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#4

Minutes of Executive Board Meeting 79/166

10:00 a.m., October 29, 1979

W. B. Dale, Acting Chairman

Executive Directors	Alternate Executive Directors
	M. Yeganeh
	D. E. Syvrud
	H. G. Schneider
	E. Eramudugolla
	C. P. Caranicas
B. J. Drabble	
	M. A. Janjua, Temporary
	J. C. Gutiérrez
	W. A. Kabli, Temporary
	T. A. Harewood
B. Kharmawan	
	G. Winkelmann
	A. Nagashima
	T. Aulagnon
F. G. Mogae	
	A. L. Morales, Temporary
	A. Alfidja
H. O. Ruding	
	L. Price
	G. Blöndal
	R. J. Lang

L. Van Houtven, Secretary
R. S. Franklin, Asssistant

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Also Present

African Department: J. B. Zulu, Director; E. L. Bornemann, E. A. Calamitsis, S. E. Cronquist, S. P. O. Itam, O. E. G. Johnson, J. W. Kratz, K. Kwateng, J. M. T. Paljarvi, C. D. Pham, M. Sidibe. Asian Department: W. Tsing. Exchange and Trade Relations Department: E. Elmholt, S. Kanesa-Thasan. Legal Department: S. A. Silard. Advisors to Executive Directors: C. Bouchard, A. K. Mullei. Assistants to Executive Dirctors: T. K. Ahmad, A. F. P. Bakker, C. Chipeta, A. B. Diao, H. Flinch, J. A. Fraser, M. Kusakabe, G. B. Lind, V. K. S. Nair, J. R. Novaes de Almeida, P. Peroz, B. H. Potter, M. Shadman, P. S. Tjokronegoro, K. K. K. Wee, P. Wichert, T. H. Williams.

1. ZAMBIA - 1979 ARTICLE IV CONSULTATION, AND MODIFICATION OF PERFORMANCE CRITERIA UNDER STAND-BY ARRANGEMENT

The Executive Directors considered the staff report for the 1979 Article IV consultation with Zambia, together with a proposed decision concluding the 1979 Article XIV consultation (SM/79/222, 8/17/79), and a paper on a request by Zambia for modification of performance criteria under its stand-by arrangement (EBS/79/573, 10/11/79). They also had before them a report on recent economic developments in Zambia (SM/79/248, 10/11/79).

Mr. Mogae made the following statement:

Since the inception of the current two-year stabilization program, the Zambian authorities have made relentless efforts to address the major internal and external imbalances that emerged in the economy in the preceding period. For the balance of the program, it is expected that the efforts underway will enable the authorities to continue to improve their record and promote the realization of the overall objectives of the program. This will then permit the authorities to concentrate more on a medium-term strategy of resumed economic expansion.

The implementation of the program in 1978 was successful on several fronts. Through a combination of corrective monetary, fiscal, and incomes policies, the authorities managed to reduce domestic demand in real terms by 7 per cent. As a result demand induced inflation moderated, with the overall rate declining to 10 per cent in the later months of 1978. It is encouraging to note that these developments occurred against a background of a deceleration in the decline of real GDP to -0.3 per cent compared with -4.1 per cent in 1977.

The burden of adjustment fell largely on fiscal policy. Given the limited policy scope on the revenue side, emphasis was put on restraining expenditures by curtailing consumer subsidies and on limiting short-term lending to parastatal organizations and statutory bodies. In the event, the overall budget deficit declined from the equivalent of 13 per cent of GDP in 1977 to less than 9 per cent in 1978. While the deficit exceeded the program target by K 24 million, overall net government borrowing from the banking system was reduced from K 220 million in 1977 to K 93 million in 1978.

While the authorities were satisfied with the budgetary outcome in 1978, they were at the same time concerned about the emergence of an excess in Treasury lending associated with problems encountered by the National Agricultural Marketing Board (NAMBOARD). These problems arose from the inflexibility in the pricing structure. The authorities undertook measures to reduce the number of items subject to administered prices, although a full review of the price structure awaited the recommendations of an ILO study.

