July 2006
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Zambia: Fourth Review of the Three-Year Arrangement Under the Poverty Reduction and Growth Facility, Request for Modification of Performance Criteria, and Financing Assurances Review—Staff Report; and Press Release on the Executive Board Consideration

In the context of the fourth review of the three-year arrangement under the Poverty Reduction and Growth Facility, request for modification of performance criteria, and financing assurances review, the following documents have been released and are included in this package:

- the staff report for the Fourth Review of the Three-Year Arrangement Under the Poverty Reduction and Growth Facility, Request for Modification of Performance Criteria, and Financing Assurances Review prepared by a staff team of the IMF, following discussions that ended on May 10, 2006, with the officials of Zambia on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on June 27, 2006. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- a Press Release summarizing the views of the Executive Board consideration of the staff report that completed the review.

The documents listed below have been or will be separately released.

Letter of Intent sent to the IMF by the authorities of Zambia*
Memorandum of Economic and Financial Policies by the authorities of Zambia*
Technical Memorandum of Understanding
*Also included in Staff Report

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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INTERNATIONAL MONETARY FUND

ZAMBIA

Fourth Review of the Three-Year Arrangement Under the Poverty Reduction and Growth Facility (PRGF), Request for Modification of Performance Criteria, and Financing Assurances Review

Prepared by the African Department
(In consultation with other departments)

Approved by Robert Corker and G. Russell Kincaid

June 27, 2006

- Discussions for the fourth review under the Poverty Reduction and Growth Facility (PRGF) were held in Lusaka, April 26–May 10, 2006. Staff met with the Minister of Finance and National Planning, Mr. Magande; the Governor of the Bank of Zambia (BoZ), Mr. Fundanga; other senior officials; and representatives of the private and financial sectors and Zambia's development partners.
- The Zambian economy continues to perform well. Real GDP growth was robust in 2005 and is expected to pick up further in 2006, while inflation has fallen. The authorities have generally maintained disciplined macroeconomic and financial policies, despite some recent softening in tax revenue. Improved macroeconomic management, extensive debt relief, and positive terms of trade have led to a substantial appreciation of the kwacha. International reserves have been built up faster than expected, though they are still low.
- The Executive Board approved Zambia's three-year PRGF arrangement on June 16, 2004, in the amount of SDR 220.1 million (45 percent of quota), of which SDR 187.1 million has been drawn. The third review of the program was completed on January 11, 2006, at the time of the 2005 Article IV consultation. Zambia reached the completion point under the enhanced Heavily Indebted Poor Countries (HIPC) Initiative in April 2005 and was granted further assistance under the Multilateral Debt Relief Initiative (MDRI) in January 2006. The Fifth National Development Plan, which will serve as Zambia's revised poverty reduction strategy paper, is scheduled to be launched in July 2006.
- Progress under the PRGF-supported program through the December 2005 test date was satisfactory; all performance criteria were met. Most 2006Q1 benchmarks were met, though there were some slippages, particularly a substantial breach of the ceiling on net government domestic financing, and delays in some structural measures. The authorities are taking corrective action. They are also pursuing a larger buildup of international reserves. Staff recommends that the Executive Directors complete the review and approve the requested modifications to the 2006 program.
- Presidential and parliamentary elections are scheduled for late 2006.
- The staff team comprised Mr. Caramazza (head), Mr. Akatu, Ms. Al-Zein, and Mr. Dunn (all AFR), Mr. Baldini (FAD), Mr. House (PDR), and Mr. Kakoza (Resident Representative).

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EXECUTIVE SUMMARY

- **Zambia has achieved robust economic growth over the last several years and poverty, though still widespread, has begun to trend downwards.** Prudent fiscal policy has reduced the government's domestic financing need and facilitated the implementation of a firmer monetary policy. Inflation has fallen steeply since last year, aided by the sharp appreciation of the currency and lower food prices.

- **The external position has strengthened markedly.** Record high copper prices significantly improved the terms of trade, and the HIPC Initiative and the MDRI have canceled the bulk of Zambia's external debt. The improved economic fundamentals have boosted confidence in the economy, leading to unprecedented inflows of portfolio investment and a large real appreciation of the currency. International reserves, however, remain low.

- **Performance under the PRGF-supported program remains broadly satisfactory.** All performance criteria and benchmarks for end-December 2005 were met, but the March 2006 indicative target ceiling on the government's domestic financing was exceeded.

- **The prospects for continued strong growth and low inflation are favorable.** The policy challenge is to stay the course on macroeconomic stabilization—anchored on lowering government's domestic borrowing—while moving ahead on the structural reform agenda to boost productivity growth and enhance international competitiveness.

- **The strong appreciation of the currency is projected to considerably reduce the kwacha value of donors' budget support and lower revenue from import taxes.** Expenditures will be cut and tax collection efforts strengthened in order to meet the 2006 net domestic financing target**.**

- **To strengthen revenue performance over the medium term, the authorities will undertake a comprehensive review and reform of the tax system**, with technical assistance from the Fund. Also a committee has been established to renegotiate mining agreements, including raising the very low royalty rate on minerals.

- **The resources from debt relief provided under the MDRI will be used gradually, in line with annual debt-service savings.** Spending on priority agriculture and infrastructure projects identified in the National Development Plan is being increased.

- **The boom in copper prices and the accompanying appreciation of the kwacha and sizable inflows of portfolio capital pose a challenge to the conduct of monetary policy and the competitiveness of nontraditional exports.** While a flexible exchange rate can best buffer real shocks such as changes in the terms of trade, efforts should be made to broaden the scope for sterilized intervention to smoothen exchange rate fluctuations and build up international reserves. It is essential also to advance the structural reform agenda to enhance international competitiveness and remove impediments to exports.

I. BACKGROUND AND THE ISSUES

1. **Economic growth in Zambia has been robust for several years and poverty, though still widespread, has begun to trend downward.** Inflation, which was high for much of this period, has fallen markedly since last year, aided by a sharp appreciation of the currency and, more recently, lower food prices as agriculture recovers. Prudent fiscal policy has reduced the government's domestic financing needs and facilitated implementation of a more restrained monetary policy. Government revenue has not kept pace with economic growth, however. The external position has strengthened, as record high copper prices significantly improved the terms of trade and nontraditional exports grew briskly. Relief under the enhanced HIPC Initiative greatly reduced Zambia's external debt burden and the Multilateral Debt Relief Initiative (MDRI) cancelled the bulk of the remaining external debt. Zambia's improved economic fundamentals have boosted market confidence in the economy, leading to substantial inflows of portfolio investment—a new phenomenon for Zambia—and contributing to a large real appreciation of the currency. International reserves, though, are low. The outlook is for continued robust economic growth, led by strong performance in mining and construction, although the currency appreciation could hamper export diversification. The policy challenge is to continue on the path of macroeconomic stabilization—anchored on lower domestic borrowing—while stepping up execution of the structural reform agenda.

2. **Against this background, discussions with the authorities focused on**

(i) the implications of recent developments for the macroeconomic framework for 2006, especially:

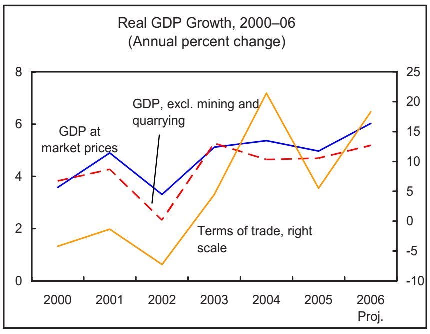
- the adverse impact of the kwacha's appreciation on the fiscal position and measures to close the projected fiscal gap;
- the inflow of portfolio capital and its implications for monetary and exchange rate policy; and
- the use of MDRI resources.

(ii) the importance of staying the course for greater macroeconomic stability over the medium term and executing the structural reform agenda to increase productivity and competitiveness.

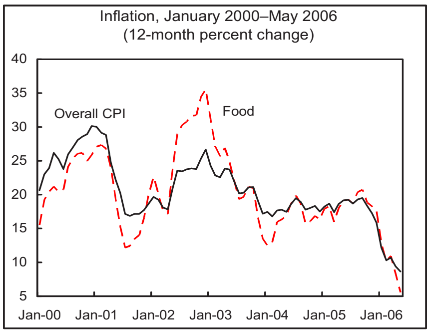
II. Recent Developments and Program Performance

3. **Performance under the PRGF-supported program has been satisfactory:**

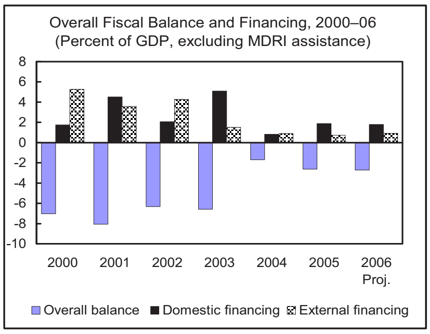
- Real GDP grew in 2005 by an estimated 5.0 percent. Strong performances in construction and mining overcame negative supply shocks such as drought in some regions, high world oil prices, and fuel shortages arising from unplanned shutdowns of the country's oil refinery. Economic activity in the first quarter and an anticipated good harvest point to real growth of about 6 percent in 2006 (Table 1).



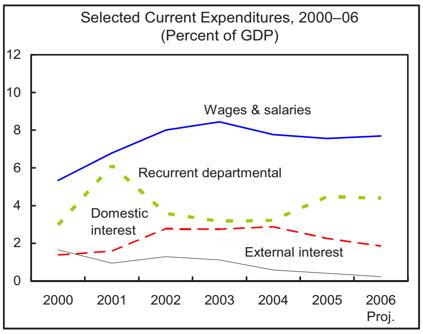
- Inflation fell in 2005 to 15.9 percent, slightly above the program target (15 percent). It fell further in early 2006 to 8.6 percent in May, the lowest rate in about 30 years.



- Firm expenditure control kept the fiscal deficit, including grants, in line in 2005, notwithstanding a modest shortfall in government revenues (Table 2). Spending on poverty-reducing programs (PRPs) other than externally financed projects amounted to 6.1 percent of GDP in 2005, 1.1 percentage points more than programmed (Table 3).



- Net domestic financing (NDF) was below the program ceiling in 2005, as not all of the K 120 billion released for payment of domestic arrears to road contractors, had cleared by the end of the year.[1] Nonbank financing more than covered the government's domestic borrowing needs in 2005, reflecting strong demand for government securities from pension funds and insurance companies, as well as by foreign investors. In 2006Q1, continued weakness in revenues, together with a sizable float effect



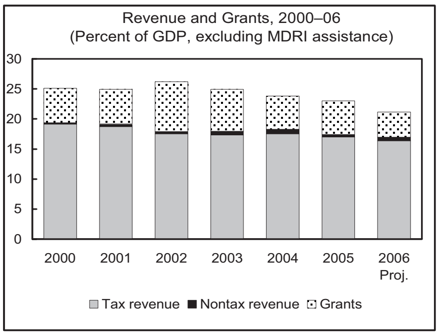
[1] In 2005, total domestic arrears (excluding statutory pension arrears) were reduced by K 254 billion. At end-December 2005, domestic arrears were K 421 billion (1.3 percent of GDP).

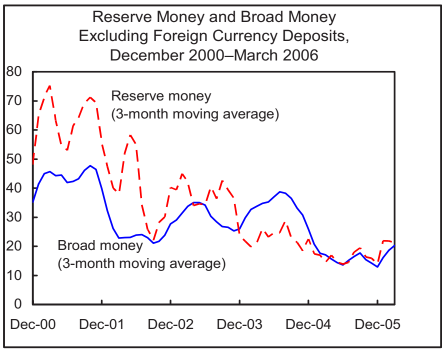
from releases in late 2005, resulted in the benchmark ceiling for NDF being exceeded by about ¾ percent of GDP.

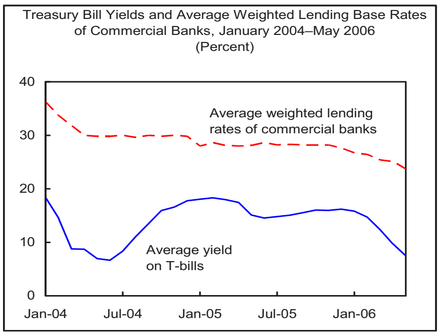
- Relative to GDP, tax revenues in 2005 slipped by half a percentage point to 17.0 percent. The slippage was particularly marked in income taxes, import VAT, and customs duties. In 2006Q1, tax revenues were weaker than expected, mainly due to (i) the impact the appreciated kwacha had on import taxes and on domestic taxes on goods and services priced in U.S. dollars (such as VAT on electricity sales to the copper mines), and (ii) the extension through June 2006 of reductions in import and excise duties on petroleum products, which were introduced in 2005Q4 in the wake of the fuel crisis brought about by the shutdown of the oil refinery, because the refinery continued to experience production difficulties.

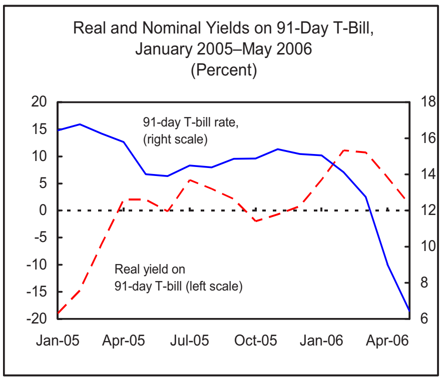
- Monetary expansion was restrained in 2005. Reserve money grew by 8.4 percent and broad money by just 0.4 percent, as foreign currency deposits fell by nearly 20 percent in kwacha terms.[2] Credit to the private sector expanded by 18.4 percent.[3] The monetary aggregates continued to expand at a moderate pace in 2006 (Tables 4 and 5).

- The average nominal yield on t-bills, which was fairly steady over the second half of 2005, declined sharply in 2006, mainly in response to falling inflation and strong demand by investors. In May 2006, the average yield on t-bills and bonds was over 10 percentage points lower than in December 2005. In real terms, the yield on the 91-day t-bill rose sharply before falling to near zero in May 2006. Commercial bank lending rates have also fallen, though at a more moderate pace.









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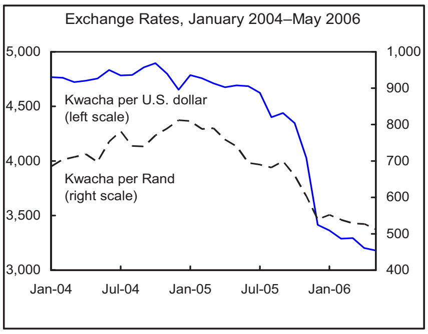
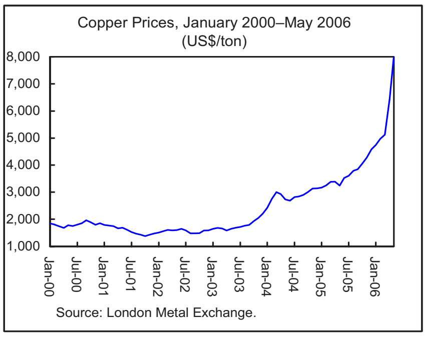
[2] Evaluated at the program exchange rate, broad money grew by 12.7 percent in 2005, compared with the program target of 14.8 percent.

[3] Credit to the private sector is evaluated at current exchange rates. Credit growth would have been considerably higher if valued at the constant program exchange rate.

- The kwacha appreciated sharply in late 2005. Extensive debt relief, combined with record high world copper prices and growing confidence in macroeconomic management, resulted in a marked strengthening of market sentiment, which triggered significant inflows of portfolio investment (Box 1). At the same time, commercial banks reduced their foreign assets position in favor of higher-yielding kwacha assets, and donors increased their support for the budget and for projects with a substantial domestic component. The absence of the BoZ from the foreign exchange market in 2005Q4 also influenced perceptions of the course of the currency. The kwacha appreciated by 20 percent against the U.S. dollar in 2005 and by 24 percent in real effective terms on a period-average basis (Box 2). It strengthened further against the U.S. dollar, though at a more gradual pace, in early 2006 but gave up most of the gains in late May as copper prices softened.[4]

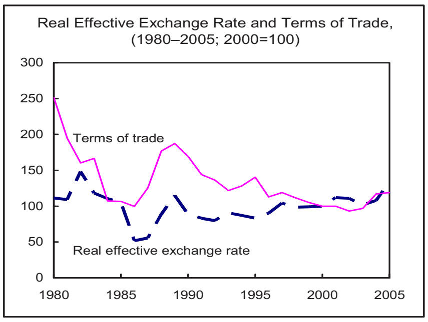


Exchange Rates, January 2004–May 2006

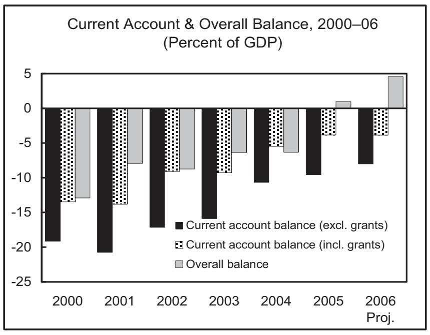


Copper Prices, January 2000–May 2006
(US$/ton)

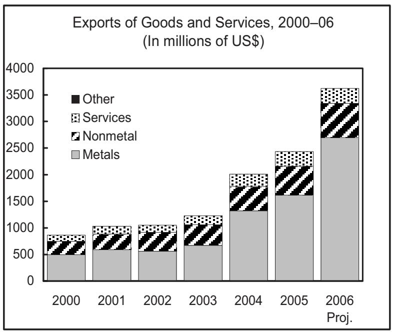
- Zambia's external position improved markedly in 2005. Receipts from both copper and nontraditional exports grew strongly and the country benefited from extensive debt relief under the HIPC Initiative, debt cancellation by Paris Club creditors, and MDRI. Despite the high price of imported petroleum products and a 40 percent decline in the price of cobalt—Zambia's second major export—the terms of trade improved in 2005 as copper prices rose to record heights. Gross international reserves increased to US$357 million as of end-2005, well above the program floor, but import coverage was low at an estimated 1.6 months. These trends largely continued into 2006 (Table 6).



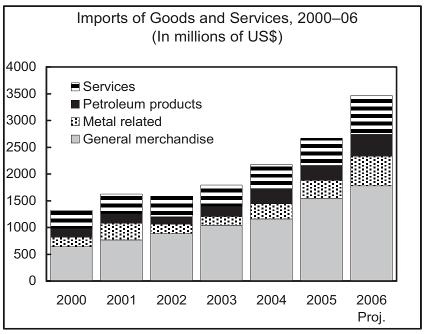
Real Effective Exchange Rate and Terms of Trade,
(1980–2005; 2000=100)



Current Account & Overall Balance, 2000–06
(Percent of GDP)



Exports of Goods and Services, 2000–06
(In millions of US$)



Imports of Goods and Services, 2000–06
(In millions of US$)

[4] Copper prices on the London Metal Exchange peaked at a record US$8800 per metric ton on May 11, before slipping to US$7400 by the end of the month.

4. **All quantitative and structural performance criteria and benchmarks were met through December 2005 (Tables 1 and 2, MEFP).** Based on information through April 2006, there has been further progress on the structural program, although some measures related to Public Expenditure Management and Financial Accountability (PEMFA) reform have been delayed. The schedule for the benchmark on assessment of ZESCO's performance under the commercialization process also proved ambitious. And, as noted, the March 2006 benchmark ceiling on net domestic financing was missed.

III. Economic Outlook and Vulnerabilities

5. **The outlook is good for sustained, robust economic growth and low inflation.** Based on large-scale investments in mining, construction, manufacturing, and energy, as well as broad trends in other sectors, real GDP is projected to grow by 6 percent a year over the medium term. In the near term, the rebound in agriculture could boost growth further. While strong appreciation of the kwacha could slow the expansion of nontraditional exports, the impact on near-term growth would be small because they account for such a small share of GDP. If sustained, however, it would work against economic diversification and broad-based growth. A firm monetary policy, supported by further reductions in government borrowing, would allow inflation to fall to low single-digit rates. The external current account deficit is projected to widen as copper prices trend downward from their current historical highs, but private capital inflows are expected to continue to grow. Together with sustained donor support, that would result in an improvement in the balance of payments and a buildup of gross international reserves to about 2½ months of imports by end-2008.

6. **As a dominantly agricultural and mining-based economy, Zambia is vulnerable to adverse climatic and terms of trade shocks.** It is particularly susceptible to booms and slumps in world copper prices and associated movements in the real exchange rate, which though temporary can have permanent effects.[5] It will be critical, therefore, to advance the structural reform agenda to enhance competitiveness and remove impediments to exports, as recommended in the Diagnostic Trade Integration Study for Zambia. Furthermore, with the advent of sizable portfolio investments, changes in market sentiment could pose an additional exchange rate risk. Maintaining sound financial policies, especially the strong fiscal performance that has anchored the macroeconomic stabilization effort, would mitigate this risk. In the near term, election year pressures and constraints will particularly challenge fiscal discipline.

[5] From 1957 through 1999, world copper prices experienced six cycles, each averaging about 80 months. On average, price booms lasted about a year longer than slumps (46.1 months vs. 34.4 months), but the average price decline during slumps was somewhat larger than the average increase during booms (-48.7 percent vs. 46.1 percent). In both booms and slumps, prices changed about 2 percent a month. (See P. Cashin, C. J. McDermott, and A. Scott, "Booms and Slumps in World Commodity Prices," *Journal of Development Economics*, Vol. 69 (2002)).

