the marketing needs to be addressed.

Regarding medium-term prospects, considerable efforts have been made by the Fund and donor countries to mobilize external resources in order to finance the program. While there will still be gaps in the years to come, I can endorse the application of a Fund-monitored program. This being said, it is essential for the authorities to establish a fair track record under the program and to step up their adjustment efforts if Zambia is to enter the rights accumulation program. As I stated earlier, I still have a number of concerns about the vulnerability of the program to any policy slippages, and I have some reservations about committing the Board to endorsing the rights approach for Zambia following the program at this stage. I wonder whether it would not be more relevant to say in the proposed decision that the Fund has noted the Managing Director's intention to support the rights approach, rather than to endorse it. Furthermore, since the rights approach is already an exceptional privilege for members in arrears, I am of the view that any front-loading that would shorten the period of the rights accumulation program would not be appropriate. We shall discuss this issue later.

Meanwhile, I urge the authorities to make every effort not only to stay current with the Fund, but also to make a substantial repayment to reduce the existing arrears. With these comments, I support the proposed decisions, as amended by the Deputy Director of the Exchange and Trade Relations Department.

Mr. Clark made the following statement:

Like other speakers, I wish to commend the Zambian authorities on the relatively good performance during the first few months of their adjustment program. After considerable delay in beginning the adjustment process, this has been an admirable start. Most of the quantitative targets were met, and there were sound reasons for the more significant deviations from the structural benchmarks. At the same time, however, I would note that if this were a regular program, supported by Fund resources, a purchase would not have been possible without waivers.

It is clear that the authorities have encountered difficulties in recent months, most notably the poor rains and the recent social disturbances. In the face of these, the authorities have shown strong resolve to continue with the adjustment effort, which, in our view, is one of the key elements required for success. We are particularly reassured by the authorities' intention to meet the performance objectives set out in March, although with some modifications. Nonetheless, as pointed out by the staff, there are potential dangers on the horizon.

As we discussed the program at some length during the March Board meeting (EBM/90/30, 3/2/90), my comments today will focus on concerns arising from the most recent developments.

We have some concern regarding the substantial slippage in international reserves, particularly as it occurred when copper prices were significantly higher than anticipated. According to the staff paper, there seem to be two primary reasons for this. The first, which accounts for the better part of the shortfall, are problems in transporting copper. Are these problems of a temporary and reversible nature, or could they lead to repeated slippages in meeting the program targets? If the latter is true, we wonder what provisions could be made in the program design to take account of these circumstances.

The second main factor contributing to the shortfall are payments by the authorities of short-term debt obligations. This is more disturbing, as they took place at the same time that Zambia failed to meet payments obligations to the Fund--an important objective of the program--and suggest that Zambia was not according the Fund preferred creditor status. From the paper by the Treasurer's Department, I note that these payments were made in the hope that they would generate new credits. Does the staff agree that there were good reasons to think that this would be the case, and are there still some prospects that new credits will be forthcoming as a result of these payments?

Another concern relates to the fiscal situation. Given the potentially damaging slippages in budgetary authorizations earlier this year, we are pleased to note the renewed efforts by the authorities to meet the original deficit objective. In particular, the setting of cash limits on all key expenditure categories could be effective as added discipline to ensure that there are no further slippages in this area. Nonetheless, we are concerned that the slower growth and higher inflation than previously anticipated could have adverse implications for fiscal consolidation, especially given the importance attached to improved revenue performance in deficit reduction. We would be interested in staff substantial effort on the part of Zambia. Accordingly, we can support the proposed decision, and, provided that Zambia performs satisfactorily, we would be prepared to endorse at a later date a rights accumulation program. We also agree with the decision on overdue obligations.

Mr. Dawson made the following statement:

Reforming Zambia's economy represents a major challenge for the country, bilateral donors, and the international financial institutions. For the Fund, in particular, the success of this cooperative endeavor will be a critical test case of whether the strengthened arrears strategy is an effective means of resolving the problem of overdue obligations on a lasting basis. Preliminary indications are encouraging, although it is still too early to declare victory, and continued caution is appropriate.

The discussions of structural adjustment facility and enhanced structural adjustment facility programs highlighted the fact that sound financial policies are an essential prerequisite for successful growth-oriented reform. We therefore welcome the reduction in Zambia's fiscal deficit in recent years, and the authorities' intention to reduce the deficit this year by an even larger amount than in the initial program, in light of the increased revenue from higher copper prices. It will be important, however, to sustain this effort in order to facilitate a tight anti-inflationary monetary policy. In this connection, and in view of the important role played by import taxes in strengthening government revenues, we urge the authorities to avoid further delays in shifting transactions to the second window. We would also be interested in knowing whether there are any plans to transfer fertilizer and oil imports to the second window.

On the expenditure side, the authorities have continued to pursue a program of expenditure switching within an overall policy of restraint. We are concerned, however, that the increase in civil service wages in excess of the planned amount has necessitated stop-gap measures that will place additional burdens on the urban poor at a time when food costs are already expected to rise sharply. In these circumstances, we would urge the authorities to accelerate the civil service reforms, in order to prevent the excessive wage increase from becoming a permanent increase in the overall wage bill and a drain on already limited revenues.

With regard to monetary policy, the sharp reduction this year in inflation to well below the triple-digit level of 1989 represents a major accomplishment. However, continued monetary restraint is essential, given that inflation remains at very high levels, and given the slippage from the program target. In this context, we wonder whether the higher than programmed inflation rate might indicate that the liquidity position of the economy may not be as tight as expected. Thus, the increase in reserve money as a result of last September's sizable increase in currency in circulation, the effects of higher copper receipts, and repayment of domestic arrears, may well have more than offset the effects of government debt operations. In this regard, we would be interested in knowing whether the increased copper receipts have been fully sterilized. Alternatively, the higher inflation rate may reflect a higher than expected money multiplier due to lack of confidence in the authorities' continuing commitment to reduce inflation. In either case, more rapid deregulation of the financial sector and the attainment of positive real interest rates would improve management of monetary policy and provide increased incentives for savings.