With regard to monetary policy, the authorities raised interest rates and brought total credit expansion down to 18 per cent from 30 per cent in 1977. This outcome was aided considerably by the success registered in restoring the financial viability of the mining sector and hence reducing the recourse of mining companies to central bank financing. The mining companies reduced operating costs by 15 per cent and registered a profit of K 5 million, as against a projected loss of K 114 million. Consequently, borrowing from the central bank was held within the target, despite an accumulation of excess stocks of finished copper worth SDR 100 million.

Zambia's external performance remained problematic in 1978 due to a transportation crisis. There was a large shortfall in export receipts, amounting to SDR 85 million, and even though import payments were 11 per cent lower than forecast, the current account deficit was SDR 20 million higher than the original target. The overall deficit remained at SDR 207 million instead of declining to the program target of SDR 140, and in turn the external payments arrears target could not be observed. In October 1978 a decision was taken to reopen the southern route, which had been closed since 1973, but the results have only become visible in the current year.

For 1979, the stabilization strategy remains unchanged. However, major decisions taken late last year and earlier this year would appear to be assisting the authorities in consolidating and improving on their past accomplishments.

With regard to fiscal policy, the aim is to continue restraining the budgetary deficit, while making at the same time a modest effort to permit a revival of economic activity. Thus, the 1979 budget introduced a number of measures, including an increase in the excise tax to raise revenue as well as a job tax credit system and a reduction in the corporate tax to increase employment. While there will not be substantial change in tax revenues from last year, the planned reduction in consumer subsidies and in net short-term lending, together with the intention to keep total expenditures close to their 1978 level in nominal terms, will ensure that the overall budgetary deficit as a proportion of GDP is kept to 9 per cent, the same level as in 1978.

Measures taken to reduce subsidies and short-term lending by the Treasury are largely those designed to improve NAMBOARD'S financial position. Accordingly, the crops handled by NAMBOARD have been reduced and the resale price of maize and fertilizer have been raised from K 6.25 to K 10.21 and from K 168 to K 220 per ton, respectively. These and other measures should lessen NAMBOARD'S future needs for Treasury financing, although for the time being it will prove necessary for the Treasury to cover NAMBOARD'S losses incurred since 1977. These disbursements, together with the new requirements of the Agricultural Finance Corporation, were not accounted for in the original program, although they are fully reflected in the anticipated larger budget deficit of K 255 million, or 9 per cent of GDP. This will necessitate a revision in the requirement of the Government for borrowing from the banking system from K 50 million to K 94 million--the same level as in 1978. The staff has pointed out that, in the letter requesting a modification on the subceilings in net bank credit to the Government for the third and fourth quarters of 1979, the authorities also request a lowering of the subceiling on the Bank of Zambia's credit to the mining companies by K 40 million during the same period. The implication is that a much smaller adjustment is necessary in the ceiling on total domestic credit, which in any case provides for a marked deceleration in total credit expansion from 18 per cent in 1978 to 10.5 per cent in 1979. In view of this, and given the measures undertaken by my Zambian authorities to restrain the budgetary deficit and to improve NAMBOARD'S financial position, I feel that the request is quite reasonable, and I hope that my colleagues can accept it.

The reopening of the southern route, together with improved copper prices has had a positive effect on the mining sector, which in turn permitted a reduction in that sector's recourse to bank credit. Apart from permitting a moderation of the rate of overall credit expansion, this development will create some scope for a moderate expansion in credit to the rest of the private sector.

The improved export prospects enabled Zambia to register a large overall balance of payments surplus in the first half of 1979. This allowed the authorities to reduce external payments arrears by SDR 84 million, compared with the target of SDR 73 for the year 1979. It is now anticipated that Zambia will register an overall balance of payments surplus of SDR 80 million in 1979. In view of this, my authorities intend to reduce external payments arrears by a further SDR 36 million during the second half of the year, a plan that clearly underscores their determination to wipe out these arrears as soon as practicable.

