FOR AGENDA

EBS/87/108

CONFIDENTIAL

May 21, 1987

To: Members of the Executive Board

From: The Secretary

Subject: Zambia - Overdue Financial Obligations to the Fund - Further Review of Decision on Complaint Under Rule K-1

The attached paper is scheduled for consideration by the Executive Board tomorrow, Friday, May 22, 1987. A draft decision appears on pages 5 and 6.

Mr. Blalock (ext. 8341) or Mr. Corr (ext. 7621) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

Att: (1)

CONFIDENTIAL

INTERNATIONAL MONETARY FUND

Zambia - Overdue Financial Obligations to the Fund - Further Review of Decision on Complaint Under Rule K-1

Prepared by the Treasurer's, African, and Legal Departments

(In consultation with the Exchange and Trade Relations Department)

Approved by David Williams, A.D. Ouattara, and F.P. Gianviti

May 21, 1987

1. On May 22, 1987 the Executive Board will conduct a fourth review of its decision adopted on August 25, 1986 to limit Zambia's use of the Fund's general resources until such time as Zambia is current in its obligations under the Articles of Agreement relating to repurchases and the payment of charges in the General Department.

In the decision adopted at the third review on March 23, 1987, 1/ the Fund, inter alia, again urged Zambia to make full and prompt settlement of the overdue financial obligations to the Fund, noted Zambia's efforts to address its economic problems, and called on the authorities to implement the comprehensive economic adjustment measures required in Zambia's circumstances as a matter of urgency. The decision provided for a further review not later than May 22, 1987, with the expectation that a decision to declare Zambia ineligible to use the Fund's general resources would then be adopted in the absence of full settlement of Zambia's overdue obligations in the General Resources Account by that date.

This paper describes recent developments with respect to Zambia's overdue financial obligations to the Fund and submits a decision for the consideration of the Executive Board.

2. Zambia's arrears to the Fund at the time of issuance of the complaint under Rule K-1 in July 1986 amounted to SDR 51.5 million, and had risen to SDR 166.5 million 2/ by the time of the third review on March 23, 1987, despite payments in that period totaling SDR 40.2 million.

Since the third review, Zambia has made no further payments to the Fund, and additional obligations totaling SDR 22.0 million have become due. Consequently, as of May 14, 1987, Zambia's overdue financial obligations to the Fund totaled SDR 188.5 million, as shown in Attachment II. Zambia's forthcoming obligations are shown in Attachment III.

1/ See Attachment I.
2/ Reflects a payment of SDR 3.9 million received on March 23, 1987.

3. In EBS/87/61 (3/16/87) the staff reported that a mission was in Lusaka to review recent developments in Zambia and their implications for the future course of adjustment policy. It may be recalled that this mission was preceded by the announcement by Zambia of the cancellation of the foreign exchange auction system, with an exchange rate being officially established at K 9 = US$1. Also, the Government had announced the budget for 1987 which envisaged an overall deficit on a commitment basis equivalent to 20 percent of GDP.

The March mission reached understandings with the authorities on the modalities of a two-tier exchange rate system on the basis of which foreign exchange auctions were resumed on March 28, 1987. These understandings were to be the basis on which further policy understandings would be reached with the authorities in fiscal, monetary, and other areas. Following the resumption of the auctions, the kwacha depreciated sharply from K 15 = US$1 to about K 21 = US$1, but moved back to K 15 = US$1 at the last auction, held on April 30, 1987.

A Zambian delegation led by the Prime Minister and Minister of Finance visited Washington during April 14-24, 1987 and had discussions with Fund management. In addition, the Prime Minister also addressed informally Executive Directors of donor countries. The focus of the discussions between the Zambian delegation and Fund management and staff was (i) the size of the budget deficit for 1987; (ii) the level of and the planned program for phasing out fertilizer and maize subsidies; (iii) monetary and interest rate policies; and (iv) the authorities' serious concern about the rapid depreciation of the exchange rate. The Zambian delegation also held parallel discussions with the World Bank management and staff on the subsidy issue and on other structural policies related to disbursement of the Bank's credits to Zambia.

