ZAMBIA STABILIZATION (ZAMSTAB) PROGRAM

PROJECT NUMBER 611-0217

PROGRAM ASSISTANCE APPROVAL DOCUMENT

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I. EXECUTIVE SUMMARY

Zambia's economy is at an impasse. Between 1985 and 1989, the economy performed very poorly. Average annual GDP growth was a bare 2.4 percent, resulting in a per capita decline of about 1.3 percent per year. Domestic revenues of the central government declined from 22 percent of GDP in 1985 to 16 percent in 1989, and expenditures, especially on capital investment, declined even more rapidly. Monetary performance was very weak, with the four-year average annual inflation rate at 65 percent, peaking in 1989 to an inflation rate of over 150 percent. Despite an 85-percent increase in copper prices over the four-year period, Zambia was unable to cover payments on a massive debt burden contracted during the first half of the decade. To compound this problem, Zambia's real effective exchange rate at year-end 1989 reduced its international competitiveness compared with 1985, despite the fact that 1986 saw a 50-percent depreciation in real effective terms compared with 1985.

In the wake of a series of economic reform efforts earlier in the 1980s (sometimes with, and other times in rejection of, the assistance of the multilaterals), Zambia undertook significant reform efforts in 1989. In addition, the government also successfully sought the multilaterals' approval of its new reform tack in 1989. This culminated in a late-1989 agreement with the IMF and IBRD on a four-year policy framework paper (PFP) and an early 1990 agreement among the same parties on a first-year program of reforms. The bilateral donors, most of whom had severely curtailed assistance to Zambia following its 1987 rejection of IMF-supported reforms, rallied in support of the new reform agenda. An April 1990 Zambia Consultative Group (CG) meeting in Paris outlined the 1990 program and was successful in obtaining pledges of donor support. At the Paris CG, the U.S. Government pledged to provide "up to $23.6 million" in rapidly disbursing balance of payments assistance to Zambia in 1990, assuming that Zambia's multilateral arrears situation could be cleared up. The proposed funding under the ZAMSTAB program is to fulfill this pledge.

During 1990, the IMF informally monitored Zambia's macroeconomic stabilization efforts, as the GRZ, the multilaterals, and the donor community sought to put together a financing package to enable Zambia to get out from under its massive external arrears problem. First- and second-quarter (March and June 1990) targets under the stabilization program were met by the Zambian authorities, generally speaking, but the program fell apart during the latter half of the year. Budgetary spending exceeded planned levels, and resulted in monetary expansion inconsistent with inflation-reduction objectives. Zambia ended 1990 with an inflation rate of about 80 percent, compared with the desired rate of 40 percent. At the same time, during 1990 the GRZ instituted a number of positive macroeconomic and sectoral reform measures. The exchange rate was depreciated sufficiently to realize a real effective devaluation of between 15 and 20 percent, although the exchange rate was still at a level far from equilibrium. The OGL (open general license) experiment in market-based allocation of foreign exchange was significantly expanded during the latter part of the year. The late-1990 announcement of the 1991 budget provided for some correction of lax fiscal policy during 1990. Interest rates were progressively adjusted to reduce (if only partially) their negativity in real terms. Finally, the GRZ began to implement a tariff reform package during 1990. Thus, although the 1990 performance targets were breached, the GRZ continued with qualitative aspects of the reform program and took measures to prevent a future breaching of targets.

Under this proposed program, the Mission recommends that $19,415,491 in ESF balance of payments assistance, to be deobligated from various Mission programs and projects, be disbursed to support the GRZ's stabilization and adjustment efforts during FY 1991. The funds will be used to assist the GRZ in its critical early-1991 clearing of arrears to the multilateral agencies. If a financing package is not in place and these arrears are not cleared early in 1991, Zambia's balance of payments position is likely to become untenable, severely undermining the stabilization and adjustment program for the year, as designed. The Mission proposes that the funds available under this ZAMSTAB program be disbursed in a single action, to meet multilateral debt commitments, when A.I.D. has received satisfactory assurances from both the GRZ and the multilateral agencies that the multi-donor external financing package is firmly in place. Host country-owned local currency counterpart to the program assistance dollars will be deposited into a special, non-commingled local currency account for expenditure on mutually agreed items within the GRZ's 1991 budget, and for the USAID/Zambia OE Trust Fund. Such expenditures will be monitored.

The risks attendant in such an AID program are not minor. First, the program benchmarks established by the GRZ and the IMF are tight, and depend heavily (even in the short term) on significant inflows of donor resources, in addition to complete deferral of bilateral debt and in addition to bridge financing to clear multilateral arrears. Second, entrenched interests opposed to reform exist in Zambia, as they do in any country contemplating a dramatic policy reform effort. Third, 1991 is Zambia's first election year under the recently approved multiparty system, probably heightening the risk that the reform program will not proceed as planned. Despite these risks, we believe that the USG should lend its maximum support to laying the external financing groundwork, which is a necessary condition to the success of the reform efforts, as currently designed.

II. RECENT ECONOMIC PERFORMANCE AND POLICY HISTORY

A. Problem: A Deteriorating Economy, 1985-89

It is generally acknowledged by observers that Zambia's economy deteriorated during the latter half of the 1980s, in almost every respect. The following discussion is based on Tables 1-4 in the statistical appendix.

Between 1985 and 1989, the Zambian economy performed very poorly. Average annual GDP growth was a bare 2.4 percent over the four years, resulting in a per capita decline of about 1.3 percent per year. Sectoral performance was mixed: non-mining GDP grew at 2.8 percent on an average annual basis, agriculture posted 6.6 percent annual growth, and mining declined 1.4 percent per year despite a 9.5 percent increase in 1989 alone. Consumption increased, in real average annual terms, by 4.6 percent per year, exceeding the population growth rate. Investment declined, however, decreasing from 23.8 percent of GDP in 1986 to a scant 8.7 percent in 1989. By 1989, the economy was clearly consuming beyond its means, given external resource flows, and investment cuts were the price paid. The GDP growth rate in 1989 was a negligible 0.1 percent, and further symptoms of the economic malaise were evident in the government budget, the financial sector, and the balance of payments.

Domestic revenues of the central government declined from 22 percent of GDP in 1985 to 16 percent in 1989. Current expenditures (including interest payments on a commitment basis) declined by even more, dropping from 33 percent of GDP in 1985 to 20 percent in 1989. The central government deficit, on a commitment basis and exclusive of capital receipts and repayments, improved; public savings were a negative 14 percent of GDP in 1985 and a negative 8 percent of GDP in 1989. Although this is strictly speaking an improvement, the level in 1989 was still untenably high and required heavy use of domestic banking system financing. This use of domestic financing was required despite the fact that the government covered about 85 percent of its external commitments by nonpayment.

Changes in the domestic financial system picture reflected an average annual inflation rate of over 65 percent for the four years 1986-89, with the 1989 figure peaking at 152.8 percent inflation on a December-to-December basis. The average money stock increased at about the same rate on an average annual basis, but this disguises the fact that the income velocity of money grew sharply in the latter two years after falling in the first two years of the period. This instability of the velocity figure is especially disturbing because it makes inflation control through reductions in money supply growth less accurately predictable. Domestic credit grew very rapidly, especially during the 1988-89 period, and although credit to the "non-government" sector grew more rapidly than to the central government, the latter grew by an average of 40 percent in 1988/89. This distinction between non-government and government is deceptive, however, inasmuch as the very large parastatal sector is included in the non-government statistics.

Zambia's balance of payments is in a very precarious situation, despite improvements in the balance of trade over the period. The trade balance moved from a $37 million surplus in 1985 to a surplus of $362 million in 1989, almost solely as a result of an 85 percent increase in copper prices in dollar terms over the period. Zambia's merchandise exports (again in dollar terms) increased by $527 million, and her imports increased by $202 million, or by 5.6 percent per year on average. This latter increase is more than double the real GDP growth rate of 2.4 percent for the period, a disturbing trend. External interest owed increased by 50 percent over the period, nonfactor service payments increased by 150 percent, and official transfers dropped sharply from their 1986 peak. In the capital account, disbursements of foreign loans dropped by over 70 percent, from $301 million in 1985 to $83 million in 1989, while amortization payments due barely changed, dropping from $330 million in 1985 to $305 million in 1989. This worsened capital account most likely reflects external dissatisfaction with the course of Zambian economic policies in 1987 and 1988.

Zambia's external debt situation is critical at this stage. The stock of official external debt stood at $5.4 billion as of the end of 1988, of which $2.6 billion was bilateral debt and $2.2 billion was multilateral debt. To cover its balance of payments gaps, Zambia's annual arrears on external debt payments (including both principal and interest) rose from $348 million in 1985 to $796 million in 1987 and continued high at $632 million in 1989. The stock of external arrears, as of year-end 1988, was $2.1 billion, of which $652 million was on bilateral debt and $961 million was on multilateral debt. The situation has worsened during 1989, despite Germany's writing off $350 million worth of debt in 1989.

Finally, Zambia's real effective exchange rate, after depreciating by over 50 percent in dollar terms in 1986, revalued steadily so that its 1989 average level was slightly above the 1985 level and was 110 percent above its 1986 level. In 1989, a large December-to-December nominal devaluation of over 50 percent was eroded by domestic inflation, resulting in an average 28 percent appreciation for 1989 compared with 1988.

The worsening of several indicators in 1989 occurred despite reform measures (described below) that the GRZ (Government of the Republic of Zambia) undertook during 1989 in tandem with its quest for donor assistance through an agreement with the multilaterals. The fact that the economic situation in 1989 was not even worse is probably attributable to those measures. However, it is clear that much more needs to be done before Zambia's economy can turn around.

B. Source of the Problem: The Policy Framework

Zambia's economic policy framework has been a major source of its domestic and external problems over the past several years. Commodity prices have largely been controlled by the government, as has most trading (domestic and external) activity. About 85 percent of manufacturing assets are estimated to be in parastatal hands, and the large mining sector is parastatal controlled. The parastatals receive large subsidies and are generally not well managed. The exchange rate has been generally appreciating due partly to high domestic price inflation, itself the result of excessive bank financing of central government deficits. Interest rates have also been distinctly negative. Finally, Zambia has suffered severe foreign exchange shortages in recent years, following massive borrowing in the pre-1985 period, and these shortages have been primarily dealt with by incurring external payments arrears, also on a massive scale.

Zambia has followed a somewhat eclectic reform path over the past five years, beginning with a donor-supported comprehensive stabilization and adjustment program in the mid-1980s, followed by a rejection of that program in early 1987, and most recently characterized by seeking once again external support for reforms.

1. 1985-87: IMF-Supported Economic Reforms

In 1983, following dissatisfaction with development planning in the preceding period, the GRZ initiated, with the support of the IMF, a general economic reform program. A succession of stand-by arrangements were agreed to, the most recent covering the period October 1985 to April 1987. The policy framework reforms to which the GRZ agreed included (a) exchange devaluation, (b) decontrol of prices, including the rate of interest, (c) import liberalization, (d) reducing the role of the government in economic management, (e) public expenditure restraint to control money supply growth and the rate of inflation, and (f) exploring the privatization of state enterprises. At the outset of the reform period, the GRZ tackled its tasks vigorously. Consistent excess demand for a sharply overvalued kwacha brought successive devaluation as Zambia auctioned off its foreign exchange earnings. Decontrol of prices led to increases in real earnings of crop producers and an expansion of crop production. However, the GRZ's attempts to curb inflation faltered severely, as the government's inability to reduce the fiscal deficit required recourse to domestic borrowing and a consequent increase in the money supply. In 1986, the central government deficit was nearly 30 percent of GDP, and the broad money supply expanded by over 90 percent. Rapidly growing monetary expansion put tremendous pressure on the exchange rate auction, given the rate of supply of foreign exchange to service the auction.

As the stand-by arrangement with the IMF drew to a close, the GRZ announced a reversal of many of the reforms they had undertaken. The GRZ had decided that its experiment with market forces by relaxing government control of the economy would not work. The GRZ had stood by the reform program until rioting following the decontrol of prices for mealie meal, the basic staple, became too much for the government to bear politically.

2. INDP (1987-88) Goals and Objectives

In May 1987, the GRZ announced a return to greater state management of the Zambian economy. The goal of the INDP (Interim National Development Plan -- July 1987 through December 1988) was to stabilize the economy, especially its inflationary tendencies, by reintroducing state control of economic variables such as the exchange rate, the allocation of foreign exchange, prices of basic commodities, the rate of interest, and distribution of resources away from consumption and toward investment. An important element of this approach was to reduce the country's reliance on external resources to support development, characterized in the GRZ's words "growth from own resources." A central reason for this clarion call was the extremely high level of external debt the country had incurred, and the consequently high debt-service burden.

The INDP departed significantly from the economic management policies pursued by the GRZ in the 1984-86 period. The GRZ generally overturned what had been an increasing reliance on market forces and reasserted the primacy of central planning. First, the GRZ reversed what had been a progressively liberalized foreign exchange regime. This was done by (a) revaluing and freezing the exchange rate, and (b) halting the experimental foreign exchange auction system and returning to administrative allocation of foreign exchange. Second, the GRZ reinstituted ceilings on interest rates at levels beneath what they had been prior to the INDP. Third, the GRZ reversed its position on the removal of subsidies on basic foodstuffs (particularly mealie meal); the original removal was a step to increase public savings. Fourth, the GRZ announced a unilateral policy of limits on external debt payments rather than continuing to seek formal rescheduling of its massive debt. These proposals were made, according to the GRZ, because the reform program on which the country had embarked with the donor community's support had in at least the short run put the country into worse economic straits than it had been prior to the reforms. Foreign exchange liberalization was cited as the reason for very high inflation rates, and for the ultimate political insolvency of the reforms.

Despite this fundamental dismantling of the reform program agreed to with the donors and the multilaterals, it is important to note that certain objectives of the INDP (although not the means to attain them) were similar to objectives the GRZ had pursued during the previous reform period. Inflation was to be controlled, exports were to be diversified, positive growth was targeted, the exchange rate was to be reviewed, and subsidies were to be gradually withdrawn. The major difference with the previous period lay in the revived emphasis on direct state management of the economy.

In late 1987, some six months after the GRZ had announced that it was pulling back from key aspects of the donor-supported economic policy reform program of 1986, the GRZ suggested to the IMF, the IBRD, and the donor community that the government was considering embarking on new reform initiatives in six interrelated areas. These were (a) the exchange rate, (b) debt service payments, (c) monetary policy, (d) the budget deficit, (e) interest rates, and (f) price controls. These six areas were precisely those on which the GRZ had pulled back early in 1987. In the event, when the 1988 central government budget was finally unveiled in January 1988, it was clear that the GRZ had in the interim decided not to move on any of these fronts, with the exception of relaxation of price controls. The disappointment of the donor community was profound, and led to a significant reduction in donor contributions to Zambia's economic recovery.

C. Policy Developments in 1989

In late 1988, prior to the 1989 budget address, the GRZ again discussed with various donors GRZ plans for picking up the pace of economic policy reforms. Following these discussions, the GRZ did announce plans in all six areas cited above. The changes announced in late 1988 included: (1) a significant nominal devaluation of the kwacha, (2) an intention to reduce the budget deficit so as to reduce monetary growth and inflation, (3) a minor upward adjustment in interest rates, which were decidedly negative in real terms, and (4) a decision to remove price controls on all controlled items except maize. During 1989, the GRZ indeed moved further on a number of these policy areas.

First, in November 1988 and again in June 1989, the exchange rate was devalued sufficiently to halve its nominal value compared with the rate in effect for the entire March 1987 -- October 1988 period. Although the rapid rate of inflation in Zambia (compared with its major trading partners) was so high that the real effective rate was almost certainly well overvalued, the November 1988 and June 1989 devaluations were initial steps in the right direction after a long period of GRZ inattention to Zambia's external competitiveness. During the period since June 1989, the kwacha has been steadily devalued. In February 1990, the GRZ opened a second foreign exchange window for a narrow range of imports, at an exchange rate much closer to the then equilibrium rate, i.e. an exchange rate more devalued than the official rate. That window, providing a (limited) open general license system for certain imports, was a further attempt by the authorities to bring the price of foreign exchange into line.

Second, although there were reports that Zambia was paying more serious attention to debt service obligations, the overhang was so great that the GRZ still continued to make only a dent in current obligations, let alone arrears. Presumably one hope of the GRZ in accelerating the pace of reforms and in seeking IMF-IBRD approval of this pace was that the bulk of non-multilateral debt would be rescheduled in the near future.

Third, the GRZ in 1989 made an attempt to take monetary policy in hand by raising the deposit requirements of the domestic banking system. Despite some reining in of money supply growth and consequent slowing of inflation in the third quarter of 1989, the fourth quarter saw a surge of price increases as banks did not adhere to the deposit requirements. The end-year consumer price index number was a staggering 154 percent above the year-end 1988 figure.

Fourth, there were unconfirmed reports that, as far as fiscal policy was concerned, the GRZ was attempting to stick close to its 1989 calendar-year budget. For example, although consumer prices were originally expected to increase by over 90 percent in 1989, the salaries and wages portion of the budget was slated to increase by only about 50 percent. Unit wage increases announced for public servants in 1989 were less than one third the average inflation rate for the year. On the other hand there was a strong likelihood that the amount of subsidies required would exceed the planned level. This would occur despite increases in controlled prices of fertilizer and mealie meal, partly because of increases in interest rates.