With regard to the medium-term strategy and policy options, I feel that the staff has presented a very lucid and constructive analysis. Certainly, my authorities are first and foremost determined to complete the stabilization exercise. Concurrently, they see a need to initiate measures to revive economic activity gradually, with priority going to recovery in agricultural production and copper exports. They are committed to changing the incentive structure to permit greater savings and investment in areas that will permit a faster recovery and expansion of the economy. In this respect the ILO study, with its recommendations on pricing policies, should prove helpful as a first step in the right direction. My authorities also intend to manage their foreign exchange in the best way possible in order to ensure its effective utilization in the process of development.

Lastly, on behalf of my Zambian authorities and for myself, I would like to thank the staff for the various ways in which it has contributed to the smooth working of the program, and not least for preparing a set of excellent papers.

Mr. Syvrud welcomed the commitment of the Zambian authorities to the continuation of the stabilization program; he had no difficulty with the request for modification of performance criteria under the stand-by arrangement. He agreed with the staff that Zambia's problems required both a sound investment program and a stabilization effort, and in that connection he would appreciate information about any World Bank activities in Zambia.

One area deserving special attention, Mr. Syvrud continued, was restrictions--both domestic and external--on the price mechanism. Such restrictions had not been effectively implemented in Zambia, in part because of the relatively weak administrative structure, and he encouraged the authorities to reduce them as soon as possible. In general, he was impressed by the honest efforts of the authorities to resolve Zambia's difficulties. To ensure that continued external support was forthcoming, the Fund should work out with Zambia a comprehensive economic program that would provide the basis for use of the extended Fund facility and the supplementary financing facility. Any country willing to make the effort to resolve its problems should be encouraged in its endeavor, and financing should be made available for the purpose.

Mr. Price observed that the authorities had adhered to the program limits with considerable dedication, and a large measure of stabilization had been achieved. Inflation had been halved, economic activity had risen somewhat, the budget deficit appeared to be under firm control, and credit expansion had been effectively curtailed through restrictive lending policies and high interest rates. While performance on the external side of the economy during 1978 had been disappointing, the lower than expected export receipts had been attributable mainly to transport difficulties, which had reduced the volume of copper exports, rather than to any policy shortcomings. However, over the first six months of 1979 the transport situation appeared to have improved, enabling the authorities to achieve a higher volume of copper exports in recent months. Moreover, a rise in copper prices had brought about a marked improvement in the terms of trade. Higher export receipts during 1979 had enabled the authorities also to achieve a large overall balance of payments surplus and to reduce payments arrears on schedule, with important effects on international confidence in the Zambian economy. However, recent disruptions in the Tanzania Zambia (TAZARA) Railway had again restricted exports and might dampen the prospects for the external side of the economy; for the time being the situation remained uncertain, but it was to be hoped that security in the region would soon improve.

One disappointing area highlighted in the staff report was the budget deficit, Mr. Price remarked, particularly that portion of it attributable to the higher than originally planned subsidy payments. Clearly, the authorities needed to allow a greater role for market pricing. While there was scope for improvement in many parastatal enterprises, pricing policies seemed particularly unsatisfactory in the agricultural sector of the economy. The financial position of NAMBOARD was unsound; he welcomed recent decisions to modify its role and to alter both subsidy levels and producer prices. The authorities should give priority to ensuring that producer prices were set at levels at which they would act as a stimulus to production.

The program for the Zambian economy could be looked at in two parts, Mr. Price considered. The first objective had been to achieve stabilization, and the authorities had had some success in that respect. The second and perhaps more fundamental goal was to secure adjustment for the longer term. Demand restraint measures, including wage limits and a tighter monetary policy, had been central to the stabilization effort; but if the authorities were unable to tackle simultaneously the inappropriate pricing structure and the problem of insufficient domestic savings, the best that could be hoped for was temporary relief from external difficulties. The staff had rightly observed that the severe demand restraint exercised in Zambia could not be maintained forever and that a less restrictive import policy should be assumed in an assessment of Zambia's medium-term prospects. It was clear that, if there were even a modest increase in import volume, external financing requirements would become large. One crucial need was greater investment in the copper mines to sustain higher export volumes, particularly as copper prices might not remain at their current high levels. Further measures to raise the level of cobalt production, such as an increase in price to the free market level, would be similarly beneficial. There remained considerable scope for increasing agricultural production, too, and thus lowering food imports. It had been estimated that less than 20 per cent of potentially arable land was currently being farmed, and appropriate producer prices might act as a stimulus to production.