Successful reform will also require that sound financial policies be complemented by a thoroughgoing structural reform of the public enterprises. The decontrol of prices and the reduction of subsidies represent a significant first step, although further efforts are still needed with regard to the maize and fertilizer subsidies. However, we are concerned about the apparent lack of urgency in liquidating and privatizing the parastatals, and the continuing excessive government involvement in the economy. The recent external borrowing by the copper company to finance government spending illustrates the kinds of conflicts of interest that can inevitably emerge when public finance and private economic decisions are intermingled. While we understand the staff's decision to relax the external borrowing benchmark to assure that the copper company can meet its operational needs, we are concerned that this type of loophole in the program will weaken monetary policy. We would appreciate learning what steps are being taken to close this loophole in the future, and whether lenders to the copper company will be treated as preferred creditors even though the funds were used for general government spending. We would also urge the authorities to pursue a more vigorous privatization program, possibly with the recent proposals to sell only minority interests in state enterprises as a first step in a clearly defined process leading to full privatization.

It is in the area of external policies that recent Zambian performance has fallen well short of expectations. Despite more favorable copper prices than projected, reserves fell below programmed levels, rather than increasing as provided by the contingency mechanism. Arrears to the Fund also increased significantly, while payments were made to other creditors, despite the Fund's preferred creditor status. The important currency reforms introduced with the adoption of a second window and the depreciation of the official rate have not been adequately followed up. Thus, the transfer of transactions to the second window was delayed despite the surplus that was accumulated, and the proposed reform of the trade sector has also been postponed. We welcome the inclusion of new benchmarks on the second window and trade reforms, as well as the authorities' commitment to a competitive exchange rate, although we would still prefer a faster timetable for unification of the exchange rate than the mid-1992 deadline. We urge the authorities to move expeditiously on each of these fronts in order to create the essential preconditions for a successful rights program in 1991.

We welcome the closing of the 1990 financing gap, which will permit the current program to be treated as a Fund-monitored program. However, we are concerned that this has been achieved in large measure by increasing the amount of Fund arrears to be addressed under the rights program, rather than through increased payments by Zambia. Indeed, the proposed $38 million in payments under the contingency mechanism represents only about a third of the obligations falling due to the Fund in the second half of the year. Similarly, we are concerned about the very substantial net flow of resources to the World Bank in 1990, and the very modest increase in Bank exposure during the period of the proposed rights program. This will imply a very heavy burden on bilateral donors at a time of tight budget constraints and competing demands.

In these circumstances, and with Fund flexibility fully utilized, it will be especially important to assure that there are no further slippages in the program, and that the projected financing gaps during the period of the rights program do not increase. This highlights the importance of Zambia staying the course in its economic reform program, and utilizing every opportunity to accelerate the pace of the reform process. Absent such policies, it will be extremely difficult to obtain the very substantial bilateral donor support already being sought.

We welcome the progress that has been made to date, although it is still early in Zambia's reform effort, and continued caution is warranted. In these circumstances, we believe that the staff's proposal that a possible rights accumulation program should only commence in January 1991 is a prudent course of action that will enable the Board to assure itself that the reform effort is well and truly launched, that Zambia has the capacity to undertake the rigors of the rights approach, and that adequate financing is available. At this juncture, and in light of the continuing uncertainties involved, we appreciate the concerns expressed by some Directors that the proposed decision may go too far, and create unwarranted expectations that could prejudice the Board's deliberations on the rights program. Similarly, while we note the staff's recommendations on front-loading and the length of the rights program, we believe that it would be premature for the Board to signal its intentions at this time. Nevertheless, we would be prepared to go along with the proposed decision, on the clear understanding that the Fund is not committing itself to proceed with, or the modalities of, a rights program at this time, and that any decision will be taken in light of Zambia's performance under the Fund-monitored program, and its agreement to a strong, comprehensive and fully financed program under the rights approach.

Mr. Cirelli made the following statement:

Despite contradictory influences, such as, inter alia, a less favorable than expected growth of real GDP and delays in mobilizing donor assistance, economic performance under the Fund-monitored program for Zambia has been broadly satisfactory. The payments performance, however, has not been fully satisfactory so far. That notwithstanding, all in all, the Zambian authorities deserve credit for their continued commitment to economic reform, and there is no reason to doubt their determination to keep the program on track, as illustrated by Mr. El Kogali's statement. We are in agreement with the thrust of the staff reports.

Fiscal adjustment remains an important tool in the stabilization process, and we are pleased to acknowledge the progress that has already been made in that regard. Maintaining the objective of an overall budget deficit of 3 percent of GDP will be essential. On the revenue side, the current trend, which has paved the way for a higher than anticipated level of net revenue, should be strengthened. The larger budget surplus that allowed for an increase in net repayments to the banking system is welcome.

On the expenditure side, however, we agree with the staff that additional budgetary fundings during the first quarter of 1990 are a serious cause of concern. Further developments should be kept under close control, all the more since the civil service wage bill will register an increase of 85 percent, instead of the 60 percent originally envisaged in the program. It is also urgent to implement without delay the civil service reform initiated with the assistance of the World Bank. The authorities' intent to partially offset salary increases through a reduction in subsidies is a step in the right direction, but taking into account the extreme sensitivity of certain subsidies, we urge the authorities to pay sufficient attention to developments in other outlays, such as prestige expenditures, since the room for maneuver appears very slim, and since it is important that the burden of adjustment be shared equally across all segments of the population. The technical assistance recently provided by the Fund will be very helpful in seeing to it that slippages in outlays that could jeopardize program performance are avoided.

There is also an urgent need to pursue rigorously the current reform of parastatals and the privatization of several state enterprises. The discussions with the World Bank on an Economic Recovery Credit provide the opportunity to establish the precise framework for structural reforms that could lay the groundwork for further decisive steps in this area. That such discussions should be pursued without delay, as they are indispensable for the sustainability of the adjustment process in Zambia, cannot be overemphasized.