Fifth, the interest rate ceiling was increased to 35 percent in 1989, from 20-25 percent, to better reflect the opportunity cost of money and the cost of capital to the economy. Unfortunately, price inflation in 1989 was well above that level, resulting in a continuation of the negative real interest rates that have characterized the Zambian economy for the past several years. Although this increase in interest rates was certainly desirable, the fact that the GRZ had to underwrite (subsidize) large blocks of credit in the fertilizer-maize sectors somewhat reduced the impact of this policy measure.

Finally, the GRZ has removed almost all commodity price controls in the economy by statute. This was clearly an important measure, although floor prices remained on a wide range of agricultural crops as a guarantee to producers that the government would act as buyer of last resort at those prices. Price controls remained on fertilizer, maize (the staple crop, consuming about 90 percent of fertilizer), and mealie meal (maize processed for human consumption), but all these prices were also increased twice during 1989 to bring these controlled prices into better correspondence with other prices changing in the economy. To protect less fortunate consumers, a meal coupon subsidy program was introduced early in 1989. Unfortunately, the means of establishing those prices that remained controlled was probably less than ideal.

III. ZAMBIA'S CURRENT STABILIZATION AND ADJUSTMENT PROGRAM

A. The First Policy Framework Paper (1989)

The late 1988 and the 1989 initiatives on economic policy reforms were carried out in tandem with a series of increasingly serious discussions between the GRZ and the multilateral agencies (the IMF and IBRD) on the possibilities of developing a stabilization and adjustment program blessed by (and hopefully funded by) the multilaterals. These discussions went on as arrears in payments to those agencies and the donor community at large crept up. The GRZ was clearly seeking a means of stemming domestic and external imbalances through a combination of improved policies and expanded external support. These discussions culminated, in the fall of 1989, in a PFP (a policy framework paper) that was approved by the GRZ, the IMF, and the IBRD. Following the approval of the PFP, the GRZ requested that the IMF review an annual program of policy changes covering 1990, bless that program as being within the standards called for under Fund-supported programs, and assist the GRZ in monitoring performance against quarterly benchmarks established under the 1990 program. The IMF in March 1990 responded positively in the first two of the three, but indicated that a Fund-monitored program could not occur until the financing gap for the period in question appeared to be filled. That positive response was the subject of an IMF Staff Report, dated 13 February 1990 which spelled out the 1990 program and benchmarks in detail.

In May-June 1990, the GRZ, IMF, and IBRD reviewed performance under the program, especially with reference to the first (March) set of quarterly benchmarks. The generally satisfactory review of Zambia's performance is contained in a 22 June 1990 IMF Staff Report, which also recommends that the IMF respond positively to the GRZ requests that (1) a Fund-monitored program formally begin from July 1990, and (2) the Fund handle IMF arrears through a rights accumulation mechanism. The willingness of the Fund to respond to these requests was strengthened by donor pledges at the April 1990 Consultative Group meeting, the then-planned July 1990 Paris Club meeting on Zambia, and the strong likelihood that rescheduling and existing donor pledges would permit the program for the balance of 1990 to be fully financed.

In September 1990, the IMF and IBRD returned to Zambia to (1) carry out a review of the performance against June benchmarks, (2) prepare a Fund-monitored annual program, and (3) prepare a new PFP. Discussions between the multilaterals and the GRZ, both on performance and on future steps, took longer than anticipated and are, as of this writing, still being negotiated.

From the foregoing, it is apparent that the entire process has been management-intensive, primarily because of the severe deterioration of policy conditions in Zambia over the 1987-88 period. There was simply much to be done, and to discuss concerning the most appropriate steps to take. In addition, the presence of immense debt arrears, and the fact that a significant portion of these were not reschedulable, added to what was already a difficult situation. The entire process was further delayed due to performance problems (discussed below) in the latter half of 1990, as well as, a timing problem in terms of financing the payment of multilateral arrears in early 1991.

The following sections provide details on the program since the latter part of 1989, and provide a preliminary assessment of that program. The next step in the process, a 1991 program, will be discussed in the next section.

1. Objectives of the Overall Program

The fall 1989 PFP identifies rapid inflation and inappropriate relative prices as primary among the policy errors that underlie Zambia's economic problems. The main thrust of the program was to adjust price incentives in the economy to reflect resource scarcities, largely to ensure a diversification away from the copper sector. An important element in price adjustment was to ensure that the exchange rate would more adequately reflect the true value of the kwacha, thereby providing more realistic incentives for producing tradable goods. At the same time, the GRZ must (primarily through fiscal and monetary policy) bring the rate of price inflation down to a level that stabilizes expectations. A large unknown in the equation was the level of external financial support for the GRZ program, complicated by the large ($950 per capita) external debt overhang and attendant stock of arrears. Key to the success of fiscal policy was whether the GRZ will be able to reduce the level of subsidies, now primarily focused in the fertilizer-maize sectors, plus sustain those reductions in future years. In addition, the currently low level of fiscal revenues (in relation to GDP) must rise.

Considerable testimony to the severe degree and extent of structural maladjustment lies in the sheer breadth of the discussion in the PFP. There are twelve sections in the document's policy matrix, covering not only external policies, monetary policy, and fiscal policy, but also sectoral policies. Included in the fiscal policy measures is a section on parastatal reforms. Although one might quibble with the timing of some measures planned for the 1990-93 period, the matrix is an exhaustive and useful compilation of policy reforms that are necessary, if not sufficient, conditions for sustained longer term growth in the Zambian economy. The degree of detail presented in the fiscal policy section of the matrix is particularly noteworthy. In addition, the matrix also notes specific areas for "priority early action," suggesting that these will be underscored in agreements reached on actions for the first and second years of the program.

The program targets for the years through 1993 under the fall 1989 PFP call for real growth to average 3.4 percent annually, with growth accelerating throughout the period. Even at this rate, annual per capita growth will only be positive in the latter two years of the program. To generate the capacity for growth, investment is slated to rise from its very low 13.6 percent of GDP in 1989 to 27.4 percent, or double that share, by 1993. <u>This growth of investment, in turn, implies a reduction in per capita consumption (in real terms) of about 4 percent per year on average. If investment is to rise as planned, only a large increase in resource inflows (i.e., net imports of goods and nonfactor services) can protect Zambians from an even larger decline in real per capita consumption.</u>

Under the program described in the fall 1989 PFP, Zambia plans to bring price inflation sharply under control. The end-period consumer price index (CPI) projected 96.1 percent price inflation for 1989, with a planned drop to 55 percent in 1990, and an ultimate inflation target of 20 percent for 1993. (As described below, these projections and plans were distinctly optimistic.) Through a combination of inflation reduction and freeing up of domestic price fixing, stabilization and adjustment would get underway. In addition, the PFP policy matrix expressed the GRZ's commitment to bring the exchange rate to a market-clearing level no later than mid-1992.

The easing of inflationary pressures would occur, according to the PFP, through a combination of monetary and fiscal measures. Control over money supply growth, by raising minimum reserve requirements, raising interest rates, and reducing government resort to the banking system (through a combination of revenue and financing measures) was to bring down inflation, while realizing that some initial increase in the velocity of circulation might occur. Money supply growth was to drop from a projected 50 percent in 1989, to 40 percent in 1990, and a further drop to 20 percent by 1993. The requisite domestic credit steps to be taken would entail net reductions in government banking system exposure, in order to permit sufficient growth of credit to the private sector.

Although the PFP contained no balance of payments projections, the text described a process in which a large expected drop in copper earnings beginning in 1990 would be only negligibly compensated for by improved nontraditional export earnings. According to the program, copper prices in 1990 were expected to decline by 30-plus percent from 1989 levels, severely affecting what amounts to over ninety percent of Zambia's export earnings, and the prospects for copper production through the end of the decade of the Nineties was also bleak. The bulk of the balance of payments adjustment would come from improved levels of external financing, including increased balance of payments support and orderly debt rescheduling. However, the financing gap for the program period still remained difficult to fill.

2. Defining the First Annual Program (1990)

In order to permit more realistic monitoring of the broad program laid out in the PFP, the GRZ worked with the IMF and IBRD to put together an annual program covering 1990, replete with quarterly benchmarks that could be assessed. These benchmarks were established in early 1990 but modified in mid-1990. The following is a preliminary analysis of the benchmarks themselves, based on our understanding of the assumptions that lay behind them.

The benchmarks are relatively standard stabilization and adjustment targets that normally appear in IMF programs, based on the assumption that monetary and fiscal tools, operating on the money supply, can act to reduce inflationary pressures without unduly reducing private sector access to banking system credit. With regard to the external sector, the benchmarks also call for ceilings on the accumulation of certain types of external debt and for maintaining an adequate level of gross foreign reserves. Although there are no explicit targets on exchange rate management in the program's documentation that has been released to donors, the text of this documentation discusses understandings between the GRZ and the multilaterals on exchange management in general terms.

Money supply benchmark: Perhaps the single most serious macroeconomic management issue in the Zambian economy is rapid inflation. Consequently, annual targets for growth of the money supply in 1990 were agreed to in the PFP, based on assumptions about changes in the velocity of money. The June IMF Staff Report targeted about a 50 percent increase in the CPI (compared with a 154 percent increase in 1989), and called for a 25 percent increase in broad money to meet that target. For 1990, velocity thus is expected to increase as the pace of monetary expansion is reduced. This is, of course, a reasonable assumption, and provides a margin of conservatism in shooting for the inflation target. This increase in velocity is on the order of 20 percent and, with the assistance of increased interest rates (though still negative in real terms), should help in meeting the inflation target.

Quarterly program benchmarks in the 1990 program aimed to tackle the inflation problem by establishing ceilings on the growth of the money supply. Rather than acting purely through credit limits, the GRZ and the IMF agreed to set benchmarks for maximum quarterly levels of "reserve money," defined as currency in circulation plus statutory reserve deposits at the central bank. According to the IMF Staff Report, one reason for setting a reserve money target was that data on this indicator are available on a more timely basis than are those on the broad money supply, thereby permitting more rapid response by the authorities if additional money supply restrictions were needed to contain inflation. A second reason for using this indicator was that it would be easier to monitor the relatively unpredictable effects of copper price changes on the money supply.

The quarterly reserve money benchmarks may be compared with desired broad money growth objectives. For the year as a whole, with the inflation target set at 50.3 percent and the corresponding broad money growth target set at 25.4 percent, the reserve money benchmark was set at a level implying about 35 percent growth over 1989. This was consistent with the GRZ's mandated increase in the minimum statutory reserve requirement, from about 26 percent to 29 percent.

Public Sector Credit Benchmark: Another key element of the inflation control program was to to reduce the amount of net credit extended to the government by the banking system. Given adherence to the money supply growth objectives, estimates of changes in net foreign assets, and the thus-implicit growth in net domestic credit, it was imperative that the GRZ reduce its exposure to the banking system in order to permit sufficient credit to the non-government sector to permit the latter to operate. Consequently, a program benchmark on reducing net domestic credit to the government was included in the program, such that credit to the non-government sector was anticipated to expand by about 70 percent during 1990. According to the June IMF Staff Report, the GRZ intended to reduce net banking system claims on government by well over 50 percent during the course of the year. The program benchmarks themselves were somewhat confusing at first glance, in that they show almost no change in the level of net credit to government over the year. However, this is explained by the fact that the benchmarks exclude credits to a blocked GRZ deposit account. Inasmuch as these were expected to increase over time, the government's net position with respect to the monetary survey would improve even with no apparent improvement in the benchmark.

The benchmark on credit to the government was, according to the program, to be adjusted downward in each quarter if (1) external grants and loans exceeded the expected amount in any quarter, or (2) the mineral resource levy generated revenues. In other words, if the GRZ received "windfall" revenues from either of these two sources, they were to go in their entirety to accelerating the GRZ's repayments to the banking system, rather than to increased current or capital spending. Consequently, the GRZ's only two means of financing spending in addition to that planned for 1990 was to either realize revenues beyond the planned level or to seek domestic nonbank (i.e., noninflationary, such as the sale of additional Treasury Bills or bonds) financing of the additional spending.

Given the monetary and fiscal objectives of the program, these benchmarks on net banking system claims on government appear sound. Not only would they permit a significant increase in credit to the nongovernment sector, but they also restricted certain increases in expenditure, providing for the possibility that windfall revenues would essentially be converted into further expansion of nongovernment credit in a noninflationary manner.

<u>Fiscal revenue benchmark</u>: With an eye to reversing what has been a significant decline in fiscal revenues since 1986, the program provided for a sharp increase in recurrent revenues in 1990. The program expected a real increase in recurrent revenues on the order of 20 percent, bringing the level of recurrent revenues up by three percentage points of GDP, from a very low 16 percent in 1989 to 19 percent in 1990. This would be augmented by projected external grants, which were expected to also increase by about three percentage points of GDP in 1990. Together, this 6 percentage point increase would permit about a three percentage point increase in government spending and a similar reduction in the deficit for financing. As noted earlier, the GRZ expected to reduce its domestic exposure, allowing external debt rescheduling to cover the remaining financing needed.

The quarterly targets on revenues, which were expressed as a floor level, appear to be spread relatively evenly over the year, considering the value of each quarterly addition to revenues in real terms.

<u>Reserve and debt benchmarks</u>: In addition to the usual relatively strict prohibitions on contracting non-concessional external debt, the program contained a floor on accumulation of gross foreign reserves. That benchmark during the course of 1990 was originally set at the level that obtained in September of 1989, an acceptable level that is equivalent to just under two months of imports. That benchmark was adjusted downward during the first program review in June 1990 such that the resulting

target was approximately equivalent to six weeks of imports. This level is probably still acceptable, especially given Zambia's extreme dependence on concessional external financing.

The gross reserve benchmark, as was the case with the domestic borrowing benchmark, contained a proviso for altering the benchmark upward if copper prices exceeded those contained in the program estimates. In the event that copper prices in a given quarter exceeded the level set in the program, the "copper price contingency mechanism" in the program called for 60 percent of the excess copper earnings to be placed into reserves (with the target suitably adjusted upward), 30 percent of the excess to go to reducing the financing gap, and the 10 percent balance to be used at Zambia's discretion. (The excess earnings were calculated after any shortfalls in external import financing were deducted.)

Additional benchmarks and understandings: In addition to the explicit program benchmarks discussed above, the program provided for a set of qualitative benchmarks over the course of 1990, and the program documentation available made passing reference to understandings reached on exchange rate management and movement, the latter with particular reference to the official exchange rate that governed the bulk of Zambia's foreign trade at the time. Of primary interest to the program was the qualitative benchmark referring to the experimental OGL (open general license) allocation system for foreign exchange.

Under the program, the GRZ agreed to begin an OGL early in 1990, and to gradually expand the list of eligible imports such that only a small negative list would be excluded by end-June 1990. In the event, delays in reaching agreements with donors on possible financing delayed both the start and the progress of the program, and the deadline for expansion was extended to end- 1990. The idea of the OGL was that any non-copper foreign exchange earnings could be sold to the GRZ through the OGL, at an established exchange rate in excess of the official rate. Any eligible importer (of goods or services) would have access to foreign exchange through the OGL window, and the exchange rate operating at the OGL would be one that balanced supply of and demand for foreign exchange. Donors were encouraged to augment the normal resources available to supply foreign exchange to the OGL by providing untied balance of payments assistance to Zambia. In step with the expansion of this mechanism, the GRZ agreed to unify the official and OGL exchange rates as soon as feasible, but no later than mid-1992.

The OGL appears to us to be a valid mechanism for moving toward a market-determined exchange rate, provided that it works smoothly and transparently. As to the issue of movement of the official exchange rate, we simply do not know the details. Our assumption, however, is that that in addition to agreeing to move the two exchange rates to unity at a market-clearing rate no later than mid-1992, the GRZ agreed to ensure that it did not permit the official exchange rate to appreciate in real effective terms over the intervening period.

3. Performance Under the Program to Date

a. Review of March 1990 Benchmarks

The upshot of the first review, as noted earlier, was that "...compliance with the program's financial and structural benchmarks has been reasonably satisfactory...." The reserve money benchmark was exceeded by only 2 percent, when an adjustment to earlier, incorrectly formulated benchmarks were adjusted, i.e. when an incorrect calculation of the end-1989 broad money supply by the BOZ was identified and corrected in the base period calculations for setting the benchmarks. Although inflation dropped compared with the preceding months, it was at a higher level in the first quarter of 1990 than planned under the program, at an annual rate of 77 percent compared with the expected 50 percent. The upshot of both the review of the money supply benchmark and the reality of the inflation situation was that benchmarks for subsequent periods, beginning in June 1990, were modified. For example, the overall annual inflation target of 40 percent was revised upward to 50 percent, an interesting revision because it had been revised downward from 55 percent to 40 percent between the August 1989 PFP and the February 1990 establishment of program benchmarks. The reserve money benchmarks for June and beyond were also revised upward, in this case to reflect not only the earlier incorrectly formulated benchmarks, but also the fact that even the quarterly growth rate of reserve money as originally envisioned for June over March had been exceeded by the time that the Fund team arrived in June. It appears that the Fund and the GRZ agreed, during that June visit, to revise the June benchmark for reserve money to reflect a zero growth rate of reserve money for June (compared with May). For the two remaining quarterly benchmarks on reserve money, the IMF and GRZ apparently agreed that growth should be slower than in the original program, given excessive growth during the first half of the year.