It was understood that a Fund staff mission would visit Zambia in early May to finalize the discussions. In the meantime, on May 1, 1987, the authorities announced major policy initiatives which were fundamentally different from the course of policy discussions between the management and staff and the Zambian delegation in the previous weeks. As the staff reported on May 4 to the Board, the new policy orientation of the authorities contained the following major measures:

1. With effect from May 4, 1987 the foreign exchange auction system was replaced by a fixed rate system with the rate set at K 8 per US$1, compared with the last auction rate of K 15 per US$1;

2. The policy of issuing import permits without restriction for "no funds involved" imports would be reviewed with a view to restricting use of such permits to essential consumer goods, manufacturing inputs, and machinery;

3. Debt service on external obligations will be limited to 10 percent of total export earnings after allowing for allocations to meet the requirements of ZCCM (the copper mining company), ZIMOIL (the

petroleum importing company), NAMBOARD (the agricultural marketing board for fertilizer imports), and Zambia Airways. However, debt service on new obligations would be as per their terms;

4. Lending interest rates, which were reduced in late January 1987, were reduced again to 15 percent with a maximum rate now set at 20 percent, compared with a rate of 35 percent in December 1986 under the Treasury bill auction system;

5. Prices of all commodities were frozen, with a view to reducing prices. The Prices and Incomes Commission would work out new prices for all domestically manufactured and imported products with the objective of putting these new prices into effect by end-May;

6. An export-import bank with an initial capital of K 50 million would be set up; and

7. A revolving fund would be established under the management of the Bank of Zambia to support small-scale enterprises.

The thrust of the above policies is at variance with the policy framework discussed with the Zambian delegation and which was to form the basis for a possible stand-by arrangement and an arrangement under the SAF, once the overdue obligations to the Fund were settled. In the circumstances, the planned staff mission was cancelled. However, on May 5, 1987 the Managing Director communicated to the President of the Republic of Zambia the Fund's desire to maintain friendly and cooperative relations with Zambia and its readiness to renew discussions at any time convenient to the authorities. In a communication of May 15, 1987, the authorities stated that Zambia would cooperate with the Fund as deemed necessary under the Articles of Agreement.

4. As indicated in paragraph 1, the Executive Board meeting on May 22, 1987 will constitute the fourth review of the decision to limit Zambia's use of the Fund's general resources. In considering what steps should be taken at this stage, it may be useful to compare Zambia's situation with those of the four other members that have reached the stage of a fourth review under the Fund's procedures relating to overdue financial obligations (see summary in Attachment IV).

In Nicaragua's case, the member had become current by the time of the fourth review and the complaint had been withdrawn. The decision at the review constituted formal completion of the review process.

In the case of Guyana, the Executive Board decision at the fourth review, pursuant to an "expectation" provision that had been expressed in the decision taken at the previous review, declared Guyana ineligible to use the general resources of the Fund with effect on the date of the review. In the cases of Sudan and Sierra Leone, the Board declared the

member ineligible to use the general resources at the fourth review, 1/ but refrained from making the declaration effective immediately. Instead, in order to allow some further time for the member to make progress toward implementation of adjustment measures then under discussion with the Fund and to discharge the overdue financial obligations, the declarations of ineligibility were not to take effect until a future date--one month from the date of the decision in the case of Sudan and ten weeks in the case of Sierra Leone. With respect to Sudan, in view of the absence of concrete action to implement the policy measures that had been under discussion and a clear prospect of full and prompt settlement of the arrears, the declaration of ineligibility went into effect as provided in the Board's decision. As regards Sierra Leone, in the light of subsequent developments, including the authorities' readiness to implement appropriate adjustment measures and progress that had been made toward financing arrangements to clear the arrears, the Executive Board later agreed to an Executive Director's request that the effective date of ineligibility be postponed for a further two months. In that subsequent period, the member discharged the overdue obligations in full, the complaint under Rule K-1 was withdrawn, and, accordingly, the declaration of ineligibility did not take effect.