Box 1. Foreign Investment in Government Securities

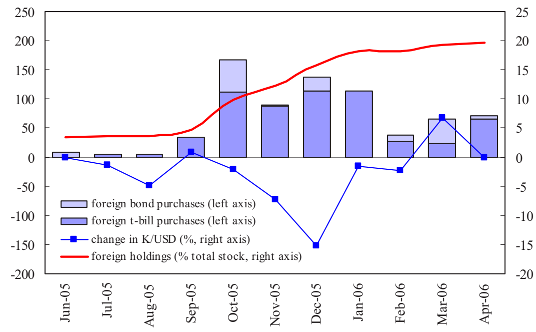
As a result of extensive debt relief, growing confidence in macroeconomic management, and the global search for yield, Zambia began to see substantial foreign investment in its kwacha-denominated domestic government bonds and t-bills in 2005. After Zambia attained the HIPC completion point in April 2005, the stock of government securities held by foreign investors rose from a negligible amount to K 540 billion by end-2005, of which about K 400 billion (about US$100 million) were purchased in the fourth quarter, and to K 840 billion by May 2006 (see figure). This strong surge of private inflows contributed to the appreciation of the kwacha and the decline in interest rates on government securities.

There were several reasons for foreign demand for Zambian securities, primarily from hedge funds: (1) Improved macroeconomic fundamentals and more stable public policy have reduced Zambia's risk premium. (2) After Uganda and Tanzania reached the HIPC completion point, investors observed substantial improvements in their balance of payments, currency appreciation, and compression in yields. They seem to have anticipated the same effects in Zambia. (3) There are no external capital controls and auctions of government securities by the Bank of Zambia have been transparent.

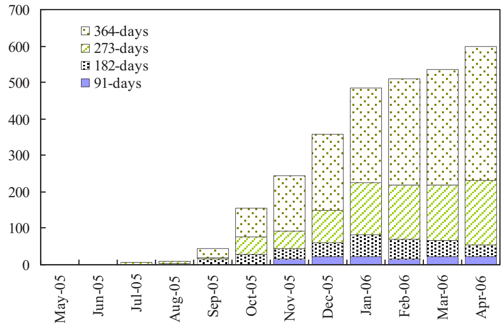
To respond to foreign demand and to reduce external vulnerabilities, the authorities have begun to extend the maturities of government debt. The market smoothly absorbed the three- and five-year fixed-rate government bonds introduced in 2005. By May 2006, 57 percent of the bonds held by foreign investors was in the new maturities. Foreign t-bill holdings also favor longer maturities (see figure). Though the BoZ has the authority to issue seven-, ten- and fifteen-year bonds, a decision has yet to be taken to further lengthen maturities.

Moving into the second quarter of 2006, the market for Zambian government paper has become more competitive. Spreads against other emerging money centers in sub-Saharan Africa have tightened substantially (see figure). Local investors, especially pension funds seeking longer-term investments to match their liabilities, have begun to outbid foreign buyers in some auctions. In international markets, Clearstream and Euroclear have labeled the kwacha a "tradable currency," permitting trade (but not settlement) in kwacha-denominated securities. The BoZ is now building a system of primary dealers to encourage secondary trading in Zambian government securities. The African Development Bank is also considering issuance of kwacha-denominated debt.

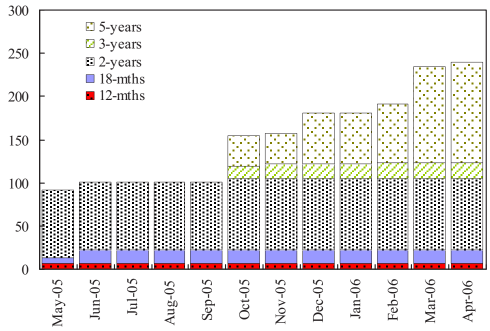
Foreign Purchases of Gov't Securities (K billions)



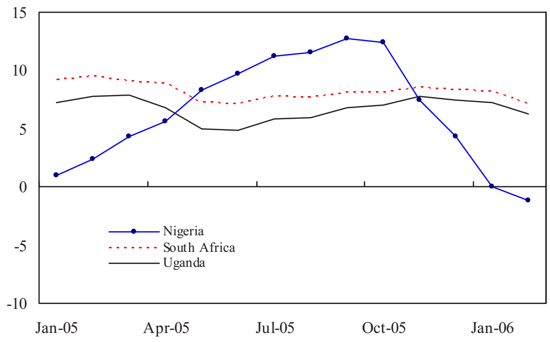
Maturity of Foreign GRZ T-Bill Holdings (In K billions)



Maturity of Foreign GRZ Bond Holdings (In K billions)



Regional 90-Day T-Bill Spreads (In percentage points)



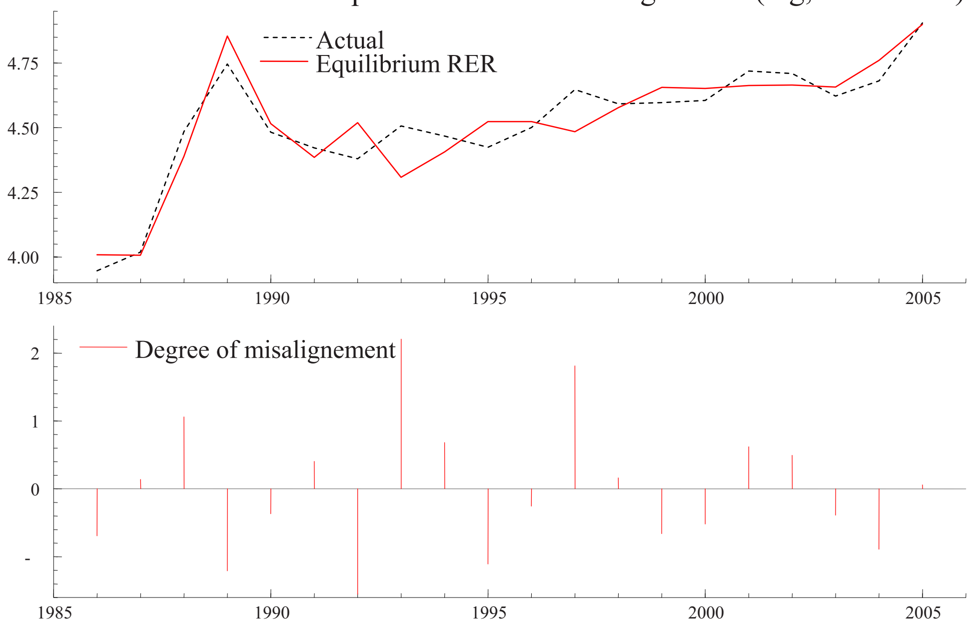
Box 2. The Real Equilibrium Exchange Rate of the Zambian Kwacha

The real effective exchange rate (RER) of the kwacha appreciated strongly in the past two years. The appreciation was associated with a marked improvement in the fundamental determinants of the equilibrium RER. In particular, the terms of trade improved owing to the steep rise in copper prices, and Zambia received extensive debt relief.

Empirical estimation of the equilibrium RER for the period 1986-2005 found that much of the long-run behavior of the RER is explained by terms of trade and openness to trade. Changes in these variables, as well as changes in real interest differentials, government consumption, real per capita GDP, and the ratio of investment to GDP were also found to affect the short-run dynamics of RER.[1] Moreover, the RER was close to its estimated equilibrium value in 2005, suggesting that the appreciation in the past two years has not caused a misalignment of the exchange rate (see chart).

Even an equilibrium appreciation of the exchange rate, however, affects the international competitiveness of nontraditional exports. More generally, swings in the real exchange rate induced by cyclical movements in copper prices, expected to be temporary, can still be costly and hamper diversification. For instance, if firms do not have access to sufficient credit to finance temporary losses brought about by exchange rate appreciation, they may have to curtail investment or production. This underlines the importance of growing the financial sector to enhance access to credit and the availability of hedging instruments—and the critical importance of structural reforms to enhance the flexibility and productivity of the economy.

Actual and Equilibrium Real Exchange Rates (log, 1985-2005)



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[1] The estimated error correction model gave the following result:

$$
\begin{aligned}
\Delta rer_t = {} & \underset{(5.9)}{0.1} + \underset{(6.6)}{0.6\,\Delta tot_{t-1}} - \underset{(-3.5)}{0.4\{\Delta\, open_t + \Delta open_{t-1}\}} + \underset{(3.4)}{0.8\,\Delta pcy_{t-1}} - \underset{(-2.6)}{0.01\,\Delta INVY_{t-1}} + \underset{(2.4)}{0.2\,\Delta\, gcy_{t-1}} \\
& + \underset{(1.9)}{0.1\{\Delta RDIFF_t + \Delta RDIFF_{t-1}\}} - \underset{(-5.6)}{0.9\{rer - 1.1\ ltot + 1.0\ open - 0.5\ pcy - 0.5\ RDIFF\}_{t-1}} - \underset{(-2.0)}{0.1\ D92}
\end{aligned}
$$

$R^2 = 0.95$ $\quad F(8, 10) = 25.96^{**}$ $\quad DW = 1.99$ $\quad SE = 0.04$

Where *rer* is the real effective exchange rate, *tot* is the terms of trade, *open* is openness to trade, *pcy* is per capita real GDP, *INVY* is the investment-to-GDP ratio, *gcy* is government consumption in percent of GDP, *RDIFF* is the real interest rate differential, and *D*92 is a dummy variable that took on a value of 1 in 1992 (the start of the current floating exchange rate regime); variables in lower case denote natural logarithms; "Δ"stands for the first difference; and *t*-values are in parentheses.

IV. Policy Discussions

7. **Policy discussions focused on measures to ensure that macroeconomic and financial policies continue to track medium-term program objectives and on structural reforms that will increase productivity and international competitiveness.** The overriding medium-term macroeconomic objective of the authorities is to achieve and maintain macroeconomic stability to support high rates of sustainable GDP growth and poverty reduction. The PRGF-supported program therefore aims to lower government domestic borrowing and restrain monetary growth while gradually building up international reserves. There was agreement on the importance of meeting the target for government net domestic financing in 2006; this would allow monetary policy to remain firm while accommodating a healthy expansion of bank credit to the private sector.

A. Fiscal Issues

8. **The authorities will take both revenue and expenditure measures to meet the 2006 NDF target.** The kwacha appreciation is expected to result in a net shortfall in revenue and grants of about 1.1 percent of GDP, owing mainly to the reduced kwacha value of donor budget support (0.4 percent of GDP) and the VAT on imports and customs duty (0.7 percent of GDP). The failure to gain parliamentary approval of some VAT measures proposed in the 2006 budget and extension of the reduced levies on fuel will result in further lost revenue of around 0.2 percent of GDP. To close the fiscal gap, the authorities will reduce nonpriority expenditures, mainly by delaying new capital projects that are not designated PRPs and restricting allowances and travel expenses for the civil service in the second half of the year. There will be some savings from lower interest costs on domestic debt in 2006, but much of the recent decline in yields on government securities would only affect costs in 2007, when most newly issued t-bills reach their maturity. On the revenue side, tax compliance will be strengthened, especially for VAT and the collection of tax arrears, and the deferment of VAT on imports of noncapital goods will be repealed. These measures should limit NDF, excluding MDRI assistance, to 1.8 percent of GDP, which is consistent with the original target of 1.5 percent of GDP plus the increase in MDRI-supported spending and the float effect incurred by paying down domestic arrears in late 2005.[6] Government would still proceed with its planned hiring of new teachers and health workers and the intended increase in domestically financed PRP spending of ½ percentage point of GDP. MDRI debt relief provides for additional government spending on PRPs in 2006 of about 0.2 percent of GDP.[7]

[6] It is proposed that the unused portion (K 50 billion) of the adjustor to NDF for additional payments of domestic arrears made in 2005 be carried forward to 2006, leading to a corresponding increase in the NDF ceiling.

[7] Despite a projected modest increase in disbursements of project grants and loans in U.S. dollars, the portion of PRPs consisting of donor-financed projects falls by 39 percent in kwacha terms in 2006. Overall PRP spending in 2006 thus declines compared to the outturn in 2005, which had significantly exceeded planned spending.

9. MDRI debt relief from the Fund will make it possible to increase spending on priority agriculture and infrastructure projects identified in the National Development Plan 2006-10. The authorities intend to use these resources in line with annual debt-service savings. In 2006, the US$18 million in debt-service savings from the cancellation of obligations to the Fund will be spent on irrigation development and livestock disease control. The International Development Agency (IDA) and African Development Fund (AfDF) have also canceled 100 percent of Zambia's pre-cutoff date debt to each institution. Debt-service savings under the MDRI will be offset by one-to-one reductions in new commitments by these institutions. However, Zambia could qualify for additional resources through a performance-based allocation system (Box 3).

10. **The authorities shared staff's concern about the decline in tax revenue relative to GDP.** They also agreed on the need to broaden the tax base rather than intensifying the burden on current taxpayers. Stagnant tax collections over the past several years have reflected the difficulty of bringing more segments of the economy into the tax net, especially the agricultural sector and the informal sector, as well as the negligible royalty on minerals, particularly in a period of high copper prices. Weaknesses in nontax collections and the low yields in VAT have also contributed. In 2005-06, the strong appreciation of the kwacha has worsened the situation. The staff cautioned that a piecemeal approach to tax policy in the past and poor compliance, as evidenced by the large tax arrears, tended to diminish the equity of the tax system and narrow the tax base. The recently approved Zambian Development Act, which would introduce tax incentives for a wide range of new investments, could also have a detrimental revenue impact over time. It is important therefore, to expedite the planned comprehensive review of the tax system. The review should also cover nontax revenue sources and revenue administration so as to increase efficiency and fairness and eliminate discretionary elements that could create governance problems. The recommendations of the review should be implemented starting with the 2007 budget. The authorities agreed. They have requested technical assistance from the Fund for a diagnostic review of tax administration and tax policy.[8] Also, they have established a committee to negotiate with the mining companies amendments to agreements to increase revenue from the sector, including raising the royalty rate on minerals which, at 0.6 percent of gross sales value, is low by international standards.

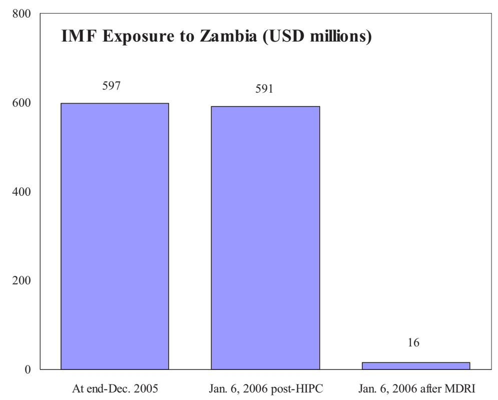
[8] A Fiscal Affairs Department tax administration mission is scheduled to visit Lusaka in July 2006.

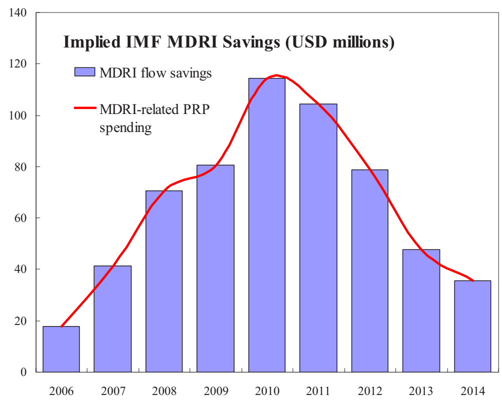
Box 3. The Multilateral Debt Relief Initiative (MDRI)

On January 6, 2006, Zambia received SDR 402.6 million (US$581.6 million) of debt cancellation from the IMF under the MDRI, which reduced Zambia's debt to the Fund by 97 percent (left chart below) and cut its total estimated public and publicly guaranteed external debt by 17 percent. MDRI assistance from the Fund is equivalent to 7.9 percent of 2005 GDP, 45 percent of 2005 central government revenue, and 23 percent of 2005 exports of goods and services. The corresponding annual debt-service savings rise steeply over the next several years to peak at about US$120 million in 2010 (right chart). Including interest saved, the reduction in annual debt service to the IMF will average US$66 million (0.8 percent of 2005 GDP) from 2006 through 2014.[1]

The Boards of IDA and AfDF have also approved the 100 percent cancellation under the MDRI of Zambia's outstanding pre-cutoff date debt to each institution, though the modalities have yet to be fully specified. In the first stage, debt-service savings under MDRI will be offset by one-to-one reductions in new commitments by these institutions. However, Zambia could qualify for additional resources through a performance-based allocation system. Because estimates of net assistance are not yet available, the baseline projections assume no additional assistance from IDA and the AfDF under the MDRI.

IMF resources disbursed to Zambia have traditionally been onlent by the Bank of Zambia (BoZ) to the central government. With its liabilities to the Fund now reduced, the BoZ has reduced its claims on government by the kwacha-equivalent amount.[2] Annual MDRI-related poverty-reducing program (PRP) expenditures will support government priorities in agriculture and infrastructure under the National Development Plan (NDP) and are presently programmed at annual levels equal to the yearly debt-service savings resulting from the IMF debt reduction. In 2006 and 2007, the cash for MDRI-related PRP expenditure will be drawn from a government deposit account at the BoZ that contains the amounts remaining from past IMF disbursements.





[1]Unless otherwise indicated, MDRI relief includes any remaining post-HIPC completion point assistance from the IMF.
[2]Possible increases in net assistance flows from IDA and the AfDF under the MDRI will pass directly to the government and will not result in reductions in central government liabilities to the BoZ.

B. Monetary and Exchange Rate Policy

11. **Monetary policy will be kept sufficiently firm to keep inflation heading downward to low single-digit rates by 2007.** Reserve money growth will be limited to 10.3 percent in 2006; broad money would expand by 14.6 percent. Given the continued strong demand of nonbank investors for government securities, commercial banks are expected to provide only limited financing to government during the year, which would allow for an ample expansion of 15.4 percent in credit to the private sector.

12. **The Bank of Zambia (BoZ) has implemented its reserve money program more effectively, but liquidity management remains a challenge.** The staff encouraged closer coordination between the Ministry of Finance and National Planning and the BoZ to strengthen liquidity management and urged the authorities to ensure that the BoZ has enough securities to conduct desired monetary operations. The authorities agreed to allow the BoZ to convert a portion of its holdings of nonmarketable government bonds into marketable securities so that they can be used for monetary operations. This will give the BoZ more scope to undertake sterilized interventions in the foreign exchange market.

13. **While remaining committed to a flexible exchange rate regime, the BoZ will intervene in the foreign exchange market as needed to smooth temporary fluctuations in the exchange rate and meet international reserve targets without compromising the inflation objective.** Given the outlook for a stronger balance of payments than was previously projected, the authorities will step up their efforts to build international reserves. In 2006, official reserves will be augmented by at least US$153 million, about US$100 million more than planned. Over the medium term, reserves are projected to rise annually by over 1 percentage point of GDP, bringing reserves from the equivalent of 1.6 months of imports in 2005 to 2.4 months of imports in 2008. The recent sizable portfolio investment flows also suggest a need for greater reserve coverage and perhaps alternative measures of reserve adequacy. Larger reserves are needed to guard against the liquidity risks of unanticipated capital movements. In this respect, Zambia's reserves appear relatively modest: in April 2006, the ratio of international reserves to short-term external debt residual maturity was 75 percent, and the ratio to M2 was 15 percent. In planning its reserve accumulation this year, the BoZ has taken into account the maturity profile of securities held by external investors.

C. Public Sector Reform

14. **Advancing the comprehensive Public Expenditure Management and Financial Accountability (PEMFA) reform agenda is critical to improving the efficiency and effectiveness of public services and enabling donors to give more assistance in the form of budget support. Progress continues despite some delays.** Formation of a PEMFA work plan and budget for 2006 on which all stakeholders could agree has been slower than expected. A team of government, donors, and expert consultants was assembled in May to study the issues and recommend a way forward. It is expected that this exercise will facilitate

future budgeting and planning. The process of contracting a supplier for the integrated financial management and information system (IFMIS) remains roughly on track. In anticipation of implementation of IFMIS, the integrated budgeting and accounting chart of accounts has been modified to comply with the IMF Government Finance Statistics (GFS) 2001. The authorities are also stepping up its efforts to strengthen the financial management system. Beginning in September 2006, the Accountant General will begin to submit a quarterly report to the Secretary to the Treasury on compliance with the commitment control system.

15. **In other areas of public sector reform, the payrolls of all but one ministry (defense) have been added to the automated payroll management and establishment control (PMEC) system**. This has helped to eliminate a large number of ineligible employees from public sector payrolls and should facilitate future wage negotiations. The PMEC system should also improve planning for human resource needs, processing of new hires, and the timeliness of wage payments and pension contributions. The payroll of the Ministry of Defense is expected to join the PMEC system once a full head count and audit is done. Progress in rightsizing and pay reform has been slow, however, partly because of the high cost that pay reform could have on pension liabilities.

D. Pension Reform

16. **Although steps have been taken to address unfunded public pension liabilities, further measures to limit the cost of pension reform must await conclusion of the review of the constitution.** The accumulation of future unfunded liabilities has been curbed by enrolling new public sector employees (except for police and the military) in the National Pension Scheme (NAPSA), which has a benefit ratio closely aligned with contributions and is presently operating with large surpluses. Government is responsible for financing the operational deficits (0.2–0.4 percent of GDP a year) of the unfunded Public Sector Pension Fund (PSPF), which will continue for many years, owing mainly to the reduction in new contributors. A constitutional amendment is needed to achieve a financially sound benefit-contribution ratio in the future.[9] Over the medium term, government has budgeted for paying down its arrears on contributions to the PSPF (K 100 billion a year), which together with timely payments of current contributions, would largely meet the PSPF's annual obligations.