As to fiscal performance during the first quarter, a cash surplus exceeding expectations was realized despite the fact that the GRZ did not, strictly speaking, meet the revenue benchmark. The revenue benchmark was missed by an amount approximately equivalent to a late payment of taxes by ZCCM, the copper parastatal. On a commitment basis, therefore, the revenue benchmark could have been judged to have been met. As to net lending to the government, the benchmark was met, though in part because expenditures on a cash basis lagged behind their commitment (and authorized) level. This deferral of payments is worrisome, however, because it would presumably catch up with the GRZ, and the means of financing this spending, according to the program parameters, was solely the banking system.

As to external benchmarks, a delay in carrying out deliberations to garner donor support for the program resulted in a breach of the arrears benchmarks, both with respect to overall arrears and with respect to arrears to the Fund. This unavoidable situation resulted in redefining the arrears target in such a manner as to change the start date for zero arrears accumulation from January 1990 to July 1990, the start date for the formal IMF-monitored program for Zambia. The gross reserves benchmark was seriously missed, for a variety of reasons. First, copper volumes were not as high as expected. Second, unexpected payments were made on Bank of Zambia short-term obligations. Third, import transactions were higher than planned. Finally, unexpected payments on nonmultilateral debt were made, with the expectation of leveraging additional new funds. Consequently, as noted earlier, the gross reserve benchmarks for the June 1990 period onward have been revised downward to reflect these realities.

Although several of the performance benchmarks were not met and were subsequently revised, it is fair to concur with the Fund's assessment that the program was broadly on track at the time of the June review of the March benchmarks. First, although the reduction in inflation did not meet expectations, the annual rate for the first quarter was, at 77 percent, significantly below the 154 percent for year-end 1989. Second, although the inception of the OGL was delayed, the GRZ took the important step of announcing a second legal foreign exchange conversion rate that put the price of foreign exchange at a more realistic level. Third, between July 1989 and March 1990, the GRZ had frequently adjusted the official exchange rate to prevent its real effective level from appreciating. Finally, the GRZ appeared to be on track with structural benchmarks, included in the 1990 program, concerning parastatal review, streamlined export licensing, tariff reform, and civil service reform. Given the foregoing, and given the fact that the program was barely underway, a negative judgement of the program would have been very counterproductive.

b. Evaluation of Remainder of 1990 Targets

Evaluating the GRZ and Zambian economy's performance for the second, third and fourth quarters of 1990 is complicated by the facts that (1) the IMF staff have not prepared an official report which reviews performance for these quarters; (2) the GRZ was unable to provide a quarterly breakdown of all the relevant economic data for 1990; and (3) the IMF staff make a number of unspecified "adjustments" to the data the GRZ provides to the IMF to arrive at the actual figures used in their reports and review of performance. Given these complicating factors, the approach used below to evaluate actual performance is less detailed than that presented above for March, 1990. Quarterly and annual quantitative measures of performance are used to the extent possible. In addition, a relatively detailed discussion of qualitative and structural policy measures are also presented to complete the picture.

Monetary Developments: The revised quarterly targets from the IMF's June 22, 1990, "Zambia-Staff Report for the First Review of the Economic and Financial Program for 1990" provide the benchmark data for Net Domestic Credit to the Government (NDCG, excluding the blocked GRZ account 851 for debt service) and broad money (M2) presented in the following table. Data provided by the Bank of Zambia for 1990, allow the construction of similar series for actual performance, even though it was not possible to reconstruct the IMF figures from the Bank of Zambia data. Therefore, the discussion of performance is based on the relative changes in these two sub-components of the monetary survey compared to a March, 1990 base.

Using this approach from a March 1990 base value, NDCG was to have decreased 7.5 percent by June, 8.6 percent by September, and 32.5 percent by December under the revised IMF program targets. For June, the GRZ had actually performed better than expected, decreasing NDCG relative to March by 20.9 percent. By the end of September, however, this improved performance had been eroded with NDCG decreasing by only 6.4 percent as opposed to the target of 8.6 percent compared to March, i.e., a performance erosion compared to March of 2.4 percentage points. By December, the situation was much worse with an actual expansion of NDCG of 14.7 percent compared to a targeted decrease of 32.5 percent, a swing of 47.2 percentage points.

A similar pattern also occurred with respect to the developments in the growth of the broad money supply (M2). The targeted percentage increases in M2, again compared to a March base, for June, September and December were 9.7 percent, 17.2 percent and 26.2 percent, respectively. In June the actual percentage increase in M2 compared to March was 7.6 percent, 2.1 percentage points better than under the revised IMF targets. By September the expansion of M2 compared to March was 27 percent which represented an overshooting of the targeted rate of increase by 9.8 percentage points. Finally, by December the actual expansion had reached 46.8 percent compared to a targeted expansion of 26.2 percent, an excess of 20.6 percentage points.

Table 1. Analysis of Monetary Performance for 1990
(Kwacha Millions and Percentages)

Item	March	June	September	December
IMF Revised Targets				
Net Domestic Credit to the Government, (excl. 851)[NDCG]	4,101	3,794	3,750	2,769
Percent Change Compared to March	n.a.	-7.5	-8.6	-32.5
Broad Money (M2)	16,625	18,237	19,489	20,984
Percent Change Compared to March	n.a.	9.7	17.2	26.2
Ratio of NDCG to M2 (Percent)	24.7	20.8	19.2	13.2
Index of the Ratio of NDCG to M2	100.0	84.3	78.0	53.5
Bank of Zambia Data				
Net Domestic Credit to the Government, (excl. 851)[NDCG]	5,203	4,116	4,872	5,968
Percent Change Compared to March	n.a.	-20.9	-6.4	14.7
Broad Money (M2)	16,619	17,881	21,108	24,387
Percent Change Compared to March	n.a.	7.6	27.0	46.8
Ratio of NDCG to M2 (Percent)	31.3	23.0	23.1	24.5
Index of the Ratio of NDCG to M2	100.0	73.5	73.7	78.2

Given the fact that a full Monetary Survey is not currently available, information concerning the development of Net Foreign Assets (NFA) is missing. Thus, it is difficult to make further generalizations concerning the composition of the expansion of the broad money supply. Abstracting from any developments in NFA, however, examining the patterns in the ratios of NDCG to M2 which gives an indication of the contribution of government borrowing to the broad money supply, can provide some clues to the likely course of developments. Such an examination clearly shows that the actual trend in this ratio was moving upwards, rather than downwards as expected under the IMF program. Given the relative values of the index numbers for this ratio, it is clear that the changes in net domestic credit to the government was generally being matched by changes in net credit to the non-government (including parastatals) sector from June through September. The increase in this index number between September and December, however, indicates that government borrowing was dominating the expansion of non-government credit expansion in driving the growth of the broad money supply.

For the year as a whole, the slippage in performance during the last half of the year resulted in a 45.8 percent increase in broad money as opposed to a programmed increase of 25.4 percent.

The principal reason why there was such a variation in the actual expansion of NDCG compared to that programmed is due to the unplanned granting of both wage and housing allowance increases (a wage increase was planned) while the Minister of Finance was out of Lusaka early in the second half of 1990. These increases resulted in the violation of the budgetary targets (see below), and thus the observed expansion of credit to the government. In the Budget Speech for 1991, given in November 1990, the Minister of Finance announced a number of measures designed to correct for the budgetary overruns. (These measures are discussed below in the section on Other Developments.) According to discussions with IMF staff, these measures are expected to be sufficient, along with the other planned restraints on budgetary expenditures, to place the IMF's stabilization program for 1991 back on track.

<u>Fiscal Policy</u>: Since data concerning the quarterly performance of the budget are not available, the evaluation of fiscal policy performance can only be based upon the end-1990 budgetary outturn. Under the IMF program, Revenues and Grants were expected to be at least 24.5 percent of GDP, Expenditures and Net Lending were targeted not to exceed 30.4 percent of GDP, thus resulting in a deficit on a commitments basis of no more than 5.9 percent of GDP. On a cash basis (after interest relief and arrears), the deficit was not to exceed 3.6 percent of GDP. The division of the financing of the deficit between external sources and domestic sources was expected to be 98.8 percent external and only 1.2 percent domestic.

Based on the estimated end-1990 budget figures, Revenues and Grants turned out to be 25.7 percent of GDP compared to a required minimum of 24.5 percent of GDP. Thus, the Revenue and Grants target was satisfied. In terms of Expenditures and Net Lending, however, the preliminary results indicate that this category was 35.5 percent of GDP, compared to a maximum target of 30.4 percent of GDP. This 5.1 percentage point violation of the expenditures target resulted in the commitments deficit being 9.9 percent of GDP, or 4 percentage points above the target of 5.9 percent. Due to the accumulation of additional interest arrears, the cash basis deficit was held to 3.5 percent of GDP compared to a target of 3.6 percent of GDP. The financing of the cash deficit was divided 11.4

percent from external sources and 88.6 percent from domestic sources, compared to the targets of 98.8 percent and 1.2 percent for external and domestic sources, respectively.

An alternative presentation of the end 1990 budgetary targets excludes the effects of donor activities on the budget and judges strictly on the basis of the domestic components of the budget. This alternative presentation thus excludes Grants and Foreign Interest from the above targets. On this basis, the targets were for Revenue to be at least 19.4 percent of GDP, Expenditures excluding foreign interest to be no more than 23.1 percent of GDP, and the Deficit on a commitments basis, excluding grants and foreign interest of no more than 3.7 percent of GDP.

Considering this alternative presentation, the preliminary results for revenues was 21.1 percent of GDP, so that the conclusion that the revenue component of the targets were met. The expenditures component of the fiscal targets was 28.1 percent of GDP, so that this portion of the fiscal targets was again violated by a significant amount (5 percent of GDP). Once again the deficit target of 3.7 percent was exceeded by 3.3 percentage points since this alternative budget calculation resulted in a deficit of 7 percent of GDP.

Economic Performance: In terms of the actual performance of the economy, the IMF had expected that the program would result in a 0.9 percent increase in real GDP, a 68.8 percent inflation rate measured by the GDP deflator, or an inflation rate of 50 percent measured by the Consumer Price Index (CPI). In actual fact, GRZ estimates indicate that real GDP actually declined by 1.7 percent from 1989 to 1990, a shift of 2.6 percent points. Rather than increasing by just under 69 percent compared to 1990, the GDP deflator is estimated to have increased by over 82 percent.

For inflation as measured by the Consumer Price Index, the estimates for the 1990 percentage increase ranges between 75 percent and 100 percent. While the CPI for December 1990 has not yet been released, the percentage increase in the CPI for November 1989 to November 1990 is just over 91 percent.

In short, Zambia's economic performance during 1990 fell short of that expected under the IMF program. In large part, these shortfalls can be traced back to the violation of the fiscal targets, which drove the violation of the monetary targets, which in turn resulted in an increase in inflation.

IMF Arrears: Under the agreed program, the GRZ was expected to cap its arrears to the IMF at the levels of the end of June, 1990. Estimates of the payments needed to achieve this cap were $126.5 million. The GRZ's actual payments over the second half of the year were only $34.5 million, resulting in the accumulation of $92 million in new arrears to the IMF.

This accumulation of new arrears should be considered in the context of other developments in the external accounts. Copper prices averaged

$1.20/lb over 1990 compared to a programmed level of $0.86/lb. Based on estimates of the volume of copper actually exported, this price differential implies that copper export earnings were $340 million above the originally programmed level. Offsetting this, petroleum prices were higher than programmed primarily due to the uncertainties created in the latter half of the year by developments in the Persian Gulf. This shift in petroleum prices cost the GRZ an additional $50 million for petroleum imports. Finally, only approximately $294 million of the $450 million pledged by donors for 1990 was actually disbursed. The shortfall in donor disbursements of $156 million and the $50 million additional funds required for petroleum imports represent a $206 million shortfall in the balance of payments. The major increase over programmed levels in copper export revenues, however, more than offset this shortfall, actually resulting in a surplus of $134 million compared to the revised program. Thus, the major unexpected developments in the balance of payments actually improved Zambia's balance of payments position by this amount.

Based on the above, broad developments in the balance of payments provide no explanation for the GRZ's failure to cap its arrears to the IMF as agreed, especially since the unexpected surplus alone would have been more than enough to cover the IMF payments. Since the capping of IMF arrears was already included in the programmed balance of payments structure, the accumulation of $92 million in new IMF arrears implies a cash swing in favor of the GRZ of $226 million.

Exchange Rate Developments: From March 1990 through December 1990, the nominal exchange rate (monthly averages) moved from K25.37/US$ to roughly K40/US$, a nominal devaluation of 36.6 percent. The evolution of this movement was to move the K29.27/US$ by June (a 13.3 percent nominal devaluation compared to March) and on to K34.04/US$ in September (a further 14.3 percent devaluation over June). In real terms the movement from March to December represented an estimated 12.8 percent real devaluation. When the exchange rates are expressed in terms of kwacha per SDR, the nominal devaluation from March to December was 40.7 percent and the real devaluation over the same time period was approximately 18.2 percent.

While the above performance in terms of the real rate of devaluation represents progress, it should be remembered that if the GRZ wished to move immediately to an equilibrium exchange rate, a further devaluation of 40 percent to 55 percent would be required. Given that the current exchange rate policy is to operate as a crawling-peg and given that Zambia's inflation is likely to continue at a rate of 40-50 percent over the next year, the crawling-peg will have to become more of a walking-peg if the achievement of an equilibrium exchange rate is to be achieved as scheduled.

An alternative way of looking at the current situation is that the average exchange rate for November 1990 represented a 34 percent real appreciation of the K8/US$ exchange rate set in May, 1987. At the same time, the fact that exporters may retain up to 50 percent of the foreign exchange they earn implies that the effective exchange rate for exports

Table 2. IMF Revised End-Year 1990 Targets for Fiscal Policy and Economic Performance

Item	1990 Revised	Estimated/Actual
Fiscal Policy (as % of GDP)		
Revenue and Grants	24.5	25.7
Expenditure and Net Lending	30.4	35.5
Deficit:		
Commitment Basis	5.9	9.9
Cash Basis	3.6	3.5
Revenue (excluding Grants)	19.4	21.1
Expenditure and Net Lending, excluding Foreign Interest	23.1	28.1
Deficit, Commitment Basis, excluding Grants and Foreign Interest	3.7	7.0
Deficit Financing (as % of deficit):		
External (net)	98.8	11.4
Domestic (net)	1.2	88.6
Monetary Policy		
Percent Change in M2	25.4	45.8
Economic Performance		
Real GDP Growth (Percent)	0.9	-1.7
Inflation (Percent/year):		
GDP Deflator	68.8	82.3
CPI (End-Period)	50.0	75-100
(Nov 89-Nov 90, est)		91.3

is "better" than that cited above. For example, with export retentions trading at K79/US$ and a second window exchange rate of K50/US$, the effective exchange rate earned by an exporter would be K60/US$ - a 17% effective devaluation compared to the rate at the second window.

Other Developments: While it can be readily admitted that the general stabilization program ran into significant problems in the latter half of 1990, the GRZ did make significant positive moves in other areas. Some of these areas are discussed below.

In mid-February 1990, the GRZ introduced a second window for foreign exchange which functions as an Open General Licensing System (OGL).

While the list of eligible commodities for the OGL began as a very restricted list, the GRZ has progressively expanded the list of products eligible for importation under the OGL. By December 1990 this list of eligible commodities covered roughly 84 percent of the commodities imported during the base period (1986-1988). On January 14, 1991, the eligibility list was again expanded increasing the proportion of base period imports covered by the OGL to 86-87 percent. The GRZ is currently negotiating with the IMF concerning the contents of the "negative list" for the OGL.

While the introduction of unplanned housing allowance increases in the 1990 budget was responsible for much of the problems involved in the 1990 stabilization program, the Minister of Finance announced a number of measures to help correct the budgetary hemorrage during his Budget Address for the 1991 budget. Some of the revenue measures proposed were:

a) A reunification of the Company Tax rate at 45 percent for all companies as opposed to the current rate structure of 40 percent for manufacturing firms and 45 percent for service sector firms;
b) Seventy-five percent of the increased Housing Allowance introduced during 1990 will be taxed as personal income.
c) A reduction in the tax rate on dividend income from 20 percent to 15 percent;
d) Introduction of accelerated depreciation for implements, plant and machinery in calculating tax liabilities; and
e) The base of the domestic sales tax is to be broadened to include auto and electrical repair services, and domestic air travel.

In terms of budgetary expenditures, the crucial items include agreement to limit the expansion of personal emoluments to simply the amount implied by the normal promotion process, i.e., no general wage or salary increases in 1991. In addition, subsidies are effectively to be limited to their current level, implying that any increase in fertilizer or maize procurement costs will have to be passed on to the final consumer.

In October, 1990, the Bank of Zambia increased the general level of interest rates of roughly 5 percentage points raising the Bank Rate from 29 percent to 34 percent, the maximum lending rate for commercial banks from 35 percent to 40 percent, the Treasury Bill rate from 25 percent to 30.5 percent, the minimum interest rate on savings accounts from 23 percent to 27 percent, and the interest rate payable on one-year Government bonds was raised from 6 percentage points above the Treasury Bill rate (31 percent) to 9.5 percentage points above the Treasury Bill rate (40 percent), and the introduction of a 6 percentage point penalty over the ruling Bank Rate on commercial banks' overdrafts on their Bank of Zambia accounts.