He endorsed the staff view that policies should be geared toward increasing domestic savings by strictly controlling the growth of both private and public consumption and further raising interest rate levels, Mr. Price concluded. In view of Zambia's good record under the program, and considering the continuing need for adjustment, he could accept the proposed change in performance criteria.

Mr. Blöndal noted that the Zambian economy had in recent years suffered from negative growth rates and deteriorating terms of trade, but the authorities now appeared to be dealing seriously with the situation. Demand management had been strict overall, as demonstrated by the fact that domestic demand had been falling more sharply than GDP. One area in which progress had been slower than anticipated had been the pricing policies of NAMBOARD. The failure to produce satisfactory results in that area had led to a larger than estimated budget deficit for 1979 and made it likely that the subceiling on net bank credit to the Government and the ceiling on total domestic bank credit incorporated as performance criteria in the stand-by arrangement would be exceeded.

The functioning of NAMBOARD was most unsatisfactory from an economic viewpoint, Mr. Blöndal continued; its pricing policies represented a serious obstacle to the resumption of economic growth. Still, it had to be recognized that it was not easy to make a major adjustment in pricing policy, which affected Zambia's principal consumer goods, and that the authorities were serious about doing so. Despite the various constraints, in August 1979 the authorities had increased the price of maize meal, the nation's staple food, by 64 per cent--implying a 9 per cent increase in the consumer price index--without easing the strict wage guidelines adopted earlier in the year. The price adjustment imposed a considerable burden on the urban population in particular, and he would be interested in hearing from the staff or Mr. Mogae what the reactions to it had been in the labor market and elsewhere. Finally, he could support the request by the authorities for a modification of performance criteria under the stand-by arrangement.

Mr. Ruding said that he agreed in general with the comments by previous speakers and supported the requested modification of performance criteria. The two-year stand-by program agreed in 1978 was basically a good one, and he hoped that it could be adhered to with the modifications proposed. While much progress had been achieved, the results had been mixed. In the first year of the program, adverse developments affecting the external sector--largely beyond the authorities' control--had led to two requests for a modification of performance criteria regarding arrears; if the current request was approved, it would mean that the performance criteria would have been modified three times in one year.

The program difficulties appeared to lie in inadequate policy implementation, Mr. Ruding remarked. The level of subsidies, which had painstakingly been reduced from 11 per cent of government expenditure to 5 per cent in 1978, had once again risen to 11 per cent of government expenditure. The necessary reduction in the government deficit had been postponed for another year, and inflationary pressures were building.

The measures under the program appeared reasonable themselves, but they had not been pursued with consistency, and the result had often been overambitious planning without sufficient financing, whether through external aid or domestic savings. The lack of coordinated decision-making also meant that the headway made in the incomes, fiscal, and monetary fields was quickly slipping away because of the lack of a consistent pricing policy. Unfortunately, the same problems appeared to be part of the new Third National Development Plan.

Recent studies by the ILO and the World Bank suggested that the planning process for investment should be improved, Mr. Ruding noted. The emphasis on the cities as opposed to the rural areas had perpetuated a situation in which the growth of agricultural production fell short of the population growth and necessitated an increase in food imports, which had already absorbed the additional export receipts resulting from favorable developments in copper prices. While there were various social constraints governing agricultural policy in Zambia, the only way to attain the official target of self-sufficiency was to implement effectively the recommendation of the ILO and the IBRD that there be more realistic producer and retail pricing in the agricultural sector.

