

EBS/81/220

CONFIDENTIAL

November 6, 1981

To: Members of the Executive Board

From: The Secretary

Subject: Zambia - Request for Waiver and Modification of Performance
Criterion Under Extended Arrangement

There is attached for consideration by the Executive Directors a paper on a request from Zambia for a waiver and modification of performance criterion under the extended arrangement for that country. A draft decision appears on pages 7 and 8.

This subject has been tentatively scheduled for discussion on Wednesday, November 18, 1981.

Att: (1)

INTERNATIONAL MONETARY FUND

ZAMBIA

Request for Waiver and Modification of Performance Criterion
Under Extended Arrangement

Prepared by the African Department

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

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

November 6, 1981

I. Introduction

On May 8, 1981 the Executive Board approved an extended arrangement for Zambia for a three-year period in the amount of SDR 800 million (EBS/81/91, Supplement 2, May 11, 1981), equivalent to 378 per cent of Zambia's quota (SDR 211.5 million). Of this amount, SDR 125.8 million (59 per cent of quota) would be from ordinary resources, and SDR 674.2 million (319 per cent of quota) would be made available from borrowed resources. Purchases in the first 12-month period are limited to SDR 300 million, equivalent to 142 per cent of quota. Thus far Zambia has made one purchase of SDR 120 million on May 18, 1981; the second purchase of SDR 90 million under the arrangement, which could have been made on August 15, was not effected because Zambia did not observe performance criteria as of the end of June 1981. As of the end of September, Zambia has observed all of the performance criteria, except the criterion on external payments arrears (Table 1). In the attached letter to the Managing Director dated October 29, 1981, the Minister of Finance and the Governor of the Bank of Zambia request a waiver of the performance criterion for external payments arrears for the end of September and a modification of the same criterion for the end of December. 1/

On October 8, the Executive Board approved a purchase of SDR 59.3 million under the compensatory financing decision. As of October 30, 1981, the Fund's holdings of Zambian kwacha amounted to SDR 657.4 million, or 311 per cent of quota, of which SDR 99.7 million (47 per cent of quota) were under the CFF, SDR 10.6 million (5 per cent) under the Oil Facility, and SDR 120 million (56.7 per cent) under the Enlarged Access Policy.

1/ A mission consisting of Messrs. Itam (AFR) and Sukachevin (ETR) visited Lusaka during October 22-29, 1981 in connection with this request.

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

(At end of period)

	1980 <u>1/</u>	1981							
		Mar. <u>1/</u>	April	May	June	July	Aug.	Sept.	Dec.
(In millions of kwacha)									
Total domestic credit of the banking system									
Ceiling	1,859.7	1,930.0	...	...	1,999.0	...	...	2,094.0	2,134.0
Actual <u>2/</u>	1,859.0	1,957.4	2,034.9	2,085.2	2,009.2	2,106.1	2,164.5	2,089.7	
Claims on Government (net) of the banking system									
Ceiling	1,354.4	1,420.0	...	...	1,454.4	...	...	1,489.4	1,521.4
Actual <u>2/</u>	1,354.2	1,458.5	1,490.3	1,547.5	1,478.2	1,530.1	1,556.2	1,484.7	
Bank of Zambia credit to mining companies									
Ceiling	61.4	61.4	...	...	61.4	...	...	61.4	61.4
Actual	61.4	61.4	70.4	70.4	65.4	61.4	61.4	61.4	
(In millions of SDRs)									
Outstanding external payments arrears									
Ceiling	461.0	500.0	...	...	455.0	...	...	410.0	361.0
Adjusted ceiling <u>3/</u>	461.0	500.0	...	...	479.0	...	...	447.0	...
Requested modification	...	...	...	...	...	...	...	...	399.0
Actual	461.0	545.0	600.6	522.6	529.0	537.0	565.9	574.0	
New external borrowing directly undertaken or guaranteed by the Government in the maturity range of: <u>4/</u>									
1-10 years									
Ceiling	...	...	...	...	...	...	...	...	350.0
Actual	...	11.2	11.2	11.2	11.2	11.2	11.2	11.2	
1-5 years									
Ceiling	...	...	...	...	...	...	...	...	150.0
Actual	...	---	---	---	---	---	---	---	

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

1/ Figures on ceilings at end-1980 and end-March 1981 were the preliminary estimates made during the negotiation of the program in February-March 1981.

2/ Based on the definition included in the program. These data differ slightly from those in Table 4 of SM/81/196 because a few of the components have been revised.

3/ Adjusted in accordance with EBS/81/91 for 75 per cent of the shortfall in export receipts.

4/ Cumulative from beginning of year.