It may also be noted that in four other cases--Viet Nam, Liberia, Tanzania, and Peru--decisions containing a declaration of ineligibility were adopted at earlier stages of the Fund's procedures with respect to overdue financial obligations. These declarations of ineligibility contained provisions that they would take effect on future dates, which, in light of the circumstances of the individual member, varied from six weeks from the date of the decision in the case of Viet Nam, to two months in the case of Liberia, three months in the case of Tanzania, and four months in Peru's case. In three of these cases--Viet Nam, Liberia, and Peru--the declarations of ineligibility went into effect on the dates provided in the Executive Board's decisions. With respect to Tanzania, developments occurred along similar lines as in the case of Sierra Leone, and the Executive Board agreed to postpone the effective date of ineligibility for a further nine days. In that period, Tanzania became current in the General Resources Account and the declaration of ineligibility did not take effect.

Zambia's circumstances are not identical to those of any of the members discussed above (although, as noted in the staff paper for the

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1/ In Sierra Leone's case, the Board's decision at the preceding review had expressed the expectation that Sierra Leone would be declared ineligible at the fourth review unless it had become current in its financial obligations to the Fund; at the third review of Sudan's overdue obligations, the decision indicated that consideration would be given to the possibility of a declaration of ineligibility at the next review if Sudan had not become current, which provision had also been included in the decision adopted at the second review.

previous review, there were some parallels with that of Sudan at that stage 1/). In Zambia's case, the member has decided not to continue discussions with the Fund aimed at finding solutions to its economic and financial problems and has adopted economic measures at variance with those that were recently discussed with the Fund. In addition, the authorities have provided no indications with respect to the prompt settlement of the overdue financial obligations to the Fund, and it cannot be assumed that settlement is in early prospect. It has been the practice of the Executive Board in circumstances such as these, and following an earlier expression of an expectation of ineligibility, to declare the member ineligible to use the general resources of the Fund. As noted above, in a number of cases where it has appeared that to defer the effective date of the declaration of ineligibility might be helpful in securing progress toward settlement of the arrears to the Fund, the Executive Board has decided to make the declaration effective at some future date. A decision along these lines could be considered in this case.

However, recent developments in the relationship of Zambia and the Fund may suggest that it may be desirable in this case to allow an adequate time period to re-establish a sound working relationship. The Executive Board may wish to consider, in light of the particular circumstances of this case, whether some delay in the declaration of ineligibility of the member might be productive in helping to re-establish working relations with Zambia and in finding appropriate solutions to Zambia's economic and financial problems and securing settlement of the arrears to the Fund. Substantive discussions with the Zambian authorities may be expected to take place during the Annual Meetings. The Executive Board may wish to consider deferring any decision on ineligibility until a date soon after the meetings. If substantial progress in resolving the situation of Zambia's arrears to the Fund has not been achieved by that time, it would be understood that the Executive Board will review the matter again with the intention to declare Zambia ineligible with effect from the date of the review.

Accordingly, the following draft decision, which incorporates in paragraph 4 the alternatives discussed above, is submitted for the consideration of the Executive Board:

Draft Decision

1. The Fund has reviewed further Decision No. 8370-(86/137), 8/25/86, in light of the facts described in EBS/87/108 (5/21/87) pertaining to Zambia's overdue financial obligations to the Fund.

2. The Fund regrets the continuing nonobservance by Zambia of its financial obligations to the Fund in the General Resources

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1/ See EBS/87/61 (3/16/87), p. 4.

Account and notes that further substantial obligations will fall due in the near future. The Fund again urges Zambia to make full and prompt settlement of the overdue financial obligations to the Fund.

3. The Fund attaches importance to continued cooperation with Zambia and expresses its readiness to assist Zambia in finding appropriate solutions to its economic and financial difficulties.

[4. Unless by [ ] Zambia is current in its financial obligations to the Fund in the General Resources Account, with effect on that date Zambia will be ineligible pursuant to Article XXVI, Section 2(a) to use the general resources of the Fund.]

[4. The Fund will review this decision not later than October 21, 1987, taking into account any further developments. Unless by that time Zambia is current in its financial obligations to the Fund in the General Resources Account, or substantial progress has been made by Zambia in resolving the problem of its overdue financial obligations to the Fund, it is expected that the Fund will declare Zambia ineligible pursuant to Article XXVI, Section 2(a) to use the general resources of the Fund with effect from the date of the review.]