E. Financial and Private Sector Development

17. **With a new institutional framework for implementing the Financial Sector Development Plan, elements of the plan are moving forward.** The BoZ's ability to supervise bank and nonbank financial institutions has been strengthened and the capacity is being built to move to a fully risk-based approach in 2007. In January 2006, the regulations governing microfinance institutions came into force and the guidelines to facilitate licensing

[9] The amendment would also allow for pay reform without substantially increasing pension liabilities.

and establishment of a credit reference bureau were approved. Though resolution of troubled nonbank financial institutions is proceeding slowly, negotiations for the sale of 49 percent of the Zambia National Commercial Bank have been completed and the sale is expected to be finalized soon.

18. **Progress on priority measures under the Private Sector Development Initiative to reduce the cost of doing business—streamlined licensing, labor law reform, and opening the international telecommunications gateway—has been limited.**[10] Instead, the authorities have emphasized adoption of legislation to promote investment by creating a one-stop investment agency and giving incentives to priority sectors. While there could be some much-needed efficiencies from the merger of investment-related agencies, extensive use of incentive schemes could erode the tax base.

F. External Debt

19. **While Zambia's debt sustainability position is quite benign following debt cancellations under the HIPC Initiative, Paris Club agreement, and MDRI,[11] the authorities have indicated that they will be careful to avoid an excessive buildup of new debt.** In line with the recent LIC DSA for the 2005 Article IV consultation, Zambia's debt indicators are projected to remain well-below sustainability ceilings for the foreseeable future, even in the event of substantial borrowing for infrastructure investments. Here the institutional framework for ensuring that resources from government borrowing or credit guarantees are spent on high-return projects still needs strengthening through, e.g., the PEMFA reform and effective governance of government-owned utilities. The authorities indicated that they will maintain their policy of not contracting or guaranteeing any nonconcessional debt.

20. **Further progress has been made in resolving the arrears to two commercial creditors.** One of the claims has been settled in full; the other remains in litigation in commercial court in London. The outstanding claim does not pose a risk to Zambia's adjustment effort.

G. Strengthening Economic Statistics

21. **Zambia's economic statistics should be improved to provide a more accurate picture of recent developments and allow more meaningful analysis,** notably with respect to the national accounts, the consumer price index, and the balance of payments. The authorities have committed to funding an economic census so as to rebase the national

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[10] Zambia ranks among the highest cost countries for terminating employees.

[11] Based on the recent Low-Income Country Debt Sustainability Analysis (LIC DSA) for the 2005 Article IV consultation (see Appendix VI of IMF Country Report No. 06/39).

accounts in 2007. In the interim, the Central Statistics Office will use available information to partially update the weights used in the national accounts. In addition, the BoZ intends to request technical assistance from the Fund to help it update and expand the coverage of the balance of payments statistics.

V. Staff Appraisal

22. **Sustained robust growth in 2005 and declining inflation despite adverse supply shocks are a testament to Zambia's improved macroeconomic policies in recent years.** The immediate challenge for the authorities is to adhere, in an election year, to the prudent fiscal policy that has anchored the stabilization effort. Looking ahead, the broader challenge is to seize the opportunity provided by debt relief and external assistance to build upon the improved economic performance to substantially reduce poverty. In light of the kwacha appreciation, it will be crucial to complement strengthened macroeconomic management with structural reforms to boost productivity and enhance competitiveness.

23. **Increased spending on poverty-reducing programs, including hiring more teachers and health workers, and restrained domestic borrowing are most welcome.** With a large proportion of the financing for the MDGs expected to come from domestic sources, however, revenue mobilization needs to be strengthened.

24. **The decrease in tax revenues is a concern.** A piecemeal approach to tax policy and poor compliance have undermined the fairness and efficiency of the tax system. The authorities should guard against possible erosion of the tax base from an incentives approach to attracting investment, and the likelihood of rent-seeking activities and governance issues. Staff welcomes the authorities' intention to conduct a comprehensive review of tax policy and tax administration. Implementation of the Zambia Development Act should await the review of tax policy.

25. **A more efficient and effective public sector is critical for reorienting spending toward priority poverty-reducing programs and obtaining more donor support.** Staff welcomes the progress on the comprehensive PEMFA reform, in particular, on the IFMIS pilot program. Financial management and commitment control systems should continue to be strengthened, however, throughout the extended roll-out of the IFMIS.

26. **Staff is heartened by the steps being taken to address the unfunded liabilities of the public sector pension fund.** It is essential that government keep current with its obligations to the pension funds. Staff urges the authorities to proceed expeditiously with the measures needed to curb the financial burden of pension reform, particularly amendment of the constitution.

27. **A sound financial sector and increased access to financial services are central to the private-sector-led growth strategy.** The strengthened regulatory framework and the Credit Reference Bureau guidelines are steps forward in addressing factors, such as a poor credit culture, that have hampered access to financial services, especially for small and

medium-scale enterprises. Resolution of financially troubled nonbank financial institutions should be speeded up.

28. **The boom in copper prices and sizable inflows of portfolio capital and the accompanying appreciation of the kwacha pose a challenge to the competitiveness of nontraditional exports and the conduct of monetary policy.** While a flexible exchange rate can best buffer real shocks such as changes in the terms of trade, staff supports government efforts to broaden the scope for sterilized intervention to smooth exchange rate fluctuations and to build up international reserves.

29. **The appreciation of the kwacha has also underscored the importance of structural reforms to improve international competitiveness and diversify exports.** Staff stresses the importance of increasing productivity by implementing the structural reform agenda and making sound investments in infrastructure.

30. **Staff recommends that the fourth review of the PRGF arrangement be completed**. Staff further recommends approval of the authorities' request to modify the June 2006 performance criteria for net domestic financing, net domestic assets, and gross international reserves, and that the financing assurances review be completed.

Table 1. Zambia: Selected Economic and Financial Indicators, 2003-08

			2005		2006		2007	2008
	2003	2004	Prog.	Prel.	Prog.	Proj.	Proj.	Proj.
	(Annual percentage change, unless otherwise indicated)							
National income and prices								
Real GDP	5.1	5.4	4.3	5.0	6.0	6.0	6.0	6.0
GDP deflator	19.8	20.4	18.9	18.9	11.5	14.2	6.0	3.2
Consumer prices (annual average)	21.4	18.0	18.4	18.3	14.4	9.2	8.6	4.9
Consumer prices (end of period)	17.2	17.5	17.0	15.9	10.0	9.0	5.0	5.0
External sector								
U.S. dollar value of exports of goods and services	16.2	62.6	16.3	20.8	10.2	48.3	-4.0	-7.2
U.S. dollar value of imports of goods and services	13.3	21.1	18.6	22.8	10.2	29.6	10.0	6.1
Export volume (goods)	2.6	15.7	5.5	6.9	16.1	15.7	10.5	5.8
Import volume (goods)	7.0	4.0	9.4	16.2	8.9	12.2	18.3	18.1
Copper export volume	7.1	11.3	6.0	7.6	17.4	15.0	14.0	10.0
Nonmetal export volume	-1.1	7.4	13.1	15.5	9.2	18.9	1.5	1.1
Copper export prices (average, U.S. dollars per pound	0.78	1.20	1.52	1.56	1.42	2.39	1.93	1.56
Nominal effective exchange rate (annual average)	-14.1	-2.6	1.3	7.4	...	...	...	...
Real effective exchange rate (annual average)	-1.7	8.1	12.2	20.3	...	...	...	...
Terms of trade	4.4	21.4	2.1	5.5	-6.6	18.3	-9.7	-7.0
Money and credit (change in percent of beginning-of-year broad money)								
Net foreign assets 1/	-9.0	13.9	12.2	18.0	-1.2	6.7	3.7	5.5
Net domestic assets 1/	32.5	16.3	-3.6	-17.6	15.5	7.9	9.9	7.9
Net domestic credit	36.6	16.4	0.4	-13.7	15.5	8.7	9.9	7.9
Net claims on government	27.0	1.0	6.7	-1.8	6.7	2.1	1.3	1.2
Claims on nongovernment	9.6	15.4	13.1	7.5	8.9	6.6	6.8	7.2
Broad money	23.4	30.2	8.6	0.4	14.3	14.6	13.6	13.4
Velocity (ratio of GDP to broad money)	5.5	5.3	5.5	5.6	5.3	5.8	5.7	5.5
Central government budget								
Revenue (excluding grants)	26.5	28.8	21.0	19.0	19.2	17.4	16.4	11.9
Grants 1/	5.5	0.6	35.0	27.4	21.8	448.6	-82.9	7.8
Expenditures	24.6	9.2	23.3	20.7	19.4	10.8	11.7	10.5
Domestic expenditures 2/	27.1	18.8	10.2	9.8	16.2	14.6	12.3	11.0
	(Percent of GDP)							
Investment and savings								
Gross national savings	16.3	18.8	17.5	19.2	17.3	19.7	19.9	19.6
Gross foreign savings 3/	9.3	5.5	6.0	3.8	5.7	3.8	5.1	5.9
Gross domestic investment	25.6	24.3	23.5	23.0	22.9	23.5	25.0	25.5
Of which: public investment	11.4	8.7	7.4	7.0	8.4	4.8	5.7	6.4
Central government budget								
Revenue and grants 1/	24.9	23.7	23.9	23.0	24.2	42.3	21.3	21.7
Revenue (excluding grants)	18.0	18.2	17.8	17.4	18.0	16.8	17.5	17.9
Expenditures (excluding interest)	27.1	23.2	23.8	23.1	24.4	21.5	22.1	22.5
Interest due	3.9	3.5	2.7	2.7	2.4	2.0	1.3	1.1
Domestic expenditures 2/	20.9	19.6	19.9	19.5	20.0	20.5	20.5	20.8
Overall balance, cash basis 1/	-6.6	-1.7	-2.7	-2.6	-2.6	13.5	-2.1	-2.0
Domestic financing 1/	5.1	0.8	1.9	1.9	1.5	1.8	1.0	1.0
External sector								
Current account balance, excluding grants	-15.9	-10.7	-11.9	-9.6	-10.9	-7.9	-9.0	-9.7
Current account balance, including grants	-9.3	-5.5	-6.0	-3.8	-5.7	-3.8	-5.1	-5.9
	(Percent of exports of goods and services, unless otherwise indicated)							
External official debt service 3/	14.6	18.3	7.0	6.7	3.9	2.5	2.1	2.6
External program assistance	4.4	3.2	5.7	6.3	4.7	3.4	3.8	4.3
NPV of external public sector debt 3/	359.9	220.3	...	81.1	...	13.2	14.4	16.0
NPV of total public sector debt (percent of GDP) 3/4/	131.8	104.6	...	46.4	...	20.1	18.9	18.0
	(Millions of U.S. dollars, unless otherwise indicated)							
Current account balance, including grants	-400	-298	-415	-278	-466	-465	-668	-829
Overall balance of payments 1/	-275	-343	-279	70	-301	582	20	39
Gross official reserves (end of period)	194	222	312	357	358	495	645	795
Months of imports of goods and services	1.3	1.2	1.4	1.6	1.5	1.7	2.0	2.4

Sources: Zambian authorities,and IMF staff estimates and projections.

1/ Figures reflect cancellation of obligations to the Fund under the Multilateral Debt Relief Initiative (MDRI) and related capital transactions and financing amounting to SDR 402.59 million (5.1 percent of GDP) in 2006.

2/ Excludes external interest payments and foreign-financed project expenditure.

3/ After debt relief from the enhanced HIPC Initiative, Paris Club creditors, and MDRI.

4/ Includes government arrears to the Public Sector Pension Fund and other domestic claimants.

Table 2. Zambia: Central Government Overall Operations, 2003-08
(Billions of Kwacha)

	2003	2004	2005		2006				2007	2008
			Prog.	Prel.	Prog. Jan-Mar	Prel. Jan-Mar	Prog.	Revised Prog.	Proj.	Proj.
Revenue and grants	5,104	6,173	7,671	7,468	1,928	1,785	9,192	16,635	9,418	10,469
Revenue	3,680	4,740	5,736	5,643	1,516	1,368	6,835	6,622	7,706	8,623
Tax revenue	3,548	4,546	5,578	5,513	1,475	1,311	6,654	6,382	7,456	8,349
Income taxes	1,622	2,032	2,469	2,455	688	673	2,935	2,993	3,337	3,742
Excise taxes	482	607	750	768	194	189	918	936	1,114	1,219
Value-added tax (VAT)	1,034	1,362	1,697	1,633	427	311	2,008	1,812	2,233	2,420
Domestic VAT	393	453	695	623	161	124	801	805	940	1,023
Import VAT	642	909	1,002	1,010	266	187	1,207	1,007	1,294	1,396
Customs duty	409	544	661	656	166	138	793	641	773	968
Nontax revenue	132	194	158	130	41	58	181	240	250	275
Grants	1,424	1,433	1,934	1,825	412	418	2,357	10,014	1,712	1,846
Program	229	258	486	543	89	89	482	310	337	360
Sector Wide Approaches (SWAPS) Grants	...	...	0	0	71	71	386	284	278	280
MDRI assistance	...	...	...	...	...	...	...	8,410	...	...
Of which: from the IMF	...	...	...	...	...	...	...	2,018	...	...
Project	1,195	1,175	1,448	1,282	252	258	1,489	1,010	1,097	1,206
Expenditures	6,337	6,919	8,528	8,350	2,132	1,988	10,180	9,248	10,311	11,392
Current expenditures	4,002	4,654	6,160	6,082	1,638	1,457	6,986	7,368	7,781	8,284
Wages and salaries	1,728	2,012	2,543	2,455	654	621	3,019	2,967	3,486	3,754
Public service retrenchment	10	20	66	44	0	0	75	75	80	78
Other current expenditures	1,465	1,711	2,653	2,709	770	661	2,975	3,519	3,656	3,902
Domestic interest	563	746	747	731	187	156	777	731	491	463
External interest	229	152	135	133	27	20	130	68	56	67
Contingency	6	13	16	10	0	0	10	7	12	20
Capital expenditure	2,335	2,265	2,367	2,267	495	531	3,195	1,880	2,530	3,108
Domestically financed	507	585	536	565	45	75	766	766	1,336	1,823
Donor-financed	1,828	1,681	1,831	1,702	450	456	2,429	1,114	1,195	1,285
Change in balances and statistical discrepancy (- = overfin.) 1/	-116	304	0	30	0	-259	0	-50	0	0
Overall balance (cash basis) 2/	-1,349	-442	-857	-852	-205	-461	-988	7,337	-893	-923
Overall balance excluding grants	-2,774	-1,875	-2,792	-2,677	-617	-620	-3,345	-2,677	-2,605	-2,769
Financing	1,349	442	857	852	205	461	988	-7,337	893	923
Domestic	1,041	212	621	611	136	392	589	-1,312	433	465
Bank	979	45	391	-102	99	66	424	-1,893	90	90
Of which: Amortization (Bank of Zambia on lending of IMF borrowing)	...	...	...	...	...	...	...	-2,018	...	...
Nonbank	62	167	230	713	37	326	165	581	343	375
External	308	230	236	241	69	70	399	-6,025	460	458
Program loans	46	96	145	84	0	0	93	45	21	18
Project loans	633	526	554	608	127	127	554	492	534	571
Amortization	-371	-392	-463	-451	-57	-57	-248	-6,562	-95	-131
Of which: Cancellation of debts to IDA and AfDF under MDRI	...	...	...	...	...	...	...	-6,392	...	...
Memorandum items:										
Poverty-reducing spending (wider definition) 3/	...	...	3,311	4,207	...	...	4,071	3,994	4,636	5,342
Of which: domestically financed	...	...	1,607	1,995	...	...	2,058	2,638	3,113	3,576
External budget support	275	354	631	628	89	89	575	355	357	378
External debt service	600	544	598	584	84	77	377	6,630	156	187
Foreign financed projects financing	1,828	1,701	2,002	1,889	450	456	2,429	1,786	1,909	2,057
Of which: for recurrent expenditures	0	20	172	187	0	0	...	672	715	773
Domestic arrears (end period) 4/	747	675	386	421	396	385	248	110	95	0
Pension arrears PSPF (end period)	322	...	414	414	...	...	314	214	118	0
Domestic debt (end period) 5/	4,481	4,693	5,314	5,304	5,440	5,696	5,903	6,010	6,443	6,908
MDRI-supported spending	...	...	...	...	...	...	...	63	138	240
GDP (annual)	20,479	25,916	32,141	32,450	38,036	39,299	38,036	39,299	44,142	48,292

Sources: Zambian authorities, and Fund staff estimates and projections.

1/ Statistical discrepancies for 2004 and 2005 mainly reflect end-year releases to line ministries that have not been fully executed and thus are not reflected in the domestic financing figures. For 2006, the statistical discrepancy of K 50 billion reflects releases to clear expenditure arrears to road contractors in 2005 but executed in 2006.
2/ The overall deficit without the IMF MDRI assistance for 2006 relief is K 1,068 billion or 2.7 percent of GDP.
3/ From 2005, fiscal accounts identify poverty-reducing spending according to a wider definition consistent with Zambia's Poverty Reduction Strategy Paper.
4/ Audited at June 30 for K 593.5 billion by the Zambian authorities, excluding statutory pension arrears, which were K 414 billion for 2005.
5/ From 2004, at cost value. Includes bonds issued in 2001 in favor of BoZ (K 1,646 billion) and in 2002 in favor of the Zambia National Commercial Bank (K 248 billion).

Table 3. Zambia: Central Government Overall Operations, 2003-08
(Percent of GDP)

	2003	2004	2005		2006				2007	2008
			Prog.	Prel.	Prog. Jan-Mar	Prel. Jan-Mar	Prog.	Revised Prog.	Proj.	Proj.
Revenue and grants	24.9	23.8	23.9	23.0	5.1	4.5	24.2	42.3	21.3	21.7
Revenue	18.0	18.3	17.8	17.4	4.0	3.5	18.0	16.8	17.5	17.9
Tax revenue	17.3	17.5	17.4	17.0	3.9	3.3	17.5	16.2	16.9	17.3
Income taxes	7.9	7.8	7.7	7.6	1.8	1.7	7.7	7.6	7.6	7.7
Excise taxes	2.4	2.3	2.3	2.4	0.5	0.5	2.4	2.4	2.5	2.5
Value-added tax (VAT)	5.1	5.3	5.3	5.0	1.1	0.8	5.3	4.6	5.1	5.0
Domestic VAT	1.9	1.7	2.2	1.9	0.4	0.3	2.1	2.0	2.1	2.1
Import VAT	3.1	3.5	3.1	3.1	0.7	0.5	3.2	2.6	2.9	2.9
Customs duty	2.0	2.1	2.1	2.0	0.4	0.4	2.1	1.6	1.8	2.0
Nontax revenue	0.6	0.8	0.5	0.4	0.1	0.1	0.5	0.6	0.6	0.6
Grants	7.0	5.5	6.0	5.6	1.1	1.1	6.2	25.5	3.9	3.8
Program	1.1	1.0	1.5	1.7	0.2	0.2	1.3	0.8	0.8	0.7
Sector Wide Approaches (SWAPS) Grants	...	...	0.0	0.0	0.2	0.2	1.0	0.7	0.6	0.6
MDRI assistance	...	...	...	...	...	...	...	21.4	...	...
Of which: from the IMF	...	...	...	...	...	...	...	5.1	...	...
Project	5.8	4.5	4.5	4.0	0.7	0.7	3.9	2.6	2.5	2.5
Expenditures	30.9	26.7	26.5	25.7	5.6	5.1	26.8	23.6	23.4	23.6
Current expenditures	19.5	18.0	19.2	18.7	4.3	3.7	18.4	18.8	17.6	17.2
Wages and salaries	8.4	7.8	7.9	7.6	1.7	1.6	7.9	7.5	7.9	7.8
Public service retrenchment	0.0	0.1	0.2	0.1	0.0	0.0	0.2	0.2	0.2	0.2
Other current expenditures	7.2	6.6	8.3	8.3	2.0	1.7	7.8	9.0	8.3	8.1
Domestic interest	2.8	2.9	2.3	2.3	0.5	0.4	2.0	1.9	1.1	1.0
External interest	1.1	0.6	0.4	0.4	0.1	0.1	0.3	0.2	0.1	0.1
Contingency	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Capital expenditure	11.4	8.7	7.4	7.0	1.3	1.4	8.4	4.8	5.7	6.4
Domestically financed	2.5	2.3	1.7	1.7	0.1	0.2	2.0	1.9	3.0	3.8
Donor-financed	8.9	6.5	5.7	5.2	1.2	1.2	6.4	2.8	2.7	2.7
Change in balances and statistical discrepancy (- = overfin.) 1/	-0.6	1.2	0.0	0.1	0.0	-0.7	0.0	-0.1	0.0	0.0
Overall balance (cash basis) 2/	-6.6	-1.7	-2.7	-2.6	-0.5	-1.2	-2.6	18.6	-2.0	-2.0
Overall balance excluding grants	-13.5	-7.2	-8.7	-8.3	-1.6	-1.6	-8.8	-6.9	-5.9	-5.9
Financing	6.6	1.7	2.7	2.6	0.5	1.2	2.6	-18.6	2.0	1.9
Domestic	5.1	0.8	1.9	1.9	0.4	1.0	1.5	-3.3	1.0	1.0
Bank	4.8	0.2	1.2	-0.3	0.3	0.2	1.1	-4.8	0.2	0.2
Of which: Amortization (Bank of Zambia on lending of IMF borrowing)	...	...	...	...	...	...	...	-5.1	...	...
Nonbank	0.3	0.6	0.7	2.2	0.1	0.8	0.4	1.5	0.8	0.8
External	1.5	0.9	0.7	0.7	0.2	0.2	1.0	-15.3	1.0	0.9
Program loans	0.2	0.4	0.5	0.3	0.0	0.0	0.2	0.2	0.0	0.0
Project loans	3.1	2.0	1.7	1.9	0.3	0.3	1.5	1.3	1.2	1.2
Amortization	-1.8	-1.5	-1.4	-1.4	-0.2	-0.1	-0.7	-16.7	-0.2	-0.3
Of which: Cancellation of debts to IDA and AfDF under MDRI	...	...	...	...	...	...	...	-16.3	...	...
Memorandum items:										
Poverty-reducing spending (wider definition) 3/	...	...	10.3	13.0	...	...	10.7	10.2	10.5	11.1
Of which: domestically financed	...	...	5.0	6.1	...	...	5.4	6.7	7.1	7.4
External budget support	1.3	1.4	2.0	1.9	0.2	0.2	1.5	1.0	0.8	0.8
External debt service	2.9	2.1	1.9	1.8	0.2	0.2	1.0	16.9	0.4	0.4
Foreign financed projects financing	8.9	6.6	6.2	5.8	1.2	1.2	6.4	4.5	4.3	4.3
Of which: for recurrent expenditures	0.0	0.1	0.5	0.6	0.0	0.0	...	1.7	1.6	1.6
Domestic arrears (end period) 4/	3.6	2.6	1.2	1.3	1.0	1.0	0.7	0.3	0.2	0.0
Pension arrears PSPF (end period)	1.6	...	1.3	1.3	...	...	0.8	0.5	0.3	0.0
Domestic debt (end period) 5/	21.9	18.1	16.5	16.3	14.3	14.5	15.5	15.3	14.6	14.3
MDRI-supported spending	...	...	...	...	...	...	...	0.2	0.3	0.5
GDP (annual; in billions of kwacha)	20,479	25,916	32,141	32,450	38,036	39,299	38,036	39,299	44,142	48,292

Sources: Zambian authorities, and Fund staff estimates and projections.