On January 21, 1991, another revision of interest rates was announced. In this round the Bank rate was increased to 39 percent, the maximum lending rate was increased to 43 percent, the Treasury Bill rate was increased to 37 percent, the minimum interest rate on savings accounts went to 30 percent, the rate paid on one-year Government Bonds was increased to 46 percent, and a new eighteen month bond was introduced which currently carries an interest rate of 50 percent.

Given Zambia's current inflation rate, these revised interest rates continue to be negative in real terms, however, these changes have reduced the degree of this problem.

In the November 1990 Budget Address, the Minister of Finance announced the first step in the reform of Zambia's tariff system. Currently, the tariff system has nominal tariff rates ranging from 0-100 percent with an 20 percent sales tax on imported goods. Given the way the sales tax is calculated, this system implies that effective rates range from 25-150 percent, if the items subject to a zero tariff rate are subject to the sales tax, or 0-150 percent otherwise.

The proposed changes involve a reduction in the range of the nominal duty rates to 0-50 percent, except for some luxury goods (beer, cigarettes, jewellery, perfumes and cosmetics). The method for calculating the sales tax is also being modified. Finally, a 15 percent minimum duty, with no sales tax, is being introduced for items currently exempt from duty except for crude oil, material for making mealie meal bags, hessian bags, fertilizer and fertilizer production materials, and medical supplies. These changes imply that for most goods the effective tariff rates will be in the 15-86 percent range, a reduction from the existing range.

The GRZ is also in the process of revising the investment code and statutes in order to help promote domestic investment and to attract foreign investment. The code will be debated by Parliament in early 1991.

In the course of 1990, four major developments occurred in terms of maize and fertilizer marketing. At the beginning of the year, the Cooperative Unions were in a monopoly position in terms of purchasing maize from farms and also were in a monopsony position for selling maize to millers. In September, the GRZ announced that individual farmers and/or private traders could fully participate in maize marketing, i.e., could purchase maize from farmers and sell to millers or others. Thus, the cooperatives' monopoly and monopsony positions were eliminated. Unlike the situation in January 1986 when a similar decree was issued, the maize meal subsidies are currently paid to millers so that the subsidies no longer present an economic block to the participation of private traders in maize marketing.

The next two major developments in this sub-sector deal with the importation of fertilizer and the export of maize. At the beginning of the year, Nitrogen Chemicals of Zambia (NCZ) was the sole legal importer of fertilizer. Again in September, this legal monopoly was abolished. While anyone, other than NCZ, importing fertilizer would not be able to receive the continuing fertilizer subsidy, it could be profitable for a large farmer or group of farmers to privately import fertilizer if they are in a region where subsidized fertilizer distribution is unreliable or unavailable.

The third major change concerns the ability to export maize. At the beginning of the year, the Zambia Cooperative Federation (ZCF) had the legal monopoly on maize exportation. The change introduced in September was that any producer could export their production in excess of 10,000 bags of maize in a given season. While this change will have limited impact, except for some large commercial farmers, it represents a move towards a more liberalized marketing and trade system.

The fourth and final major change in this sub-sector was the GRZ's agreement to proceed with the development of a Maize Policy Action Plan developed with the cooperation of USAID/Zambia's ZATPID II project. This Action Plan lays out the specific policy actions and timing over a twenty-four month period in order to achieve the full liberalization of the maize marketing system and to eliminate the consumer maize subsidy, except for a restricted and highly targeted consumer food subsidy for the nutritionally vulnerable population. This Maize Policy Action Plan is currently being considered for adoption as official policy by the GRZ.

c. Overall Assessment of Performance in 1990

Based upon the above information it is clear that the GRZ's performance under its stabilization and structural adjustment program agreed to with the IMF was not ideal in 1990. Major problems occurred in the stabilization program due to excessive budgetary expenditures which drove an excessive expansion of the money supply, which in turn resulted in much higher inflation than originally programmed. The GRZ also did not fulfill its commitments in terms of resuming full payments to the IMF beginning in July 1990.

On the plus side, the GRZ has made progress in adjusting the exchange rate, but will need to increase the pace at which it has been devaluing if the establishment of an equilibrium rate is to occur as scheduled. The expansion of the OGL has proceeded apace and appears to be on-track despite the slow start in its definition and funding. The 1991 budget address proposed a number of new revenue measures and severe limitations on key expenditure elements which are designed to correct the fiscal hemorrage which occurred in 1990. Interest rates have been adjusted twice in order to help reduce the degree of negativity in the structure of real interest rates. The first phase of tariff reforms has been announced which will reduce the range of effective tariff rates on most, but not all goods, from 0-150 percent to 15-86 percent. Within the maize and fertilizer sub-sectors, the maize marketing monopoly and monopsony of the provincial cooperatives have been eliminated, the legal monopoly of NCZ for importing fertilizer has been eliminated, and the maize export monopoly of ZCF has been eliminated on a restricted basis.

In conclusion, it is difficult to say in the case of Zambia whether the cup is half-full or half-empty. Such judgements must be made by each viewer of the cup. What can be said with certainty, however, is that even though the stabilization portion of the program has been put back on-track at this time, it must be maintained on-track in the future for the effectiveness of the various structural measures being adopted not to be severely eroded or even eliminated.

B. The Second Policy Framework Paper (1991)

1. Policy Framework Commitments, 1991-93 Period

Following intensive discussions, among the GRZ, the IMF, and the World Bank, on the Zambian economy during 1989, the parties agreed to a PFP (policy framework paper) in the fall of 1989. The PFP was a comprehensive statement of the GRZ's reform intentions with respect to Zambia's policy framework. In addition to macroeconomic policy undertakings, the PFP contains specific policy reforms in agriculture, manufacturing, mining, transport, and energy, as well as education, health, and the environment.

The main thrust of the program in this late August 1989 PFP was to adjust price incentives in the economy to reflect resource scarcities, largely to ensure a diversification away from dependence on the copper sector for foreign exchange earnings. An important element in price adjustment would be to ensure that the exchange rate more adequately reflect the true value of the kwacha. At the same time, the GRZ would bring the rate of price inflation down to a level that stabilized expectations, primarily through fiscal and monetary policy. Key to the success of the fiscal policy objectives was whether the GRZ would be able to reduce the level of subsidies, primarily focused in the fertilizer and maize subsectors.

In February 1990, the GRZ provided the IMF with a letter detailing policy steps and quantitative macroeconomic targets to be implemented during 1990, the first year of the PFP program. Pending the accumulation of sufficient external financing to fund the proposed program, IMF management agreed to begin to monitor the 1990 program as the year unfolded. During the course of 1990, it became increasingly evident that the program's quantitative targets would not be met; this evidence emerged during the second half of the year, as the World Bank was attempting to close the balance of payments gap by appealing to the donor community. For all practical purposes, the latter part of 1990 involved efforts to: (1) redefine a policy action plan for the 1991- 93 period, and quantitative targets for 1991; (2) provide for a creative solution to Zambia's large multilateral debt (including arrears) overhang; and, (3) garner sufficient (and sufficiently flexible) donor financing to meet Zambia's external financing requirements in a staged manner during 1991. These efforts culminated in a new PFP in the first quarter of 1991 and a financing scenario to meet the PFP's objectives.

The two versions of the PFP are fairly similar, especially in terms of their broad objectives of reducing inflation and improving the structure of relative prices in order to bring about a more efficient allocation of resources, as well reverse external and domestic imbalances. The policy matrix in the 1991 PFP is divided into twelve sections, beginning with macroeconomic sectors (external, fiscal, and monetary policies), going through productive sectors (agriculture, industry, mining, transport, and energy), and ending with primarily social sectors (education and health) and the environment. The following discussion of "sectoral" policy commitments includes a comparison of the commitments of the GRZ under the two PFPs.

a. External Policies

Given Zambia's serious balance of payments current account financing problem, the first section of the PFP policy reform agenda deals with external policies, subdivided into four categories. Under the first category, the exchange rate, the 1991 PFP calls for more rapid movement toward a "market- clearing level" than did the 1989 PFP. In the earlier version, such a level was to be attained by mid-1992; in the current version, year-end 1991 is the target date for reaching unification of the official and "second window" rate, at a market-clearing level. In the earlier version, to complement the putatively market-determined exchange rate at the second window (the OGL; open general license), the GRZ agreed that the official exchange rate would not lose ground, in real effective terms. Although this latter measure is not explicit in the 1991 PFP, it is certainly implicit. The point of these adjustments, of course, is to provide price incentives for exports and efficient import substitutes, and to provide more efficient prices for imports.

However, in addition to realignment of the kwacha price of foreign exchange, there are other external policies that should be re-examined, because there are other aspects of the trade regime that distort the economy. Important among these -- and prominent in the PFP policy matrix -- are quantitative restrictions on imports and a highly discriminatory and protective tariff structure. As to the quantitative restrictions, the GRZ has made apparently impressive advances by shifting all imports, except for those by ZCCM, plus fertilizer, petroleum and medical supply imports,as well as a small negative list, to the OGL as of late 1990. The intention is to fully employ the OGL for imports relatively early in 1991. Although the Foreign Exchange Management Committee (FEMAC) was abolished in September 1990, it is not clear yet how applications for use of the OGL are handled. To the extent that import licensing requirements are truly free, the OGL should permit relatively rapid movement toward a market-clearing rate, perhaps earlier than the end- 1991 deadline. Tariff reform is proceeding more slowly, and the GRZ's objectives under the PFP are somewhat inexplicit. The objective is "to lower the average level and dispersion of protection" by end-1992.

According to the 1991 PFP policy matrix, the two requisite actions on the export liberalization front, the third category of external policies requiring attention, occurred by year-end 1990. By then, the export licensing process was streamlined and the number of products Zambians were prohibited from exporting was reduced from 48 to 4. The fourth category of external policies is that concerned with Zambia's serious external debt problems and with its external aid coordination. The policy matrix calls for, as top-priority actions, Zambia's maintenance of currency with respect to Fund obligations since the June 1990 arrears cut-off date and Zambia's clearing of arrears to "other multilaterals." The former policy action is important if a Fund- monitored "rights" program is to take place, especially because Zambia's arrears to the Fund continued to mount, during the second half of 1990, despite the fact that the original cut-off date was moved from December 1989 to June 1990. The clearing of arrears to the other multilaterals (particularly the World Bank) is equally critical, if Zambia is to regularize its debt position with respect to the outside world. In the absence of performing on its multilateral debt obligations, it is almost assured that Zambia will not only lose ground gained on bilateral debt rescheduling, but also additional inflows of what promises to be relatively untied donor funds.

b. Fiscal Policy

The second major set of policy commitments in the 1991 PFP concerns fiscal policy. It is interesting to note that while the 1989 PFP placed fiscal policy in third place (after monetary policy), the 1991 PFP elevated it to second position. This is a critical change, because a commonly accepted reason for the monetary expansion that has begotten inflation in Zambia is the weakness of the GRZ in maintaining budgetary discipline. Additionally, although not among the first of the five fiscal reform policy categories laid out in the 1991 PFP, the category of "fiscal management" is the only category designated for priority action. The three elements of fiscal management, all to be carried out during 1991, are (1) to strengthen procedures for monitoring and controlling expenditures, (2) to reduce to normal float (i.e., unpaid commitment) levels, and (3) to monitor the budget from the commitment, the vouchers-issued, and cash bases. These are absolutely vital to depressing the inflationary pressures in the Zambian economy.

Another category of fiscal policy reforms contained in the 1991 PFP is to broaden the revenue base, in order to ensure stable and sufficient revenues to enable the GRZ to meet expenditure commitments. A third category of fiscal reforms concerns reducing the real level of current (non-interest) expenditures and restructuring expenditures such that high-priority sectors are adequately provided for. Finally, and in consonance with expenditure rationalization, civil service reform is slated to take place during 1991, to improve efficiency of the public service without raising costs. The civil service reform will involve a reduction of the number of civil servants in non-priority areas, in conjunction with a process of improving the pay and performance incentives of the employees in the priority areas (agriculture, basic health, primary education, and transportation/infrastructure).

c. Monetary Policy

Monetary policy is the third major policy reform sector in the 1991 PFP. The most important undertaking by the GRZ is to cut the growth of broad money in half, comparing 1991 with 1990. In addition to fiscal measures to be taken to reduce the likelihood of monetary expansion, the GRZ agreed to introduce a new bond issue and to actively manage interest rates such that positive real interest rates obtain. The partial purpose of these measures is to reduce central government demands on the banking system. An additional purpose is to achieve a more efficient allocation of credit and, presumably, investment. In the 1989 PFP, the major monetary policy measures concerned minimum reserve requirements and the liquid assets ratio. As noted earlier, one of the reasons for excessive money supply growth at the end of 1989 was the inability of the BOZ to enforce newly increased minimum reserve requirements. In the 1991 PFP, the GRZ (and the multilaterals) more squarely lay the blame for poor monetary performance on fiscal indiscipline.

d. Privatization and Parastatal Reform

Although the 1989 PFP did not specifically highlight privatization or parastatal reform as policy reform "sectors," the 1991 PFP does place privatization immediately after the major macroeconomic policy reforms sectors, and lists parastatal reform as a separate policy reform agenda component, following privatization in the policy reform matrix. This revision in the policy matrix is probably attributable to the fact that the USG, during its presentation at the April 1990 CG, strongly urged the GRZ and multilaterals to focus on this issue. Within these two components of the policy matrix in the 1991 PFP, the GRZ is undertaking in early 1991 to identify a list of parastatals to be privatized in a "first phase" of the exercise, to establish a mechanism for valuing parastatals and various rules under which they are to be sold. The GRZ has stated its willingness to sell up to 49 percent of its current equity in parastatal enterprises, except in the case of public utilities and selected "strategic" enterprises. The first offering of parastatals for sale in this first phase is to occur in the middle of 1991. Under the parastatal reform component, another group of parastatals will undergo financial assessment with an eye to improving their performance. In addition, and also during 1991, the GRZ has agreed to end public monopolies for insurance, real estate, and gemstone exports. All these moves, if they occur, should result in a great improvement in resource allocation in the economy, given the overbearing size of the parastatal sector. On the other hand, the sector's very size and the corresponding entrechment of interests, should make the reforms difficult.

e. Agriculture Sector Policies

The 1991 PFP contains policy changes in the agriculture sector that are decidedly more ambitious than those in the 1989 PFP. The most important policy reforms in agriculture in both versions of the PFP are those

Table 3. Zambia: External Balance and Financing

	1989	1990	1991 Q1	1991 Q2	1991 Q3	1991 Q4	1991 TOTAL
CURRENT ACCOUNT			(million US dollars)				
Merchandise Trade	386	167	2	2	2	2	7
Exports (FOB)	1411	1283	282	282	282	282	1126
Metal Sector	1340	1155	245	245	245	245	980
Other	71	128	37	37	37	37	146
Imports (CIF)	1023	1115	280	280	280	280	1119
Metal Sector	373	358	88	88	88	88	350
Fertilizer	73	49	0	0	0	0	
Petroleum	103	141	33	33	33	33	130
Other	474	567	160	160	160	160	639
Nonfactor Services	-178	-157	-34	-34	-34	-34	-135
Private Transfers	-28	-45	-7	-7	-7	-7	-28
CURRENT BALANCE (before interest and grants)	182	-35	-39	-39	-39	-39	-156
DEBT SERVICE OBLIGATIONS							
Multilaterals	296	383	524	75	90	88	777
World Bank	75	89	339	17	24	31	410
Scheduled Obligations	75	89					
Principal	37	40					
Interest	38	49					
Arrears Reduction							
IMF	179	238	161	34	43	34	272
Repurchases	136	121					
Charges	43	117					
Arrears Reduction [1]							
Other Multilaterals	42	56	24	24	24	24	94
Principal	24	16					
Interest	18	40					
Non-Multilaterals	359	2578	10	10	10	57	87
Scheduled Obligations	359	394					
Principal	225	268					
Interest	134	126					
Arrears Reduction		2049					
Interest on Arrears and Reschedulings		135					
TOTAL DEBT SERVICE (cash basis for 1991)	834	2961	534	85	100	145	864
FINANCEABLE BALANCE	-652	-2996	-573	-124	-139	-184	-1020

Table 3. Zambia: External Balance and Financing (cont)

FINANCING ITEMS	1989	1990	1991 Q1	1991 Q2	1991 [illegible]	1991 Q4	1991 TOTAL
Private Flows (incl E & O)	81	-1	10	10	10	10	39
Reserve Actions (- is increase)	-93	32	0	0	0	0	0
IMF Purchases							
Other Actions	-93	32	0	0	0	0	0
Incurrence of Arrears	493	277	0	0	0	0	0
Multilaterals		277					
World Bank		76					
IMF		201					
Non-Multilaterals							
Rescheduling Actions	0	2392					
On Arrears		2034					
On Current Obligations		358					
External Financing	171	294	330	0	70	70	470
World Bank	0		265		70	70	405
Non-Multilaterals (grants and loans)	171	294	65	0	0	0	65
"Normal" Flows		205					
SFA Flows		89					
IBRD Arrears Financing			65				
UNFINANCED GAP	0	2	233	114	60	105	512