Top priority should be given to a further reduction in arrears, Mr. Ruding considered. An encouraging reduction had already taken place, but it could have been larger if the increase in imports had not taken place. The level of arrears was still higher than that originally called for under the program. In the previous Article IV consultation discussion on Zambia, the staff had stated that, under the program, three quarters of any increase in export earnings would be used to reduce arrears and only one quarter would be used to increase imports; he would appreciate some explanation of why that intention had not been followed. Finally, while he agreed with Mr. Mogae on the desirability of a medium-term strategy for resumed economic expansion, he would stress that the expansion should be sustainable, and that would require more structural and institutional economic adjustments than had been achieved thus far. In future, therefore, Zambia might be a candidate for an extended arrangement with the Fund.

Mr. Drabble stated that, like previous speakers, he could support the request for a modification of performance criteria under the stand-by arrangement. The Zambian authorities should be commended for the considerable success of their stabilization efforts and for the extent to which that success had been the result of well-coordinated fiscal, monetary, and incomes policies. He was happy to see that, since the previous request for modification of performance criteria, there had been an important reduction in the large outstanding payments arrears, made possible by the improvement in the transportation situation resulting from the opening of the southern rail route. In that connection, he wondered whether the recent disruption of TAZARA was expected to affect forecasts that had been made for the balance of 1979.

Despite the considerable progress made in the stabilization effort, Mr. Drabble continued, there remained some serious problems, particularly with respect to the operations of NAMBOARD. Some important price adjustments had been made; given the current stance of incomes policy, they seemed very large indeed. But the tendency in the past for producer prices to be held down in the interest of restraining the urban cost of living had had the inevitable effect of contributing to a serious migration from the rural areas into the cities. Hence, while the short-run effects of price adjustments might be painful, and while the phasing in of realistic pricing had to take account of difficult political and social questions, correcting the distortions nevertheless had to be a major element in any medium-term strategy.

Another problem facing the Zambian authorities, Mr. Drabble remarked, was that the availability of foreign exchange was very tight and as such tended to hamper efforts to improve the overall growth performance of the economy. Even though the authorities had had some success with efforts toward stabilization, they would still have to rely to a considerable extent on external financial assistance, particularly for further imports of capital investment goods. External financing would also be necessary to raise mining output closer to optimum levels and to allow some easing of the tight restrictions on current payments, which were contributing to the present stagnation in output. He wondered to what extent the staff felt there was scope for further rescheduling of official credit in the period ahead to provide more room with respect to foreign exchange.

Like others, Mr. Drabble said, he had been led to the conclusion that, at the end of the stand-by arrangement, it would be desirable for the Zambian authorities to work out a medium-term program with the Fund--perhaps in conjunction with an IBRD program--that would call on the resources available under both the extended Fund facility and the supplementary financing facility. It would not be easy to get the growth of output moving, but having seen the success that the Zambian authorities had had in their efforts toward stabilization, he was confident that with appropriate international support they could deal with the problem.

Mr. Winkelmann commended the Zambian authorities for the success that they had achieved by exercising sound, restrictive fiscal and monetary policies. The fall in GDP had been stopped and inflation had slowed, although it might increase again because of certain changes in the price structure. He would appreciate an indication of what price performance was expected to be like in 1979/80. The balance of payments was approaching equilibrium, and economic policy should make it possible to reduce arrears substantially. However, there remained some uncertainties in the medium-term outlook. There were production bottlenecks in the copper industry, for example, and steps had to be taken to encourage higher production by ensuing that there were enough skilled laborers and sufficient foreign exchange to buy the necessary machinery.

Another bottleneck was in the transport sector, and it would be necessary to increase investment in that area in the near future.

The recent increase in the retail price of maize meal had, as noted by the staff, raised the consumer price index by some 9 per cent, Mr. Winklemann observed. While the sudden price push would create some difficulties, if the new pricing policy was pursued with consistency and foreign investment was encouraged, the prospects for the medium term should improve. Finally, he had noted that the Zambian authorities were actively exploring the possibility of linking the kwacha to a basket of other currencies. He wondered what effects such a move would have on import and export patterns and whether it would help the authorities to reduce restrictions.

Mr. Drabble remarked that there seemed to be a serious time lag in the reporting of the financial position of some parastatal agencies in Zambia, and it made budget planning more difficult. He wondered to what extent the problem was being addressed, and whether technical assistance might be of use in correcting it.