II. Recent Financial Developments

Recent economic developments and performance under the extended arrangement are discussed in detail in the staff report on the 1981 Article IV consultation with Zambia (SM/81/196) and the related paper on recent economic developments (SM/81/208).

Since then additional data have become available on Zambia's performance vis-à-vis the performance criteria for end-September as well as on balance of payments and monetary developments (Tables 2 and 3). There was a sharp reduction in net claims on Government of the banking system during the month of September reflecting seasonally large revenue collections (in particular in connection with payment of the first installment of the company tax), borrowing from the domestic nonbanking sector, and the determined efforts of the Government to contain expenditure within the budgetary limit through strict enforcement of monthly expenditure authorizations. There was also a decline in total domestic credit in September, largely reflecting the improvement in government finance. As a result of the improvement in the budget situation in September, the program's fiscal and monetary targets for 1981 are regarded as feasible.

As for the balance of payments, on the basis of the latest available information, it now appears that imports will be some 8 per cent higher than estimated in Table 2 of SM/81/196; however, they would still be about 7 per cent below the original program projections (Table 2). As a result, the trade balance is now estimated to show a deficit of SDR 52 million instead of a surplus of SDR 25 million, and the overall deficit would increase to SDR 250 million. The reduction in external payments arrears is now projected at SDR 62 million, compared with the original program target of SDR 100 million, for reasons explained in the following section.

III. Request for Waiver and Modification

When discussions were held on the medium-term program in late February/early March 1981, it was estimated that external payments arrears would reach a peak of SDR 500 million at the end of March. In the event, reflecting the very tight foreign reserve position in the early part of 1981, external payments arrears rose to SDR 545 million by end-March and reached SDR 601 million by the end of April, prior to the Board approval of the arrangement on May 8, 1981. Following the first purchase under the arrangement in May, arrears fell to SDR 523 million at the end of May, and then increased gradually to SDR 574 million at the end of September, as compared with the applicable ceiling of SDR 447 million, after adjustment for 75 per cent of the export shortfall as envisaged in the program 1/. If the ceiling were to be adjusted for the fact that the starting point prior to the

1/ See paragraph 16 of the Memorandum on the Economic and Financial Policies of Zambia, EBS/81/91, page 55.

Table 2. Zambia: Balance of Payments, 1977-81

(In millions of SDRs)

	1977	1978	1979	1980		1981	
				Estimates Program	Prel. Actual	Projections Program	Revised
Exports, f.o.b.	768	662	1,065	1,081	908	1,063	979
Imports, c.i.f.	<u>-711</u>	<u>-617</u>	<u>-735</u>	<u>-1,085</u>	<u>-1,017</u>	<u>-1,107</u>	<u>-1,031</u>
Trade balance	57	45	330	-4	-109	-44	-52
Services and unrequited transfers, net							
Investment income	-114	-109	-97	-179	-163	-205	-194
Other services	-58	-64	-71	-79	-127	-70	-160
Private transfers	-83	-85	-86	-86	-95	-86	-100
Government transfers	13	20	27	39	26	53	53
Total	<u>-242</u>	<u>-238</u>	<u>-227</u>	<u>-305</u>	<u>-359</u>	<u>-308</u>	<u>-401</u>
Current account	-185	-193	103	-309	-468	-352	-453
Nonmonetary capital, net							
Government	17	53	134	79	100	71	58
Mining companies	-15	-15	-23	26	26	114	110
Other (including errors and omissions)	-60	-52	-56	-24	114	--	20
Total	<u>-58</u>	<u>-14</u>	<u>55</u>	<u>81</u>	<u>240</u>	<u>185</u>	<u>188</u>
SDR allocation	--	--	15	15	15	15	15
Overall balance	-243	-207	173	-213	-213	-152	-250
Financing							
Use of Fund resources, net	--	149	73	6	6	253	312
Purchases	(19)	(149)	(99)	(50)	(50)	(300)	(359) ^{1/}
Repurchases	(-19)	(--)	(-26)	(-44)	(-44)	(-47)	(-47)
Payments arrears (decrease -)	170	102	-145	111	111	-100	-62
Other foreign assets, net (increase -)	73	-44	-101	96	96	-1	--
<u>Memorandum items:</u>							
Gross international reserves (at end-period) ^{2/}	54.6	39.2	60.7	61.3	61.3	43.7 ^{3/}	43.7 ^{3/}
In weeks of imports, c.i.f.	4.0	3.3	4.3	2.9	3.1	2.1	2.2

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

^{1/} Including the purchase under the CFF of SDR 59.3 million.

^{2/} Excluding gold, which is 0.217 million fine troy ounces.