1/ Statistical discrepancies for 2004 and 2005 mainly reflect end-year releases to line ministries that have not been fully executed and thus are not reflected in the domestic financing figures. For 2006, the statistical discrepancy of K 50 billion reflects releases to clear expenditure arrears to road contractors in 2005 but executed in 2006.
2/ The overall deficit without the IMF MDRI assistance for 2006 relief is K 1,068 billion or 2.7 percent of GDP.
3/ From 2005, fiscal accounts identify poverty-reducing spending according to a wider definition consistent with Zambia's Poverty Reduction Strategy Paper.
4/ Audited at June 30 for K 593.5 billion by the Zambian authorities, excluding statutory pension arrears, which were K 414 billion for 2005.
5/ From 2004, at cost value. Includes bonds issued in 2001 in favor of BoZ (K 1,646 billion) and in 2002 in favor of the Zambia National Commercial Bank (K 248 billion).

Table 4. Zambia: Monetary Survey, 2003-08
(Billions of kwacha, unless otherwise indicated; end of period)

	2003	2004	2005			2006 2/			2007	2008
			Base 1/	Prog.	Prel.	Prog.	Revised Base	Revised Prog.		
					(Billions of kwacha)					
Net foreign assets	-1,454	-1,113	-1,543	-830	-494	-906	1,740	2,131	2,379	2,799
Bank of Zambia	-2,377	-2,518	-2,986	-1,369	-1,235	-1,377	1,194	1,631	1,879	2,299
Assets	892	1,189	1,254	1,682	1,822	1,832	1,250	1,824	2,147	2,749
Liabilities	-3,269	-3,707	-4,240	-3,051	-3,057	-3,209	-55	-193	-268	-450
Commercial banks	922	1,405	1,443	539	741	472	545	500	500	500
Assets	1,030	1,592	1,635	1,029	1,205	...	886	...	...	...
Liabilities	-108	-187	-192	-491	-464	...	-341	...	...	...
Net domestic assets	5,922	6,930	7,359	7,148	6,335	8,129	4,102	4,563	5,224	5,822
Net domestic credit	2,323	2,685	2,629	2,652	1,830	3,633	2,660	3,169	3,830	4,428
Net claims on government	2,746	2,518	2,518	2,910	2,416	3,334	2,202	2,327	2,417	2,507
Net claims on government (excluding MDRI)	2,746	2,518	2,518	2,910	2,416	3,334	2,416	2,480	2,425	2,507
Claims on government 3/	3,830	3,862	3,862	...	3,773	...	...	...	...	...
Government deposits	-1,085	-1,344	-1,344	...	-1,357	...	...	...	...	...
Other government deposit 4/	...	...	...	...	...	...	-214	-153	-8	0
HIPC Initiative account	-1,929	-2,067	-2,123	-3,253	-3,253	-3,262	-2,209	-2,209	-2,097	-2,133
Claims on nongovernment	1,506	2,234	2,234	2,995	2,667	3,560	2,667	3,052	3,509	4,054
Claims on private sector	1,390	2,059	2,059	2,759	2,437	3,320	2,437	2,812	3,264	3,786
Claims on public enterprises	116	175	175	236	230	240	230	240	245	268
Other items (net)	3,599	4,244	4,730	4,496	4,505	4,496	1,441	1394	1,394	1,394
Broad money	4,468	5,817	5,817	6,317	5,841	7,223	5,841	6,694	7,603	8,622
Narrow money	1,696	2,041	2,041	2,363	2,280	2,535	2,050	2,613	2,968	3,365
Quasi money	2,772	3,775	3,775	3,955	3,561	4,688	3,791	4,081	4,635	5,269
Foreign exchange deposits	1,619	2,440	2,440	...	1,981	...	...	...	...	...
Other	1,153	1,336	1,336	...	1,580	...	...	...	...	...
					(Change in percent of beginning period broad money)					
Net foreign assets	-9.0	13.9	...	12.2	18.0	-1.2	...	6.7	3.7	5.5
Net domestic assets	32.5	16.3	...	-3.6	-17.6	15.5	...	7.9	9.9	7.9
Net domestic credit	36.6	16.4	...	0.4	-13.7	15.5	...	8.7	9.9	7.9
Net claims on government	27.0	1.0	...	6.7	-1.8	6.7	...	2.1	1.3	1.2
Claims on nongovernment	9.6	15.4	...	13.1	7.5	8.9	...	6.6	6.8	7.2
Claims on private sector	9.0	14.1	...	12.0	6.5	8.9	...	6.4	6.8	6.9
Claims on public enterprises	0.6	1.3	...	1.0	0.9	0.1	...	0.2	0.1	0.3
Other items (net)	-4.1	-0.1	...	-4.0	-3.9	0.0	...	-0.8	0.0	0.0
Broad money	23.4	30.2	...	8.6	0.4	14.3	...	14.6	13.6	13.4
Velocity (GDP/M2) 5/	5.5	5.3	...	5.5	5.6	5.3	...	5.8	5.7	5.5

Sources: Zambian authorities, and IMF staff estimates and projections.

1/ The base for the year *t* is obtained by recalculating the figures for end-year *t*-1 on the basis of the program exchange rates assumed for the year t.
2/ The proposed revised program is based on an exchange rate of K3509/US$ (as against K4550/US$ for the original program).
3/ Beginning in 2004, government securities are recorded at cost rather than face value.
4/ Resources available from a deposit account previously maintained for making debt service payments to the IMF.
5/ The 2005 program figure is based on the year end stock of broad money. All other figures are based on the average stock during the year.

Table 5. Zambia: Assets and Liabilities of the Bank of Zambia, 2003-06
(Billions of kwacha, unless otherwise indicated; end of period)

	2003	2004	2005 Base 1/	2005 Prog.	2005 Prel.	2006 2/ Base	2006 2/ Prog.	2006 2/ Revised Base	2006 2/ Revised Prog.
Net foreign assets	-2,377	-2,518	-2,986	-1,841	-1,235	-1,369	-1,377	1,194	1,631
Assets	892	1,189	1,254	1,295	1,822	1,682	1,832	1,250	1,824
Liabilities	-3,269	-3,707	-4,240	-3,136	-3,057	-3,051	-3,209	-55	-193
Of which : IMF (net)	-3,242	-3,701	-4,234	-3,136	-3,057	-3,051	-3,209	-55	-193
Net domestic assets	3,796	4,237	4,713	3,749	3,239	3,248	3,441	702	461
Net domestic credit	-476	-516	-572	-1,536	-1,809	-1,794	-1,683	-918	-857
Net claims on government	1,090	1,241	1,241	1,361	1,070	1024	1,210	856	917
Net claims on government (excluding MDRI)	1,090	1,241	1,241	1,361	1,070	1,024	1,210	1,070	1,070
Claims on government 3/	1,973	...	...	...	1,940	1,820	...	...	...
Government deposits	-883	...	...	...	-870	-796	...	...	...
Other government deposit 4/	...	...	...	...	...	...	...	-214	-153
IMF HIPC Initiative Account	-1,929	-2,067	-2,123	-3,253	-3,253	-3,253	-3,262	-2,209	-2,209
Claims on nongovernment	363	310	310	356	375	435	369	435	435
Of which: claims on banks	262	...	...	...	...	...	...	...	...
Other items (net)	4,272	4,753	5,285	5,285	5,048	5,042	5,124	1,639	1,318
Of which : onlending of loans from the IMF	4,082	4,234	4,234	3,685	3,057	3,051	3,209	2,073	193
Reserve money	1,419	1,719	1,727	1,908	1,896	1,879	2,064	1,896	2,092
Currency in circulation	670	816	816	...	962	1,049	...	962	...
Required reserves (kwacha deposits)	286	352	352	...	413	409	...	413	...
Required reserves (foreign exchange deposits)	224	295	303	...	300	338	...	300	...
Dollar/denominated	224	295	303	...	300	338	...	300	...
Kwacha/denominated	0	0	0	...	0	0	...	0	...
Current accounts	233	249	249	...	213	77	...	213	...
Nongovernment deposits	6	7	7	...	9	6	...	9	...
Memorandum items:									
Multiplier (broad money/reserve money)	3.1	3.4	...	3.5	3.2	3.4	3.5	3.2	3.2
Reserve money (percent change from end of previous year)	17.8	21.1	...	10.5	9.8	8.8	9.8	9.8	10.3
Program exchange rate (kwacha/US dollar)	4334	4656	4,771	4,771	4,771	4,550	4,550	3,509	3,509

Sources: Zambian authorities, and IMF staff estimates and projections.

1/ The base for the year *t* is obtained by recalculating the figures for end year *t* -1 on the basis of the program exchange rates assumed for the year *t* .

2/ The proposed revised program is based on an exchange rate of K3509/US$ (as against K4550/US$ for the original program).

3/ Beginning in 2004, government securities are recorded at cost rather than face value.

4/ Resources available from a deposit account previously maintained for making debt service payments to the IMF.

Table 6: Zambia: Balance of Payments, 2003–08
(Millions of U.S. dollars, unless otherwise indicated)

	2003	2004	2005		2006		2007	2008
			Prog.	Prel.	Prog.	Proj.	Proj.	Proj.
Current account balance 1/	-686	-581	-826	-696	-891	-872	-1,095	-1,287
Merchandise trade balance	-302	82	59	32	54	635	123	-448
Exports, f.o.b.	1,061	1,779	2,095	2,161	2,316	3,341	3,177	2,906
Metals	669	1,322	1,557	1,616	1,728	2,700	2,521	2,239
Nonmetal	392	457	538	545	588	641	656	667
Imports, f.o.b.	-1,393	-1,727	-2,068	-2,161	-2,295	-2,739	-3,089	-3,391
Metal sector	-169	-286	-309	-336	-369	-552	-705	-869
Nonmetal	-1,224	-1,441	-1,759	-1,825	-1,926	-2,187	-2,384	-2,522
Of which : Petroleum	-183	-280	-365	-279	-441	-413	-457	-474
Goods procured by airlines	29	31	32	32	34	34	35	37
Services (net)	-238	-215	-265	-237	-268	-442	-422	-337
Receipts	165	232	246	272	265	280	297	313
Payments	-403	-447	-512	-509	-533	-722	-718	-650
Income (net)	-143	-424	-592	-466	-645	-1,067	-781	-474
Of which: Official interest payments	-126	-121	-110	-110	-101	-24	-17	-20
Current transfers (net)	-3	-25	-28	-24	-33	2	-16	-29
Of which: Sector wide approach (SWAP) grants	...	...	...	...	...	87	83	82
Capital and financial accounts	411	238	547	766	590	1,454	1,115	1,326
Project grants	240	239	306	287	321	311	327	353
Capital transfers 2/	...	...	...	1,793	...	2,403	...	...
Financial account	171	-1	241	-1,314	269	-1,260	789	973
Official loan disbursement (net)	-141	-221	-113	-1,882	-42	-1,722	106	101
Disbursement	101	110	120	136	119	152	159	167
Amortization 3/	-242	-331	-233	-2,018	-161	-1,874	-53	-66
Change in NFA of commercial banks (-increase)	48	-90	17	91	-10	13	9	2
Private capital (net)	264	310	337	477	321	449	674	870
Foreign direct investment	347	364	259	380	240	438	479	525
Private borrowing (net)	-83	-54	78	97	81	11	194	345
Of which: mining borrowing (net) 4/	-117	-70	75	-46	97	-5	34	45
Errors and omissions, short-term capital	-46	58	0	-354	0	0	0	0
Overall balance	-275	-343	-279	70	-301	582	20	39
Financing	321	285	279	284	301	-582	-20	-39
Change in net int. reserves of BoZ (-increase)	-161	-44	-336	-351	-20	-691	-126	-150
Gross official reserves of BoZ (-increase)	89	-28	-90	-109	-47	-149	-150	-150
IMF (net)	-244	-10	-240	-236	27	-542	24	0
Disbursements	0	248	16	16	48	40	24	0
Repayments 5/	-244	-257	-256	-252	-21	-582	0	0
Debt relief	389	264	480	480	197	0	0	0
Non-HIPC 6/	154	245	152	152	70	0	0	0
HIPC, including IMF	235	19	328	328	127	0	0	0
Of which : IMF	169	0	219	219	2	0	0	0
Of which : Paris Club	16	-2	38	38	51	0	0	0
Program support	55	65	134	155	124	109	106	111
Grants	45	44	105	131	104	95	100	105
Loans	10	21	29	24	20	14	6	5
Unidentified financing (+ deficit)	0	0	0	0	0	0	0	0
Memorandum items:								
Current acc't bal. excl. grants (percent of GDP)	-15.9	-10.7	-11.9	-9.6	-10.9	-7.9	-9.0	-9.7
Current acc't bal. incl. grants (percent of GDP)	-9.3	-5.5	-6.0	-3.8	-5.7	-3.8	-5.1	-5.9
Merchandise trade balance (percent of GDP)	-7.0	1.5	0.8	0.4	0.7	5.3	0.9	-3.2
Terms of trade (percentage change)	4.4	21.4	2.1	5.5	-6.6	18.3	-9.7	-7.0
Copper export volume (thousands of metric tons)	353	393	417	423	489	486	555	610
Copper export price (U.S. dollars per pound)	0.78	1.20	1.52	1.56	1.42	2.39	1.93	1.56
Oil price (U.S. dollars per barrel)	28.89	37.76	54.23	53.35	61.75	68.00	71.00	69.50
Gross official reserves 7/	194	222	312	357	358	495	645	795
(Months of imports)	1.3	1.2	1.4	1.6	1.5	1.7	2.0	2.4
Official debt service, cash payments	184	373	166	166	101	76	71	86
(Percent of exports)	14.6	18.3	7.0	6.7	3.9	2.1	2.0	2.6
Official budget debt service, cash payments	108	114	129	129	81	73	63	74
MDRI debt-service savings	...	...	...	...	...	26	58	90
Of which on obligations to the IMF	...	...	...	...	...	18	41	71

Sources: Bank of Zambia (BoZ); Ministry of Finance and National Planning; and Fund staff estimates and projections.

1/ Includes SWAP grants, but not project and program grants.
2/ In 2005, the amount of debt cancelled by the Paris Club at the completion point; in 2006, the amount of debt stock reduction provided by the Fund under the MDRI, and estimated debt stock reduction by IDA and AfDF.
3/ In 2005, includes $1793 million in settlement of Paris Club debt; in 2006 includes US$1822 in possible debt stock cancellation by IDA and AfDF.
4/ Reflects revised amortization projections on external loans to privatized mining sector.
5/ In 2006, the settlement of liabilities in the context of the MDRI to the Fund on pre-COD (i.e., end-2004) debt outstanding at end-2005.
6/ Indicates the portion of debt relief provided under the eHIPC Initiative that would have been available under traditional debt relief mechanisms.
7/ Unencumbered reserves at current exchange rates.

Table 7. Zambia: Schedule of Disbursements Under the PRGF Arrangement, 2004-07

Amount (In millions of SDRs)	Amount (In percent of quota)	Availability Date 1/	Conditions Necessary for Disbursement
82.536	16.88	16-Jun-04	Board approved the three-year arrangement and endorsed the annual program.
82.536	16.88	17-Dec-04	Board completed the first review based on observance of performance criteria for September 30, 2004.
5.502	1.13	15-Apr-05	Board completed the second review based on observance of performance criteria for December 31, 2004.
5.5024	1.13	9-Nov-05	Observance of performance criteria for March 31, 2005.
5.5024	1.13	25-Jan-06	Board completed the third review based on observance of performance criteria for June 30, 2005.
5.5024	1.13	25-Jan-06	Observance of performance criteria for September 30, 2005.
5.5024	1.13	31-May-06	Observance of the performance criteria for December 31, 2005 and completion of the fourth review.
11.0045	2.25	15-Dec-06	Observance of the performance criteria for June 30, 2006 and completion of the fifth review.
11.0045	2.25	31-May-07	Observance of performance criteria for December 31, 2006 and completion of the sixth review.
5.5024	1.13	31-May-07	Observance of performance criteria for March 31, 2007.

1/ For past disbursements, date refers to actual date of disbursement.

June 19, 2006

Mr. Rodrigo de Rato
Managing Director
International Monetary Fund
Washington, D.C.

Dear Mr. de Rato

The attached Memorandum of Economic and Financial Policies (MEFP) reviews the progress made in implementing the Government of Zambia's financial and economic program supported by the IMF under the Poverty Reduction and Growth Facility (PRGF). The memorandum reviews developments since the completion of the third review of the program on January 11, 2006 and sets out the policies that the Government of Zambia will pursue for the remainder of the year. Our strategy remains focused on achieving high rates of economic growth and reducing poverty through the continued pursuit of prudent fiscal and monetary policies and structural reforms to strengthen public expenditure management and accountability, improve the environment for private sector development, and strengthen governance.

The Government of Zambia requests the completion of the fourth review and seventh disbursement under the PRGF arrangement in an amount equivalent to SDR 5.5024 million. The Government also requests the IMF Executive Board to approve a modification of the quantitative program targets for June 2006, mainly to reflect revisions to the macroeconomic framework arising from additional spending on poverty-reducing programs made possible by the IMF's contribution to the Multilateral Debt Relief Initiative (MDRI) and the payment of domestic arrears in late 2005 that affected Government's net domestic financing in 2006. The proposed modifications also include a greater targeted buildup of international reserves than previously planned. For 2006 as a whole, the program will maintain the prudent fiscal stance and monetary restraint envisaged in the MEFP for the third review. To this end, the Government will take the necessary expenditure measures required to meet the end-year ceiling on net domestic financing. Efforts will also be made to strengthen collection of tax and nontax revenue, the VAT deferment on imported noncapital goods will be repealed by end-July 2006, and Statutory Instrument 1 of 2006, which extended reductions on selected taxes on petroleum products, will expire on June 30, 2006. Also, the Government has established a committee to review development agreements with the mining companies, including raising the royalty on minerals, and will undertake and complete before end-December 2006 a comprehensive assessment of tax policy and tax administration as part of a broad reform of Zambia's tax system.

In keeping with our objective of reorienting spending toward poverty-reducing programs, the Government of Zambia's budgetary expenditure on PRPs in 2006 (excluding spending financed by MDRI assistance) will be ½ percentage point of GDP greater than in 2005. Amongst other things, this will allow the recruitment of an additional 4,578 teachers and 800 medical personnel. The resources made available by the MDRI will be used to increase spending on priority poverty-reducing programs under the forthcoming National Development Plan 2006-2010. In 2006, the equivalent of the savings on debt service that would have been due to the IMF will be used to increase spending on agricultural projects.

The Government of Zambia believes that the policies set forth in the attached MEFP are adequate to achieve the objectives of its program, but it will take any further measures that may become appropriate for this purpose. Zambia will consult with the IMF on the adoption of these measures and in advance of revisions to policies contained in the MEFP, in accordance with the Fund's policies on such consultation.

The Government of Zambia authorizes the IMF to make the staff report for the fourth review under the PRGF arrangement and this letter and attached memoranda available to the public, including through the placement of these documents on the IMF website, subject to the removal of market-sensitive information, following the IMF Executive Board conclusion of the review.

Yours sincerely,

/s/
Ng'andu P. Magande, MP
Minister of Finance and National Planning

Memorandum of Economic and Financial Policies

I. Review of Recent Developments and Performance Under the PRGF-Supported Program

1. **The Zambian economy continued to perform well in 2005 and early 2006.** Real GDP grew by about 5 percent in 2005, as a strong expansion in construction—driven by a robust demand for housing and large-scale investment in the copper sector—and a marked pick up in mining production outweighed a number of setbacks, including a drought in some regions of the country and fuel shortages caused by an extended shutdown of the country's oil refinery (Indeni). With a healthy recovery in agriculture underway, real GDP growth is set to increase to about 6 percent in 2006. The kwacha's appreciation created additional downward momentum for inflation, which fell to 15.9 percent in December 2005 and to 9.4 percent in April 2006—marking the first time in about 30 years that Zambia has achieved single-digit inflation. The prospects of a bumper crop in maize has helped to ease pressure on food prices in recent months. Cash crop production for the export market and the tourism sector have continued to grow at a strong pace in the first quarter of 2006. However, the sharp appreciation of the kwacha in late 2005 has posed a major challenge to the international competitiveness of these sectors.

