

LOAN COMMITTEE

LC/M/86/13

April 25, 1986

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WBG ARCHIVES

Minutes of the Loan Committee Meeting of April 11, 1986 to consider ZAMBIA - Proposed Recovery Credit

A. Present

Committee:

- Messrs. Stern (Chairman)
- Dubey (OPSVP)
- Krueger (VPERS)
- Goldberg (LEGVP)
- Dherse (EISVP)
- Jaycox (ESAVP)

Others

- Kopp
- Rogers
- Imam
- Fox
- Christoffersen
- Messenger
- Grawe
- Durdag
- Gebhart
- Mwine
- Al Habsy
- Aguirre-Sacasa
- Penalver-Quesada
- Gulhati
- Hopcraft
- Acquah (IMF)

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COMMITTEE

- Senior Vice President, Operations (Chairman)
- Senior Vice President, Finance
- Vice President & General Counsel
- Vice President, Operations Policy
- Regional Vice President concerned*
- Vice President, Energy & Industry (for lending in these sectors and SALs)
- Vice President, Economics and Research (for non-project lending)

OTHERS

Standard (see OMS 9.25 page 7)

*Copy to all other Regional Vice Presidents

1. The meeting was called to discuss the Initiating Memorandum on the proposed Zambia Recovery Credit.

B. Issues

2. The discussion touched on a number of issues raised in the Country Policy Department's memorandum of April 9, 1986 on the subject. Issues discussed included agricultural pricing and marketing (particularly the issue of maize subsidies and the role of private traders in the marketing process), the functioning of the foreign exchange auction in Zambia, the level of interest rates, the progress made on parastatal reform and the role of ZIMCO.

C. Discussion

Agricultural Pricing and Marketing

3. The discussion of agricultural pricing and marketing centered on how private traders will be able to participate in the marketing of maize under a system of subsidized pricing. The Region explained that while the phasing out of maize subsidies entirely and the introduction of private trading in an open marketing arrangement remain the objectives, there is a question of how to introduce private trading in the interim period until the subsidy is fully abolished. Because of the short-term burden on the population resulting from the economic reform measures with inflation running above 50 percent, it is not considered politically feasible to raise the consumer price of maize at this time. The interim mechanism being considered is to shift the maize subsidy from NAMBOARD to the millers so that private traders can recover their full distribution cost. The details of how this would work are being developed by the consultants carrying out the Maize Marketing and Fertilizer Distribution study. At the same time, discussions are underway on the system to be used to determine the floor prices to be offered farmers by NAMBOARD in its future role of buyer and seller of last resort. Finally, the impact on the poor of the elimination of the maize subsidy will be assessed later this year, along with the feasibility of targetting a future maize subsidy to the lowest income groups. It is expected that the maize subsidy will be eliminated in 1987 but that it might be desirable to provide specific relief for the lower income group. It was agreed that these issues would be further developed in the President's Report, including a timetable of actions.

Foreign Exchange Auction

4. The Region reported that the foreign exchange auction was running smoothly and that there were signs that the anticipated benefits were beginning to emerge, particularly in the industrial sector which had been receiving the bulk of the foreign exchange under the auction. One disappointment was the lack of successful bidding by farmers and agricultural machinery supply firms, and thus the lack of imported inputs going into that important sector. The Region indicated several possible reasons for this, including the fact that the cost of imported items had

shot up tremendously due to the devaluation, interest rates had increased sharply and the farmers and traders lacked the Kwacha to bid because of suppressed profits prior to the recent reforms. Further analysis of the problem and the development of possible solutions are underway. In response to a question from the Committee, the Region noted that about 50 percent of all foreign exchange transactions are now passing through the auction which sets the rate for all foreign exchange transactions. Under the proposed Recovery Credit we expect to agree with the Government on a timetable for including government transactions in the auction.

Interest Rates

5. In response to the question as to why interest rates were not yet positive in real terms, the Region noted that there had been a sharp rise in interest rates following decontrol and that rates are now determined freely by the commercial banks. It is thought that the present inflation rate (50%) does not reflect the medium-term prospective rate which would be substantially lower. Compared with the medium-term inflation prospects, the current interest rate would probably be slightly positive in real terms.

Parastatal Reform

6. The Region reaffirmed its belief that the Zambian authorities were determined to undertake a systematic reform of the parastatal sector, including the public enterprises. Evidence of this is the extensive work underway on the parastatal sector. Most of the major parastatals are under review currently for the purpose of drawing up restructuring or divestiture plans. Privatization is an option being actively considered in this process. ZCCM heads the list of parastatals being, or to be, reviewed, and the list includes all public enterprises under INDECO, Nitrogen Chemicals of Zambia, Zambia Airways, Refined Oil Products, the National Brewery, and many more.

ZIMCO

7. One speaker questioned the role of ZIMCO in the management structure governing the parastatals. Practically all parastatals, including ZCCM, fall under ZIMCO's purview, and, with the President as the Chairman of the Board, ZIMCO wields considerable weight as regards parastatal policy and operations. The Region responded that its approach heretofore has been to focus on the individual parastatals or enterprises (and INDECO itself) rather than to work on a global level through ZIMCO. Of course, ZIMCO's management has been involved and approved of the work that has been going on with the parastatals. The Region agreed that the role of ZIMCO was of great importance and was presently being reviewed as part of the Bank's ongoing public expenditure review.

Conditionality of the Credit

8. The Chairman said that while everyone recognizes the advances that Zambia has made on the policy and institutional reform front, the economic situation remains extremely grave and the authorities must press ahead to broaden and deepen the reform effort. The Region, he said, must continue to insist on progress in the various reform areas in return for continued Bank support. He said that the President's Report should indicate clearly the advances being made in this regard under the proposed credit, in the context of a medium-term policy program. Also, there should be a firm timetable agreed, with specific dates, for phasing out the consumer subsidy, and any remaining producer subsidy, on maize.

D. Conclusion

The Committee authorized the Region to proceed with the appraisal of the proposed credit.