DETAILS OF BOP FINANCING	1991 Q1	1991 Q2	1991 Q3	1991 Q4	1991 TOTAL
UK	40				80
France	1				1
Denmark					15
Finland	7				26
Canada	1				14
Norway	15				34
Sweden	81				113
EEC	16				66
USA	19				[illegible]
Germany	15				53
Japan	10				[illegible]
ADB	15				69
Netherlands	5				[illegible]
TOTAL COMMITMENTS	225				561

relating to the maize and fertilizer sectors. Not only has the incorrectness of prices of these commodities resulted in skewed resource allocation, but the effects on the fiscal balance, through massive subsidies to parastatals handling maize and fertilizer, have been debilitating to the economy. The policy matrix in the 1991 PFP calls for removing the parastatal monopolies and monopsonies in these two commodities, a step actually taken in the fall of 1990. Early in 1991, the floor producer prices for maize are to be revised to include variations on the basis of season and geography, and by mid-1991 prices of maize and maize meal products are to be decontrolled. At an unspecified time during 1991, fertilizer prices are to be decontrolled. The decontrolled fertilizer price will result in a phasing out of fertilizer subsidies, and in maize, only the existence of a coupon subsidy program on maize meal will require continued subsidization. It is important to note that the 1989 PFP called for such steps by the end of 1993, significantly later than in the current version of the PFP. Moves on these two commodities must be taken together for reforms on either to be successful, and this fact appears programmed into the PFP.

f. Industry

The main thrust of the policy reforms in the 1991 PFP in the non-mining industrial sector are to encourage private competition with the parastatal sector. In early 1991, the GRZ is expected to issue a "major policy statement" on the role of the private sector, and to revise, sometime during 1991, the investment code "to enhance incentives through streamlining procedures and liberalizing treatment of foreign investment. In addition, during 1991-93 the GRZ will develop "action programs" to facilitate and promote small-scale industry. The late-1990 budget speech announced that the GRZ was simplifying procedures for small-scale enterprise registration, in order to allow for investment and production growth in that sector.

g. Mining

Zambia is well aware of the fact that copper production will begin tailing off soon, thereby significantly reducing what is currently the country's major source of export earnings. The 1991 PFP focuses, in mining sector policy reforms, on improving ZCCM's investment planning and on ensuring an adequate allocation of foreign exchange to enable the copper sector to continue to produce (and export) as much as is efficiently possible.

h. Transport and Energy Sector

The main theme in these two sectors is to refrain from investment in new capacity while raising the efficiency and quantity of output by rehabilitating and repairing existing systems. The importance of agriculture in the economy and its potential as a major source of exports results in the inclusion in the 1991 PFP of a separate statement on rehabilitation and maintenance of feeder road systems. Finally, in energy, the GRZ has undertaken to price petroleum products at "economic" levels, including taxes.

i. Education

Given the increasingly disproportionate share of fiscal expenditures on education that are going to non-primary education, the 1991 PFP calls for a reversal of this trend. In addition, the PFP lays emphasis on rehabilitation of existing facilities rather than building new ones, as well as on expanding the private sector's participation in education.

j. Health and Population

Similarly, in health the 1991 PFP stresses rehabilitation and repair of primary health care facilities, and on shifting emphasis away from curative care toward preventive care. As in education, the private sector's participation is to be encouraged. Cost recovery measures, which are apparently already underway in the health sector, are to be continued and expanded, on the basis of users' ability to pay for services. A national population policy, which currently does not exist despite the very high (i.e., 3.7 percent) population growth rates that obtain in Zambia, is to be adopted. An AIDS policy is not on the PFP agenda.

k. Environment

The environmental policies expressed in the 1989 PFP have not changed in the current version. The GRZ has agreed to increase resources for the parks service and to carry out the National Energy Strategy. The purpose of the former step is to conserve wildlife resources and promote tourism and the latter to reduce deforestation and land degradation.

2. Expected Economic Performance for the 1991-93 Period

The title of this section is deliberately somewhat ambiguous. The 1989 PFP contained data tables that provided major macroeconomic indicators for the economy during the 1990-93 period, but these data do not show sufficient detail to enable a complete fleshing-out of the interrelationships among the data. The February 1990 IMF Staff Report had much more detail, but these primarily covered 1990, the first year of the informal Fund-monitored program described in the document. As of this writing (January 1991), the 1991 PFP is not available and we have no idea of the extent to which the PFP will provide data on the program. The following discussion of "expected" economic performance represents our best guess of what the 1991 PFP will contain, rather than a discussion of what we "expect" will actually occur in economic performance terms. We will comment on what we actually expect in the following section of this paper. The following discussion is based on the five data tables in Appendix C to this paper, and the Appendix walks the reader through the accounting framework represented by those tables.

a. Production and Use of Resources, 1991-93

The PFP calls for annual increases in GDP slightly in excess of the population growth rate of 3.7 percent. The bulk of the increase in GDP is to come from the agriculture sector with some contribution from industry, both to compensate for expected drop-offs in mining sector production. However, in order to realize increases in GDP, gross domestic investment, which had dropped to an undesirably low 9 percent of GDP by 1989, would have to increase to well in excess of 20 percent during the 1990s. Even though external assistance is expected to put Zambia in the position of adding somewhat to the resources available for investment and consumption as a whole, the requisite sharp investment increases mean that there will have to be a reduction in the portion of GDP that remains available for consumption. With government consumption expected to grow at approximately the same rate as GDP, private consumption on a per capita basis will likely fall sharply, perhaps as much as 7 percent per year over the next three years.

b. Balance of Payments Objectives, 1991-93

From the standpoint of stable and orderly external payments, the economy's future is clearly unsustainable without extraordinary external financing. Best estimates of total export earnings show an annual drop of 4 percent in dollar terms, comparing 1993 with 1990. Although non-metal exports are expected to grow at a respectable 9.5 percent over the three-year period, they would have to grow at a practically astronomical 35 percent per year just to make up for the expected fall-off in copper earnings. Barring something unforeseen, exports will clearly fall over the period. By contrast, imports are expected to increase by 1.7 percent per year on average, adding to a worsening trade balance. In fact, we suspect that this increase in imports may be too low, given usual assumptions about an income elasticity of imports in the neighborhood of 0.7 to 0.8. Were the latter the case, imports would be more likely to grow at about double the annual rate projected given the hoped for increase in income.

Zambia's debt service ratio on current (i.e., non-arrears-related) debt obligations is between 60 and 70 percent during the 1991-93 program period and, despite the fact that Zambia's merchandise trade balance is respectably low, the country cannot afford to service its debt. Zambia's approach over the past two-plus years has been to unilaterally reschedule, by simply not meeting the bulk of debt obligations. During this program period, however, Zambia is seeking an orderly rescheduling process. Over the three-year period, total net multilateral flows are expected to sum to a negative $719 million, with net payouts to the IMF of $514 million and a net zero balance with the World Bank. As of the end of the period, World Bank arrears will have been cleared (in 1991) and the GRZ will be in a position to fully "reschedule" its arrears with the IMF using the "rights" approach. To cover this immense outflow of resources to the multilaterals, as well as to cover Zambia's other financing requirements, it is expected that the non- multilateral agencies will provide a net inflow totalling $1,153 million over the period. This net inflow includes current debt service, rescheduling actions, grants, and loans. The net position between the non-multilateral and multilateral flows is approximately the equivalent of the current account balance of payments deficit over the period, not surprisingly. The viability of the balance of payments is thus heavily dependent on Zambia's obtaining this level of external inflows. Judging from pre-1990 experience, it is also safe to assume that Zambia's receipt of this external assistance is closely dependent upon its maintaining adequate policy program ties with the multilaterals.

c. Fiscal Performance Objectives, 1991-93

Although Zambia's fiscal performance has in past years proved critical to its meeting its inflation reduction objectives, as of this writing it is difficult to comment in detail on fiscal performance objectives for the 1991-93 program period. However, it appears clear that fiscal prudence continues to be an important plank in the GRZ's program and that the GRZ intends to rely on a combination of reduced fiscal deficits, external financing of these deficits to the extent possible, and resort to the domestic non-banking system for any residual domestic financing required to close the fiscal gap. In 1990, on the other hand, despite budgetary plans to have the government actually repay a small portion of its debts to the banking system, net domestic credit to the government actually rose by well over 50 percent. This situation undoubtedly contributed greatly to the massive overshooting of the broad money growth target in 1990.

It seems likely that the GRZ will for the balance of the period attempt to reduce net domestic credit to the government, perhaps to a level of zero, using the same combination of steps planned for 1990. Without better institutional controls in various ministries, however, this will be very difficult to accomplish. And to the extent that it is not accomplished, pressures on domestic prices and the exchange rate will continue to mount.

d. Monetary Policy Objectives, 1991-93

As noted in the policy objectives discussion in the preceding part of this paper, the GRZ's policy matrix prepared in 1989 called for increasing the level of and the compliance with statutory reserve requirements as a major means of controlling the growth of the money supply. The 1991 PFP recognizes the more urgent problem of fiscal policy failings on the money supply. Given a money growth target consistent with a desired reduction in inflation, and given urgent non-government sector requirements for credit expansion to enable the productive sectors of the economy to meet growth objectives, it is critical that the government sector restrict its demands on domestic credit to well within agreed credit ceilings.

3. The 1991 Stabilization and Adjustment Program

1991 is to be the first year of the three-year IMF-monitored "right approach" program. Although the IMF monitored performance against benchmarks during 1990, there was no formal program. Despite original plans to initiate the formally monitored program in July 1990, the multilaterals were unable to put the external financing in place to ensure a closed gap for the first year of the program. During the latter half of 1990, considerable efforts on the part of the GRZ and the multilaterals, as well as the donor community, to establish the framework for a more formal program beginning in 1991 occurred, and it now appears that all the elements are in place so that Zambia (after lapses in performance against objectives during the second half of 1990) can begin a formal, fully financed program.

a. Policy Objectives for 1991

As noted above, details on the 1991 program are not as complete as one might like, and as of this writing the GRZ and the multilaterals have not yet come to full agreement on the program. However, it is still possible to describe key elements of the program for the year, and we understand that these elements are not under negotiation. Key among the performance objectives of the 1991 program is to sharply reduce the rate of domestic inflation, to 40 percent compared with inflation approximately double that in 1990 and almost quadruple this in 1989. Meeting -- or at least getting close to -- this target is important to providing stability in the economy, thus permitting economic actors to be sufficiently confident in the economy to invest and increase production. A critical means of meeting this inflation target is a sharp reduction in growth of the broad money supply. Monetary growth for 1991 is targeted at 25 percent, compared with approximately double that rate in 1990. In addition to relying on statutory reserve requirements and their enforcement, the GRZ now realizes that it must apply considerable control over budgetary spending, if the money supply (and hence inflation) targets are to be met. The 1991 program calls for a fiscal deficit of 1 percent of GDP (excluding foreign grants and interest), well down from the 4 percent deficit projected for 1990.

The 1991 budget (unveiled in December 1990) provided a host of details on budgetary measures to accomplish the GRZ's objectives for 1991. Key among these were the GRZ's intention to freeze public service wages this year, and to initiate a tax on the housing allowances that were an important element in the inauspicious fiscal results in 1990. The GRZ has also asked for IMF technical assistance in budgetary monitoring and control, although all involved admit that such assistance will not have an immediate effect in reducing some of the excesses of 1990. In addition, a series of small, if cumulatively not insignificant, revenue measures (e.g., adjustments in the company tax rates, lowering of taxes on dividend income, taxation of 75 percent of the 1990 increase Housing Allowances, introduction of a tax on the state lottery, broadening of the base of the domestic sales tax, etc.) were announced in the 1991 budget.

In addition to these fiscal and monetary policy measures, the GRZ appears poised to move on a number of policy areas that have been somewhat problematical in the past. As noted in the discussion above of the 1991-93 policy matrix, the pace of liberalization of the maize and fertilizer sectors has been increased considerably. The importance of this liberalization, not only to a more efficient allocation of resources in Zambia but also to a reduction of the immense pressures that agriculture-related subsidies place on the budget-balancing objectives of government, is self-evident. A second key area of reform is in foreign exchange pricing and management. An OGL has been underway for nearly a year now, and the GRZ has agreed to expand the OGL to cover all foreign exchange requirements for merchandise imports sometime early in 1991. The official and OGL exchange rates are practically identical, following steady depreciation of the official rate over the past year. This merging of the rates, however, must be followed by movements in the merged rate, if Zambia is to reach its commitment to have the exchange rate at a market-clearing level by the end of 1991.

b. External Financing Requirements, 1991

Zambia will be unable to meet these ambitious program goals without sufficient external financing of the balance of payments. The alternative of a return to financing balance of payments gaps by incurring large external arrears is not a desirable option. If sufficient financing does not emerge, there is likely to be import compression, and an addition to inflationary pressures (ceteris paribus), with negative implications for economic growth.

The key action in the near future is for Zambia to return to a regular relationship with the multilaterals. As to the IMF, Zambia's pre-cutoff (i.e., pre-July 1990) arrears, amounting to approximately $1,300 million, will be coped with using the new "rights" approach, such that Zambia will accumulate "rights" to rescheduling these arrears if Zambia remains in compliance with its Fund(-monitored) program during that period. In addition, Zambia has accrued post-cutoff arrears (on the order of $90 million) during the second half of 1990 with respect to Fund obligations, and these must be cleared in the first quarter of 1990 before the formal Fund-monitored program can begin (see Table 3, following page). During the three-year rights accumulation period, Zambia must stay current with post-cutoff obligations to the Fund, but will make no SDR purchases. Total obligations to the Fund during first quarter 1991 are $161 million. As to Zambia's relations with the World Bank, Zambia must clear arrears of $312 million in order for the Bank to begin to finance programs in Zambia. In addition to these arrears payments, which must be made during the first quarter of 1991, Zambia's first quarter repayment of current Bank obligations is about $27 million.

As to obligations to the donor community, Zambia's payments during the first quarter of 1991 amount to a scant $10 million, after current debt obligation rescheduling takes place. For the first quarter, therefore, Zambia's external balance for financing is $573 million, consisting of an expected first-quarter current account deficit of $39 million and cash debt obligations of $534 million. Comparable figures for the year are $864 million for cash debt service and $156 million in the current account, bringing total financing needs for 1991 to $1,020 million. Assuming that arrears are cleared to the Bank and the Fund during the first quarter, gross Bank credits to Zambia will be about $265 million for the first quarter. The time between the clearing of arrears and disbursement of the Bank's first-quarter credit will be bridged, by the Bank of England. The Bank's $265 million disbursement plus donor commitments of an additional $65 million during the first quarter to clear the Bank's arrears lower the first-quarter financing requirement to about $233 million. For 1991 as a whole, the gap remaining after Bank disbursements and the arrears contribution are accounted for is about $512 million.

Information as of January 1991 put 13 donors in line to support the GRZ to clear the remaining first-quarter financing gap. The ZAMSTAB program's $19.4 million is the third largest first-quarter contribution, following $81 million by Sweden and $40 million by the UK. Details of these and other contributions are included in the final segment of Table 3. We expect that although these data will probably be modified over the coming weeks, they provide a fairly certain indication that, if ZAMSTAB funds are included in Zambia's first- quarter financing exercise, the gap for the quarter is fundamentally filled.

c. <u>Assessment of the 1991 Program</u>

The 1991 stabilization and adjustment program is probably technically feasible, judging from the details we have seen so far. In other words, if the budget deficit can be held to its planned level, and if statutory reserve requirements facing the banking system are adhered to, it is likely that money supply growth can be held to the planned level. And a sharp drop in money supply growth is likely to be translated into a reduction in recorded inflation in Zambia. A steady devaluative crawl of the exchange rate over the year, at a rate of one-plus kwacha (per dollar) per week would put the exchange rate close to what one roughly estimates as a market-clearing or appropriate rate by the end of 1991.

Experience in past years (and, most recently, last year) has shown that the GRZ has departed most frequently from its program objectives through its inability to hold to fiscal goals. A major problem within the fiscal system is that there are very poor controls on spending, and these might themselves undermine a stabilization program under the best of circumstances. Externally financed technical assistance promised Zambia is unlikely to arrive in time to establish control systems that are effective. To compound this traditional problem, 1991 is an especially sensitive year for the ruling UNIP party and its government, with the first presidential elections under a multiparty system since 1972 scheduled for no later than October. The pressures to demonstrate to the electorate that the government is not lowering living standards through stabilization-related belt-tightening may prove so strong that prudent fiscal management may well be difficult to attain.

In addition, there appears to be strong interest, on the part of some donors, in having Zambia redouble its stabilization efforts, after the poor showing during the latter part of 1990. Indeed, in order to put together the financing package needed in this first quarter of 1991 to clear the multilateral arrears, the IMF has noted that the program targets for 1991 are more stringent, in many respects, than they were under the original (1989) PFP. More stringent targets, designed to demonstrate even more commitment on the part of the GRZ, in a year in which the political climate for reform may be less favorable, may be questioned by some observers of the Zambian scene.

In sum, we believe that high-level technocrats within the government are likely to be more convinced of the need for a stabilization program, of the type designed with multilateral assistance, than they have been in the recent past. Coupled with this, the 1991 budget addressed the budgetary excesses of 1990 with some concrete measures. At the same time, both traditional institutional and new political circumstances will likely serve to undercut these positive observations. The outcome between these opposing considerations is impossible to predict in early 1991.