2. **Poverty is still widespread in Zambia with 68 percent of the population falling below the poverty line in 2004**. In rural areas, the incidence of poverty is even more severe. Nevertheless, the rising trend in poverty rates that prevailed during the 1990s has begun to be reversed. As part of the expansion of poverty-reducing programs (PRPs) made possible through debt relief, the Government eliminated user fees for health clinics in rural areas beginning in April 2006.

3. **Fiscal performance was broadly in line with budget projections in 2005.** The overall fiscal deficit, including grants, was nearly equal to the budget target. Current expenditures were trimmed, beyond the savings on interest costs, to offset lower nontax revenue and the reductions in fuel import taxes and duties granted during the fourth quarter of the year to ease the burden on consumers from the Indeni shutdown. Relative to GDP, the overall fiscal deficit, including grants, was 2.6 percent, compared with the modified program target of 2.7 percent. Net domestic financing of government in 2005 was somewhat below the target, as some of the payments to road contractors did not clear government accounts until January 2006. Tax revenue amounted to 17.0 percent of GDP in 2005, compared with the budget projection of 17.7 percent, suggesting that a good portion of the economy's growth escaped the tax net. The weak revenue performance continued in the first quarter of 2006. In addition to an extension of the reduction in import and excise duties on petroleum products, the appreciation of the kwacha significantly lowered the kwacha value of revenues from VAT on imports and customs duties, as well as VAT on domestic goods and services valued in U.S. dollars (such as electricity purchases by the mining companies).

4. **The Bank of Zambia (BoZ) maintained the growth of reserve money—the BoZ's operating target—broadly in line with the 2005 monetary program through most of the year**. On an annual basis, reserve money increased by 16 percent on average compared to 23 percent in 2004. Broad money (M3) remained flat during 2005, largely reflecting the valuation effect of the exchange rate appreciation on the U.S. dollar deposits in commercial banks.[1] The yield on government securities has come down sharply in recent months, driven largely by the decline in inflation and strong demand, particularly by nonbank institutions (pension funds) and foreign portfolio investors that have been active in the market since the third quarter of 2005. The average yield on Treasury bills declined from nearly 17 percent in late December 2005 to just under 8 percent in early May, accompanied by a decline in commercial banks' average lending rate from 27.6 percent to 23.7 percent.

5. **The kwacha appreciated by 26 percent against the U.S. dollar in 2005 and has continued to strengthen at a more moderate pace in 2006**. The appreciation has been associated with increased market confidence in the economy stemming from the greatly improved prospects of the copper sector, the cancellation of the bulk of Zambia's external debt, and expected continued commitment to prudent fiscal and monetary policies. The favorable market sentiment has been reflected in the substantial inflows of foreign investment in government securities. The real appreciation of the kwacha poses a challenge for nontraditional exports, which will have to step up improvements in productivity to maintain their competitiveness in international markets, and for government to implement the necessary structural reforms to lower the cost of doing business.

6. **Zambia's external position has strengthened substantially in 2005 and early 2006.** In addition to a reduction in the current account deficit of the balance of payments relative to GDP, led by favorable developments in the terms of trade and rapidly rising export earnings, Zambia has benefited from extensive debt relief following the attainment of the completion point under the HIPC Initiative in April 2005, debt cancellation by Paris Club bilateral creditors in May 2005, and the cancellation of debt to the IMF under the Multilateral Debt Relief Initiative (MDRI) in early 2006.[2] Record high world prices of copper—Zambia's principal export—together with strong growth in copper export volumes arising from a series of major investments in the sector following privatization, have driven export earnings sharply higher. Nonmetal exports also experienced strong growth in 2005, which continued through the first quarter of 2006. While imports also grew rapidly during this period—reflecting the economy's robust growth, the strength of the kwacha, and high world petroleum prices—the current account deficit, including grants, narrowed from 5.5 percent of GDP in 2004 to 3.8 percent in 2005. Moreover, rising capital inflows,

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[1] Evaluated at the constant program exchange rate, M3 grew by 13 percent in 2005.

[2] The Boards of the World Bank and the African Development Bank approved the MDRI for their respective institutions in March 2006. Implementation is expected to begin in July 2006.

including about US$120 million of portfolio inflows in 2005—a new phenomenon in Zambia, which continued into 2006—more than covered the current account deficit in 2005, allowing for an increase in the BoZ's international reserves by US$135 million to US$357 million by the end of the year. While still low, reserves grew from 1.2 months of imports in 2004 to 1.6 months as of end-2005.

7. **All quantitative and structural performance criteria and benchmarks under the PRGF-supported program were met through December 2005. However, there have been some difficulties and delays in meeting the benchmarks in early 2006 (Tables 1 and 2).** The March 2006 benchmark ceiling on net domestic financing was missed by K 256 billion. This was mainly due to end-2005 authorized expenditure, including the payment of K 120 billion in arrears to road contractors, some of which was executed in early 2006, and the shortfall in tax collections. On the structural side, the continuous performance criterion on restricting government spending to budgeted items and legal liabilities was observed through March, as were the benchmarks regarding the validation of external debt data, governance and transparency in budget execution, and the issuance of rules and procedures to implement and enforce a new cash management framework. Other measures (benchmarks for March 2006) related to the Public Expenditure Management and Financial Accountability (PEMFA) reform were not implemented as scheduled. New summary tables on budget execution were issued in May 2006. The layman's draft of the Financial Regulations was submitted in March to the Ministry of Justice and is expected to be finalized by end-June 2006. The corresponding final manuals will be issued to heads of accounting units by end-December 2006. Under private sector development, the electricity company (ZESCO) has not completed preparing the required information for the assessment of its performance under the commercialization process (end-April benchmark). In particular, the draft financial statement for the fiscal year that ended March 31, 2006 will only be available by end-July 2006.

II. Medium-Term Objectives and the PRGF-Supported Program

8. **In line with the forthcoming Fifth National Development Plan (FNDP), scheduled to be launched in July 2006, and the medium-term macroeconomic framework as set out in the December 2005 MEFP for the third review under the PRGF arrangement, the Government aims to implement a macroeconomic policy framework and an agenda of structural reforms that will support strong economic growth and a substantial reduction in poverty.** Under this current scenario for 2006–2008, the Government aims to:

- Achieve real GDP growth of at least 6 percent a year;

- Bring down end-year inflation to no more than 10 percent in 2006 and 5 percent in 2007 and 2008;

- Limit domestic borrowing to 1.8 percent of GDP in 2006, 0.7 percent of GDP in 2007, and 0.5 percent of GDP in 2008 to strengthen the domestic debt position and limit the crowding out of credit to the private sector;

- Increase the coverage of official gross international reserves to at least 1.7 months of imports in 2006, 2.0 months in 2007, and 2.4 months in 2008;

- Remain current with foreign debt service; and

- Increase spending under the budget on Poverty Reducing Programs (PRPs) by at least ½ percentage point of GDP a year.

9. **The reduction in the Government's domestic borrowing over the medium term is the anchor to Zambia's macroeconomic stabilization effort.** That reduction will be achieved by gradually raising government revenues by introducing appropriate tax measures—notably by improving tax administration and widening the tax base by further bringing in the informal sector—while exercising strict control on government expenditures. In addition, the Government will explore the scope for revising the taxation of mining and renegotiating development agreements.. Increases in donor assistance, including in the form of budget support, would provide room for a greater expansion of government spending. A strengthening of budget execution will not only be critical to enable donors to increase budget support, but also to improve public sector service delivery and investment. The Government has a large outstanding stock of arrears to the Public Service Pension Fund (PSPF). Over 2006-2008, about 1.5 percent of GDP will be allocated to reducing the stock of pension arrears.

10. **The structural reform agenda is mainly aimed at increasing productivity.** Implementation of the Financial Sector Development Plan (FSDP) and the Private Sector Development (PSD) action plan will be instrumental in addressing the main credit and administrative constraints to private sector development in Zambia. The structural reform agenda will also include measures to improve the quality, efficiency, cost effectiveness, and delivery of public services. Increasing productivity in the public sector will rely on continued progress with ongoing reforms to strengthen PEMFA, public service management, including rightsizing of the civil service, and decentralization.

III. Policies for the Remainder of 2006

11. Economic and financial policies for the remainder of 2006 will remain largely in line with those outlined in the December 2005 MEFP. However, in light of recent developments, notably the strong appreciation of the kwacha, the late payment of domestic arrears to road contractors, and the cancellation of obligations to the IMF under the MDRI, some modifications to the program are warranted, particularly in setting the quantitative performance criteria and benchmarks for the second half of the year.

A. Fiscal Policy

12. **Fiscal policy is aimed at containing the Government's net domestic financing over the remainder of the year—in order to observe the annual target of 1.8 percent of GDP—while increasing spending by the Government on PRPs by 6.7 percent of GDP**, in line with the original program target plus additional MDRI resources available in 2006. To overcome the revenue shortfall during the first quarter of the year, efforts will be made to strengthen tax compliance, especially with regard to VAT, and the collection of tax arrears. Administration of the fertilizer program will be strengthened to overcome slippages in non-tax revenues. Statutory Instrument number 64 of 2005 as extended by Statutory Instrument number 1 of 2006 on petroleum products will lapse on June 30, 2006 and the deferment of VAT on imports of noncapital goods will be repealed by end-July. Nonpriority expenditures will be reduced by K 203 billion by decreasing expenditures on ordinary RDCs, domestically financed non-PRP capital expenditures and other emoluments. Expenditures that will be cut include purchases of office equipment and motor vehicles and commutation of leave days. At the same time, the Government will meet its commitments in a timely manner to further the progress achieved in paying down domestic arrears. In particular, it will stay current on its contributions to the Public Sector Pension Fund (PSPF) and NAPSA. Included in the PRPs budgeted for 2006, funds have been allocated for the recruitment of an additional 4,578 teachers and 800 medical personnel.

13. In view of the weakening revenue performance, the Government will expedite the planned review of the tax system with a view to broadening the tax base and enhancing its efficiency. To this end, the Government will undertake and complete by end-December 2006 a diagnostic review of tax policy and tax administration (end-December 2006 performance criterion) as part of the broad reform of Zambia's tax system. The recommendations of this review shall be implemented starting with the 2007 budget. The Government also has established a committee to review development agreements with the mining companies, including raising the royalty rate on minerals.

14. The resources made available by the Multilateral Debt Relief Initiative (MDRI) will be utilized by Government to support programs to speed up achievement of the Millennium Development Goals (MDGs). The resources will be used over time in line with annual debt-service savings. The transfer of debt relief resources to the government has been effected through a decrease in Bank of Zambia claims on the government, reflecting the onlending arrangement between the Bank of Zambia and the government of IMF resources disbursed to Zambia. The residual balance in the GRZ/PRGF deposit account at the Bank of Zambia from past onlending of IMF disbursements has been transferred to a special government deposit account. This balance, which became freely available for government's use as a result of the IMF's MDRI relief to Zambia, stood at K 213.6 billion (about US$61 million) on January 6, 2006. Withdrawals from this account will be used to finance additional expenditures on priority poverty-reducing programs in 2006 and 2007. In 2006, the withdrawals will amount to US$18 million in debt service savings for the year, and will be spent on agricultural projects, namely irrigation development and livestock disease control. From 2008 onward, when the funds in this account will have been exhausted, the

Government will annually set aside resources equivalent to the MDRI debt-service savings in that year for additional expenditure on poverty-reducing programs.

B. Monetary and Exchange Rate Policies

15. **The Bank of Zambia will maintain an appropriately firm monetary stance in 2006 to keep inflation on a downward path and curb further expectations of high inflation.** Reserve money growth will be limited to 10.3 percent. Accordingly, broad money and credit to the private sector are projected to grow by 14.6 percent and 15.4 percent, respectively.

16. **The Government remains committed to a flexible exchange rate regime.** The BoZ will intervene as appropriate in the foreign exchange market to smoothen temporary fluctuations in the exchange rate and to build up international reserves without compromising the inflation objectives.

17. **The Bank of Zambia's scope to carry out sterilized intervention has, however, been constrained by the lack of adequate instruments.** To this end, the Government and the BoZ will adopt institutional arrangements that ensure that the BoZ has the necessary instruments to meet agreed monetary objectives. In particular, it has been agreed to convert the Government's outstanding bridge loan and a portion of the Mega bond held by the BOZ into marketable securities.

C. External Prospects and Policies

18. **The balance of payments performed strongly in 2005 and looks set to continue doing so in 2006.** Supported by ongoing investment in the metal sector and a continued demand-driven rise in world copper prices, metal export receipts are projected to increase by over 50 percent in 2006. Similarly, nontraditional exports, including tourism, are set to grow by about 15 percent, resulting in a projected 48 percent increase in U.S. dollar terms of receipts from exports of goods and services in 2006. Imports of goods are expected to grow by 20 percent in U.S. dollar terms in 2006 owing to the combined effects of higher oil prices and the appreciation of the kwacha. Overall, the balance of trade in goods and services is projected to improve by about US$460 million, but this is expected to be offset by income outflows related to foreign direct investment, leaving the current account (including grants) virtually unchanged at 3.8 percent of GDP.

19. **The capital account is expected to continue strengthening in 2006.** Overall, grants and loans from foreign donors are projected to increase by about 16 percent in 2006 to US$676 million (5.5 percent of GDP), but budget support is expected to decrease to about US$125 million (US$100 million in grants) from the US$155 million provided in 2005. At the same time, external debt service charged to the budget has been cut by one-third to about US$90 million (0.7 percent of GDP) following attainment of the HIPC Initiative completion point. Based on expected continued improvement in Zambia's macroeconomic fundamentals, external investments in Zambia's sovereign debt market are expected to remain strong.

20. **The Government remains committed to maintaining and deepening the openness of its commercial and capital accounts.** The government will work with SADC and COMESA to strengthen their concerted efforts to reduce tariff and nontariff barriers to trade. At the same time, the government will consider unilaterally phasing out its 25 percent tax on exports of scrap metal.

D. Structural Measures

21. **Structural reforms in 2006 are aimed at increasing productivity in both the public and private sectors and raising international competitiveness.** The agenda comprises reforms of public expenditure management and financial accountability (PEMFA), debt management, pension reforms, financial sector development, private sector development, and governance and accountability. Table 2 presents the specific measures that are included in the PRGF-supported program for 2006 as structural performance criteria and benchmarks.

Public Expenditure Management

22. Following some delays in reaching agreement with the cooperating partners on the 2006 work plan, the implementation of the PEMFA reforms is set to make major progress; the process for contracting the installation of an integrated financial management and information system (IFMIS) is on course to initiate the pilot phase as presently scheduled.

- The contractor with the best technical and financial proposal has been selected and negotiations on the technical proposal have been concluded. The post qualification process has been completed ahead of schedule.

- To strengthen existing expenditure management systems, the Accountant General has issued rules and procedures for implementing and enforcing the new cash management system. The Accountant General will also prepare, within 60 days of the end of each quarter, quarterly reports for the Secretary to the Treasury on compliance with the commitment control system by ministry, province and spending agency (end-September 2006 benchmark).

- The Budget Execution Working Group has developed a new summarized report on budget execution and the first quarterly report (on releases and expenditures in 2006 Q1) was issued in May 2006.

- Final regulations and accounting manual for the new Finance Act will be completed and distributed to accounting heads by end-December 2006.

23. Progress, albeit slower than hoped, has also been made under the Public Service Management (PSM) program. Payrolls of most ministries have been transferred to the Payroll Management and Establishment Control (PMEC) system. The introduction of the PMEC system has significantly reduced headcount on the payroll, by removing large

numbers of ineligible employees. To further strengthen the program, the Ministry of Defense will be transferred to the PMEC system, once a full head count and audit is done.

Debt Management

24. The Ministry of Finance and National Planning (MoFNP) continues to monitor and validate end-quarter data on external debt stocks and, within 45 days of the end of quarter, produces updated three-year schedules of projected debt service. The MoFNP is preparing an annual report on external debt management operations during 2005, and by end-June 2006, will validate the stock of on-lending agreements to ensure their effective enforcement. The MoFNP has also begun the process of developing a comprehensive database for the management of domestic debt, including contingent liabilities and the debts of the remaining parastatals (some of which are government secured), including the debts of the utility companies. In cooperation with the Bank of Zambia, the Ministry is also working on a program to strengthen debt management through further development of debt markets, including through the introduction of secondary markets for government securities.

Pension Reform

25. The main challenges facing the pension schemes are to bring promised pension benefits more in line financially with employees' contributions under the PSPF, assure that resources are available to meet Government's current and past obligations to NAPSA and the PSPF, and to ensure a sound investment strategy is maintained for NAPSA's large and growing pension fund. To meet these challenges, Government will continue to pay down outstanding arrears on contributions to PSPF by at least K 100 billion a year during 2006–08, while fully meeting current obligations in a timely manner. Secondly, Government is undertaking pension reforms to slow down the pension liability accrual rate, protect only accrued pension benefits, and allow parametric changes to the PSPF pension system. Full implementation of the reforms will, however, need to await the amendment of Article 124 and related Articles of the Constitution, as well as relevant Acts.

Financial Sector Development

26. **To enhance financial system stability, the Bank of Zambia (BoZ) is proceeding with the introduction of risk management systems.** The BoZ has taken a number of measures to further strengthen bank supervision. Online facilities for data submission have enhanced the timeliness and effectiveness of off-site supervision, while onsite supervision has been expanded to cover money laundering. A draft Deposit Protection Scheme Bill is being developed for banks and nonbank financial institutions (NBFIs). Nevertheless, introduction of legislation will be contingent on the establishment of the necessary preconditions for the introduction of the scheme, including the resolution of deposit-taking NBFIs. The necessary capacity is being developed to enable the BoZ to move to a fully risk-based approach to onsite supervision in 2007. A risk-management survey was conducted in the last quarter of 2005, and, drawing on the results of the survey, the BoZ has begun work

on the development of risk-management guidelines that will form the basis of the risk-management framework for banks and NBFIs.

27. **The Financial Sector Development Plan (FSDP) includes a number of initiatives to foster increased availability of credit and the provision of financial services in rural and peri-urban areas.** These include the establishment of a Credit Reference Bureau and the development of a well-functioning microfinance system. Guidelines for the Credit Reference Bureau have been put in place and the BoZ has licensed one credit reference services provider, which is able to meet standards of best practice. Regulations for the operation and supervision of microfinance institutions have been introduced, paving the way for the licensing of these institutions. Preparation of a rural financing policy and strategy will begin before the end of the year.

28. **The implementation of action plans for the problem nonbank financial institutions (NBFIs) is proceeding slowly.** The legal framework for the action plans is now in place, but other aspects of implementation have lagged. The Government remains firm in its commitment to reduce its shareholding in the DBZ to 25 percent. So far two investors have taken up equity in the institution, but more are needed. As for the National Savings and Credit Bank (NSCB), funding from IFAD and technical assistance for the installation of a new computer system have not yet been received; as a result, problems with unreconciled balances continue. The institution is exploring other options for its funding needs. Regarding the Zambia National Building Society (ZNBS), the Government has made a decision on the resolution of the institution, which will be effected by end-June 2006. Negotiations for the sale of 49 percent of the Zambia National Commercial Bank (ZNCB) have been completed and the privatization is expected to be completed soon.

Private sector development

29. **In the area of private sector development, the Government has focused its efforts on creating a business-friendly environment through the establishment of the Zambia Development Agency and the promotion of multi-facility economic zones (MFEZs).** The Government intends to provide infrastructure for the MFEZs and investors producing for both the domestic and export markets would be eligible for tax incentives. The Citizens' Empowerment Bill, which aims to provide opportunity to economically disadvantaged citizens to meaningfully participate in business activities, was recently approved by Parliament. With regard to reforms of costly labor regulations that inhibit formal sector employment, Government is presently processing Statutory Instruments for the Official Gazette that will limit minimum wage benefits and conditions of service to a more narrowly defined disadvantaged segment of the workforce. Consultations on other initiatives, such as the opening up to competition of the telecommunications international gateway and streamlining licensing requirements are ongoing.

30. Expanding Zambia's electricity generation capacity and network is a high priority in providing infrastructure support for private sector development. Moreover, Zambia could

become a major exporter within the Southern African Power Pool. In agreement with the World Bank and IMF, and in lieu of privatization, the Government has pursued the commercialization of the state-owned electricity company (ZESCO), with the goal of achieving operational efficiency, sound financial management, and effective implementation of investment projects. By end-July 2006, ZESCO's management will provide all the necessary financial, technical, and managerial information to the World Bank and the IMF for an assessment of ZESCO's performance as required for the evaluation point under the commercialization process, particularly during the first year of operations under its new business plan, which ended on March 31, 2006. To ensure the independence of ZESCO's operations, the Government will not on-lend or guarantee any external credits to ZESCO prior to a satisfactory assessment at the evaluation point. (Following a satisfactory assessment, the Government would continue to adhere to its policy of providing guarantees only on concessional borrowing.) In addition, prior to the evaluation point assessment, ZESCO will pay all of its tax arrears to the ZRA that were accumulated since the initiation of the commercialization process. Looking ahead, to reinforce transparency and corporate governance, Government will explore procedures in line with international best practice on reporting and managing ZESCO's profits from export sales.