The staff representative from the African Department recalled that questions had been raised about Zambia's performance in view of the various modifications that had already been made in the ceilings. The stabilization program should be looked at within its two-year framework, rather than on a year-to-year basis. For instance, while there had been a larger balance of payments deficit in 1978 than was shown for the current year, the original estimate for the deficit in the two years together had been SDR 190 million, whereas the actual deficit for the two years would be only SDR 127 million. Copper prices in 1979 had, of course, been higher than the projections made at the beginning of 1978, but oil prices had also been higher and capital inflows had been smaller. Overall, therefore, the performance of the balance of payments during the two years was quite good.

The modification of the ceiling on arrears was linked with overall performance, the staff representative continued. While it was true that the ceiling at the end of June 1979 had been higher than the original ceiling for the end of December 1978, the reduction in arrears had continued. At the end of August 1979, arrears had been SDR 387 million, which was lower than the actual level at the end of December 1978 and much lower than the actual level at the beginning of the program period. Similar remarks could be made about budget subsidies. While subsidies would again rise in 1979 to a fairly high level, it should be remembered that the main reason for them had been eliminated by the increase in prices, and it was expected that in 1980 budgetary subsidies would once again go down. Finally, the real volume of imports had not been much different from what had been foreseen at the beginning of the program. It had increased somewhat in 1979 but had declined much more in 1978 than had been projected. While the authorities continued to attach priority to eliminating arrears, there was also an important need to increase imports in order to raise the utilization of productive capacity.

The staff had no detailed information on the damage to TAZARA, the staff representative explained; he could therefore say little about short-term prospects for exports. The bulk of exports of copper were currently going by the southern route. A mission was due to go to Zambia at the end of November to discuss the program for 1980; more information on the damage to TAZARA should be available at that time, and the staff could then review its forecasts.

Producer prices in Zambia had been increased in recent years, the staff representative observed, and had behaved even better than wages, so that some change in the distribution of income in favor of agriculture had taken place. The producer price for maize, which had already been raised earlier in 1979, had been further increased by almost 17 per cent for the next crop season, a move that implied a further increase in the consumer price for maize meal. When the consultation paper had been written, the decision to increase the maize meal price had not yet been taken, and the inflation forecast in the report therefore did not take account of the increase. Clearly, inflation would be worse in 1979 than the projection, but the deterioration would be the result of a one-time policy measure and was not expected to be repeated

The problems of NAMBOARD and the state enterprises stemmed in part from a lack of data, which had also made it difficult for the staff to foresee the needs of the agency for 1979, the staff representative commented. The authorities had asked for technical assistance from the Fund, and some discussions on the matter had taken place at the Annual Meetings in Belgrade; however, there were problems of management and staffing that added to the data collection difficulty.

The authorities had indicated that they did not wish to reschedule their long-term and medium-term debt at the present time, the staff representative noted, in part because the amounts were relatively small and most of the debts were due to private banks and had not been guaranteed. The authorities had expressed a willingness to consider some kind of arrangement for arrears, but reaching an agreement had thus far proved difficult.

The liberalization of prices had also been a problem, the staff representative remarked. Pricing policy was linked to wage policy, and the reaction by the trades unions to the recent maize meal price increase had hardly been joyous. However, the Government had made it clear that the measure had been necessary to create funds for investment and growth. The authorities had begun to follow the suggestion of the ILO that the wage increase should be equal to only half the cost of living increase, but the current balance of payments prospects and the foreign exchange constraints made the rapid adoption of pricing policy measures difficult.

A question had been asked by Mr. Winkelmann on exchange rate policy in Zambia, the staff representative recalled. The exchange rate had been changed twice, once in 1976 and again prior to the beginning of the stabilization program. Recent discussions with the authorities had centered on what would be an appropriate basket to which to peg the kwacha. Currently it was pegged to the SDR, the movement of which had little connection with the economic structure of Zambia. The staff had developed a multilateral model of real effective exchange rates for copper producers and had been able through it to work out a basket that was considerably different from the SDR basket. Once the administrative machinery was in place, the authorities might make a change. Interestingly, the past movements in the proposed basket were little different from the movements in the SDR, so that there was at the moment little concern about switching.