IV. PROGRAM DESCRIPTION

A. Program Rationale

The rationale for providing USG assistance to Zambia under this balance of payments assistance program is that, on the basis of significant reform efforts made to date by the Zambians, we believe that Zambia should be given the best possible opportunity to demonstrate its continued commitment to the current stabilization and adjustment program. Zambia has clearly reinitiated the reform process; the only question, and an important one it is, is whether Zambia will continue with that process at the pace required. The most effective means of demonstrating, to both the Zambians and external donors, our financial, program and psychological support for Zambia's efforts is through a rapidly disbursing balance of payments support program with appropriate safeguards to ensure the continuation of reforms, at least over our program period. The alternative of providing sectoral program assistance at this juncture would arguably dilute the current macroeconomic reform effort by slowing the disbursement rate. This is not to say that the GRZ should turn its attention away from sectoral issues, but that its major preoccupation in the very short term should be to ensure the sustainability of the stabilization effort.

B. Program Purpose

The purpose of this program is to assist the GRZ in its immediate stabilization efforts, with specific regard to supporting Zambia's payment of non-reschedulable multilateral debt, either arrears or current payments. The GRZ has undertaken an IMF-monitored stabilization and adjustment program, the most critical short-term elements of which are (1) to sharply reduce domestic price inflation through improved fiscal and monetary policies, and (2) to improve the economy's external competitiveness through adjustment of the exchange rate. The former is partly a question of sufficient government revenue to reduce budgetary demands on the banking system (given expenditure goals), and partly a question of enforcing monetary discipline in the banking system. The latter is a question of ensuring sufficient supply of foreign exchange to permit an orderly devaluation of the nominal exchange rate, thereby bringing about large enough real effective exchange rate depreciation to move toward a realistic equilibrium rate of exchange. The conditionality, use of dollar resources, and disposition of local currency counterpart amounts under this program will all support the GRZ's stabilization efforts.

C. Short-Term Foreign Exchange Requirements

The focus of the resources to be made available under this program is on the external resource gap during the first two quarters of 1991. The current immediate debt-handling scenario facing Zambia is that in the first quarter of 1991 it would (a) pay out $339 million to become current on World Bank debt, and (b) pay out $161 million to become current on IMF obligations (due since the July 1990 cut-off date for initiating a "rights" approach), in addition to estimated import requirements on the order of $280 million. Balancing these requirements are (a) export earnings estimated at $282 million (providing a small non-debt current account surplus), and (b) expected IDA disbursements of $265 million (providing a net outflow of $74 million to the World Bank). Given the inadvisability of Zambia's further drawing down reserves, this requires financing on the order of $220 million from the donor community, of which a December 1990 informal donors' meeting was able to identify about $150 million. (This is, of course, in addition to Paris Club rescheduling exercises that have been carried to their maximum extent.) Of this pledged figure, the USG indication of support amounted to $20 million in balance of payments support. The World Bank expects to have closed the remaining $70 million first-quarter financing gap in time to permit resolution of the debt problem during the first quarter. If the gap is closed and if both the Fund payments and the Bank payments are made current during the first quarter, this will trigger an immediate release of the IDA financing noted above. A key element in this equation is a short-term loan by the Bank of England, to bridge between the arrears reduction to the World Bank and the release of IDA funds.

The proposed ZAMSTAB funds are a significant element in the foregoing scenario for the first quarter of 1991. If our funds are not available, the currently unfinanced gap rises by over one quarter. In addition, if we are unable to indicate our support by meeting our pledge, this will send a strong negative signal to not only the Zambians, but also other donors. As an alternative, import compression does not provide a viable source for gap-filling: imports are already expected to remain constant in nominal terms in 1991, compared with 1990. And for Zambia not to once and for all resolve the multilateral debt question would be to delay the initiation of the more formal stabilization and adjustment program to an undesirable extent. If, for example, the resolution of the multilateral debt problem were to slip to the second quarter of 1991, arrears charges would increase by $8-10 million and the ex ante financing gap would be even larger.

D. Conditionality Under the Program

The funds to be provided under ZAMSTAB are planned for a single obligation- cum-disbursement during the first quarter of 1991, at a time when A.I.D. receives reasonable assurances that the financing gap for the first quarter is closed. Thus, for all practical purposes, there will be a condition precedent not simply to disbursement, but also to the obligating action that consists of the signing of the Grant Agreement.

Were A.I.D. to obligate the funds under ZAMSTAB prior to receiving such assurances, A.I.D. would be risking an obligation that might not result in a disbursement supportive of the purpose of the ZAMSTAB program. Although obligations without reasonable certitude about likelihood of disbursement are undesirable in any circumstance, the history of the Zambian reform efforts during the 1980s and the fact that the bulk of the ZAMSTAB funding is sourced to an ESF program that itself became moribund, both argue even more forcefully for pre-obligation assurances.

The nature of the gap-financing exercise that is currently underway, and the pre-eminent role that the World Bank is playing in that exercise, suggest that the World Bank should be at least a confirming source of the assurances that A.I.D. is seeking prior to obligation. We propose that A.I.D. enter into a formal understanding with the GRZ, in the context of the request for assistance letter from the GRZ, that indicates that the GRZ will provide A.I.D. with information on firm commitments to close the balance of the financing gap. When A.I.D. receives those from the GRZ, the mission will cable AID/W, conveying the details provided us by the GRZ, and asking that AID/W confirm these details with the World Bank (and perhaps the IMF). When AID/W is satisfied, the mission will be cabled that the Grant Agreement should be signed. Disbursement can occur as soon thereafter as to not only permit a timely payment of the debt payments to be covered by ZAMSTAB funds but also preclude the ZAMSTAB funds remaining in the dollar special account for too lengthy a period.

In addition to the foregoing conditions precedent, the Grant Agreement should also contain covenants that require the GRZ to not only continue to adhere to its agreements with the multilaterals, but also provide A.I.D. with reports indicating the status of performance against the quarterly targets, for at least the balance of 1991. The most desirable means of casting such a covenant would be for the GRZ to provide these reports in the context of a quarterly meeting between A.I.D. and GRZ staff, at a level in the two organizations that permits a frank discussion of technical details.

E. Programming and Tracking Dollar Resources

There are three acceptable means of programming dollar resources made available under ESF cash transfer assistance agreements with less advanced developing countries, according to the most recent (1987) AID guidance. First, in situations where the foreign exchange regime is completely illiberal, guidance recommends that the funds be used on a dollar-by-dollar basis to cover specific categories of commodity imports, public or private sector, preferably from the U.S. Second, in situations where there is evidence that the recipient government is making attempts to liberalize the foreign exchange regime, the dollar resources can be made available to support the more liberalized elements of that regime. Third, in situations where external debt is a barrier to development, or where the uses of dollars are not traceable, the dollars can be programmed to meet external debt obligations of the recipient government.

The Zambian government has taken initial steps to liberalize the foreign exchange regime, through exchange rate depreciation and through the institution of an "open general license" system to allocate foreign exchange by non-administrative means, suggesting that the first option (i.e., disbursing through a commodity import program mechanism) would be less than desirable because it would essentially establish yet another administrative allocation mechanism. The second option would perhaps be the most preferable, were not Zambia in a situation where external debt is not only a pronounced barrier to development, but especially to the current stabilization program. Debt solutions, in terms of rescheduling both bilateral and multilateral official debt, have proceeded as far as they can. The current bind in which Zambia finds itself is that if it cannot soon find the necessary external program financing to become current on its nonreschedulable debts to the multilaterals, the requisite financing will grow and the momentum for stabilization in Zambia is likely to falter. Thus, we recommend the third option for use of these ZAMSTAB funds, based on the immediacy of the situation on debt "clearing" to permit the commencement of the IMF supported "rights" program and a renewed inflow of World Bank funding.

The proposed disbursement and tracking approach would be to disburse the entire amount of ZAMSTAB funds into a GRZ-designated special dollar account in a U.S. bank acceptable to both parties. Special instructions governing the account would require that A.I.D. confirm, to the U.S. bank, GRZ instructions regarding release of funds from that account. Such an approach would be unlikely to be burdensome to A.I.D., given that the release of the funds to pay Zambian debt to either IMF or World Bank would occur in a single payment. Any interest accruing to funds while in the account would remain in the account until the release occurs, and would be used for the same purpose as the principal in the account. At the time of signing the Grant Agreement, it might not be clear whether the funds would be used for payments to the IMF or the World Bank, and the Agreement should leave this as a detail to be worked out prior to disbursement (or release from the special account). Such flexibility is important to the overall debt-clearing effort currently underway, because it is conceivable that other donor funds might be earmarked for debt payments to one of the two organizations. Once funds were released to the multilateral recipient, A.I.D.'s tracking and monitoring responsibilities for the dollars would cease.

The approach would be simple, clean, straightforward, and would fulfill recent FM guidance on tracking and monitoring dollar resources. The required A.I.D. confirmation on the release of the dollars from the special account would obviate the need to carry out the FM-required assessment of the Bank of Zambia (the central bank), which is the entity in whose name the dollar special account would most likely be.

F. Programming and Tracking Local Currency

Given the nature of the use of the dollars under this program, there is an offset entry in the GRZ budget that shows that the local currency equivalent has been paid out to cover a debt payment, at the same time that a compensating revenue entry appears on the other side of the ledger indicating that the GRZ received the local currency equivalent of the dollar disbursement from A.I.D. In terms of USAID/Zambia's programming and tracking of the local currency equivalent of the ZAMSTAB dollars, however, the Mission proposes the use of 7.5 percent of the funds for an OE Trust Fund, 32.5 percent of the funds for on-going or planned USAID/Zambia project activities, and 60 percent of the funds for budgetary attribution.

There are certain local currency expenditures, related to other A.I.D.-financed projects, that A.I.D. has an interest in seeing the GRZ incur. These are, presumably, on-budget expenditures. To the extent that these are not included in the budget, A.I.D. will wish to see the budget modified to ensure their inclusion. After negotiating such inclusions with the GRZ (and the multilaterals, given the importance of fiscal prudence to the macroeconomic stabilization and adjustment program), it would seem useful to include any requisite changes in GRZ budget line items as covenants to the ZAMSTAB Grant Agreement. So doing would provide assurances that these expenditures would actually be made and that they were on-budget. In addition, as an added safeguard to these expenditures, in the Grant Agreement the GRZ would agree to deposit a sufficient quantity of local currency into a special non-commingled local currency account, to cover these expenditures.

In addition, the A.I.D. mission in Lusaka has a legitimate requirement that the GRZ make available to the mission, in the form of a local currency OE trust fund, an amount of local currency equivalent to 7.5 percent of the dollar resources A.I.D. has made available under the ZAMSTAB program. A trust fund agreement, external to the Grant Agreement, but contingent upon the release of funds from the special dollar account, could be entered into, such that when the release occurs, the GRZ deposits, on-budget and from its own local currency resources, the required amount of local currency into the trust fund account. A schedule of deposits will be worked out by the A.I.D. Director and the Senior Permanent Secretary of the Ministry of Finance.

Thus, of the approximately one billion kwacha (K1,000 million) to be generated under the ZAMSTAB program, the general breakdown of the use of the funds is as follows:

ACTIVITY	AMOUNT
- USAID/Zambia OE Trust Fund (7.5%)	K 75 million
- On-going or planned USAID/Zambia Projects or Local Currency Agreements Calendar year 1991	325 million
- Budgetary attribution during the GRZ's 1991 fiscal year	600 million

In addition to the use of local currency funds for on-going or planned USAID/Zambia projects, as mentioned above, the K325 million tentatively programmed, includes funds to finance a local contract between the GRZ and a local accounting firm to assist in the management and tracking of the use of these funds for USAID activities.

The K600 million tentatively programmed for budgetary attribution will be used for current expenditures, i.e., non-capital expenditures, in support of activities in the agricultural, infrastructure maintenance, AIDS control and prevention, and family planning sectors, or in other sectors as mutually agreed between USAID/Zambia and the GRZ.

It should be stressed that all the local currency funded activities under discussion will be included within the GRZ budget to avoid creating problems within the overall macroeconomic stabilization efforts.

G. Program Evaluation

In a program such as this, one justified on balance of payments grounds, there is little need to carry out a formal evaluation. During the course of 1991, the program itself provides for quarterly consultations between the Mission and the GRZ on the progress Zambia is making with respect to the IMF-monitored program targets and other related matters. This will serve as a first-level "evaluation" of the success of ZAMSTAB. In addition, the Mission expects to carry out a more comprehensive assessment of the progress of the stabilization and adjustment program as part of its CPSP exercise, currently planned for forwarding to AID/W in the fall of 1991.

H. Negotiating Status

The Mission first publicly committed the funds proposed under ZAMSTAB in support of Zambia's adjustment efforts during an April 1990 Consultative Group pledging session. At that time, it was anticipated that the ZAMSTAB funds would be provided in support of the OGL (open general license) experiment in market-based foreign exchange allocation. At that time, furthermore, the GRZ understood that conditionality for a two-tranche ZAMSTAB program would be similar to the quarterly targets under the IMF-monitored program. The Mission has apprised the GRZ of the shift in the ZAMSTAB program to using the funds for non-reschedulable debt payments and to the altered conditionality. The GRZ has no objections to this altered approach, and even welcomes the change in view of the required first-quarter 1991 debt-clearing exercise with the multilaterals.

V. RISK ANALYSIS

Part III of this PAAD contains, in various places, explicit and implicit discussions of the likelihood that the GRZ's stabilization and adjustment program for the 1991-93 period is likely to be successful. What we would like to address below is the extent to which these factors put into jeopardy the success of the ZAMSTAB Program itself.

The purpose of the ZAMSTAB program is to support the stabilization and adjustment effort, with specific regard to supporting the immediate clearing of arrears on nonreschedulable external debt. In other words, it is clear that if the multilateral arrears are not cleared, overall external financing will be less than currently committed. If external financing is less (for the year as whole) than currently committed, there will be significant additional pressure on what is already a very tight GRZ budget. Thus, it is fair to view the clearing of arrears (and thus the ZAMSTAB Program) as a necessary condition for success of the stabilization and adjustment program. At the same time, given the considerations discussed in Part III.B.3.b., above, it is important to realize that the ZAMSTAB Program is by no means a sufficient condition for the success of the stabilization program.

Another potential source of riskiness in the ZAMSTAB Program has, we believe, been dealt with by requiring that A.I.D. receive firm evidence that the multilateral arrears-clearing financing package is place before ZAMSTAB funds are obligated. To require less than this would be to risk an obligation of once-deobligated funds, that would not result in a disbursement, thereby unduly tying up USG funds.

With these caveats in mind, the Mission believes that the potential benefits (in terms of successful Zambian stabilization and adjustment efforts) of ZAMSTAB outweigh the attendant risks.

APPENDIX C

STATISTICAL APPENDIX

This statistical appendix is separated into two sections. The first section contains a set of four data tables that provide a picture of the Zambian economy, primarily at the macroeconomic level, for the period 1985-89. These tables are the statistical background for the discussion in Part II of this ZAMSTAB PAAD. The second section contains some rudimentary macroeconomic projections on Zambia, covering the period 1991-93, projections related to the discussion in Part III of this paper.