Strengthening data

31. **The Government will take steps to expand Zambia's capacity to collect and report quality economic data.** At present, there are serious shortcomings in the data for the national accounts, consumer price index, and the balance of payments. The rebasing exercises for the national accounts and CPI, both of which use 1994 as the base year, are long overdue. As a result, there are large distortions in the data and some important sectors and consumer products are not even represented in the statistics. Major gaps also exist in the BOP statistics, greatly handicapping analysis of external sector developments. Systematic data is lacking on the inflows and outflows of the mining sector, workers' remittances, foreign direct investment, and private sector income and capital flows. Moreover, data on donor support that does not pass through the government are not captured in the balance of payments. To remedy this situation, Government will allocate funding for a comprehensive economic census for the rebasing of the national accounts. The census will be completed by end-May 2007 (Benchmark). The Central Statistics Office will also commence the rebasing of the CPI statistics by July 2006, with the aim of completing the exercise by March 2007. In addition, the BoZ will request technical assistance from the IMF to shore up its survey methods for the BOP.

E. Technical Assistance Needs

32. The Government has requested technical assistance from the IMF in the areas of tax administration and policy, including a diagnostic review of the present system. In addition, the Government will request technical assistance for the updating and rebasing of the national accounts and CPI statistics. Government will also seek technical assistance from the donor community for conducting the economic census, which would form the foundation

for the rebasing of the national accounts. The BoZ will request a second follow-up mission in the area of liquidity management, monetary, and exchange rate policies. The BoZ will also request technical assistance to strengthen the balance of payments statistics.

IV. Program Monitoring

33. Progress in implementing the PRGF-supported program will continue to be monitored quarterly, with semi-annual reviews, based on the quantitative and structural performance criteria and benchmarks in Tables 2 and 3. The government requests modification of the performance criteria for end-June 2006, which will be the basis for the fifth review expected to be completed by December 2006, for the ceiling on Government's net domestic financing and the ceiling and floor on the BoZ's net domestic assets and gross international reserves, respectively (see Table 3). The program for the remainder of 2006 sets quantitative indicative targets for end-September and performance criteria for end-December, which will be the basis for the sixth review expected to be completed by May 31, 2007. In line with the schedule set out in Table 2, performance criteria under the structural program will be part of the basis for completing program reviews. The quantitative and structural performance criteria and benchmarks are defined in the attached technical memorandum of understanding.

MEFP: Table 1. Zambia: Quantitative Performance Criteria (PC), Benchmarks and Indicative Targets Under the PRGF Program 1/
(In billions of Kwacha, unless otherwise indicated)

		2004	2005											
		Dec. Stocks	March Prog.	March Act.	**Status**	Jun. Prog.	Jun. Act	**Status**	Sep. Prog.	Sep. Act.	**Status**	Dec. Prog.	Dec. Act.	**Status**
	Performance Criteria													
1	Ceiling on the cumulative increase in net domestic assets (NDA) of the Bank of Zambia 2/ 3/ 4/ 5/	6,836	14	-185	**Met**	182	-41	**Met**	104	-306	**Met**	166	-344	**Met**
	Adjusted ceiling		94			296			286			226		
2	Ceiling on the cumulative increase in net domestic financing (NDF) 2/ 5/	3,305	60	168	**Met**	217	319	**Met**	301	513	**Not met**	500	611	**Met**
	Adjusted ceiling		190			374			496			661		
3	Floor on the stock of gross international reserves (GIR) of the Bank of Zambia (In millions of U.S. dollars) 2/	238	232	251	**Met**	204	275	**Met**	244	308	**Met**	246	331	**Met**
	Adjusted floor		225			192			194			259		
4	Ceiling on new external payment arrears (in millions of US dollars)		0	0	**Met**	0	0	**Met**	0	0	**Met**	0	0	**Met**
5	Ceiling on the stock of short-term debt and on contracting or guaranteeing of nonconcessional debt (In millions of U.S. dollars) 6/		0	0	**Met**	0	0	**Met**	0	0	**Met**	0	0	**Met**
6	Ceiling on cumulative new concessional loans collateralized or guaranteed by the central government or the Bank of Zambia for ZESCO.		20	0	**Met**	20	0	**Met**	20	0	**Met**	20	0	**Met**
7	Floor on the cumulative payment of domestic arrears of the government 5/		62	65	**Met**	100	144	**Met**	151	220	**Met**	284	413	**Met**
	Quantitative Benchmarks													
8	Cumulative ceiling for the Central Government wage bill 5/		593	508	**Met**	1,236	1,090	**Met**	1,876	1,782	**Met**	2,531	2,455	**Met**
9	Ceiling on the cumulative arrears on the Central Government wage bill		0	0	**Met**	0	0	**Met**	0	0		0	0	**Met**
	Memorandum items:													
10	Cumulative net balance of payments support (In millions of U.S. dollars)		-8	-14		-29	-41		4	-45		13	25	
	Balance of payments assistance		31	36		41	41		98	64		133	155	
	Central Government debt service obligations (excl. IMF)		-39	-51		-78	-83		-93	-109		-120	-130	
	Shortfall (-)/Excess (+) net BOP support			-6			-12			-49			12	
	Program exchange rates													
	Kwacha/US$	4,771												
	US$/SDR	1.5478												

1/ The definitions of the indicative targets are contained in the Technical Memorandum of Understanding (TMU).
2/ Adjustors, including for balance of payments support are defined in the TMU.
3/ Excludes HIPC debt relief from the IMF.
4/ The ceiling will be adjusted for changes in the legal reserve requirements.
5/ Cumulative from the end of 2004.
6/ Nonconcessional loans are defined as having a grant element of less than 40 percent.

MEFP Table 2. Zambia: Performance Under the Structural Program for 2006[1]

Measure	Timing[2]	Status
Performance Criteria		
The government will refrain from paying any amounts for which it is not legally liable and which are not included in the budget.	Continuous	Observed.
The Investment and Debt Management Department (IDM) of the MoFNP will validate the stock of onlending agreements with a view to effectively enforcing these agreements. The IDM will report to the Secretary of Treasury on the validation of these agreements.	end-June 2006	Process of compiling the information has commenced and was finalized in March. Verification began in April.
Initiate the piloting of an integrated financial management and information system (IFMIS) in at least three line ministries.	end-September 2006	The process is on schedule. A contractor has been selected and negotiations on the technical proposal have been concluded. The post-qualification process has also been concluded. A contract is expected to be signed in June 2006.
Complete a diagnostic review of tax policy and administration.	end-December 2006	
The IDM will validate the stock of government contingent liabilities, including loan guarantees, and pension obligations. The IDM will report to the Secretary of Treasury on the validation of these liabilities.	end-December 2006	
Report on the findings of a preliminary review of the piloting of the IFMIS in at least three line ministries.	end-March 2007	The process of selecting a contractor to install the IFMIS is on schedule.
Benchmarks		
Public expenditure management and financial accountability (PEMFA)		
Issue summary tables, developed in consultation with the PEMFA Joint Technical Working Group (JTWG), using activities based budgeting classification and identifying poverty reducing programs.	end-March 2006	Reports based on recommendations from the Budget Execution Working Group were implemented in May 2006.

MEFP Table 2. Zambia: Performance Under the Structural Program for 2006[1]

Measure	Timing[2]	Status
Issue new regulations and revised accounting manuals for the new Finance Act.	end-March 2006	Layman's Draft Financial Regulations, will be finalized by end-June 2006. A technical team has produced initial draft manuals, which will be reviewed and finalized by end-December 2006.
In consultation with the PEMFA JTWG, issue (i) accountability rules and procedures under the new cash management framework and (ii) corresponding administrative procedures for enforcement, to ensure the timely release of funds by the Ministry of Finance and National Planning (MoFNP).	end-March 2006	Cash-flow framework was finalized and implemented with accompanying user manual in 2005. Loading of 2006 activities-based budget classification and cash-flow framework has been completed.
Submit to Cabinet the first draft ("Green Paper") of the Medium-Term Expenditure Framework (MTEF) for 2007-2009.	end-August 2006	Work in progress. Pending finalization of the Fifth National Development Plan.
The Accountant General will, within 60 days of the end of each quarter, submit to the Secretary to the Treasury quarterly reports on compliance with the commitment control system by ministry, province, and spending agency.	Continuous Beginning September 2006	
Debt management		
Validate end-quarter external debt stock data and, within 45 days, provide updated 3-year schedule of debt service falling due to the Budget Director.	Continuous	Observed through March 2006.
The MoFNP will issue an annual report on external debt management operations during 2005.	end-June 2006	Preparation of the report has begun.
Financial sector development		
The National Savings and Credit Bank (NSCB) and the Development Bank of Zambia (DBZ) submit to the Bank of Zambia (BoZ) plans for their incorporation under the Companies Act.	end-December 2005	Observed.
Execute the action plan adopted by the Government on the resolution of the Zambia National Building Society (ZNBS).	end-June 2006	.

MEFP Table 2. Zambia: Performance Under the Structural Program for 2006[1]

Measure	Timing[2]	Status
Submit to cabinet a proposal for the legal framework establishing a credit reference bureau, including the necessary amendments to privacy laws.	end-June 2006	BoZ has issued interim guidelines and is in the process of licensing a provider for credit referencing services. BoZ has commenced drafting the layman's law for credit reference agencies and will engage a consultant for finalizing a proposal by March 2007.
Incorporate the NSCB and DBZ under the Companies Act.	end-December 2006	
Private sector development		
ZESCO's management will provide all the necessary financial, technical, and managerial information to the World Bank and the IMF for an assessment of ZESCO's performance in line with the conditions for reaching the evaluation point under the commercialization process.	end-July 2006	
Governance and transparency		
Unbudgeted expenditure requirements will be funded only to the limits of the contingency resources indicated in the budget or only after the cabinet has approved any changes by finding compensatory funding within the approved budget resources.	Continuous	Observed through March 2006.
Publication of quarterly budget execution reports using the activity-based budgeting classification, within 45 days of the end of each quarter, including summary tables developed in consultation with the PEMFA JTWG.	Continuous	Observed. Report for the fourth quarter of 2005 was published on time, but coverage was incomplete. MoFNP is correcting the data.
Statistics		
The Central Statistics Office will complete a comprehensive economic census for the full rebasing of the national accounts.	end-May 2007	

[1]The definitions of the prior actions, structural benchmarks, and performance criteria are contained in the technical memorandum of understanding (TMU).
[2]Refers to end of month for non-continuous measures.

MEFP: Table 3: Zambia: Quantitative Performance Criteria (PC), Benchmarks and Indicative Targets Under the PRGF Program 1/
(In billions of Kwacha, unless otherwise indicated)

		2006 Base	2006 Revised Base	2006					
				Mar			Jun.	Sep.	Dec
				Prog.	Act	Status	Prog.	Prog.	Prog.
	Performance Criteria								
1	Ceiling on the cumulative increase in net domestic assets (NDA) of the Bank of Zambia 2/ 3/ 4/ 5/	3,019	2,911	-37	-236	Met	-138	-126	-241
	Adjusted ceiling				-236				
2	Ceiling on the cumulative increase in net domestic financing (NDF) 2/ 5/	3,825	3,917	136	392	Not met	439	629	706
	Adjusted ceiling			121					
3	Floor on the cumulative increase in gross international reserves (GIR) of the Bank of Zambia (In millions of U.S. dollars) 2/	331	342	8	11	Met	58	65	153
	Adjusted floor			11					
4	Ceiling on new external payment arrears			0	0	Met	0	0	0
5	Ceiling on the stock of short-term debt and on contracting or guaranteeing of nonconcessional debt (In millions of U.S. dollars) 6/			0	0	Met	0	0	0
7	Floor on the cumulative payment of domestic arrears of the government 5/ 7/			50	80	Met	89	155	238
	Quantitative Benchmarks								
8	Cumulative ceiling for the Central Government wage bill 5/			654	621	Met	1,385	2,176	2,967
9	Ceiling on the cumulative arrears on the Central Government wage bill			0	0	Met	0	0	0
	Memorandum items:								
10	Cumulative net balance of payments support (In millions of U.S. dollars)			0.4	3.8		-16.7	36.3	36.7
	Balance of payments assistance			16.9	26.9		35.2	55.0	125.6
	Central Government debt service obligations (excl. IMF)			-16.5	-23.1		-51.9	-18.7	-88.9
	Shortfall (-)/Excess (+) net BOP support				3.4				
	Program exchange rates								
	Kwacha/US$	4,550	3,509						
	US$/SDR	1.436	1.429						

1/ The definitions of the items in the quantitative program are contained in the Technical Memorandum of Understanding (TMU). Targets for September and December are indicative.
2/ Adjustors, including for balance of payments support are defined in the TMU.
3/ Excludes HIPC debt relief from the IMF.
4/ The ceiling will be adjusted for changes in the legal reserve requirements.
5/ Cumulative from the end of 2005.
6/ Nonconcessional loans are defined as having a grant element of less than 40 percent.
7/ This includes K100 billion for the payment of arrears to the Public Service Pension Fund.

Technical Memorandum of Understanding for
The Poverty Reduction and Growth Facility (PRGF) Arrangement

I. INTRODUCTION

1. This memorandum sets out the understandings between the Zambian authorities and the International Monetary Fund (IMF) regarding the definitions of the quantitative and structural performance criteria and benchmarks for the program for 2006 supported by the PRGF arrangement, as well as the related reporting requirements. The definitions are valid at the start of the program, but may need to be revisited to ensure that the memorandum continues to reflect the best understanding of the Zambian authorities and IMF staff to monitor the program.

II. QUANTITATIVE PERFORMANCE CRITERIA AND BENCHMARKS: DEFINITIONS AND DATA SOURCES

A. Net Domestic Assets (NDA) of the Bank of Zambia (BoZ)

2. Net domestic assets (NDA) of the BoZ are defined as the monthly average (based on daily data) of reserve money less net foreign assets of the BoZ calculated at Kwacha 3,509.0 per U.S. dollar (program exchange rate).[1] Reserve money consists of currency issued, required reserves on Kwacha deposits, required reserves on foreign currency deposits (at the program exchange rate), positive current account balances of banks with the BoZ, and deposits in the BoZ of non-central government institutions. Net foreign assets of the BoZ are defined as gross international reserves (defined below) plus any other foreign assets, including the US$25 million blocked reserves at the former Meridien Bank (MBZ), minus foreign liabilities (defined below). The Kwacha values are derived from the U.S. dollar values using the program exchange rate.

3. Foreign reserve liabilities are defined as short term (one year or less in original maturity) foreign currency-denominated liabilities of the BoZ to nonresidents and outstanding use of IMF credit.

4. The ceilings on NDA will be adjusted upward by the amount of the shortfall of balance of payments support net of debt service as indicated in Table 3 (item 10) of the Memorandum of Economic and Financial Policies (MEFP), up to a maximum of US$20 million for the period end-December 2005 to end-December 2006. External disbursements that occur anytime during the month of the test date will be treated as if they

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[1] Unless otherwise defined, program exchange rates for 2006 between the U.S. dollar and other (non-Kwacha) currencies will be equal to the end-December 2005 rates. The U.S. dollar/SDR rate for program purposes is 1.4293. Any other assets (e.g. gold) would be revalued at their end-December 2005 market prices.

were disbursed on the first day of the month.[2] In the event of excess balance of payments support net of debt service, the ceiling on NDA will be adjusted downward by 100 percent of the additional excess support. However, if part of the excess support is used to reduce the stock of Treasury bills or bonds held by commercial banks and the non-bank sector, then the programmed NDA will be adjusted upward by that amount. The Kwacha value of the cumulative shortfall/excess will be calculated at the program exchange rate.

5. The ceiling on NDA will be adjusted downward/upward to reflect decreases/increases in the legal reserve requirements on deposits in commercial banks. The adjustor will be calculated as the percent change in the reserve requirement multiplied by the actual amount of required reserves (Kwacha and foreign-currency denominated) at the end of the previous calendar month.

B. Net Domestic Financing (NDF)

6. Net domestic financing is defined as the Central Government's net borrowing from the banking and non-banking sectors (See table 1).[3] All government-issued securities will be recorded at cost (face value less discount). NDF will be defined as:

(a) the net position of the Government with commercial banks, including: (i) Treasury bills; (ii) government bonds; (iii) loans and advances; less (iv) support to MBZ; and (v) central government deposits (defined to include account balances under the authority of controlling officers); plus

(b) BoZ holdings of: (i) Treasury bills; (ii) government bonds; (iii) the Kwacha bridge loan (overdraft facility); less (iv) the government's position at the BoZ; and (v) the donor suspense account; plus (vi) the long-term non-transferable security issued against the government's total indebtedness to BoZ as at end-2002.

(c) Nonbank holdings will include: Treasury bills; and government bonds.

7. The NDF ceiling will be adjusted upward by the amount of the shortfall in balance of payments support net of debt service as indicated in Table 3 (item 10) of the MEFP, up to a maximum of US$20 million for the period end-December 2005 to end-December 2006. In the event of excess balance of payments support net of debt service, the ceiling on NDF will be adjusted downward by 100 percent of the additional excess support. The Kwacha value of the cumulative shortfall/excess will be converted at the program exchange rate.

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[2] This implies that, for purposes of monitoring the NDA, the targeted NDA will be increased by the amount of the disbursement divided by the number of business days in the month and multiplied by the number of business days from the beginning of the month to the day prior to the disbursement.

[3] The Central Government includes all the administrations identified by the budget heads listed in the 2006 Yellow Book.

8. The data source for the above will be the "Net Domestic Financing" Table produced by the BoZ Economics Department, submitted on a weekly basis, and reconciled with the monthly monetary survey.

C. Gross International Reserves of the BOZ

9. Unless otherwise noted here, gross international reserves of the BoZ will be defined as reserve assets of the BoZ (See Table 2). Reserve assets are defined in the IMF BOP manual (5^{th} edition) and elaborated in the reserve template of the IMF's special data dissemination standards (SDDS). They exclude, for example, foreign assets not readily available to or controlled by the monetary authorities, and foreign currency claims on Zambian residents.

10. Gross international reserves consist of (i) monetary gold; (ii) foreign currency in cash; (iii) unencumbered foreign-currency deposits at non-resident banks; (iv) foreign securities and deposits; (v) SDR holdings and Zambia's reserve position with the IMF; and (vi) balances in the BIS account related to debt service to Paris Club creditors. Gross reserves exclude non-convertible currencies, pledged, swapped, or any encumbered reserve assets including but not limited to reserve assets used as collateral or guarantees for third-party external liabilities, commercial bank reserve requirements in foreign currency, and the US$25 million deposit in MBZ (in liquidation).

11. The floor on gross international reserves will be adjusted: (i) downward by the amount in U.S. dollars of the shortfall in balance of payments support net of debt service as indicated in Table 3 (item 10) of the MEFP, up to a maximum of US$20 million for the period end-December 2005 to end-December 2006; (ii) upward by 100 percent of the cumulative excess balance of payments support net of debt service. However, if part of the excess support is used to reduce the stock of Treasury bills or bonds held by commercial banks or the non-bank sector, then the programmed reserves buildup will be adjusted downward by that amount; (iii) downward/upward for any shortfall/excess in the U.S. dollar value of programmed disbursements from the IMF under the PRGF arrangement; (iv) downward for any increase in BoZ short-term foreign currency denominated debt (to residents and nonresidents), using the definition of short-term debt below.

12. For the purpose of this target, as well as those for external debt and arrears, valuation will be in U.S. dollars using the program exchange rates.

13. Data on gross international reserves, including its components, will be reported by the BoZ on a weekly and end-month basis.

D. External Payment Arrears

14. The performance criterion on the non-accumulation of new external arrears is continuous. Official external payment arrears are defined as unpaid debt service by the Central Government and BoZ, beyond the due date and/or the grace period, if any. This definition excludes arrears subject to rescheduling.

15. Data on arrears are compiled jointly by the Ministry of Finance and National Planning (MoFNP) and BoZ and will be reported by the MoFNP on a quarterly basis.

E. Official Medium- and Long-Term Concessional External Debt

16. Official medium- and long-term concessional external debt is defined as all forms of official debt with original maturity of more than one year contracted or guaranteed by the Central Government and BoZ having a grant element of no less than 40 percent, but excludes debts subject to rescheduling. The grant element is to be calculated by using currency-specific commercial interest reference rates (CIRRs) reported by the DAC of the OECD; for maturities of less than 15 years, the grant element will be calculated based on six-month averages of CIRRs, and for maturities longer than 15 years, the grant element will be calculated based on 10-year averages. Adjustment lending from the IMF will be excluded.

17. This minimum grant element applies not only to debt as defined in Point 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt (Decision No. 12274-(00/85) of August 24, 2000; see Annex), but also to commitments contracted or guaranteed for which value has not been received. This excludes non-concessional loans stemming from the rescheduling of external arrears.

18. Detailed data on all new concessional and non-concessional debt contracted or guaranteed will be provided by the MoFNP on a monthly basis.

F. Official External Short-Term Non-Concessional External Debt

19. Official external short-term non-concessional external debt is defined as the outstanding stock of external debt with original maturity of less than one year owed or guaranteed by the central Government or the BoZ. For this purpose short-term debt will include forward commodity sales but will exclude normal trade credit for imports. No new official external short-term debt will be contracted or disbursed during the program period. The term "debt" has the meaning set forth in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt (Decision No. 12274-(00/85) of August 24, 2000; see Annex).