Some speakers had raised the question of the role of the IBRD in Zambia's development program, the staff representative observed. The authorities had sought the help of the IBRD in recent years, and a group had been formed to examine the development program. The decision of that group, as shown in its report, had been to define within the general program a core investment plan to be implemented over the coming three years. While the overall development program had been publicized in Zambia, no decision had yet been taken with respect to the smaller investment program, which would be among the items for discussion with the Zambian authorities during a mission early in November-December 1979. The Zambian authorities were certainly interested in continued cooperation with the Fund in the framework of an extended arrangement or another two-year stand-by arrangement, but those possibilities would not be looked at in detail until nearer to the end of the current stand-by period.

In response to a question by the Acting Chairman, the staff representative explained that it was difficult to derive information on NAMBOARD's financial position from banking data because the role of commercial banks in financing NAMBOARD was limited to seasonal crop financing. After NAMBOARD had shown a large deficit in early December 1978, the commercial banks had refused to finance the agency in the summer of 1979 and had agreed to resume financing only after the price increase in August and the introduction of certain measures designed to streamline NAMBOARD.

Mr. Kharmawan, commenting on the difficulties faced by a country attempting to dismantle restrictions and introduce a freer exchange system, said that it was only natural that governments should be reluctant to take measures when there was insufficient foreign exchange available. On the other hand, liberalization itself had an impact on the availability of foreign exchange. The absence of restrictions did not mean that there would be enormous demand for foreign exchange for imports of goods or the financing of services; on the contrary, liberalization often had a beneficial effect on the availability of foreign exchange. There could, for example, be a reflux of capital from abroad, as well as a greater willingness to invest. Moreover, the World Bank might provide Zambia with program lending to finance the country's development plan.

The staff representative from the African Department explained that, in the circumstances of Zambia, liberalization measures were difficult to implement both socially and politically. The authorities were conscious of the effects of liberalization on the availability of foreign exchange, but the overhang of arrears in Zambia exceeded the resources that might be provided by the Fund or the World Bank, and the authorities were therefore cautious in addressing the problem. Confidence in Zambia depended on many factors, including pricing policies and the role of the private sector in the development of the economy. But it was also linked to the security situation in the country, and it was the feeling of the authorities that, unless the prospects for security in the area improved considerably, there would not be much of an inflow of capital. If a new program could be agreed with the Zambian authorities, the issue of liberalization would certainly be raised and dealt with in that program, as would the problem of arrears.

Mr. Mogae remarked that, by agreeing to the proposed modifications in the performance criteria, the Fund would make it possible for Zambia to meet most of the program targets over the two-year period. Without that agreement, the situation could easily deteriorate.

The authorities acknowledged the weaknesses in NAMBOARD and in the parastatal enterprises, Mr. Mogae continued. Some of them had been remedied through the recent courageous decision to increase the price of Zambia's staple food by 64 per cent. While that move should perhaps have been made earlier, other decisions had been taken--the 10 per cent devaluation, the wage freeze in the public sector, the increase in indirect taxes and the increase in producer prices--that had had the effect of raising the cost of living. It was possible that the population might not have wished to accept all those measures and a retail price increase at once, and that their acceptance had been made easier by a staggered implementation.

The question had been raised whether increases in export earnings above the levels projected would be used to reduce arrears, Mr. Mogae recalled. There was of course a need to reduce arrears, and the authorities were not backing away from their commitment to do so. On the other hand, after a number of years of a shortage of foreign exchange and a lack of growth, there was also a need to import capital goods, resume increases in production, and replace investment. Even the lower level of current output could not be sustained without replacement investment, which unfortunately competed with the objective of reducing arrears.