Table 1. Zambia: National accounts

	1985	1986	1987	1988	1989
	(In millions of kwacha)				
Gross Domestic Product	7072	12963	19778	30021	63019
Consumption	6071	10096	16797	25477	53247
Central Government Consumption	1292	2094	3047	3819	5675
Nongovernment Consumption	4779	8002	13750	21655	47567
Investment	1053	3087	2741	3631	5773
Nongovernment	872	2575	2181	2230	3187
Central Government	181	511	561	1401	2777
Net exports of goods and nonfactor services	-52	-219	240	867	3078
Exports	2575	5467	8165	9054	21451
Imports	2671	5686	7925	8187	17912
Real GDP growth	1.9	[illegible]	2.7	6.2	[illegible]
GDP deflator (percent change)	41.1	[illegible]	45.5	42.3	110.7
CPI (percent change in composite index)	36.9	52.4	44.4	54.7	124.5
CPI (Dec. over Dec.)	55.7	34.6	50.4	64.1	152.8
			(In percent of GDP)		
Consumption	85.9	77.9	84.9	84.9	86.2
Central Government	13.7	16.2	15.4	12.7	9.2
Nongovernment	67.6	61.7	69.5	72.1	77.0
Gross domestic investment	14.9	23.8	13.9	12.1	8.7
Nongovernment	12.3	19.9	11.0	7.4	4.2
Central Government	2.6	3.9	2.8	4.7	4.5
Resource balance	-0.7	-1.7	1.2	2.9	5.1

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Table 2. Zambia: Balance of Payments

	1985	1986	1987	1988	1989
	(In millions of dollars)				
Trade Balance	37	17	95	191	322
Exports, f.o.b.	871	698	867	1080	1398
Of which: copper	678	574	736	907	1245
other metals	120	65	66	91	79
nonmetal	73	60	66	82	74
Imports, c.i.f.	-834	-681	-772	-889	-1076
Services (net)	-323	-354	-413	-495	-527
Interest	-268	-308	-342	-409	-402
Other factor	1	1	-2	-2	0
Nonfactor (net)	-56	-47	-69	-84	-125
Receipts	79	50	51	60	90
Payments	-135	-97	-120	-144	-215
Unrequited transfers	15	100	75	65	43
Private	-38	-45	-30	-35	-29
Official	53	145	105	100	72
Current account	-271	-237	-242	-239	-162
Nonmonetary capital	-100	-55	-205	-141	-81
Disbursements	301	303	130	196	87
Amortization	-330	-342	-341	-344	-305
Other (including short-term)	-72	-16	6	5	141
Errors and omissions	-85	-182	-17	9	-59
Overall balance	-456	-473	-463	-371	-302

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	1985	1986	1987	1988	1989
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Financing	456	473	463	371	272

IMF (net)	-95	-52	-273	-206	-126
Purchases		122			
CFF		81			
Stand-by		41			
ESAF					
Repurchases (as sched.)	-95	-174	-273	-206	-126
Other foreign assets					
net (increase -	-23	-18	-50	-101	-108
Central Bank	-33	43	-16	-64	-67
Gross official	-123	146	-2	-58	-47
Off. liabilities	90	-103	-14	-6	-20
Commercial Banks	10	-61	-34	-37	-41
Revaluation	21	24	21	-4	1
Rescheduling		1020			
Scheduled obligations		352			
Arrears		669			
Arrears	547	-502	726	663	505
Incurrence (+)/cash reduction (-)	547	167	726	663	505
Commercial payments	-9	0	-69	-104	-127
Rescheduled debt	208				
Other debt (incl IMF)	348	167	795	766	632
Of which:					
Gov't payments (reduction -)					-87
Other payments (reduction -)					-7
Rescheduled arrears		-669			
Financing gap					
Exceptional financing					
Rescheduled obligations					
Rescheduled arrears					
Exceptional loans					
Exceptional grants					
Accumulation of arrears					
Residual Financing Gap					
Cumul. Financing Gap					

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Table I. Zambia: Central Government Operations

	1985	1986	1987	1988	1989
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			(In percent of GDP)		
Revenue and grants	22.0	24.7	22.1	18.7	16.9
Tax revenue	19.6	21.2	19.7	15.5	14.8
Of which: mineral sector	1.8	3.1	2.4	1.8	2.7
import taxes	4.7	6.9	7.6	5.2	4.8
domestic goods & services	6.3	4.6	4.0	3.7	3.6
income taxes	6.7	6.5	5.7	4.9	3.7
Nontax revenue	2.3	2.2	1.9	1.6	0.6
Grants	0.5	1.2	[illegible]	1.6	1.6
Measures					
Expenditure and net lending	36.7	53.2	32.9	31.1	25.7
Current expenditure	33.1	41.7	29.6	26.0	19.2
Personal emoluments	7.6	5.1	5.1	3.8	2.8
Recurrent development costs	5.9	4.4	5.5	4.7	3.5
Subsidies	2.7	4.4	3.4	4.7	2.9
Interest: domestic	3.6	5.2	[illegible]	[illegible]	[illegible]
Interest: foreign	6.1	12.9	5.6	[illegible]	[illegible]
Transfers & pensions	2.5	3.1	2.1	2.0	1.7
Other	4.5	5.7	4.3	4.2	2.7
Capital expenditure and net lending	3.6	7.5	3.2	4.5	4.4
Exceptional expenditure	0.0	4.1	0.1	0.5	2.1
Overall deficit (commitment basis)	-14.4	-28.5	-10.8	-12.4	-8.7
Financing requirement	14.4	28.5	10.8	12.4	8.7
External (net)	5.0	20.3	4.0	7.0	3.4
Domestic (net)	9.4	9.2	6.8	5.4	5.3

Table 4. Zambia: Monetary Survey

	1985	1986	1987	1988	1989
CHANGES IN:					
	(In millions of kwacha)				
Net foreign assets of banking system	-9790	-22233	-15400	-17061	-23915
Domestic credit	4010	5374	6275	9657	14962
Government (net)	2693	3489	3799	5200	5923
Rest of economy	1316	1885	2475	4457	9039
Other items net	-7884	-20921	-15391	-17531	-25083
Money and quasi-money	2104	4062	6266	10127	16130
Income velocity of money (GDP/Mavg)	3.8	4.8	4.0	3.9	4.8
	(Change as a percent of beginning period money stock)				
Broad money	23.5	93.1	54.3	61.6	59.3
Net foreign assets	3.6	-591.4	168.2	-26.5	-67.7
Domestic credit	49.6	64.8	22.2	54.0	52.4
Government	23.8	37.8	7.6	22.4	7.1
Rest of economy	25.8	27.0	14.5	31.6	45.2
Other items (net)	-31.7	-519.5	136.1	-34.2	-74.6
	(Annual percentage change)				
Domestic credit		34.0	16.8	53.9	54.9
Government		29.6	8.9	36.9	13.9
Rest of economy		43.2	31.3	80.1	102.8

ZAMBIA: MACROECONOMIC PROJECTIONS, 1991-93

The purpose of this appendix is to discuss the internal consistency of the GRZ's macroeconomic program for the PFP period (1991-93). To best engage in this discussion, one should have access to the most detailed information on projected variables for the period in question, as well as to the assumptions that lie behind the projections of these variables. However, neither the PFP nor the other GRZ or IMF documents available to us contains sufficient detail to permit us to work through the proposed program. The following discussion uses projections prepared by us on (1) production and uses of domestic product, (2) the external sector, (3) government finances, and (4) money and credit. The projections are interdependent among components, as is usually the case in an economy. Unfortunately, the projections are not likely to be fully consistent with the data set behind the 1991 PFP, a document not available to us yet. At this writing, we have relatively detailed balance of payments projections, but little on domestic product, the central government budget, or the monetary survey. These latter components are all projected by us, using fairly reasonable assumptions (though probably not precisely those that will be used by the GRZ in its agreement with the IMF and World Bank).

The discussion that follows is based on Tables 1-5 in this appendix. Table 1 enables us to test the effects of, and display the results of, changes in key macroeconomic variables. We have selected the following input variables in the system: (1) the GDP growth rate, (2) a proxy for the velocity of circulation, (3) the nominal growth of total imports, (4) the nominal growth of metal sector exports, (5) the nominal growth of other exports, (6) gross non-multilateral financing, and (7) the growth rate of the broad money supply. Results variables in the table include (1) the average kwacha-dollar exchange rate, (2) the ratio of the resource balance to GDP, (3) the debt service- export ratio, (4) net official capital inflows, (5) various budget ratios to GDP, (6) relative domestic and external financing of the budget deficit, and (7) the percentage increase in net domestic credit, broken down by credit to the government and to non-government. Of course, one might select alternative variables to display in Table 1, either as independent or dependent variables within the system. In addition, other variables can be manually changed within the other four tables in the system.

Table 2 provides information on sources and uses of Gross Domestic Product. The GDP figures for 1991-93, denominated in current prices, are derived by inflating the 1990 figure by the postulated GDP growth rate (from Table 1) and the GDP deflator (derived within Table 2 from the year-end CPI estimate). Net exports of goods and non-factor services are derived from the inputs in Table 1, as well as other information in the balance of payments table (Table 3). The distribution of GDP among its two other components (consumption and investment) has been derived by using the share structure presented in the 1989 PFP, for want of a better alternative. Similarly, growth rates for the agriculture and mining sectors are from the same source, with "other" GDP growth left as a residual.

Table 3 contains the balance of payments and its financing, in both dollars and SDRs. The data in the table, for the most part, come from data tables provided to the donor community by the multilaterals as background information for an informal donors' meeting in December 1990. The presentation in Table 3 is not the standard balance of payments presentation. The current account balance, the first segment of the table, is defined as excluding external grants and interest payments. The second segment of the table contains details of debt service obligations, including arrears reduction placed in the actual or expected years of occurrence. The final segment of the table is the financing detail. The merchandise import and export figures can be modified by appropriately changing Table 1 entries, as can the inflows of exceptional financing (i.e., "non-normal" non-multilateral gross inflows).

Table 4 details components of the central government's budget, with 1991-93 projected from estimates for 1990. Generally, components of recurrent revenue and expenditures are assumed to grow in relation to either changes in the exchange rate or changes in domestic prices, with some items (such as external grants and interest) drawn from the balance of payments table. After changes in interest arrears and debt relief on interest are factored in, a current deficit on a cash basis is derived. External financing of the current budget deficit includes gross inflows less amortization due, any change in principal arrears, debt relief on principal, and a final category called "residual financing." Residual (external) financing nets the central government's expected official foreign exchange inflows from its foreign exchange requirements. In other words, this is the government's net external position after taking into account all balance of payments components that are the responsibility of the government. A positive residual financing figure indicates an additional external (i.e., foreign exchange) financing requirement on the government's part. A negative figure, by contrast, represents an "excessive" inflow of official foreign exchange (given government's, as opposed to the economy's, requirements). After total external financing is defined, the balance of financing is net domestic financing of the budget. A positive domestic financing figure requires government borrowing, from the domestic banking system or from domestic non- banking sources. A negative figure indicates the government's ability to reduce its claim on domestic credit sources, freeing up credit for the non- government sector. Table 4a provides details of the budget as percentage shares of GDP, for comparison purposes.

Table 5 is the final table in the accounting framework, and presents the monetary survey, in terms of both flows and stocks. Changes in broad money are of course drawn from the independent variables section of Table 1. Changes in net foreign assets are based on the balance of payments and changes in other items reflect a constant growth rate. Long term

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foreign borrowing is defined as the non-government sector's external borrowing requirement and is the difference between the unfinanced balance of payments gap and the residual external financing position in the government budget. Changes in net domestic credit are a residual category. Within net domestic credit, the government component is defined in the "domestic bank financing" position in Table 4, and net domestic credit to the non-government sector (i.e., the private sector and the parastatals) is therefore the final residual derived in the monetary survey.

The five tables in this accounting framework trace through important relationships in the Zambian economy. A targeted broad money growth figure and assumptions about the velocity of circulation result in calculated CPI (consumer price index) and GDP deflator figures (Table 1, top section). Coupled with a targeted GDP growth rate, the deflator permits a calculation of the a nominal GDP series (Table 2). The balance of payments is defined by (1) import and export assumptions (from Table 1), (2) exogenous factors (such as debt service obligations and "normal" external inflows), and (3) assumptions about "exceptional external financing" made in Table 1. The government budget derivation is the next step, depending as it does on GDP, the balance of payments, and the exchange rate (which is itself derived from inflation assumptions and assumptions about the pace of movement toward a market-clearing rate), presented in the lower section of Table 1. The change in net foreign assets (from the balance of payments table), long-term foreign borrowing (from the balance of payments and the budget tables), and the change in net domestic credit to the government sector (from the budget tables) complete the accounting chain. After stepping through the framework, beginning in the upper section of Table 1 and moving sequentially through Tables 2 through 5, one returns full-circle to Table 1 and its lower section, where major macroeconomic implications of the scenario defined in the upper section of Table 1 are presented. These include external indicators (the exchange rate, the resource balance-GDP ratio, the debt service ratio, and dollar figures on various capital inflows), fiscal indicators (deficit-, revenue-, and expenditure-GDP ratios, as well as the proportions of the budget balance that are externally and internally financed), and monetary indicators (percentage changes in net domestic credit to the government and non- government sectors).

This accounting framework is rudimentary, but useful. The framework, at this current stage of development, is rudimentary because additional linkages should be added to make it even more useful. For example, the investment level in Table 2 could be derived using the postulated GDP growth rate and a variety of assumptions about incremental capital-output ratios (ICORs) in the economy. One could then examine what happens to per capita consumption as a residual. As another example, import growth could also be tied to GDP growth through elasticity assumptions (which could themselves be exogenously varied). These two refinements would improve the linkages in the accounting framework. However, even in the absence of such refinements, we find this accounting framework a useful tool for understanding what happens to certain major indicators when assumptions about the economy are altered, and this ability is important when carrying out projections.

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This appendix was prepared in conjunction with a broad macroeconomic analysis of the Zambian economy in January 1991, an analysis designed for inclusion in a fall 1991 CPSP exercise. Unfortunately, during January 1991 full details of the 1991 PFP (policy framework paper) were not yet available, nor were data lying behind the PFP. Consequently, a consistent data set for 1991-93 was impossible to either gather or estimate. The Mission expects to have sufficient information in several months to check the internal consistency of the 1991-93 program objectives. As of this writing, however, there are a number of problems with the projections. Foremost among these is fiscal balance targets and the external and domestic financing components of that balance. An additional gap in our knowledge at this stage is the division of the balance of payments between government and non-government items. Both these sets of information preclude our construction of adequate money sector projections: despite the fact that we have the broad money growth targets, we cannot derive a useful estimate of the distribution between net domestic credit components and net foreign assets.

Although we offer these caveats on the data in the following tables, the financial programming framework contained in the tables is useful in following the discussion in Part III.B. of the ZAMSTAB PAAD.

Table 1. Zambia: Key Macroeconomic Variables, 1989-93

INDEPENDENT VARIABLES		1990	1991	1992	1993
GDP Growth Rate (percent)					
Null		-1.7	4.0	4.2	4.5
Desired		-1.7	4.0	4.2	4.5
CPI Change (year-end)					
Null		75	40	25	10
Desired: From Money Supply change: CPI/M2 change at:	150%	75	40	25	10
Nominal Import Growth					
Null		9.1	0.3	0.2	4.6
Desired		9.1	0.3	0.2	4.6
Nominal Export Growth (percent)					
Null					
Desired					
Metal Sector					
Null		-17.8	-15.2	-1.2	0.0
Desired		-17.8	-15.2	-1.2	0.0
Non-Metals					
Null		80.2	14.2	-9.3	26.9
Desired		80.2	14.2	-9.3	26.9
BPA External Financing					
Null		89	372	220	205
Desired		89	372	220	205
Broad Money Supply Growth (percent)					
Null		50	25	15	10
Desired		50	25	15	10

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EXTERNAL INDICATORS	1989	1990	1991	1992	1993
Average Nominal Kwacha-Dollar Exchange Rate	13.8	33.3	72.0	109.0	122.4
Average Equilibrium Kwacha-Dollar Exchange Rate	30.1	58.6	86.3	109.0	122.4
Resource Balance/GDP (pct)	5	0	-5	-6	-6
Current Debt Service/Exports of GNFS (pct)	44	66	75	69	60
Net Official Capital Inflows (US dollars millions)	-464	-275	118	145	171
Net Non-Multilateral Flows	-168	108	503	311	339
Net Multilateral Flows	-296	-383	-385	-166	-168
Net IBRD Flows	-75	-59	-21	3	5
Net IMF Flows	-179	-278	-277	-122	-119
Net Other Multilateral Flows	-42	-56	-91	-57	-54
FISCAL INDICATORS					
Budget Deficit/GDP (excl. foreign interest and grants)	9	5	3	-2	-4
Revenues/GDP (excl. foreign grants)	17	21	22	23	23
Expenditures/GDP (excl foreign interest)	26	26	25	22	20
Financing of Budget (million Kwacha)	4600	1627	15753	6786	-1023
External Share (pct)	13	27	105	314	-2008
Domestic Share (pct)	87	207	-5	-214	2108
MONETARY INDICATORS					
Increase in Net Domestic Credit (percent)	68	27	-157	-102	4567
Central Government	35	-6	-14	-285	229
Non-Government (including parastatals)	103	53	-219	-159	311

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Table 2. Zambia: Sources and Uses of GDP

	1990	1991	1992	1993
	(million current Kwacha)			
Gross National Product	33916	164296	223639	279592
Net factor income from abroad	-73686	-11956	-19704	-19202
Gross Domestic Product	107602	176252	243342	298794
Consumption	98379	144443	191938	227102
Central Government Consumption	11314	18625	26537	33944
Nongovernment Consumption	87065	125819	165401	193158
Investment	19032	33282	56281	78711
Nongovernment	12767	25051	43530	60908
Central Government	6266	8231	12752	17803
Net exports of goods and nonfactor services	-9809	-1473	-4877	-7019
Exports	44747	81047	119961	139069
Imports (incl net NFS)	54556	82521	124837	146057

KEY GROWTH RATES

	1990	1991	1992	1993
	(percent change)			
Gross Domestic Product	-1.7	4.0	4.0	4.5
Agriculture	-7.0	10.4	6.0	6.5
Mining	2.9	-4.1	-1.2	0.0
Other	-1.7	3.3	4.7	4.4
GDP Deflator	88.4	57.8	32.8	17.8
CPI (Dec on Dec)	75.0	40.0	25.[illegible]	[illegible]
CPI (period average)	114.7	57.5	32.5	17.8

RATIOS TO GDP

	1990	1991	1992	1993
	(percent)			
Gross National Product	32	92	92	94
Net factor income from abroad	-68	-7	-8	-6
Gross Domestic Product	100	100	100	100
Consumption	91	82	79	76
Central Government Consumption	11	11	11	11
Nongovernment Consumption	81	71	68	65
Investment	18	19	23	26
Nongovernment	12	14	18	[illegible]
Central Government	6	5	5	6
Net exports of goods and nonfactor services	-9	-1	-2	-2
Exports	42	46	49	47
Imports	51	47	51	49

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Table 3. Zambia: External Balance and Financing