20. The data will be reported by the MoFNP and BoZ on a monthly basis.

G. Domestic Arrears of Government

21. Domestic arrears are defined as: (i) any bill that has been received by a spending ministry from a supplier for goods and services delivered (and verified) and for which payment has not been made within 30 days after the due date of payments; (ii) wage, salary and any other payment to government employees, including pension contributions and all forms of housing allowances, that were due to be paid in a given month but remained unpaid on the 15^{th} of the following month; and (iii) interest or principal obligations which remain unpaid 30 days after the due date of payment. Included in the quarterly program floors for payment of domestic arrears in 2006 is payment of K 25 billion each quarter toward Government's arrears on contributions to the Public Sector Pension Fund.

22. Information regarding domestic arrears is to be compiled through audits of the accounts of spending Ministries and agencies, conducted by the Internal Audit division of the MoFNP. The audits will be completed and data submitted to IMF staff by the Secretary of the Treasury within six weeks of the end of each quarter.

H. The Central Government's Wage Bill

23. For the purposes of the wage bill, the definition of Central Government includes all expenditure heads covered in the 2006 Yellow Book. The Central Government's total wage bill will include payments on wages, salaries, allowances, and all other items specified as personal emoluments in the Yellow Book, and any direct or indirect payments of housing allowances to employees. The Government will provide, on a monthly basis and by budget head, the following data: (i) the number of all employees in the Central Government for each budget head; (ii) the basic salary, the allowances and any other personal emoluments released during the month; (iii) the arrears incurred during the month on the basic salary, on the allowances, and on any other personal emoluments; (iv) the number of employees retrenched and the corresponding retrenchment costs.

24. All the data will be submitted to the IMF staff by the MoFNP within three weeks of the end of each month.

III. STRUCTURAL PERFORMANCE CRITERIA AND BENCHMARKS

A. Performance Criteria

Continuous Criterion

25. The Government will refrain from paying any amounts for which it is not legally liable and which are not included in the budget.

Public Expenditure Management

26. By end-September 2006, the Government will initiate the piloting of the Integrated Financial Management and Information System (IFMIS) in at least three ministries.

27. By end-March 2007, the government will report on the findings of a preliminary review of the piloting of the IFMIS in at least three line ministries.

Debt Management

28. By end-June 2006, the Investment and Debt Management Department (IDM) of the MoFNP will validate the stock of onlending agreements with a view to effectively enforcing these agreements. The IDM will report to the Secretary of Treasury on the validation of these agreements.

29. By end-December 2006, the IDM will validate the stock of government contingent liabilities, including loan guarantees and pension obligations. The IDM will report to the Secretary of Treasury on the validation of these liabilities.

Fiscal Policy

30. By end-December 2006, complete a diagnostic review of policy and tax administration.

B. Benchmarks

Continuous Benchmarks

31. Unbudgeted expenditure requirements will be funded only to the limits of the contingency resources indicated in the budget or only after the Cabinet has approved any changes by finding compensatory funding within the approved budget resources.

32. The MoFNP will publish quarterly budget execution reports using the classification system of activity-based budgeting within 45 days of the end of each quarter, including summary tables developed in consultation with the PEMFA JTWG.

33. The MoFNP will validate end-quarter debt stock data and, within 45 days, provide updated 3-year schedule of debt service falling due to the Budget Director.

34. Beginning by September 30, 2006, the Accountant General will within 60 days of the end of each quarter submit to the Secretary to the Treasury quarterly reports on compliance with the commitment and control system by ministry, province, and other spending agencies.

Public Expenditure Management

35. By end-March 2006, the Government will issue summary tables, developed in consultation with the PEMFA Joint Technical Working Group (JTWG), using activities based budgeting classification and identifying poverty reducing programs.

36. By end-March 2006, in consultation with the PEMFA JTWG, the government will issue (i) accountability rules and procedures under the new cash management framework and (ii) corresponding administrative procedures for enforcement, to ensure the timely release of funds by the MoFNP.

37. By end-March 2006, the MoFNP will issue the new regulations and the revised accounting manual needed for the new Public Finance Act.

38. By end-August 2006, the Government will prepare and submit to Cabinet a first draft of the Medium-Term Expenditure Framework ("Green Paper") for the period 2007-2009.

Debt Management

39. By end-June 2006, the MoFNP will issue an annual report on external debt management operations during 2005.

Financial Sector Development

40. By end-June 2006, the Government will execute the action plan on the resolution of the Zambia National Building Society.

41. By end-June 2006, the MoFNP will submit to Cabinet a proposal for the legal framework establishing a credit reference bureau, including the necessary amendments to privacy laws.

42. By end-December 2006, the National Savings and Credit Bank and the Development Bank of Zambia will be incorporated under the Companies Act.

Private Sector Development

43. By end-July 2006, ZESCO's management will provide all the necessary financial, technical, and managerial information to the World Bank and the IMF for an assessment of ZESCO's performance in line with the conditions for reaching the evaluation point under the commercialization process.

Statistics

44. By end-May 2007, the Central Statistics Office will complete a comprehensive economic census for the full rebasing of the national accounts.

Zambia: Relations With The Fund

(As of May 31, 2006)

I. **Membership Status:** Joined: September 23, 1965; Article VIII

II. **General Resources Account:**	**SDR Million**	**Percent Quota**
Quota	489.10	100.0
Fund holdings of currency	489.10	100.0
Reserve position in Fund	0.02	0.0

III. **SDR Department:**	**SDR Million**	**Percent Allocation**
Net cumulative allocation	68.30	100.0
Holdings	10.13	14.83

IV. **Outstanding Purchases and Loans:**	**SDR Million**	**Percent Quota**
PRGF arrangements	22.01	4.50

V. **Latest Financial Arrangements:**

Type	**Approval Date**	**Expiration Date**	**Amount Approved (SDR Million)**	**Amount Drawn (SDR Million)**
PRGF	06/16/2004	06/15/2007	220.10	187.08
PRGF	03/25/1999	03/28/2003	278.90	237.52
PRGF	12/06/1995	12/05/1998	701.68	661.68

VI. **Projected Payments to the Fund**
(SDR million; based on existing use of resources and present holdings of SDRs)

	Forthcoming				
	2006	2007	2008	2009	2010
Principal	…	…	…	…	0.55
Charges/interest	1.64	2.14	2.14	2.14	2.14
Total	1.64	2.14	2.14	2.14	2.69

VII. Implementation of HIPC Initiative

	Enhanced Framework
Commitment of HIPC assistance	
Decision point date	Dec. 2000
Assistance committed (1999 NPV terms)[1]	
by all creditors (US$ million)	2,499.20
Of which: Fund assistance (US$ million)	602.00
(SDR equivalent in million)	468.80
Completion point date	April 2005
Disbursement of IMF assistance (SDR million)	
Assistance disbursed to Zambia	468.80
Interim assistance	351.60
Completion point balance	117.20
Additional disbursements of interest income[2]	39.47
Total disbursements	508.27

VIII. Implementation of MDRI Assistance

I.	Total debt relief (SDR million)[3]	402.59
	Of which: MDRI	398.47
	HIPC	4.12
II.	Debt relief by facility (SDR million)	

Delivery Date	GRA	PRGF	Total
January 2006	N/A	402.59	402.59

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[1] Net present value (NPV) terms at the decision point under the enhanced framework.

[2] Under the enhanced framework, an additional disbursement is made at the completion point corresponding to interest income earned on the amount committed at the decision point but not disbursed during the interim period.

[3] The Multilateral Debt Relief Initiative (MDRI) provides 100 percent debt relief to eligible member countries that are qualified for assistance. The debt relief covers all debt owed to the Fund as of end-2004 that is outstanding at the time the member qualifies for the relief.

IX. Safeguards Assessment

Under the Fund's safeguards assessment policy, the Bank of Zambia (BOZ) is subject to an assessment for the PRGF arrangement, which was approved on June 16, 2004 and is scheduled to expire on June 15, 2007. A safeguards assessment of the BoZ was completed on October 20, 2004.

The assessment identified certain weaknesses. The authorities have taken the following steps in the light of the recommendations made:

(i) In December 2004, the BoZ's board adopted the International Financial Reporting Standards as the basis for financial reporting.

(ii) In December 2004, the BoZ's board adopted a policy for the appointment of external auditors (three year-term appointment, renewable only once).

(iii) pending the approval of an amendment to the Bank of Zambia Act, the BoZ and the Ministry of Finance and National Planning (MoFNP) have adopted a Memorandum of Understanding to exclude unrealized gains from profits available for distribution to government; and

(iv) The Finance Department of the BoZ and the Economics Department of the BoZ have established a data monitoring committee to jointly reconcile the data reported to the Fund. Reconciliation reports for the first two quarters of 2005 have been submitted to the Fund.

(v) Proposed amendments to the BoZ Act to strengthen the operational independence of the BoZ have been submitted for consideration as part of the current review of the country's constitution.

X. Exchange Rate Arrangement

The currency of Zambia is the kwacha. The exchange rate for the kwacha is determined in the inter-bank foreign exchange market, in a managed float with no pre-announced path. On May 31, 2005, the BoZ mid-rate was K 3,531 per U.S. dollar. On April 19, 2002, Zambia accepted the obligations of Article VIII, Section 2, 3, and 4 of the Articles of Agreement. However, the Fund urged the authorities to eliminate the exchange restriction evidenced by the accumulation of external payments arrears, which is subject to Fund approval under Article VIII, as soon as possible.

XI. Article IV Consultations

Zambia is on the 24-month Article IV consultation cycle, subject to the provisions of the decision on consultation cycles approved on July 15, 2002. The Executive Board concluded the last Article IV consultation on January 11, 2006.

XII. FSAP Participation and ROSC

Zambia has participated in the financial sector assessment program (FSAP), and an FSAP mission from the Fund and the World Bank conducted a comprehensive external assessment of the financial system April 30-May 15 and July 15-26, 2002.

The fiscal transparency module of a Report on Observance of Standards and Codes (ROSC) assessing compliance with the IMF's Code of Good Practices on Fiscal Transparency—Declaration of Principles was issued to the Executive Board on October 31, 2001. A ROSC-data module was issued to the Executive Board on January 18, 2005.

XIII. Technical Assistance (since 2000)

Resident advisors

Department	Dates	Position
FAD	1997-2001	Advisor on budget management
	2002-2003	Advisor on public expenditure management

Technical assistance missions

Department	Dates	Purpose
MFD	November 2000	Bank supervision
	June 2001	Bank supervision
	November 2001	Monetary policy, financial sector issues, and payments system
	September 2002	Foreign exchange market
	January and May 2003	Development of foreign exchange interbank market, monetary operations, and reform of the financial system
	September 2003	Monetary operations, reform of the financial system, government securities market, and payments system
	April–October 2004	Resolution of nonbank financial institutions (three missions)

	April–May 2005	Liquidity management operations
	March 2006	Liquidity management, monetary and exchange rate policies
STA	May 2000	Balance of payments
	June 2002	General Data Dissemination System (GDDS)
	June 2002	Government Finance Statistics (GDDS)
	June 2002	Real Sector (GDDS)
	July 2002	Monetary Statistics (GDDS)
	June 2004	Data ROSC
	April–May 2005	Monetary Statistics (GDDS)
	May 2005	Government Finance Statistics (GDDS)
FAD	March 2000	Budget management
	January 2001	Public expenditure management
	May-June, 2001	ROSC—fiscal transparency module
	August 2001	Tax policy issues
	December 2002	Inspection mission to review progress in public expenditure management reform
	July–August 2005	Regulations for the Public Finance Act
	November 2005	Fiscal regime for copper mining
LEG	August-December 2004	Assistance on amending legislation on nonbank financial institutions
	February–May 2005	Proposal for amending acts of various nonbank financial institutions

XIV. **Resident Representative**

A Fund Resident Representative first took up the position in Lusaka in June 1990. Mr. Joseph Kakoza has been the Resident Representative since October 2003.

Zambia: Relations With The World Bank Group

A. Partnership for Development

1. The IDA and IMF Boards endorsed the Government's First Poverty Reduction Strategy, covering the period 2002-2004[1], in May of 2002. An Interim Poverty Reduction Strategy Paper (I-PRSP) had been presented to the Board in July 2000. The PRSP was substantially complete when the new Government took office in January 2002. The new Government endorsed the PRSP and went further to expand the PRSP in the Transitional National Development Plan (TNDP) that was published in October 2002 and covers the period 2002-2005. The first and the second Annual Progress Report on the implementation of the PRSP were presented to the IDA and IMF Boards in May 2004 and April 2005, respectively. It is expected that the second PRSP or Fifth National Development Plan (FNDP), covering 2006-10 will be presented to all stakeholders in June 2006 and endorsed by Cabinet in July 2006.

2. ***Strategic focus of the PRSP.*** The PRSP /TNDPhighlights the following barriers to poverty reduction: lack of economic growth, high inequality, excessive dependence on foreign aid, poor prioritization of public resources, inadequate safety nets, and HIV/AIDS. Therefore, the PRSP seeks to achieve poverty reduction through promoting (i) economic growth and diversification of production and exports; (ii) improved access and quality in the provision of social services; and (iii) the mainstreaming of crosscutting issues of governance, HIV/AIDS, gender, and the environment. Targets and indicators are provided for each sector and sub-sector. For example, by 2004 the poverty headcount is to be reduced to 65 percent, the same as in 1996. Even though the MDGs are not explicitly mentioned in the PRSP, given that the MDGs were not widely discussed when Zambia prepared its PRSP, some of the targets for improvements in the social indicators are similar to the MDGs.

3. ***Joint staff assessment of the PRSP and the Progress Reports.*** Bank and IMF staffs are in agreement with the major objectives set out in the PRSP and confirmed in the Annual Progress Reports. The strengths of the PRSP are: a participatory process that involved civil society, the private sector, and the donors; a poverty analysis that draws from available quantitative and qualitative data, looks at multiple dimensions of poverty, and provides data broken down by socio-economic group, gender, and region; an appropriate macroeconomic framework and financing plan; identification of priority sectors likely to contribute most to pro-poor growth; and the emphasis placed on the need to improve governance and reduce corruption. A Joint Staff Advisory Note is planned for the second

[1] Subsequently the PRSP was extended to cover also 2005 as to fully overlap with the Transitional National Development Plan.

half of 2006 and will discuss the last year of implementation of the first PRSP/TNDP and the new PRSP/FNDP.

4. Since 1995, the Fund has supported by ESAF and PRGF arrangements Zambia's economic reform program. During December 2003-May 2004, the authorities have implemented an extended Staff Monitoring Program (SMP), which has formed the basis of a new Fund-supported program under the Poverty Reduction and Growth Facility which was endorsed by the IMF Board on June 14, 2004. The PRGF focuses on (i) fiscal consolidation; (ii) inflation reduction, and (iii) maintaining an adequate level of foreign reserves. Successful performance under the PRGF is a key condition for reaching the completion point under the Enhanced HIPC Initiative.

B. World Bank Group Strategy

5. In March 2004, the Bank's executive Board discussed the Bank's current Country Assistance Strategy (CAS), which outlines the roadmap for the Bank's country support for the period 2004-2007. The CAS is explicitly rooted in a result-based framework, which links overall goals of the PRSP/TNDP to specific strategic objectives. Paying attention to cause-and-result linkages, the main focus of the planned Bank's activities is to remove obstacles to longer-term strategic development outcomes. Where appropriate, quantitative targets to be reached during the CAS period have been specified. For the CAS period, the Bank will track progress on specific outcomes and intermediate indicators directly affected by Bank interventions.

6. World Bank activities focus on three strategic priorities:

1. Strategic Priority 1: Sustained Economic Growth Anchored in a Diversified and Export-Oriented Economy;
2. Strategic Priority 2: Improved Lives and Protection of the Vulnerable;
3. Strategic Priority 3: Efficiently and Effectively Managed Public Sector.

In addition to ongoing Bank's lending operations in the areas of public sector reform, privatization, HIV/AIDS, education, social service delivery, infrastructure, support for diversification, and the environment, the CAS includes development policy lending, i.e., the Economic Management and Growth Credit, approved in December 2004. The CAS also continues project support (in particular, for public sector reforms, infrastructure, and sanitation), pursues a reengagement in the agricultural sector and to assist in the governments fight against malaria.

7. The Bank continues to undertake substantive country diagnostics providing a solid base for policy dialogue, design, and implementation of its lending operations in Zambia. A combined Public Expenditure Review (PER), Country Procurement Assessment Review (CPAR), and Country Financial Accountability Assessment (CFAA), was completed in 2003 and forms the basis for the Public Expenditure and Financial Accountability TA work jointly undertaken with cooperating partners. The main economic sector works recently

completed are a Country Economic Memorandum (CEM), an Investment Climate Assessment (ICA), an Administrative Barriers study (AB), and a Strategic Country Gender Assessment (SCGA). In addition, a collaborative Poverty and Vulnerability Assessment (PVA), an integrated framework study for trade (DTIS), and Public Expenditure Review for the education sector are currently being finalized and a Public Expenditure Review for the Health sector and an assessment of competition and regulation in Zambia's infrastructure sectors have been initiated.

8. To support the implementation of the PRSP, IDA prepared a results-based CAS for the period FY04-FY07, which was discussed by IDA's Executive Board in March 2004. IDA's active portfolio as of November 2005 contains 12 credits and grants for a total initial commitment of US$311.5 million. During FY05 2 projects were approved i.e. SEED (US$32.2 mil.) to support economic diversification in July 2004 and the Economic Management and Growth Credit (US$40 mil.) in Dec 2004. In FY06 three projects, the Malaria Booster Project (US$20 mil.), Public Sector Management Project (US$30 mil.) and Agricultural Development Support Program (US$40 mil.) were approved by IDA's Board. It is expected that three projects will be submitted for Board approval during FY07, a water and sanitation project, a bridge repair project and a Development Policy loan.

Table 1: Projects under Supervision

(As of 06/13/05)

(in US$ Millions)

Project Name	Strategic Focus	Approval FY	Date, Rev Closing	Net Comm Amt	Tot Disb	Undisbursed
Totals *				**311.5**	**96.6**	**251.8**
SEED	Pillar 1	FY05	11/30/2009	28.2	2.9	25.0
GEF SEED Biodiversity SIL (IDA GRANT)	Pillar 1	FY05	05/31/2009	4.0	0.3	3.8
3A Southern Africa Power Market	Pillar 1	FY04	12/31/2007	1.1	0.8	0.4
ZM-Road Rehab Maintenance Prj	Pillar 1	FY04	06/30/2007	50.0	5.7	43.7
Copperbelt Environment	Pillar 1	FY03	08/01/2008	19.0	1.9	18.9
HIV/AIDS (ZANARA) (IDA GRANT)	Pillar 2	FY03	02/28/2008	42.0	27.3	33.7
ZM-TEVET SIM)	Pillar 2	FY01	12/30/2006	25.0	14.4	17.8
Regional Trade Fac. Proj. – Zambia	Pillar 1	FY01	06/30/2011	15.0	7.7	9.0
Basic Ed. Subsect. Inv. Pgr	Pillar 2	FY99	06/30/2006	40.0	35.1	10.3
Agr Dev Support Program (IDA GRANT)	Pillar 1	FY06	06/30/2012	37.2	0.0	38.6
Public Service Mgmnt Prog	Pillar 3	FY06	12/31/2006	30.0	0.0	30.8
Malaria-Booster	Pillar 1 & 2	FY06	01/31/2010	20.0	0.5	19.9

*Note that Total disb plus Undisbursed amounts do not necessarily add up to total commitments due to exchange rate movements

9. The International Finance Corporation (IFC) is very much aligned with the Bank's policy agenda in Zambia. The IFC currently has a small portfolio of 12 projects totaling US$15 million outstanding. These are a mix of financial sector, agribusiness, telecommunications (mobile telephone), and tourism projects. The IFC's most prominent project was for US$30 million in the equity of Konkola Copper Mines (KCM) with Anglo-American in 2000. The IFC exited in 2002 along with Anglo, in accordance with the terms of the investment agreement.

10. Zambia is currently a group 3 country for the IFC (as defined in the recently board approved IFC strategic initiative for Africa) and thus assessed as a relatively poor investment climate, with limited prospects for stimulating new private investment and limited progress on reforms to improve the investment climate. In this environment, the IFC seeks to be responsive to individual projects where IFC can play a role, and in which there is strong development impact, but does not invest significant resources in upstream project development. The IFC is exploring, jointly with the Bank, how to support the Bank Group's activities on improving the investment climate in Zambia.

11. MIGA's outstanding portfolio in Zambia consists of four contracts of guarantee in the agribusiness and manufacturing services sector with a US$36.1 million gross exposure and a US$35.7 million net exposure as of December 2003. The projects are for the privatization, modernization, and expansion of a foundry, and for cobalt and copper facilities. They benefit the Zambian economy by saving production costs and by providing training to personnel working on projects. The estimated total amount of foreign direct investment facilitated to date is US$155.5 million

C. IMF-World Bank Collaboration in Specific Areas

12. A summary of IMF-World Bank collaboration in Zambia is provided in Table 2. There are a number of areas where the Fund leads and its analysis serve as inputs into the World Bank policy formulation and advice, including policies to maintain macroeconomic stability, fiscal, monetary, and exchange rate policies. There are other areas in which the Fund and the Bank share responsibility and are coordinating closely their policy advice to the Zambian authorities, such as trade, financial sector, public expenditure management, including debt management, and economic governance. The Bank has taken the lead in the social sectors, including health, education, social protection, water and sanitation, agriculture and rural development, private sector development including regulatory issues and the environment.

13. The Fund and the Bank shared joint responsibility in supporting the Government in the preparation of the PRSP and its annual progress reports on the implementation of the PRSP. The Fund and the Bank have also jointly provided assistance to Zambia for evaluating progress to reach the Completion Point under the Enhanced HIPC Initiative. In

addition, the Bank and the Fund are jointly assisting GRZ to improve its debt and cash management practices.