It will be crucial to maintain a firm stance of monetary and credit policy, and, in particular, to avoid a monetary financing of the budget which would impede the fight against inflation. Every effort should also be made to reduce money growth. Moreover, the authorities should be aware of further developments in the three areas underlined by the staff, namely, the arrears on crop credit for the previous and the present crop year, the freezing of the so-called "pipeline arrears" so as to avoid undue creation of counterpart funds, and the necessity of controlling the liquidity impact of excess copper earnings. Finally, the authorities should aim at restoring positive real interest rates as soon as possible, in order to foster national savings.

In the external sector, I would like to stress the importance of diversifying the export base. This will undoubtedly be a lengthy process, given the dependency of the economy on copper exports. Export diversification should be supported by a strong commitment on the part of the authorities to overcoming administrative controls, and a commitment to rely on price mechanisms. The decisions already taken in April 1990 to revamp the export licensing system in a comprehensive manner is welcome.

I am in broad agreement with the staff's recommendations regarding exchange rate policy. The delay that occurred in early 1990 in setting up the second exchange window due to the lack of availability of external financial assistance clearly demonstrates that there is no room for complacency in this area. Indeed, the second window can only be a temporary solution, and the authorities should be prepared to make further progress in order to allow for the unification of the exchange rate as soon as possible.

To complement the second window, it will also be indispensable to accelerate the tariff reform program that has been undertaken with the assistance of the World Bank, with the idea of ensuring a more transparent system overall.

There seem to be no major divergences from the anticipated figures with respect to the balance of payments outlook and the financing requirements of the program. Strong efforts on the part of both the authorities and the international financial community have been successful in covering the financing gap. We will support the application of Toronto terms to Zambia's debt during the upcoming Paris Club meeting, and we are ready to grant Option A under those terms.

With respect to developments in 1991, we endorse the phasing process for clearing arrears proposed by the staff, which will allow the World Bank and other multilateral institutions to resume their lending operations to Zambia.

Since the authorities are keenly aware of the need to establish a sufficient track record and to make repayments to the Fund after July 1, 1990, there is no need at this stage to elaborate further on the staff's recommendations. Therefore, we support the proposed decisions, as amended.

Mr. Iqbal made the following statement:

Zambia's adjustment effort is at a critical stage. Although somewhat mixed, the progress made in implementing the adjustment program has been promising so far. Steps have been taken to adjust the official exchange rate, the second window has been opened, a number of consumer prices have been decontrolled, and monetary restraints have been maintained in the face of higher inflation. As expected, by causing shifts in resource allocation and income shares, the introduction of price signals has already precipitated some resistance to change. This should be faced with determination, and the population should be convinced that there was no alternative to an early and drastic correction of the severe underlying economic distortions.

The Zambian case, being the first program to effectively qualify for the "rights approach" toward the resolution of arrears, will need to be aggressively supported by donors in order to succeed. While the financing gap for 1990 finally appears to have been plugged, questions remain for 1991. An early and full financing for 1991 would strengthen the hands of the authorities to undertake more challenging domestic corrections.

I am in broad agreement with the staff appraisal. There are concerns, which, if not addressed adequately, could scuttle the adjustment process. In particular, development impetus remains weak and vulnerable to exogenous factors. The program will inevitably lead to some worsening of the income distribution in the short run, as prices are corrected and a solid foundation is established for sustainable growth. It must be recognized that Zambia is a long way from securing its adjustment process.

A number of issues need to be emphasized. First, while the budgetary performance seems to have been adequate in the first quarter, greater vigilance is required to avoid excessive spending in the subsequent periods. Does the staff have any additional information on cash spending relative to high fundings for the first quarter? It would not seem prudent to seek to improve wages of government employees at a time of overfundings. Perhaps the pace of work on reforming the state enterprises can be accelerated, so that pressures on the budget are eased while steps are taken to adjust government wages. While reduced subsidies and the partial recapture of capital gains on the maize stock would help, these are not durable solutions. To meet a higher wage bill, I would prefer a rationalization and reduction of expenditures more than additional revenue measures. This is, of course, not intended to detract from strengthening tax administration, which should be undertaken on its own merits. Ultimately, the solution to the financial disequilibrium will have to be sought in an overall economic recovery and diversification of the economic structure; hence, the need for structural reforms.

I welcome the authorities' intention to unify the two exchange rates by mid-1992. I am confident that the authorities are aware of the advantages of a unified market. In particular, it would avoid the emergence of vested interests, reduce the burden on fiscal and monetary policies, allow an appropriate rationing of the increasingly scarce foreign exchange, and facilitate the implementation of the open general licensing of imports. Therefore, I would strongly call upon the authorities to move more quickly toward unification, as the Government's ability to finance costs of the dual exchange system is highly circumscribed. In the meantime, as the staff has also suggested, the rate in the second window should be kept competitive.

Zambia's external debt servicing leaves much to be desired. While I am reluctantly willing to condone accumulation of arrears to the Fund up to June 30, 1990, Zambia's performance will have to be immaculate from now on. It is to be expected that, should reserves permit it, the authorities will attempt to reduce arrears to the Fund. I am sure the authorities are aware that Zambia will be subject to a closer scrutiny if it hopes to become a beneficiary of the rights approach. I can support the proposed decisions.

Mr. Goos stated that he had little to add to what previous speakers had said. He agreed in particular with the concerns of Mr. Dawson and

Mr. Yamazaki. While he recognized that the Zambian authorities had taken important steps in implementing their adjustment program, he found it regrettable that significant slippages had already occurred at such an early stage of the program, and he shared the concerns of other speakers in that regard. He was not sure whether or not those slippages could be considered as start-up problems. Like others, he would have thought that the authorities would have used the unexpected favorable performance of fiscal revenues--in particular, those resulting from higher copper earnings--as an opportunity to accelerate the adjustment of existing imbalances, especially to strengthen international reserves and to increase their payments to the Fund. It was thus particularly discouraging to note that the Fund had so far only received token payments, while other creditors had received significant unprogrammed payments, in clear violation of the Fund's preferred creditor status.