Attachments

ATTACHMENT I

INTERNATIONAL MONETARY FUND

Zambia - Overdue Financial Obligations -
Review of Decision to Limit Use of the Fund's Resources

Executive Board Decision No. 8556-(87/52), Adopted March 23, 1987

1. The Fund has reviewed further Decision No. 8370-(86/137), 8/25/86, in light of the facts described in EBS/87/61 (3/16/87) pertaining to Zambia's overdue financial obligations to the Fund.

2. The Fund regrets the continuing nonobservance by Zambia of its financial obligations to the Fund in the General Resources Account and notes that further substantial obligations will fall due in the near future. The Fund again urges Zambia to make full and prompt settlement of the overdue financial obligations to the Fund.

3. While noting Zambia's efforts to address its economic problems, the Fund calls on the authorities to implement the comprehensive economic adjustment measures required in Zambia's circumstances as a matter of urgency.

4. The Fund shall review further Decision No. 8370-(86/137) not later than May 22, 1987 taking into account any further developments. It is expected that a decision to declare Zambia ineligible to use the Fund's general resources, pursuant to Article XXVI, Section 2(a), will then be adopted in the absence of full settlement of Zambia's overdue financial obligations to the Fund in the General Resources Account by that date.

Zambia - Overdue Financial Obligations to the Fund

(May 14, 1987) 1/

Type of Obligation	Date of Purchase or Loan	Due Date	Days Overdue	SDR Amount
General Department				
EF repurchase	11/30/81	06/06/86	342	9,964,327
CF repurchase	12/16/82	06/13/86	335	4,250,000
CF repurchase	10/15/81	07/14/86	304	7,412,500
Semiannual charges EA	--	07/18/86	300	11,579,140
CT repurchase	04/23/83	07/21/86	297	2,388,459
Quarterly charges	--	08/08/86	279	6,243,580
CF repurchase	05/25/83	08/22/86	265	12,150,000
Special charges GRA	--	09/02/86	254	105,300
CF repurchase	12/16/82	09/15/86	241	4,250,000
CF repurchase	10/15/81	10/14/86	212	7,412,500
CT repurchase	04/22/83	10/21/86	205	2,388,459
CT repurchase	04/22/83	10/22/86	204	1,549,041
Quarterly charges	--	11/06/86	189	6,974,567
Special charges GRA	--	11/20/86	175	295,650
EF repurchase	05/18/81	11/22/86	173	15,000,000
CF repurchase	05/25/83	11/24/86	171	12,150,000
EF repurchase	11/30/81	11/26/86	169	6,416,667
EF repurchase	11/30/81	12/06/86	159	12,875,000
CF repurchase	12/16/82	12/15/86	150	4,250,000
CT repurchase	09/30/83	12/29/86	136	2,556,818
Semiannual charges	--	01/16/87	118	9,776,279
CT repurchase	04/22/83	01/21/87	113	2,388,459
Quarterly charges	--	02/13/87	90	6,863,632
Charge on arrangement	--	02/21/87	82	472,000
Special charges GRA	--	02/23/87	80	412,808
CF repurchase	05/25/83	02/24/87	79	12,150,000
CF repurchase	12/13/82	03/13/87	62	4,250,000
CT repurchase	09/30/83	03/27/87	48	2,556,818
CT repurchase	09/30/83	04/06/87	38	3,068,182
CT repurchase	01/16/84	04/15/87	29	3,526,012
CT repurchase	04/22/83	04/21/87	23	2,388,459
CT repurchase	04/22/83	04/22/87	22	1,549,041
Assessment	--	04/30/87	14	13,065
Quarterly charges	--	05/11/87	3	6,430,370
Subtotal				186,057,133

1/ A further repurchase of SDR 15,000,000 will fall due on May 22, 1987.