	1990	1991	1992	1993		1989	1990	1991	1992	1993
					(K/$)	13.8	30.3	72.0	109.0	122.4
					($/SDR)	1.285	1.350	1.387	1.401	1.415
CURRENT ACCOUNT	(million US dollars)					(million SDR)				
Merchandise Trade	167	7	-20	-36		302	124	5	-14	-26
Exports (FOB)	1283	1126	1101	1136		1098	950	1098	1070	1066
Metal Sector	1155	980	969	969		1043	856	707	691	685
Other	128	146	132	166		55	95	392	379	381
Imports (CIF)	1115	1118	1120	1172		796	826	1093	1084	1091
Metal Sector	358	350	349	370		290	265	252	249	261
Fertilizer	49	56	55	55		56	36	40	40	39
Petroleum	141	130	134	139		80	105	94	96	98
Other	567	582	581	608		369	420	707	700	693
Nonfactor Services	-157	-175	[illegible]	[illegible]		-139	-117	-87	-84	[illegible]
Private Transfers	-45	-28	-25	-21		-22	-33	-20	-18	-15
CURRENT BALANCE (before interest and grants)	-35	-155	-162	-166		142	-26	[illegible]	[illegible]	[illegible]
DEBT SERVICE OBLIGATIONS										
Multilaterals	383	764	[illegible]	[illegible]		258	330	614	251	251
World Bank	89	400	[illegible]	91		117	102	352	106	[illegible]
Scheduled Obligations	89	88	[illegible]	91		59	66	60	[illegible]	[illegible]
Principal	40	42	44	45		29	30	30	[illegible]	[illegible]
Interest	49	46	44	46		30	36	[illegible]	[illegible]	[illegible]
Arrears Reduction		312						225		
IMF	238	273	[illegible]	[illegible]		139	176	197	87	94
Repurchases	121	60	[illegible]	[illegible]		106	90	43	4	[illegible]
Charges	117	121	[illegible]	[illegible]		[illegible]	87	87	87	[illegible]
Arrears Reduction (1)		92						55		
Other Multilaterals	56	91	[illegible]	[illegible]		[illegible]	41	[illegible]	[illegible]	[illegible]
Principal	[illegible]	[illegible]	[illegible]	[illegible]		[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Interest	40	[illegible]	[illegible]	[illegible]		14	[illegible]	[illegible]	[illegible]	[illegible]
Non-Multilaterals	[illegible]	[illegible]	[illegible]	[illegible]		[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Scheduled Obligations	394	[illegible]	[illegible]	[illegible]		[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Principal	[illegible]	249	[illegible]	[illegible]		[illegible]	[illegible]	180	[illegible]	[illegible]
Interest	[illegible]	[illegible]	[illegible]	[illegible]		[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Arrears Reduction	2049									
Interest on Arrears and Reschedulings	[illegible]	[illegible]	[illegible]	[illegible]			[illegible]	[illegible]	[illegible]	[illegible]
TOTAL DEBT SERVICE	[illegible]	[illegible]	[illegible]	[illegible]		[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
FINANCEABLE BALANCE	[illegible]	[illegible]	[illegible]	[illegible]		[illegible]	[illegible]	[illegible]	[illegible]	[illegible]

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Table 3. Zambia: External Balance and Financing (cont)

FINANCING ITEMS	1990	1991	1992	1993	1989	1990	1991	1992	1993
Private Flows (incl E & O)	-1	38	28	28	63	-1	27	[illegible]	20
Reserve Actions (- is increase)	32	-50	-25	-15	-73	24	[illegible]	-19	[illegible]
IMF Purchases									
Other Actions	32	-50	-25	-15	-73	24			
Incurrence of Arrears	277	0	0	0	384	205	0	0	0
Multilaterals	277	0	0	0		205	0	0	0
World Bank	76					56			
IMF	201					149			
Non-Multilaterals									
Rescheduling Actions	2392	415	434	392	0	[illegible]	[illegible]	[illegible]	[illegible]
On Arrears	2034					[illegible]			
On Current Obligations	358	415	434	392		[illegible]	[illegible]	[illegible]	[illegible]
External Financing	294	1019	541	518	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
World Bank		379	97	96			[illegible]	[illegible]	[illegible]
Non-Multilaterals (grants and loans)	294	640	444	422	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
"Normal" Flows	205	207	224	217		152	146	160	[illegible]
SPA Flows	89	372	220	205		[illegible]	[illegible]	[illegible]	[illegible]
IBRD Arrears Financing		65					[illegible]		
UNFINANCED GAP	2	49	14	-13	[illegible]	1	[illegible]	[illegible]	[illegible]
	=====	=====	=====	=====	=====	=====	=====	=====	=====

NOTES AND SOURCES: The data in this table are compiled from a number of sources, including the IMF, the IBRD, and the GRZ. The data for 1989 are generally based on information available in July 1990, while the 1990-93 data are primarily from estimates released to A.I.D. in December 1990 and January 1991.

MEMORANDUM ITEMS:

Resource Balance/GDP	[illegible]	-6.2	[illegible]	-6.9
Current Debt Service/Exports of GNFS (pct)	[illegible]	74.6	[illegible]	[illegible]
Net Non-Multilateral Flows	[illegible]	[illegible]	[illegible]	[illegible]
Net Multilateral Flows	[illegible]	[illegible]	[illegible]	[illegible]
Net IBRD Flows	[illegible]	[illegible]	[illegible]	[illegible]
Net IMF Flows	[illegible]	[illegible]	[illegible]	[illegible]
Net Other Multilateral Flows	[illegible]	[illegible]	[illegible]	[illegible]
Net Official Capital Inflows	[illegible]	[illegible]	[illegible]	[illegible]

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Table 4. Zambia: Central Government Budget

	(Kwacha Millions, Current Prices)			
	1990	1991	1992	1993
Revenue and Grants	27631	46269	69222	82867
Tax Revenues	21981	37685	55254	67422
Mineral Sector	4114	6000	9000	12000
Import Taxes	7807	14769	22309	26344
Domestic Gds & Services	5011	8645	12527	15057
Income Taxes	5049	8271	11419	14021
Non-Tax Revenues	779	1276	1762	2162
Grants	4870	7307	12206	13281
Expenditures and Net Lending	36065	62278	77555	82034
Current Expenditures	[illegible]	52599	63280	[illegible]
Personal Emoluments	4779	7380	10561	13402
Recurrent Dept. Charges	4651	7728	9706	11405
Subsidies	4060	3197	0	0
Domestic Interest	2271	5588	4044	0
Foreign Interest	7920	18350	24717	20767
Transfers & Pensions	2909	4582	6071	7100
Other	3921	6176	8150	9616
Capital Expenditures	4891	9680	14273	16712
Net Lending	0			
Exceptional Expenditures	1103			
Of which: Parastatal Forex losses	0			
Overall Deficit, Commitment Basis	8434	16010	8333	-800
IMF Charges	3457	8711	12642	14199
Domestic Arrears (-=increase)	-4456			
Change in Float	514	---	---	---
External Interest Arrears (-=inc)	20455	0	0	0
Overall Deficit, Cash Basis	[illegible]	[illegible]	[illegible]	[illegible]
Debt Relief Interest	[illegible]	[illegible]	[illegible]	[illegible]
Cash Deficit after Interest Relief	[illegible]	[illegible]	[illegible]	[illegible]
Memorandum Items:				
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Gross Domestic Product	[illegible]	[illegible]	[illegible]	[illegible]
GDP Deflator [illegible]	[illegible]	[illegible]	[illegible]	[illegible]

SOURCE: Zambian Authorities.

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Table 4. Zambia: Central Government Budget Financing

	1990	1991	1992	1993
	(Kwacha Millions, Current Prices)			
Financing Requirement	1627	15758	6786	-1028
External (net)	433	16622	21339	20645
Gross Inflows	2033	34593	47298	47984
less Amortization Due	9678	17546	22232	22136
Ch in Prin Arrears (+=inc)	-31882	-29085	0	0
Debt Relief: Principal	39256	8963	14159	14395
Exceptional Financing				
Residual Financing	-296	19698	-17917	-19597
Domestic (net)	3362	-864	-14553	-21673
Banking System	3911			
Non-Banking System	467			
T-Bills/Bonds	457			
Other	10			
Other	-1016			

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Table 4. Zambia: Central Government Budget

(as a percent of GDP)

	1990	1991	1992	1993
Revenue and Grants	25.7	26.3	28.4	27.7
Tax Revenues	20.4	21.4	22.7	22.6
Mineral Sector	3.9	3.4	3.7	4.0
Import Taxes	7.3	8.4	9.2	8.8
Domestic Gds & Services	4.7	4.9	5.1	5.0
Income Taxes	4.7	4.7	4.7	4.7
Non-Tax Revenues	0.7	0.7	0.7	0.7
Grants	4.8	4.1	5.0	4.4
Expenditures and Net Lending	33.5	35.3	31.9	27.5
Current Expenditures	27.9	29.8	26.0	21.9
Personal Emoluments	4.0	4.2	4.3	4.5
Recurrent Dept. Charges	4.3	4.0	4.0	3.8
Subsidies	3.8	1.8	0.0	0.0
Domestic Interest	2.1	3.2	1.7	[illegible]
Foreign Interest	7.4	10.4	10.2	9.0
Transfers & Pensions	2.7	2.6	2.5	2.4
Other	3.2	3.5	3.4	3.2
Capital Expenditures	4.8	5.5	5.9	5.6
Net Lending	0.0	0.0	0.0	0.0
Exceptional Expenditures	1.0	0.0	0.0	0.0
Of which: Parastatal Forex Losses				
Overall Deficit, Commitment Basis	7.8	9.1	3.4	-0.3
Excl. Foreign Grants and Interest	4.0	2.8	1.7	(3.8)
IMF Charges	3.2	4.9	3.2	4.8
Domestic Arrears (-=increase)	-4.2	0.0	0.0	0.0
Change in Float	0.8	0.0	0.0	0.0
External Interest Arrears (-=inc)	19.[illegible]	[illegible]	[illegible]	[illegible]
Overall Deficit, Cash Basis	28.4	14.[illegible]	3.6	4.8
Debt Relief Interest	24.9	8.1	5.8	4.8
Cash Deficit after Interest Relief	[illegible]	[illegible]	2.8	[illegible]

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Table 4. Zambia: Central Government Budget Financing

	1990	1991	1992	1993
Financing Requirement	1.5	8.9	2.8	-0.3
External (net)	0.4	9.4	8.8	6.9
Gross Inflows	1.9	19.6	19.4	15.1
less Amortization Due	8.1	10.0	9.1	7.4
Ch in Prin Arrears (+=inc)	-29.6	-16.5	0.0	0.0
Debt Relief: Principal	36.5	5.1	5.6	4.8
Exceptional Financing	0.0	0.0	0.0	0.0
Residual Financing	-0.3	11.2	-7.4	-6.6
Domestic (net)	1.1	-0.5	-6.0	-7.2
Banking System				
Non-Banking System				
T-Bills/Bonds				
Other				
Other				

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Table 5. Zambia Monetary Survey

(million kwacha)

CHANGE IN:	1990	1991	1992	1993
NET FOREIGN ASSETS	10742	23254	16020	16403
Net Official Assets	8260	23254	16020	16403
Gross Official Reserves		3600	2725	1836
Official Liabilities (- is decrease)		19654	13296	14566
Commercial Bank Assets	2482	0	0	0
LONG-TERM FOREIGN BORROWING		16170	-19442	-17394
NET DOMESTIC CREDIT	4260	-30991	11396	8271
Government	-495	-864	-14553	-21673
Non-Government (incl. parastatals)	4755	-30126	25949	29944
OTHER ITEMS	[illegible]	2160	3269	3672
BROAD MONEY SUPPLY	8365	6273	4705	3607
Narrow Money				
BROAD MONEY GROWTH (percent)				
Actual	50.0			
Target		25	15	[illegible]

STOCKS:	1990	1991	1992	1993
NET FOREIGN ASSETS	14136	53560	50138	49146
Monetary Authorities	9171			
Commercial Banks	4965			
NET DOMESTIC CREDIT	19772	[illegible]	177	8448
Government	5968	5104	-4449	[illegible]
Non-Government (incl. parastatals)	13804	[illegible]	9627	[illegible]
OTHER ITEMS	8914	11974	14240	[illegible]
BROAD MONEY SUPPLY	25094	31367	36072	39679

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Table 5. Zambia: Sources of Monetary Growth

	1990	1991	1992	1993
NET FOREIGN ASSETS	64	157	-11	-3
NET DOMESTIC CREDIT	25	-124	36	23
Government	-7	-7	-46	-60
Non-Government (incl. parastatals)	25	-120	83	83
OTHER ITEMS	40	4	10	10
BROAD MONEY SUPPLY	50	25	18	[illegible]
NET FOREIGN ASSETS	76	74	-7	-2
NET DOMESTIC CREDIT	27	-157	-192	4663
Government	-5	-14	-285	229
Non-Government (incl. parastatals)	53	-218	-159	211
OTHER ITEMS	449	25	30	26
BROAD MONEY SUPPLY	50	23	18	[illegible]

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B. Source of the Problem: The Policy Framework

Zambia's economic policy framework has been a major source of its domestic and external problems over the past several years. Commodity prices have largely been controlled by the government, as has most trading (domestic and external) activity. About 85 percent of manufacturing assets are estimated to be in parastatal hands, and the large mining sector is parastatal controlled. The parastatals receive large subsidies and are generally not well managed. The exchange rate has been generally appreciating due partly to high domestic price inflation, itself the result of excessive bank financing of central government deficits. Interest rates have also been distinctly negative. Finally, Zambia has suffered severe foreign exchange shortages in recent years, following massive borrowing in the pre-1985 period, and these shortages have been primarily dealt with by incurring external payments arrears, also on a massive scale.

Zambia has followed a somewhat eclectic reform path over the past five years, beginning with a donor-supported comprehensive stabilization and adjustment program in the mid-1980s, followed by a rejection of that program in early 1987, and most recently characterized by seeking once again external support for reforms.

1. 1985-87: IMF-Supported Economic Reforms

In 1983, following dissatisfaction with development planning in the preceding period, the GRZ initiated, with the support of the IMF, a general economic reform program. A succession of stand-by arrangements were agreed to, the most recent covering the period October 1985 to April 1987. The policy framework reforms to which the GRZ agreed included (a) exchange devaluation, (b) decontrol of prices, including the rate of interest, (c) import liberalization, (d) reducing the role of the government in economic management, (e) public expenditure restraint to control money supply growth and the rate of inflation, and (f) exploring the privatization of state enterprises. At the outset of the reform period, the GRZ tackled its tasks vigorously. Consistent excess demand for a sharply overvalued kwacha brought successive devaluation as Zambia auctioned off its foreign exchange earnings. Decontrol of prices led to increases in real earnings of crop producers and an expansion of crop production. However, the GRZ's attempts to curb inflation faltered severely, as the government's inability to reduce the fiscal deficit required recourse to domestic borrowing and a consequent increase in the money supply. In 1986, the central government deficit was nearly 30 percent of GDP, and the broad money supply expanded by over 90 percent. Rapidly growing monetary expansion put tremendous pressure on the exchange rate auction, given the rate of supply of foreign exchange to service the auction.

As the stand-by arrangement with the IMF drew to a close, the GRZ announced a reversal of many of the reforms they had undertaken. The GRZ had decided that its experiment with market forces by relaxing government

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control of the economy would not work. The GRZ had stood by the reform program until rioting following the decontrol of prices for mealie meal, the basic staple, became too much for the government to bear politically.

2. INDP (1987-88) Goals and Objectives

In May 1987, the GRZ announced a return to greater state management of the Zambian economy. The goal of the INDP (Interim National Development Plan -- July 1987 through December 1988) was to stabilize the economy, especially its inflationary tendencies, by reintroducing state control of economic variables such as the exchange rate, the allocation of foreign exchange, prices of basic commodities, the rate of interest, and distribution of resources away from consumption and toward investment. An important element of this approach was to reduce the country's reliance on external resources to support development, characterized in the GRZ's words "growth from own resources." A central reason for this clarion call was the extremely high level of external debt the country had incurred, and the consequently high debt-service burden.

The INDP departed significantly from the economic management policies pursued by the GRZ in the 1984-86 period. The GRZ generally overturned what had been an increasing reliance on market forces and reasserted the primacy of central planning. First, the GRZ reversed what had been a progressively liberalized foreign exchange regime. This was done by (a) revaluing and freezing the exchange rate, and (b) halting the experimental foreign exchange auction system and returning to administrative allocation of foreign exchange. Second, the GRZ reinstituted ceilings on interest rates at levels beneath what they had been prior to the INDP. Third, the GRZ reversed its position on the removal of subsidies on basic foodstuffs (particularly mealie meal); the original removal was a step to increase public savings. Fourth, the GRZ announced a unilateral policy of limits on external debt payments rather than continuing to seek formal rescheduling of its massive debt. These proposals were made, according to the GRZ, because the reform program on which the country had embarked with the donor community's support had in at least the short run put the country into worse economic straits than it had been prior to the reforms. Foreign exchange liberalization was cited as the reason for very high inflation rates, and for the ultimate political insolvency of the reforms.

Despite this fundamental dismantling of the reform program agreed to with the donors and the multilaterals, it is important to note that certain objectives of the INDP (although not the means to attain them) were similar to objectives the GRZ had pursued during the previous reform period. Inflation was to be controlled, exports were to be diversified, positive growth was targeted, the exchange rate was to be reviewed, and subsidies were to be gradually withdrawn. The major difference with the previous period lay in the revived emphasis on direct state management of the economy.

In late 1987, some six months after the GRZ had announced that it was pulling back from key aspects of the donor-supported economic policy reform program of 1986, the GRZ suggested to the IMF, the IBRD,