He wished to join other speakers in calling upon the Zambian authorities to accelerate the schedule for the unification of the exchange markets, and to establish as soon as possible positive real interest rates, Mr. Goos continued. On wage policy, the recent salary increases--roughly 70 percent above the program assumptions--was a matter of serious concern. While it might be difficult to contest the need for a salary adjustment in order to strengthen civil service efficiency, and while he appreciated the authorities' intention to offset increased personnel expenditures with a reduction in subsidies and a partial recapture of the capital gains on the maize stock, he wondered whether those savings--or at least a part of them--could not have been mobilized for more productive purposes, given the very difficult overall situation. Moreover, he was concerned that the high salary awards--including the much higher increases for senior civil servants--might give rise to the perception that the civil service would be spared from shouldering their fair share of the adjustment burden. Such a perception would undoubtedly risk exacerbating the present social tensions, which could erupt in renewed anti-IMF demonstrations. In view of those risks, it would be of paramount importance that the civil service reform package be finalized and implemented as a matter of urgency. He also endorsed the staff's recommendations regarding the high level of budgetary overfunding which occurred in the first quarter of 1990, which was indeed disturbing.

He wondered whether the staff could clarify to what extent any possible excess copper earnings for the year--perhaps about $250 million--might be used to increase payments to the Fund, above and beyond the authorities' commitment to make timely payment of obligations falling due to the Fund from July 1, 1990, Mr. Goos concluded. He also shared Mr. Yamazaki's concern that an endorsement by the Board at the present stage of the Managing Director's intention to recommend a rights accumulation program for Zambia at the end of 1990 or beginning of 1991 might be somewhat premature. He would appreciate the staff's comments on that point. He could support the proposed decisions on the review of Zambia's program, with the amendment proposed by the Deputy Director of the Exchange and Trade Relations Department, as well as the decision on overdue financial obligations.

Mr. Posthumus stated that he was prepared to support the staff appraisal of Zambia's adjustment effort, but, at the same time, the Board must realize that the chance that the program targets would not be met was substantial. There was uncertainty as to whether the authorities, facing new adverse developments, would stand firm, although they were currently committed to the new course they had set. The problem was that a number of policies had been decided upon, but that the institutions and systems required to implement them were not yet fully able to perform.

He worried about fiscal performance, Mr. Posthumus remarked. The staff had indicated that bringing budgetary fundings firmly under control would be absolutely essential to the success of the authorities' adjustment effort, and that overfundings which had occurred be offset by reduced fundings in the second half of the year. That was a herculean task which few fiscal authorities were able to perform. It was therefore to be expected that, notwithstanding the authorities' good intentions, implementation would fall short.

Another reason for concern was exchange rate policy, and, in particular, whether the phasing-in of the open general licensing system and the adjustment of the second window exchange rate could be managed together in such a way that the system could be made sustainable, Mr. Posthumus went on. Furthermore, he wondered how the staff's suggestion that upward adjustments be made to the exchange rate--namely, depreciations--fitted into that system. Would not a depreciation at present, with the absence of the phasing-in of the open general license system, produce excess liquidity, which would put an extra strain on monetary policy?

Developments in the succeeding months would be the real test of the program, Mr. Posthumus commented. Would monetary and fiscal expansion be tight enough to compensate for overexpansion in the preceding months? Were the authorities and the Fund not pushing too hard, while not taking adequately into account the fact that reforms took time to put in place? Reform of parastatals, civil service reform, reform of the maize and fertilizer system, were all key issues, little time for the solution of which was available. Much therefore remained to be done on the Zambian side.

He supported the program and the proposed decisions, Mr. Posthumus concluded. It was his opinion that Zambia should remain current with the Fund from the present juncture; in that respect, the past half year's experience had been rather disappointing. Was the staff confident that the following half year would be any better?

Mr. Shaffrey stated that the staff's characterization of Zambia's performance under its 1990 program as "fairly good" seemed appropriate. He could support the staff appraisal and the proposed decisions, both in respect of the economic and financial program and Zambia's overdue obligations to the Fund.

It was crucial that the Zambian authorities do their utmost to make up lost ground, and he welcomed the indications in the staff paper that actions were being taken in several areas to attempt to achieve just that, Mr. Shaffrey continued. He agreed with the staff that an important start had been made on the program, but that effort would have to be maintained and intensified, given Zambia's very precarious external finances and the need to mobilize considerable amounts of financing into the foreseeable future.

With respect to fiscal policy, he welcomed the indication that revenue performance had been strong, and that the revenue targets would be met, Mr. Shaffrey remarked. He could understand the reasons why the civil service wage increase had been much larger than assumed initially, given the severe decline in civil servants' real wages and the need to retain able staff, but the extra cost would have to be offset by permanent measures. Was it likely that the impending review of the civil service would yield substantial economies? Furthermore, the excessive `udgetary fundings were a major threat to the program, and he welcomed the moves by the authorities to improve monitoring and control mechanisms in that vital area. However, he shared Mr. Posthumus's doubts as to the authorities' ability to implement fully those measures, given the scarcity of qualified personnel.

He welcomed the Government's continued commitment to achieving positive real interest rates, Mr. Shaffrey continued, but he was disappointed that that had not yet occurred. He hoped that the new understandings between the staff and the authorities would result in a rapid achievement of that important objective. Also, it seemed that the Bank of Zambia's discount policy should be examined, given the lack of any penalty for rediscounting treasury bills.

It was pleasing to note that work had started on reform of the parastatals--but the real need was for some substantive actions--and he welcomed the progress on reforming the trade and exchange system, Mr. Shaffrey stated. Like the staff, he hoped that unification of the exchange rates could be achieved before the middle of 1992. That certainly seemed feasible, and he endorsed Mr. Enoch's view that early action on the second window rate would be appropriate.