C.1. Areas in which the World Bank leads and there is no direct IMF involvement

14. Areas in which the Bank leads and there is no direct involvement of the IMF are support for social sectors, agriculture and rural development, economic diversification, infrastructure, and the environment. In light of the complex and crosscutting nature of risk and vulnerability in Zambia, the Bank is assisting Government in developing a cross-sectoral **Social Protection Strategy**. The strategy will extend beyond traditional ex post risk-coping measures (e.g. safety nets) to include a better understanding of the role of ex ante risk-prevention and risk-mitigation measures. The strategy is being prepared in a highly participatory fashion, with the aim of integrating it within Zambia's next poverty-reduction strategy. For the same purpose, the Bank has undertaken a Poverty and Vulnerability Assessment, which is to be discussed with GRZ in Winter 2005.

15. **HIV/AIDS, Malaria, and health.** At this time, IDA is assisting the Ministry of Health with a US$12 million project under a multi-sectoral AIDS program (ZANARA) and US$20 million under its Malaria Booster project. In addition, IDA has carried out an ESW on human resources in the health sector (FY04) and plans a health sector PER in FY06. Building on this, IDA will provide support, but not necessarily financially for the Health Sector Support Program (SWAP) beginning in FY07. The improvement of water supplies under the Mine Township Services Project will also contribute to health outcomes in the areas served.

16. **In education**, the Bank is currently supporting the Ministry of Education's efforts through Adaptable Program Lending (APL). The APL1 Credit enables IDA funds to be devoted to a wide range of purposes in basic education and, following an amendment, to construct two high schools in the Eastern Province. The Bank is supporting expenditure effectiveness and efficiency in the sector through a public expenditure review (currently underway).

17. In the area of technical education, vocational, and entrepreneurship training (TEVET), the Government is carrying out reforms aimed at improving the quality of training, making it more responsive to labor market demand and financially sustainable. Reforms also aim at increasing the participation of female trainees and trainees from socio-economically disadvantaged groups. The Government's efforts in this area are being supported by an IDA Credit committed in FY01 and by several other partners.

18. **In agriculture and rural development**, the Bank's focus is two fold: improvement of productivity of the sector and increase of overall food security. The Bank is reengaging in the agricultural sector given the priority Zambia attaches to this sector, as set out in the PRSP/TNDP. Indeed, in a stable macroeconomic environment, if supporting infrastructure and adequate agricultural policy are in place, a major effort could be launched to unleash

growth and poverty reduction potential of the sector, in particular through well-targeted interventions for both smallholders and commercial agriculture.

19. Analytical and Advisory Activities (AAA) are planned to support the formulation of an agricultural policy consistent with the planned and ongoing projects in related sectors, such as roads and electricity, to remove bottlenecks that prohibit and or make difficult for farmers to produce for the market. Hence, the policy dialogue with the Government on reforms and priorities of public spending for agriculture and rural development will address both short run policy issues, as well as a long run strategy to tap the large agricultural export potential of the country, focusing on investment in land development, irrigation, and infrastructure. A balanced treatment of smallholders and commercial agriculture is important for growth and poverty reduction. As a follow-up to the AAA work, an Agricultural Support Project is planned to assist the Government with these challenges in FY06.

20. In addition, the Bank has assisted Zambia in developing an Integrated Framework for Disaster Relief and Mitigation–intended as multi-sectoral response to anticipate and address the impacts of climate shocks–under the recently closed Emergency Drought Recovery Project (EDRP). The aim was to increase food security and protect living conditions for the poorest and most vulnerable in targeted districts. Pilot programs are being designed to manage and protect against climate shocks, including dams and local irrigation, labor intensive public works, and agriculture input distribution programs. Feeding programs will be implemented in primary schools in a subset of districts; young children in Zambia are particularly at risk to high and rising levels of malnutrition.

21. The Bank supports **economic diversification** directly through its SEED project, which will assist implementation of a diversification strategy in the tourism, agribusiness, and gemstone sectors. In the initial phase, the SEED project will focus on supporting the design and establishment of appropriate policy and legal frameworks to encourage private investments in these three sectors, as well as investments, primarily in tourism-related infrastructure. The tourism component will work toward making Livingstone the flagship tourism destination in Zambia and strengthening management of national parks, which underpin Zambia's medium-term tourism development strategy. The interventions in the gemstones and agribusiness subsectors are focused to strengthen the supply chain that links rural/small-scale producers to local and export markets.

22. **Private sector development.** To improve Zambia's investment climate, the Bank and the IFC have assisted the Government with analytical work, notably an Investment Climate Assessment and a FIAS-led Administrative Barriers to Investment study. These studies are geared to facilitate the adoption of a new and more business friendly Investment Act and result in regular consultations between business and Government to discuss how to strengthen Zambia's business climate. As a result of this dialogue, the Government, with support from the Bank and the IFC, prepared a private sector development strategy. The strategy was developed through an interactive process, which included intensive

consultations with the private sector and other donors and coordination within the Government itself. Implementation of some of the reform actions identified in the strategy has already started through analytical support by the Bank and through programs funded by other donors.

23. In the **infrastructural sectors**, the Bank is assisting the authorities in the commercialization of ZESCO. Analytical work aims at identifying the main bottlenecks with regard to competition and effective service delivery. The policy recommendations and institutional changes would be supported through adjustment operations. In particular, the ongoing and proposed investment projects (Road Rehabilitation and Maintenance Project and the Water Sector Reform Project) would provide the financial resources needed for investments. Zambia will also benefit from the Southern African Power Pool Project.

24. **Environmental concerns** are addressed as part of each individual project as laid down in the Bank's safeguard policies. They are also addressed through the Bank's environmental project in the Copperbelt, which will assist Government with the cleanup of several hazardous sites in the Copperbelt and Kabwe area. The SEED project will assist the Government in making environmentally sustainable tourism in protected areas.

C.2. Areas in which the World Bank leads and its analysis serves as input into the IMF program

25. The Bank leads the dialogue on institutional dimensions of public expenditure management and financial accountability as well as public sector reform and restructuring and privatization. The Bank program will support these areas through a combination of lending and analytical work. In the area of **institutional dimensions of public expenditure management and financial accountability**, the Bank's long-term objective is to encourage a more transparent and accountable public sector by improving budget management, procurement systems, and the accountability for public funds. **The public sector reform and restructuring agenda** centers on instilling a more productive and efficient public service. To achieve this goal, reform efforts aim at promoting a more qualified and motivated civil service, developing a strategic management orientation in line ministries, improving policy coordination and implementation, and lastly, strengthening local government's capacity to participate in the development process.

26. While the Bank has taken the lead in **privatization**, the IMF has also a strong interest in these areas since many of the reforms are critical to achieving macroeconomic stabilization and enhancing Zambia's growth prospects. Accordingly, there is a high degree of consultation and coordination between the two institutions on these matters.

C.3. Areas of shared responsibility

27. The Fund and the Bank are working jointly in the following five areas (i) trade policy; (ii) financial sector reform; (iii) debt management and domestic debt market development; (iv) PRSP monitoring and evaluation; and preparation of a LIC debt sustainability analysis.

28. In the area of **trade policy,** the Bank, with collaboration from other partners, will undertake an integrated framework exercise. The Fund and the Bank jointly reviewed the Financial Sector Development Plan (FSDP). Follow ups on the FSAP and the FSDP will guide the Bank's policy dialogue and interventions in the **financial sector** in close collaboration with the IMF. The PRGF and the Economic Management and Growth Credit assist the Government on the resolution of three state-owned Non-Bank Financial Institutions and the strengthening of the operational independence of the Bank of Zambia.

29. Assistance in the areas of central government **debt management and domestic debt market development** will focus on reducing vulnerability and the cost of and the need for domestic financing. This work will draw from the Guidelines for Public Debt Management (published in March 2001) and the Handbook on Developing Government Bond Markets (published in July 2001). It will also benefit from an accompanying document to the Guidelines (prepared by the World Bank and the IMF), containing case studies from a range of countries at different stages of economic and financial development. The Bank, through its Treasury department, has under taken a debt management assessment and currently assists the Government in putting the recommended institutional changes in place.

30. The Fund and the Bank are working closely to review progress with Zambia's PRSP. The Bank and the Fund jointly prepared the Joint Staff Assessment (JSA) of the full PRSP (published in May 2002), the JSA of the first annual progress report (May 2004), and the Joint Staff Advisory Note on the second annual progress report (March 2005). Zambia reached its decision point in December 2000. Finally, the Fund and the Bank jointly prepared the HIPC-AAP document, monitored progress towards the completion point under the Enhanced HIPC Initiative, and prepared a debt sustainability analysis.

C.4. Areas in which the Fund leads and its analysis serves as input into the World Bank program

31. The Fund leads the dialogue on **macroeconomic framework,** in particular with regard to fiscal policy, advising the Government on the overall envelope for public expenditures, tax policy, as well as monetary and exchange rate policy. In these areas the Bank takes into account the policy recommendations of the Fund and ensures that its own policy advice, embedded in its adjustment operation (the Economic Management and Growth Credit), is consistent.

Table 2: IMF-World Bank Collaboration in Zambia

CAS Component	**Specialized advice from Fund**	**Specialized advice from World Bank**	***Key Instruments***
Goal: A growth conducive macro economic environment			
Subject: Economic Framework/ Management	Monetary policy; Financial sector reforms, exchange rate, fiscal policy and wage bill, debt management, balance of payments, economic statistics	Debt management; payroll management; Financial sector reforms	***IMF***: PRGF performance criteria and benchmarks on key monetary and fiscal targets and structural reforms ***Bank***: Ongoing portfolio: PSMP (FY06) New Lending : EMGC II (DPL) (FY07) ESW: Debt Management Assessment ***Jointly***: JSAN on PRSP progress report and debt sustainability analysis
Goal: A diversified and export oriented economy			
Subject: Private sector development; Trade and export diversification	Financial sector reform; trade policy; exchange rate policy	Economic growth, investment climate for private sector (infrastructure services, reforms of financial sector and pension funds, power and telecommunication sector reforms, vocational training), trade policy for export diversification, rural development, environmental regulations for the mining sector	***IMF***: PRGF performance criteria and benchmarks on key monetary and fiscal targets and structural reforms. ***Bank***: On-going Portfolio: Regional Trade Facilitation Project (FY00), TEVET (FY00), South Africa Power Pool (FY04) SEED (FY05), PMSP (FY06), ASDP (FY06). New Lending: EMGC II (DPL-FY07), Essential Bridge Rehabilitation Project (FY07), Water Sector Improvement Project (FY07), Increased Access to Electricity (FY08), ESW: Country Economic Memorandum (FY04), Investment Climate Assessment (FY04), ICT Options Study (FY06), Elements of effective regulations (FY07), trade in services (FY07) ***Jointly***: FSAP (FY02) and follow up, JSAN of PRSP progress report
Goal: Better health and long-term survival, with particular focus on at risk and vulnerable groups			
Subject: Health		Health Sector Expenditure Management. Provision of sustainable water services in provinces and districts	***Bank:*** On-going Portfolio: ZANARA (FY03), Malaria Booster Project (FY06); New Lending: Water Sector Improvement Project (FY07) ESW: Health Sector PER (FY06), Strategic Country Gender Assessment (FY04)
Goal: Reverse the spread of HIV/AIDS: decrease prevalence among it citizens			

Subject: HIV/AIDS		Behavioral change; education; prevention, care and risk mitigation services.	***Bank:*** On-going Portfolio: ZANARA (FY03), Aids Component BESSIP(FY00) New Lending: HIV/AIDS Corridor Project (Sub-regional project) (FY07) ESW: Social Safety Nets and Protection Strategy Note (FY04), Strategic Country Gender Assessment (FY04)
Goal: Better educated populace, with relevant job skills as well as academic training			
Subject: Education		Provision and quality of primary education	***Bank:*** On-going Portfolio: BESSIP I (SWAP) (FY99), TEVET(FY01) ESW: Education Sector PER(FY05)
Goal: Improved living conditions for poor/vulnerable households in drought prone areas			
Subject: Social Protection/ Risk Mitigation		Social protection and risk management systems	***IMF***: PRGF ***Bank:*** Ongoing Portfolio: SEED (FY04) New Lending: Water Sector Improvement Project (FY07): ESW: Poverty and Vulnerability Assessment, Strategic Country Gender Assessment, Social Safety Nets and Social Protection Strategy Note, Health Sector Review
Goal: Good governance and public sector management			
Subject: Public Expenditure	Medium-term budget framework, tax policy and administration. Arrears and commitment control	Public expenditure analysis, Capacity building in financial management and accountability	***IMF***: PRGF measures to put in place the IFMIS and to ensure timely reporting on budget execution ***Bank:*** On-going Portfolio: PSM (FY06), New Lending: EMGC II (FY07) Local Development Project (FY08); ESW: PEMFAR (FY03); ***Jointly***: HIPC AAP expenditure tracking assessment (FY04)
Goal: A productive and efficient public service			
Subject: Public Sector Reform and Restructuring		Pay reform, public sector restructuring	***Bank:*** On-going Portfolio: PSMP (FY05) New Lending: EMGC II (FY07), Local Development Project (FY08) ESW: PEMFAR(FY03), Governance Survey

Questions may be referred to Jos Verbeek (202-473-5539).

Zambia: Statistical Issues

1. Zambia is one of 15 countries participating in the Fund's General Data Dissemination System (GDDS) Project for Anglophone African Countries. GDDS metadata were posted on the Fund's Dissemination Standards Bulletin Board on November 1, 2002 and partially updated in June 2006.

2. Zambia's data provision is generally adequate, but there are serious shortcomings in data for national accounts, consumer prices, and balance of payments. The present arrangements for compiling macroeconomic statistics involve duplication of effort and insufficient coordination among the Bank of Zambia (BoZ), the Ministry of Finance, and the Central Statistical Office (CSO). The situation largely reflects resource constraints and organizational weakness within the CSO that have affected its ability to produce economic statistics on a timely basis.

3. A data module ROSC for Zambia, using the July 2003 DQAF methodology, was published on January 18, 2005 and is available on the IMF website.

Real sector statistics

4. The national accounts estimates are compiled according to the conceptual guidelines of the *1968 SNA*, but a phased approach to the introduction of the *1993 SNA* is planned. For the production approach, 1994 is the latest benchmark year for value-added ratios. For many important industry areas, such as wholesale and retail trade, construction, business services and many other service industries consisting mainly of small-scale private service providers, there are no appropriate indicators. In addition, the data currently available are mostly quarterly volume or quantity indicators of production. Data on total production and intermediate consumption of establishments are not available. On the expenditure side, there are no current indicators of household consumption, and private final consumption expenditure is derived residually. Source data for estimating gross fixed capital formation and changes in stocks are incomplete.

5. Current price estimates for both production and expenditure have been derived from the constant price indicators by using wholesale price indices (WPIs) and consumer price indices (CPIs) as deflators. However, for the most recent period, the WPI was no longer available and the CPI components were used throughout the system.

6. The CPI broadly adheres to international methodological standards. The classification system used for compilation closely follows the Classification of Individual Consumption by Purpose system. However, the frequency of the household budget surveys is not sufficient to capture changes in consumer expenditure structure on a timely basis. A rebasing of the CPI is planned for March 2007.

7. An IMF/DFID GDDS mission that visited Lusaka during February 2006 noted that the CSO has now obtained data comprehensive enough to enable it to produce a new benchmark for 2003. The authorities plan to conduct a comprehensive economic census to complete the rebasing of the national accounts in 2007.

Government finance statistics

8. Zambia's GFS data have not been updated since 2000. The most recent information available and published in the *GFS Yearbook 2004* is preliminary for 1998 and forecast for 1999. The data cover only budgetary central government. No monthly or quarterly fiscal data are reported for publication in *International Financial Statistics (IFS)*. The authorities report monthly budget data for the Fund's operational use in a timely manner but the data are often subject to substantial revisions later. Local government fiscal data are not available.

9. An IMF/DFID GDDS mission visited Lusaka in March 2003 to provide technical assistance to the Ministry of Finance and National Planning on fiscal issues. The mission provided advice on the initial steps toward migration to the methodology of the *Government Finance Statistics Manual 2001 (GFSM2001).*

10. An IMF/GDDS mission visited Lusaka again in April 2005 to assess the overall quality, coverage, and timeliness of fiscal data. The mission found that decentralization of government activities in earlier years had led to the creation of numerous extra-budgetary institutions. While the majority of these entities follow international accounting practices, they are not obliged to report to the Ministry of Finance. Currently an estimated 35 percent of government activities are not captured in the data. The mission also noted that the implementation of Integrated Financial Management and Information System (IMFIS) is a long-term project (full implementation is only expected towards 2009). Capacity constraints were noted regarding companies that are capable to implement the system as well as human resources.

Monetary and Financial statistics

11. There has been progress in the compilation of monetary statistics, and the monetary survey is published monthly. The BoZ has also eliminated discrepancies between its own records of IMF accounts and data from the Finance Department of the IMF.

12. In April 2003, the BoZ migrated completely to a new computing system for generating its monthly trial balance, which makes it possible to produce monetary accounts on a timely basis. An STA mission in May 2005 stated that the authorities had implemented most of the recommendations from a previous mission but BoZ was still recording deposits on a net rather than gross basis. There were also problems with the sectorization of public sector deposits reported by commercial banks.

13. Data reported by commercial banks are adequate, but the survey of other depository corporations should be expanded to cover four nonbank deposit-taking institutions. Furthermore, the BoZ should include in the survey the accounts of all the banks currently in the process of liquidation, classifying their deposits as restricted deposits and excluding them from broad money.

Balance of payments statistics

14. The quality of balance of payments data continues to be problematic, as data sources are poor and unreliable, and the methodology inadequate. The data ROSC found resources to be inadequate for developing source data through large surveys on a regular basis. The BoZ's responsibility to compile balance of payments statistics is not based on a legal act, as the CSO is legally responsible for compiling the balance of payments.

15. Significant gaps include data on reinvested earnings, trade credits, and changes in export proceeds held abroad by mining and nontraditional exporters. Source data are generally adequate in timeliness, but deficient in coverage. Because source data are insufficient to compile adequate data, estimation methods are used, some of which have remained unchanged for many years.

16. Data sources on private sector foreign assets and liabilities are insufficient to compile an international investment position statement.

Zambia: Table of Common Indicators Required for Surveillance
As of May 31, 2006

	Date of latest observation	Date received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of publication[6]	Memo Items:	
						Data Quality – Methodological soundness[7]	Data Quality Accuracy and reliability[8]
Exchange Rates	May 31, 2006	May 31, 2006	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	May 23, 2006	May 30, 2006	W	W	M		
Reserve/Base Money	May 23, 2006	May 30, 2006	W	W	F	LO, LO, LO, LO	LO, O, O, O, O
Broad Money	March 2006	May 15, 2006	M	M	M		
Central Bank Balance Sheet	March 2006	May 15, 2006	M	M	M		
Consolidated Balance Sheet of the Banking System	March 2006	May 15, 2006	M	M	M		
Interest Rates[2]	May 23, 2006	May 23, 2006	W	W	F		
Consumer Price Index	May 2006	May 31, 2006	M	M	M	O, LO, O, LO	LNO, LO, LO, LNO, LO
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	NA	NA	NA	NA	NA		
Revenue, Expenditure, Balance and Composition of Financing[3] – Central Government	March 2006	May 15, 2006	M	M	M	LO, LNO, LNO, LO	LNO, LO, O, O, LNO
Stocks of Central Government and Central Government-Guaranteed Debt[5]	Dec. 2005	April 21, 2006	M	M	A		
External Current Account Balance	2005	April 2006	A	A	A	LO, LNO, LNO, O	LNO, O, LNO, LO, LNO
Exports and Imports of Goods and Services	March 2006	April 2006	Q	Q	A		
GDP/GNP	2005	April 2006	A	A	A	LO, LO, LO, LO	LNO, LO, LNO, LNO, LNO
Gross External Debt	Dec. 2005	April 2006	Q	I	I		

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5] Including currency and maturity composition.
[6] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A); Irregular (I); or Not Available (NA).
[7] Reflects the assessment provided in the data ROSC published on January 2005 and based on the findings of the mission that took place during May 18-June 3, 2004 for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning (respectively) concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O), largely observed (LO), largely not observed (LNO), or not observed (NO).
[8] Same as footnote 7, except referring to international standards concerning (respectively) source data, statistical techniques, assessment and validation of source data, assessment and validation.

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International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes Fourth Review Under Zambia's PRGF Arrangement and Approves US$8.2 Million Disbursement

The Executive Board of the International Monetary Fund (IMF) completed the fourth review of Zambia's economic performance under a three-year Poverty Reduction and Growth Facility (PRGF) arrangement, which was approved on June 16, 2004 (see Press Release No. 04/117) in the amount of SDR 220.1 million (about US$326.6 million).

The completion of the review enables the release of a further SDR 5.50 million (about US$8.2 million), which will bring the total amount drawn under the arrangement to SDR 192.58 million (about US$285.8 million).

The PRGF is the IMF's concessional facility for low-income countries. PRGF-supported programs are based on country-owned poverty reduction strategies adopted in a participatory process involving civil society and development partners and articulated in the Poverty Reduction Strategy Paper (PRSP). This is intended to ensure that PRGF-supported programs are consistent with a comprehensive framework for macroeconomic, structural, and social policies to foster growth and reduce poverty. PRGF loans carry an annual interest rate of 0.5 percent and are repayable over 10 years with a 5½-year grace period on principal payments.