The Acting Chairman made the following summing up in concluding the discussion:

My understanding is that the Executive Directors are in broad agreement with the views expressed in the staff appraisal contained in the report for the 1979 Article IV consultation with Zambia. Directors welcomed the recent improvement in Zambia's overall balance of payments position, which has permitted a considerable reduction in external payments arrears in 1979, although not as much as would have been desirable. Concern was expressed on the difficulties and delays encountered in the implementation of pricing policies under the stabilization program, but Directors commended the recent measures taken by the Government in this area and expressed the hope that further progress would be made. Though it was regrettable that the overall budget deficit in 1979 was now anticipated to be considerably larger than planned, the measures recently taken to strengthen NAMBOARD's financial position should result in a much improved budgetary performance in 1980, provided that financial discipline continued to be strictly enforced.

Executive Directors welcomed the progress made by Zambia in reducing reliance on restrictive practices, but in view of the continued high level of restrictions, further progress was required in order to ease inflationary pressures, bring about a better allocation of resources, and facilitate a resumption of growth. Altogether, commendation was expressed for the courageous manner in which the program is being carried out by the Zambian authorities.

Executive Directors expressed concern at the medium-term outlook for Zambia's balance of payments. They stressed the need for measures to expand production for export and to increase productivity by placing strong emphasis on priority investments, especially in agriculture, transport, and mining. A continuation of prudent demand management and incomes policies is required in the foreseeable future, but Zambia will still need increased financial support from abroad on concessional terms. With a view to generating new and much-needed foreign resources, the adoption of realistic guidelines for the implementation of the new development plan based on adequate priorities among investment projects is an urgent priority. The hope was expressed that sizable Fund resources could continue to be made available in support of realistic stabilization and structural measures, preferably under an extended Fund facility program supported also by the the supplementary financing facility.

The Executive Board then took the following decision concluding the 1979 Article XIV consultation with Zambia:

1. The Fund takes this decision relating to Zambia's exchange measures subject to Article VIII, Section 2, and in concluding the 1979 Article XIV consultation with Zambia, in

the light of the 1979 Article IV consultation with Zambia conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. Zambia's exchange system is highly restrictive. During 1979 a substantial reduction has been made in arrears on current payments and transfers. The authorities intend to continue the policies that will permit further reduction in arrears and facilitate other steps toward a more liberal exchange system. The Fund welcomes the progress already made and, in the meantime, grants approval for the restrictions on the making of payments and transfers for current international transactions referred to in SM/79/248 until December 31, 1980, or the next Article IV consultation, whichever comes first.

Decision No. 6304-(79/166), adopted
October 29, 1979

The Executive Board then approved the proposed decision on the modification of performance criteria under the stand-by arrangement.

The decision was:

1. The Government of Zambia has consulted with the Fund pursuant to paragraph 4 of the letter of intent dated March 17, 1978 attached to the stand-by arrangement for Zambia (EBS/78/190, Sup. 1, 4/7/78), and paragraph 12 of the letter dated March 3, 1979 annexed thereto.

2. The letter of September 19, 1979 from the Minister of Finance and the Governor of the Bank of Zambia shall be annexed to the stand-by arrangement for Zambia, and the letters of March 17, 1978 and March 3, 1979 annexed to it shall be read as supplemented and modified by the letter of September 19, 1979. Accordingly, the limits proposed in paragraph 4 of the letter of September 19, 1979 shall be substituted for the limits on total domestic credit, the banking system's net claims on the Government, and Bank of Zambia lending to the mining companies for the period July 1, 1979 to December 31, 1979 referred to in paragraph 10 of the letter of March 3, 1979, and shall be the understandings referred to in paragraph 5(b) of the stand-by arrangement for that period.

Decision No. 6305-(79/166), adopted
October 29, 1979

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/79/165 (10/26/79) and EBM/79/166 (10/29/79).

2. JOINT COMMITTEE ON REMUNERATION OF EXECUTIVE DIRECTORS AND THEIR ALTERNATES - COMMITTEE MEMBERS

The Executive Board approves the proposal set forth in EBAP/79/308 (10/18/79).

Adopted October 26, 1979

3. APPROVAL OF MINUTES

The minutes of Executive Board Meetings 79/63, 79/64, and and 79/69 were approved (EBD/79/254, 10/22/79).

Adopted October 26, 1979

APPROVED: February 20, 1980

LEO VAN HOUTVEN
Secretary