The compilation of accurate and timely statistics seemed to be one area in which the authorities could well use some technical assistance, Mr. Shaffrey noted. He wondered whether there had been any requests from the authorities for such assistance.

The proposed decision on Zambia's overdues was a reasonable one, and he agreed that remedial measures were not appropriate in light of Zambia's progress under the program, Mr. Shaffrey concluded. However, that progress must be maintained, and repurchases that fell due from July 1, 1990 must be made.

Mrs. Hepp made the following statement:

I welcome the significant progress made by the Zambian authorities in implementing a wide range of adjustment measures and structural reforms since mid-1989 and, in particular, in adopting the measures contained in the economic and financial program for 1990.

In fact, as is shown in the staff paper, compliance so far with the program's financial and structural benchmarks has been satisfactory, with the exceptions--international reserves and arrears--clearly explained, and largely beyond the authorities' control. In this regard, we recognize the authorities' commitment to adhere to the program, as mentioned in Mr. El Kogali's statement.

We fully share the views expressed in the staff appraisal. There are three main areas that could be a cause for concern, and which imply the need for careful management by the authorities, in order to enable them to continue the successful implementation of the program.

The first is related to the performance of fiscal policy during the first months of the year, and, in particular, some factors that could result in a higher fiscal deficit for the year, and thus merit the authorities' close attention. These are the delay in introducing the second window exchange rate, resulting in a revenue loss for the Government; the higher than initially envisaged salary increase agreed for civil servants; and the possible excess in budgetary authorizations during the first part of the year.

We have noted that the policy memorandum clearly recognizes the need for corrective policy actions, and indicates several measures, such as subsidy reductions, additional taxes to capture higher revenues associated with high copper prices, and others. These measures proposed by the authorities are clearly in the right direction, and are crucial for compliance with the fiscal target for the year.

The second area of concern is related to the monitoring of the program, and to some difficulties that have been experienced in providing timely and accurate information to follow the developments of the program and propose prompt policy corrections, if necessary. In order to address the problem, the Government has already appointed a high level National Economic Monitoring and Implementation Committee reporting directly to the President. This is certainly a welcome development.

The third area of concern is the availability of adequate and timely external financial support, which, in our view, will be crucial to meet the program objectives. We are encouraged by the indication in the policy memorandum that the response of the international community in support of Zambia's program has been timely, generous, and innovative, and that the financing gap for 1990 can be closed. Furthermore, the projections for the next three years show that the remaining financing gaps could be met with the efforts and support of all the parties involved. The forthcoming meetings of the Consultative Group and Paris Club are crucial in this regard.

Given Zambia's significant progress and commitment to the objectives of the economic program, we are prepared to endorse Zambia's active cooperation in recent months in the context of the collaborative strategy, and to support Zambia's requests expressed in the proposed decision.

An early indication from the Fund that Zambia's program meets the standards of an upper credit tranche arrangement, that the Fund is prepared to monitor this program, and that the Fund could support a subsequent rights accumulation program with Zambia, would be a first real step toward the solution of one of the largest arrears cases, and would represent to all parties concerned the Fund's endorsement of Zambia's program. We fully support the proposed decisions, accordingly.

Let me express our grief for the unfortunate social disturbances which occurred during the last week of June in Zambia. This is a reflection of the difficult task of the authorities, and we encourage them to persevere in their efforts. The implementation of a social action plan--with the participation of high officials from governments and donor countries--to alleviate the social costs of adjustment for the most vulnerable groups in Zambia's society is an important step in the right direction.

We support the proposed decisions, as amended by the staff.

Mr. Dai stated that he would like to express his support for the proposed decisions. Zambia's program for 1990 meets the standards for programs supported by upper credit tranche arrangements from the Fund. He was in broad agreement with the staff's analysis and their appraisal of the Zambian economy.

In reviewing Zambia's economic and financial program for 1990, he had noted with pleasure that overall performance under the program had been generally satisfactory, Mr. Dai continued. All quantitative benchmarks--except those on arrears and international reserves--were observed, or missed by a slight margin. Unfavorable weather conditions had negatively affected real GDP growth, and civil disturbances in the last week of June were unfortunate. However, as Mr. El Kogali had mentioned in his helpful statement, the authorities had been categorical in stating that they would stay the course and adhere to the program.

As it was very clear that Zambia was facing a very difficult period in its implementation of the adjustment program and its normalization of relations with creditors, strong external financial assistance would be indispensable, Mr. Dai pointed out. With the full support of donors, a safety net program would be of vital importance to sustaining the social and political consensus in the course of the implementation of such a comprehensive and courageous program. He was sure that the courage and determination of the authorities had won them sympathy and support, and that they deserved assistance from the international community--particularly from the international financial institutions.

Zambia was one of the most difficult cases of a member in arrears, Mr. Dai concluded. Special efforts would be needed by all parties concerned to address that very difficult task. It was encouraging to note that significant progress had been made in the spirit of the newly developed arrears strategy. He welcomed the positive attitude of a number of creditor and donor countries, and he fully supported the Managing Director's intention to recommend a rights approach arrangement for Zambia under the agreed guidelines. He hoped that the authorities, with the strong support of the international community, would take full advantage of the strengthened collaborative approach, so as to be able to revitalize their economy as soon as possible.

Mr. Fayyad stated that he joined other speakers in considering that Zambia's performance under the 1990 program had been broadly satisfactory. He welcomed the strong efforts that had been made by the authorities and the staff in putting together a program for the remainder of 1990. Major challenges lay ahead, but he was encouraged by the authorities' full and continued commitment to maintaining the momentum of their adjustment and reform efforts, and, in particular, to their adherence to the course of adjustment in the face of the civil disturbances and unfortunate loss of life they had entailed. He broadly agreed with the staff appraisal, and supported the proposed decisions, as amended by the Deputy Director of the Exchange and Trade Relations Department. His chair also stood ready to support a frontloading of rights, as appropriate, under the envisaged rights accumulation program for Zambia.