Type of Obligation	Date of Purchase or Loan	Due Date	Days Overdue	SDR Amount
SDR Department				
Net SDR charges	--	05/01/87	13	985,412
Trust Fund				
Trust Fund repayment	04/30/80	04/29/87	15	934,800
Trust Fund repayment	10/31/79	04/30/87	14	501,600
Subtotal				1,436,400
Total				188,478,945

Zambia - Overdue and Forthcoming Obligations as of May 14, 1987

(In millions of SDRs)

Type of Obligation	Outstanding as of May 14, 1987	Forthcoming 1/							Total 3/ Through 1993
		1987 2/	1988	1989	1990	1991	1992	1993	
Repurchases	136.9	148.7	153.5	98.1	87.9	42.9	4.4	2.2	674.5
Quarterly charges 4/	26.5	12.9	12.8	8.3	4.2	1.0	0.0	0.0	65.7
Semiannual charges 4/	21.4	6.4	11.7	6.6	4.0	1.8	0.6	0.1	52.5
Special charges GRA	0.8	--	--	--	--	--	--	--	0.8
Net SDR charges	1.0	2.0	3.9	3.9	3.9	3.9	3.9	3.9	26.6
Trust Fund repayments	1.4	4.3	8.5	7.5	2.3	0.3	0.0	0.0	24.3
Trust Fund interest	0.0	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.2
Total 3/	188.5 5/	174.4	190.5	124.4	102.3	49.9	8.9	6.2	845.1

1/ On the basis of present use of Fund credit, Trust Fund loans outstanding, and Zambia's present position in the SDR Department. Charges are projected on the basis of current rates of charge. Special charges are not projected.

2/ Due after May 14, 1987.

3/ Totals may not add due to rounding.

4/ Forthcoming charges estimated on the assumption that overdue obligations are paid promptly; to the extent that obligations remain overdue, forthcoming charges may be higher.

5/ Includes an overdue charge on stand-by arrangement of SDR 472,000 and an overdue assessment of SDR 13,065.

Overdue Financial Obligations--Selected Information on Members That Have Reached the Stage of a Fourth Review 1/

(In millions of SDRs)

	Guyana	Nicaragua	Sudan	Sierra Leone	Zambia
Amount Overdue at Complaint	14.3	11.4	81.7	4.0	51.5
Paid between Complaint and 1st Review	4.4	7.3	35.5	3.0	36.2
Amount Overdue at 1st Review	18.6	9.0	119.6	8.5	104.2
Decision at 1st Review	Review within 3 months	Review within 3 months	Review within 2 months 2/	Review within 3 months	Review within 2 months
Paid between 1st and 2nd Review	6.9	0.0	9.7	0.9	0.1
Amount Overdue at 2nd Review	14.8	9.7	150.5	13.4	142.4
Decision at 2nd Review	Review in 2-1/2 months; possible consideration of ineligibility	Review in less than 2 months; possible consideration of ineligibility	Review in 2-1/2 months; possible consideration of ineligibility	Review in 2 months; possible consideration of ineligibility	Review in 2 months; possible consideration of ineligibility
Paid between 2nd and 3rd Review	2.6	2.7	0.0	2.6	3.9
Amount Overdue at 3rd Review	18.7	6.9	173.6	14.6	166.5
Decision at 3rd Review	Review in 3 months; expectation of ineligibility	Review in 3 months; expectation of ineligibility	Review in 2-1/2 months; possible consideration of ineligibility	Review in 2 months; expectation of ineligibility	Review in 2 months; expectation of ineligibility
Paid between 3rd and 4th Review	2.6	7.5	0.0	0.0	0.0 3/
Amount Overdue at 4th Review	18.7	0.0	208.6	17.3	188.5 3/
Decision at 4th Review	Ineligibility effective immediately	Review completed; complaint withdrawn	Ineligibility effective in 1 month	Ineligibility effective in 10 weeks	

1/ In the cases of four other members (Viet Nam, Liberia, Tanzania, and Peru), decisions to declare the member ineligible with effect on a future date were taken at an earlier stage, in light of the member's payments performance or the lack of adjustment measures that offered the prospect of early clearance of the arrears.

2/ The first review had been postponed by one month at the request of the authorities.

3/ As of May 14, 1987.