^{3/} End-September 1981.

Table 3. Zambia: Monetary Survey, 1977-81
(In millions of kwacha; end of period)

	1977	1978	1979	1980			1981			
				Mar.	June	Sept.	Dec.	Mar.	June	Sept.
Net foreign assets	...	-777.3	-621.6	-630.7	-673.0	-740.4	-828.8	-909.8	-958.6	-1,007.2
Net foreign assets of the banking system	(-183.5)	(-311.5)	(-283.1)	(-317.6)	(-366.2)	(-377.2)	(-387.9)	(-384.5)	(-452.8)	(-456.9)
External payments arrears <u>1/ 2/</u>	(...)	(-465.8)	(-338.5)	(-313.1)	(-306.8)	(-363.2)	(-440.9)	(-525.3)	(-505.8)	(-550.3)
Domestic credit	1,260.9	1,483.5	1,604.1	1,620.2	1,801.7	1,777.2	1,859.2	1,957.4	2,009.2	2,089.7
Claims on Government (net) <u>3/</u>	(791.1)	(1,061.8)	(1,121.6)	(1,168.4)	(1,317.8)	(1,278.6)	(1,354.4)	(1,458.5)	(1,478.2)	(1,484.7)
Claims on private sector	(469.8)	(421.7)	(482.5)	(451.8)	(483.9)	(498.6)	(504.8)	(498.9)	(531.0)	(605.0)
Assets = Liabilities	1,077.4	706.2	982.5	989.5	1,128.7	1,036.8	1,030.4	1,047.6	1,050.6	1,082.5
Money plus quasi-money	698.7	639.4	832.2	837.7	881.7	866.5	907.1	891.3	896.0	975.1
Money	(386.5)	(391.7)	(513.3)	(457.1)	(473.2)	(465.9)	(509.4)	(522.1)	(529.0)	(537.7)
Quasi-money	(312.2)	(247.7)	(318.9)	(380.6)	(408.5)	(400.6)	(397.7)	(369.2)	(367.0)	(437.4)
Other items (net) <u>2/</u>	378.7	66.8	150.3	151.8	247.0	170.3	123.3	156.3	154.6	107.4

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

1/ Based on data obtained from commercial banks' special reserve deposits related to external payments arrears. These differ from those in the balance of payments due to exchange rate changes, timing differences, etc.

2/ Because separate data are unavailable on external payments arrears for 1977, they are included in "other items (net)."

3/ Excludes Government Sinking Fund Account held by Bank of Zambia and, in 1981, Fund charges paid by Government but subsequently assumed by Bank of Zambia.

approval of the program was about SDR 100 million higher than estimated, then the excess over the ceiling would be only SDR 27 million, all of which could be explained by Zambia's inability to make the second purchase of SDR 90 million under the arrangement based on the performance criteria for end-June, originally envisaged to take place on August 15, 1981. In view of this fact and Zambia's observance of all other performance criteria for September, a waiver of the performance criterion for external payments arrears for end-September would appear to be justified.

As far as the December performance criterion on external payments arrears is concerned, a modification would again be warranted by the under-estimation of the starting point by SDR 100 million. On the other hand, in accordance with the expectation in the program that a significant proportion of any balance of payments assistance over and above that anticipated in the program would be used to reduce arrears, it would appear justified to adjust downwards the applicable ceiling by 75 per cent of the recent purchase of SDR 59.3 million under the CFF (which was not foreseen at the time of the program discussions in early 1981). The figure resulting from these two adjustments has been reduced further in view of the authorities' determination to remain as closely as possible to the original program target. Thus, the proposed revised ceiling for end-December would be SDR 399 million, or SDR 38 million higher than the figure of SDR 361 million included in the program. In addition, there could be a further adjustment for the shortfall in export earnings in the last quarter of 1981; however, this adjustment can only be made after the export data through December are known.

The revision in the external arrears target would imply that the reduction in external payments arrears during calendar year 1981 would be smaller than envisaged in the program (i.e., SDR 62 million compared with SDR 100 million). On the other hand, if measured from the high point reached prior to the adoption of the program in April, the reduction through December would be SDR 202 million, or considerably more than projected in the program (i.e., a reduction of SDR 139 million from the estimated March position to December 1981); moreover, the modified ceiling on arrears for December 1981 would call for a reduction in arrears during the December quarter by about SDR 175 million.