The staff representative from the African Department stated that the arrears of the agricultural cooperatives could be attributed partly to the large buildup in maize stocks of the preceding year. There had been no budgetary or other funding to build up the stock, and the cooperatives had paid the farmers for more maize than they had sold. The situation would be reversed in 1990, as the cooperatives were presently selling more maize than they had to pay the farmers for. To that extent, the arrears could be seen to be self-correcting, although the situation would need to be handled carefully, since the new crop was being purchased in the present buying season and, then, the new crop and the stocks from the previous year would be sold over the balance of the year.

That was not to underestimate the fundamental problem of the cooperatives, the staff representative continued, which tended to absorb large amounts of funds without adequate accounting procedures. In that connection, a reform of the agricultural marketing system would be part of the conditions for the World Bank's economic recovery credit; it was clear that any long-term solution would need to include private trading. In fact, the need to provide the conditions for a move to private trading lay behind the actions the Government had taken recently--which had had serious political repercussions--in the direction of reducing agricultural subsidies. A more efficient agricultural and fertilizer marketing system, to replace the current system of subsidies and cooperatives, would be essential.

The staff agreed that the automatic discount on treasury bills should be eliminated, the staff representative went on. The new Governor of the Bank of Zambia was dealing with that issue. In the previous year, nondiscountable one-year bonds had been introduced, but had not sold as well as the Government might have liked because the interest rate had not been adequately flexible. The Governor intended to remove the automatic discount from treasury bills as well.

The currency reform had not in fact led to a large increase in the money supply, the staff representative stated. Rather, before the K 500 million underreporting of currency issue was corrected, the numbers had implied a substantial decline in currency in circulation after the reform.

The authorities had managed to sterilize the increased receipts from copper, the staff representative pointed out. Variations in copper earnings were the reason for having a money target, not a credit target, in the program. The authorities were in fact meeting the money target; therefore, they were sterilizing the copper receipts.

Notwithstanding the authorities' relative success in meeting the monetary targets, inflation had been higher than anticipated, which was something of a puzzle, the staff representative commented. Part of the blame might be placed on interest rate policy, although interest rates were currently much less negative than they had been a year ago. Perhaps the long lag in response time could be blamed. The staff had little faith in the price indices, which were 15 years old; technical assistance in that area would be needed.

A number of speakers had commented that Zambia should move rapidly toward an open general license system for imports because of the effect of such a system on import duties, the staff representative recalled. In fact, because all imports--whether through the first or second window exchange rate--paid duty at the second window rate, the pace of transition to an open general license system would have no effect on import duties. That notwithstanding, the staff believed that the authorities should move more rapidly to an open general license system on its own merits. By the end of 1990, 95 percent of imports would be eligible for the second window, including fertilizers and oil, and there would be only a short negative list of imports not eligible for the open general license system.

Under the program there was a link between donor assistance and the implementation of the open general license system, the staff representative added. However, as that was formulated, it was unlikely that a slowdown in implementing the open general license system would be triggered.

A total of $450 million in foreign assistance had been pledged for Zambia for disbursement in 1990, of which $200 million was in project aid and $250 million in balance of payments support, the staff representative continued. Although project assistance was beginning to be disbursed, of the balance of payments support that had been committed, only $1 million had been disbursed to July 1990. If the program was to be financed, a rapid response of the donor community in respect of balance of payments support would clearly be needed.

The root of the problems with transport of copper was the deteriorated state of the capital stock, in particular, of the railbed and rolling stock of Zambia Railways, the staff representative stated. Substantial investments in that area would be needed. In the first four months of 1990 there had been 22 major derailments. In the previous few years, transport problems had affected not so much the total amount of copper exports, but the timing of those exports, as the railway breakdowns were highly erratic. For example, in early 1990 there had been transport problems, but shipments had resumed at a high level in April and May.

Noncopper receipts had been better than expected, and to that extent it could be said that the aim of expanding nontraditional exports was succeeding, the staff representative commented. Given the lags in trade statistics, it was difficult to break down those receipts, but receipts in the second window had been better than expected as well.

The loan that had been contracted by Zambia Consolidated Copper Mines did not in any legal sense have preferred status, although the trading companies that had extended the loan accounted for about half of Zambia's copper receipts, the staff representative noted.

The budgetary overfunding could be attributed chiefly to inadequate supervision and oversight at the higher levels of government, the staff representative went on. A system of regular reporting had not been put in place, even though a new budgetary system had been introduced. The senior officers in the Ministry of Finance had been quite shocked when the extent because all imports--whether through the first or second window exchange rate--paid duty at the second window rate, the pace of transition to an open general license system would have no effect on import duties. That notwithstanding, the staff believed that the authorities should move more rapidly to an open general license system on its own merits. By the end of 1990, 95 percent of imports would be eligible for the second window, including fertilizers and oil, and there would be only a short negative list of imports not eligible for the open general license system.

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The budgetary overfunding could be attributed chiefly to inadequate supervision and oversight at the higher levels of government, the staff representative went on. A system of regular reporting had not been put in place, even though a new budgetary system had been introduced. The senior officers in the Ministry of Finance had been quite shocked when the extent of budgetary overfunding was revealed. A reporting system, along with procedures for getting appropriations back under control, was being put in place. The authorities were not used to implementing measures for cash control, but then that had often been a difficulty for many countries.

Because the staff did not have available any historical series on which to make judgments about seasonality in outlays, there was the possibility that part of the budgetary overfunding might be attributable to capital goods expenditures for the year being funded in the first quarter of the year, which would partially deflate the problem, the staff representative pointed out.

It was true that if wages had been raised less, the increase in the maize meal price might have been less, but such offsets could be made vis-à-vis almost any two-line items in the budget, the staff representative observed. It was to be hoped that the maize meal coupon program for poor families and the social safety net that would be introduced would serve to avoid future social disruptions. However, another approach would be to avoid introducing price increases for maize meal only once a year, and instead, to raise prices smoothly and slowly over the course of the year, thus lessening the political impact. With the reduction in inflation, such increases, it was to be hoped, would not be as shocking as they had been in the past in any case.

If the increased amount from copper receipts--about $150 million--in the copper contingency mechanism materialized, additional amounts might be paid to the Fund, the staff representative confirmed. However, 30 percent of the amount in the contingency mechanism would go to reducing the program's financing gap, and 60 percent would have to be used to build up reserves until the end of the year in the eventuality that copper prices declined. The disposition of that 60 percent would have to await that final outturn for the year.

Zambia was making technical assistance requests to the Fund and the Bank and to a number of donor countries, the staff representative remarked. The Fund had fielded a number of technical assistance missions in the statistical area, and a banking advisor was to take up his assignment that month. The authorities were still looking for a monetary advisor. Unfortunately, very little of the assistance that had been requested was yet in place. The authorities were requesting substantial amounts of technical assistance partly because senior government officials were leaving; before the most recent increase, the top civil service salary had been equal to about $130 a month. One of the conclusions of a recent technical assistance mission had been that increased salaries were needed at the top of the salary scale, so that Zambia could retain its best people. It was to be hoped that the introduction of a senior executive wage scale would stem the defection of top-level government officers and professionals such as doctors and teachers. In that connection, it might be observed that the increase in salaries for the civil service had not been an increase in real terms.

Mr. Posthumus said that he wondered whether the Zambian authorities were requesting donors who were prepared to provide balance of payments assistance to make the foreign exchange available to the second window.

The staff's advice to the authorities was to depreciate the second window rate, Mr. Posthumus observed. However, there had already been a surplus at that window, suggesting that imports did not flow through fast enough. A depreciation would not cause imports to flow faster. Therefore, an acceleration of the pace of implementing the open general license system, which was also being recommended as a way to deal with that, would also imply an acceleration in the money supply, which would not help the inflation outlook. Perhaps managing all those concerns at the same time would be too much for the authorities to handle.

The staff representative from the African Department replied that an effort was being made to have donors put their assistance through the second window. Donors had wanted their balance of payments assistance to go through a market type mechanism, not through administrative allocation of foreign exchange, which was why the second window was established. A procurement mission from the World Bank, including some donor representatives, had visited Zambia in the previous month to look into the administrative procedures for the second window, and had been fairly satisfied with what it had found in that regard. As long as surpluses were being accumulated, the authorities were expected to move more items onto the open general license system. The staff was admittedly a bit baffled as to why the surpluses were continuing, in light of the fact that a significant number of items had been added in the previous month.

The staff was afraid that if the authorities did not depreciate soon the exchange rate, they would put themselves in a position in which they would not be able to move for political reasons, following which a very large exchange rate depreciation would be necessary, the staff representative observed. The authorities saw a faster movement later as preferable to a gradual adjustment even while the window remained in surplus, a position with which the staff did not agree, however.

In response to a question from Mr. Newman, the staff representative stated that an expanded open general licensing system would lead to a faster depreciation of the second window rate, which would have an effect on revenues.

The Deputy Director of the Exchange and Trade Relations Department stated that, regarding Mr. Yamazaki's reservations about the wording of the decision on the endorsement of the Managing Director's intention to recommend a future rights accumulation program for Zambia, the Managing Director's intention would itself be subject to Zambia's performing under the program, which constituted an important contingency. The decision had been drafted as it had been in order to give to other parties--most particularly, to the Paris Club--the sense of the positive thrust of the Board's discussion. The decision had been modeled on that on the Fund-monitored program for Guyana, although that decision had gone further, indicating the amount of financing that the Managing Director would recommend under the subsequent program. The case of Guyana was the first in which the Paris Club had been asked to reschedule on the basis of a Fund-monitored program. An assessment of Zambia's performance under the Fund-monitored program would take into account Zambia's payments record.

Responding to a question from Mr. Ichikawa, the Deputy Director confirmed that the decision did not rule out the possibility that if Zambia's performance were judged to be unsatisfactory, the Managing Director's intention to recommend a rights accumulation program would be reconsidered.

Mr. El Kogali thanked Executive Directors for their comments, which he said he would convey to the Zambian authorities.

The Executive Board then took the following decisions:

I. a. Review of Economic and Financial Program

Attached to EBS/90/120 is a letter dated June 22, 1990 from the Minister of Finance and National Commission for Development Planning (the "letter"), with an annexed Memorandum on the Economic and Financial Policies of Zambia (the "policy memorandum") setting forth the objectives, policies, and measures that the authorities of Zambia intend to pursue during the period through December 31, 1990 (the "Program"), and requesting that the Fund:

(i) review the Program and find that it meets the Fund's standards for programs supported by extended, enhanced structural adjustment, or upper credit tranche stand-by arrangements from the Fund;

(ii) monitor progress made by Zambia in the implementation of the Program; and

(iii) endorse the intention of the Managing Director to support a future request by Zambia for "rights" accumulation on the basis of a subsequent program, in accordance with the Chairman's summing up of the discussion on Operational Modalities of the Rights Approach (EBM/90/97, 6/20/90).

b. Assessment of Program

The Fund has reviewed the Program of Zambia and finds that it meets the Fund's standards for programs supported by extended, enhanced structural adjustment, or upper credit tranche stand-by arrangements from the Fund.

c. Monitoring of Program Implementation

The Fund will monitor, pursuant to the understandings of Zambia with the Fund, the progress made by Zambia in the implementation of its Program in accordance with the provisions set forth in the Annex to this Decision.

d. Endorsement of the Intention by the Managing Director to Recommend Future "Rights" Accumulation

The Fund endorses the intention by the Managing Director to recommend to the Executive Board that, in the event that Zambia performs satisfactorily under the Program monitored by the Fund under Section c above, he will be prepared to support a future request by Zambia for "rights" accumulation on the basis of a subsequent program, in accordance with the Chairman's summing up of the discussion on Operational Modalities of the Rights Approach (EBM/90/97, 6/20/90).