IV. Staff Appraisal and Proposed Decision

Since the adoption of the medium-term program, the authorities have made progress in implementing the adjustment measures. However, the balance of payments situation remains under great pressure, reflecting lower export earnings, both on account of volume and price factors, and sharply higher payments for services. Despite efforts by the authorities, the fiscal targets of the program for the first half of 1981 could not be achieved, and the performance criterion for bank borrowing by the Government at end-June was not observed, and the scheduled second purchase under the

arrangement could not be made. However, by end-September all the performance criteria, except that on external payments arrears, were met, reflecting the additional efforts made to increase revenues and contain government expenditure, the latter through strict enforcement of reduced expenditure authorizations. As a result, with continued determination and perseverance of the authorities, the original fiscal and monetary objectives of the program for 1981 still appear attainable. On the other hand, the balance of payments position will remain under severe pressure, and both the current account and overall deficits will be larger by about SDR 100 million in 1981, compared to the program targets. This deviation will be accounted for by lower export prices and volume, as well as higher service payments abroad.

Zambia's failure to meet the September performance criterion on external payments arrears was more than accounted for by the nonpurchase of SDR 90 million from the Fund, based on the nonobservance of performance criteria. In view of this, and the fact that all other performance criteria for September have been met, the staff recommends the waiver of the performance criterion on payments arrears for September. A modification of the performance criterion on payments arrears for end-December 1981 is also recommended on account of the higher revised base date figure of arrears, offset in part by an adjustment on account of the foreign exchange receipts under the Fund's compensatory financing facility which were not envisaged in the program. The modified performance criterion for December 1981 will still call for a reduction in arrears by SDR 202 million from their peak level at end-April 1981, immediately preceding the Fund approval of the program, and by about SDR 175 million in the last quarter of 1981 alone.

Accordingly, the following draft decision is proposed for adoption by the Executive Board:

1. Zambia has consulted with the Fund in accordance with paragraph 4 of the extended arrangement for Zambia (EBS/81/91, Supplement 2, May 11, 1981) in order to reach understandings regarding the circumstances in which purchases under the arrangement can be resumed, and to modify the quarterly limit on external payments arrears for end-December 1981.
2. The Fund finds that no further understandings are necessary with respect to external payments arrears for end-September 1981, and that, accordingly, purchases under the arrangement can be resumed.

3. The letter of October 29, 1981 from the Minister of Finance and the Governor of the Bank of Zambia shall be annexed to the extended arrangement for Zambia, and the Memorandum on the Economic and Financial Policies of Zambia attached to it shall read as modified by the letter of October 29, 1981. Accordingly, the quarterly limit on external payments arrears for end-December 1981 shall be SDR 399 million.

October 29, 1981

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

Dear Mr. de Larosière,

In our letter dated March 3, 1981 addressed to you, we described in detail the Government's objectives and policies for the period 1981-83 and the assumptions underlying these policies. Developments since then make it necessary to review the understandings related to the reduction of external payments arrears set forth in that letter. However, we would like to stress from the outset that all the other performance criteria for end-September 1981 have been observed.

When discussions were held on the medium-term program in late February/early March 1981, it was estimated that external payments arrears would reach a peak of SDR 500 million at the end of March. In the event, external payments arrears rose to SDR 545 million by end-March 1981 and reached a peak of SDR 600 million by end-April 1981 (prior to the IMF Executive Board's approval of the extended arrangement on May 8, 1981). Zambia's external payments arrears at end-September 1981 amounted to SDR 574 million, as compared with the ceiling of SDR 447 million. If the ceiling were adjusted for the fact that the starting point was much higher than estimated, then the excess over the ceiling could be explained by the delay in the second purchase under the extended arrangement. Accordingly, the Government requests a waiver concerning the performance criterion on external payments arrears for end-September 1981 indicated in paragraph 16 and Attachment IV of the Memorandum on the Economic and Financial Policies of Zambia.

As far as the performance criterion established for external payments arrears for end-December 1981 is concerned, we are requesting that the ceiling indicated in paragraph 16 and Attachment IV of our Memorandum be modified upward for the underestimation of the base figures as well as by a downward adjustment to reflect the recent purchase under the CFF (which was not foreseen at the time of the program discussions). Accordingly, external payments arrears, which stood at SDR 574 million at end-September 1981, will not exceed SDR 399 million at end-December 1981, compared with the figure of SDR 361 million included in the program. In relation to the peak reached prior to the approval of the extended arrangement, this would imply a reduction of SDR 201 million in the period May-December 1981.

The Government of Zambia remains fully committed to the policies included in the medium-term program in support of which the extended arrangement was granted, and stands ready to take additional measures which may be required to achieve its objectives.

Yours faithfully,

Kebby S.K. Musokotwane, MP
Minister of Finance
Government of Zambia

Bitwell R. Kuwani
Governor
Bank of Zambia