Decision No. 9494-(90/109), adopted
July 10, 1990

ANNEX

The following provisions will be used to monitor the progress of Zambia in the implementation of its Program:

1. The observance by Zambia of:

(a) Quarterly limits on reserve money, as described in Table 1 of the policy memorandum;

(b) Quarterly floors for the gross foreign reserves of the Bank of Zambia, as described in Table 1 of the policy memorandum;

(c) Quarterly limits on the net claims on Government by the banking system, as described in Table 1 of the policy memorandum;

(d) Quarterly floors on the domestic revenues of Government, as described in Table 1 of the policy memorandum;

(e) Quarterly limits on the cumulative change in external payments arrears, including quarterly sublimits on the change in arrears to the IMF, as described in Table 1 of the policy memorandum;

(f) Quarterly limits on the contracting of new public or publicly guaranteed nonconcessional external debt with a maturity

ANNEX (Concluded)

of more than one year, with a subceiling on debt with a maturity of one to five years, as described in Table 1 of the policy memorandum;

(g) Quarterly limits on the stock of short-term debt, as described in Table 1 of the policy memorandum;

(h) Intentions regarding structural and other policies, as described in Table 1 of the policy memorandum.

2. The avoidance by Zambia of: any imposition of new, or intensification of existing, restrictions on payments and transfers for current international transactions; any introduction of new, or modification of existing, multiple currency practices (except as provided for in paragraph 4 of the letter); the conclusion of any bilateral payments agreement that is inconsistent with Article VIII; and any imposition of new, or intensification of existing, restrictions on imports for balance of payments reasons; and

3. Zambia will remain in close consultation with the Fund during the period of the monitored Program, and, in accordance with paragraph 5 of the letter dated June 22, 1990, will consult the Fund on the adoption of any measures that may be appropriate at the initiative of Zambia, or whenever the Managing Director requests consultation because the understandings specified under paragraph 1 above have not been observed or because he considers that consultation on the Program is desirable. For the purposes of these consultations, Zambia will provide to the Fund, through reports at intervals or dates requested by the Fund, such information as the Fund requests in connection with Zambia's objectives, policies, and measures.

II. Exchange System

The exchange measures of Zambia that are subject to approval under Article VIII, Sections 2 and 3, include a multiple currency practice arising from the operation of the dual exchange market; limitations on the availability of foreign exchange for imports and for certain other current transactions, including personal remittances; the nonavailability of foreign exchange for tourism; the limitation on the availability of foreign exchange for the servicing of external debt which has given rise to the accumulation of external payments arrears; and the requirement of counterpart deposits with respect to certain external payments arrears. The Fund approves the retention of the multiple currency practice arising from the operation of the dual exchange market until December 31, 1990 or the completion of the next Article IV consultation with Zambia, whichever is earlier.

Decision No. 9495-(90/109), adopted
July 10, 1990

III. Overdue Financial Obligations - Review Following Declaration of Ineligibility

1. The Fund has reviewed further the matter of Zambia's overdue financial obligations to the Fund in the light of the facts and developments described in EBS/90/126 (7/5/90).

2. The Fund welcomes the continued active cooperation of the Zambian authorities with respect to the adoption and implementation of the comprehensive set of structural reform and adjustment policies contained in the policy framework paper, which are aimed at achieving positive per capita real income growth, lowering the rate of inflation, and attaining a more sustainable external position. The Fund also welcomes the progress already made in implementing the policies under the economic and financial program for 1990, and the Zambian authorities' intention to pursue a comprehensive adjustment program with Fund monitoring during the period through December 31, 1990. The Fund calls on external donors and creditors to augment flows of grants and concessional lending in support of Zambia's adjustment efforts on a timely basis. The Fund intends to continue to collaborate actively with Zambia under the intensified collaborative approach.

3. The Fund regrets the continued existence of Zambia's arrears to the Fund, which places a financial burden upon other members and reduces Fund resources needed to help others, and regrets that Zambia has made only a modest payment toward settlement of its overdue obligations to the Fund since the last review,

while making payments to nonmultilateral creditors. The Fund stresses that full and prompt settlement of these arrears should be given the highest priority and notes that efforts toward their settlement are under way. The Fund also notes Zambia's intention, under its Fund-monitored program for 1990, to make payments equivalent to maturing obligations to the Fund as and when they fall due from July 1, 1990, until full settlement of Zambia's arrears is achieved. In this context, it notes the recent payment by Zambia toward settlement of obligations falling due in July 1990.

4. The Fund will review the matter of Zambia's overdue financial obligations to the Fund again at the time of the Executive Board's consideration of Zambia's economic and financial program for 1991, or within six months from the date of this decision, whichever is earlier, in the light of actions taken by Zambia in the meantime regarding payments to the Fund and implementation of the economic program.

Decision No. 9496-(90/109), adopted
July 10, 1990

The Acting Chairman stated that he wished Directors to convey to their authorities the points the staff representative had made about the need for timely donor assistance to Zambia. Aid, especially balance of payments support, had not yet begun to flow in significant amounts. For the Zambian program to succeed, great efforts would be needed not only on the part of the Zambian authorities, but also on the part of the international donor community. Adequate financing in the second half of the year would clearly be crucial, and in that respect, given the fact that the year was already more than half over, the room for maneuver was very circumscribed. The staff intended to monitor the donor flow situation closely, and would report to the Board on the situation if problems arose.

DECISION TAKEN SINCE PREVIOUS BOARD MEETING

The following decision was adopted by the Executive Board without meeting in the period between EBM/90/108 (7/9/90) and EBM/90/109 (7/10/90).

2. EXECUTIVE BOARD TRAVEL

Travel by an Executive Director as set forth in EBAP/90/178 (7/6/90) is approved.

APPROVED: June 24, 1991

LEO VAN HOUTVEN
Secretary