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Zambia: Fifth and Sixth Reviews Under the Poverty Reduction and Growth Facility Arrangement and Request for Waiver of Nonobservance of Performance Criteria—Staff Report; Press Release on the Executive Board Discussion; and Statement by the Executive Director for Zambia

In the context of the fifth and sixth reviews under the Poverty Reduction and Growth Facility arrangement and request for a waiver of nonobservance of performance criteria, the following documents have been released and are included in this package:

- the staff report for the Fifth and Sixth Reviews Under the Poverty Reduction and Growth Facility Arrangement and Request for Waiver of Nonobservance of Performance Criteria, prepared by a staff team of the IMF, following discussions that ended on April 2, 2007, 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 May 23, 2007. 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 as expressed during its June 8, 2007 discussion of the staff report that completed the reviews and request; and

- a statement by the Executive Director for Zambia.

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*
Poverty Reduction Strategy Paper
Technical Memorandum of Understanding*
*Also be 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

Fifth and Sixth Reviews Under Poverty Reduction and Growth Facility Arrangement and Request for Waiver of Nonobservance of Performance Criteria

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

Approved by Robert Corker and G. Russell Kincaid

May 23, 2007

Fund Relations. The Board approved a three-year PRGF arrangement on June 16, 2004, in the amount of SDR 220.1 million (45 percent of quota), of which SDR 192.6 million has been disbursed. On May 11, 2007, a request to extend the arrangement to September 30, 2007 was submitted to the Board on a lapse-of-time basis. The fourth review was completed on July 12, 2006. Zambia reached the completion point of the Highly Indebted Poor Countries Initiative in April 2005, under which it received SDR 508.3 million in total debt relief from the Fund, and in January 2006 received further debt cancellation from the Fund under the Multilateral Debt Relief Initiative in the amount of SDR 402.6 million.

PRGF Arrangement. The performance under the PRGF-supported program was broadly satisfactory despite some slippages. Staff recommends completion of the fifth and sixth reviews in view of the actions taken to correct program slippages. A disbursement of SDR 22 million will become available upon completion of these reviews.

Staff Team. Mr. Caramazza (head), Mr. Akatu, Mr. Dunn, Mr. Mikkelsen (all AFR), Mr. Goldsworthy (FAD), and Ms. Mongrut (PDR). The team was assisted by Mr. Kakoza and Mr. Arnason (resident representatives).

Mission Dates. October 18–November 1, 2006 and March 14–28, 2007.

Interlocutors. Minister of Finance and National Planning, Mr. Magande, Governor of the Bank of Zambia, Mr. Fundanga, other senior officials, and representatives of civil society, donors, and the business community.

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EXECUTIVE SUMMARY

The Zambian economy continued to grow at a robust pace. Growth picked up further in 2006, while overall inflation was at its lowest level in three decades. Inflation picked up in the first quarter of 2007, in part because of higher food and oil prices. Record high copper prices and extensive debt relief helped to strengthen Zambia's external position and allowed it to build up international reserves.

Performance under the program was broadly satisfactory despite some slippages, which the authorities have addressed. Specifically, the ceiling on net domestic financing was not met in June and December 2006, which contributed to the delay of the fifth review. Measures have been put in place to strengthen control of net domestic financing.

Discussions focused on macroeconomic policies for 2007. Fiscal policies will aim at consolidating macroeconomic stability while scaling up pro-poor spending in line with the Fifth National Development Plan launched in January. Net domestic financing will be reduced in keeping with the government's objective to lower domestic debt and crowd-in private sector investment. Monetary policy will be directed at reducing inflation to low single digits by next year.

The structural agenda will continue to focus on strengthening public expenditure management, tax reform, improving debt management, and financial sector development.

Risks to the program remain. While measures have been put in place to improve expenditure management and coordination, the authorities may still face difficulties until the new treasury functions are fully in place. Also, notwithstanding the significant absorption of liquidity in the first few months of 2007, achieving single digit inflation in 2007 will be a challenge.

I. Introduction

1. **Program slippages in late 2006 postponed the completion of the fifth review.** Net domestic financing was substantially higher than programmed in June and December 2006 and reserve money rose steeply late in the year. Furthermore, the fiscal accounts showed a large overfinancing of the budget. A mission in March 2007 resolved these issues and the authorities have prepared a Memorandum of Economic and Financial Policies (MEFP) that sets out the policies for the remainder of 2007 and beyond. To achieve the program objectives and allow time for completion of the final two reviews, the authorities requested that the PRGF arrangement be extended by three months, to September 30, 2007. The authorities expressed a strong interest in a follow-up arrangement to be discussed with staff later this year.

II. Strong Macroeconomic Performance But Problematic Budget Execution and Monetary Management

2. **Output growth was strong and inflation subdued in 2006, but budget execution was complicated by election year pressures and monetary expansion** (Table 1)**.**

- Vigorous expansions in mining and construction and a recovery in agricultural production boosted real GDP growth to an estimated 6 percent in 2006. Aided by stable food prices, annual average inflation was halved in 2006 to 9.1 percent. However, inflation picked up in the early months of 2007 (to 12.4 percent in April 2007) due to higher food and oil prices, excessive monetary expansion in the second half of 2006, and the pass-through effect of the depreciation of the kwacha on nonfood prices.

- Fiscal consolidation continued in 2006. Measured from below the line, the fiscal deficit, excluding grants, declined from 8.2 percent of GDP to 7.1 percent of GDP (Table 2 and 3). Total revenues were as programmed while grants were somewhat greater. Spending based on 2006 budget releases was considerably lower than programmed as capital expenditures fell well short of budgeted amounts.[1] This was reflected in lower-than-planned poverty-reducing spending. Revenues were in line with projections in the first quarter of 2007.

- Net domestic financing (NDF) persistently exceeded program ceilings by wide margins. This was due to the running down of large deposits (about 1.5 percent of

[1] The above-the-line fiscal deficit (5.9 percent of GDP) was thus significantly smaller than the below-the-line financing (7.1 percent of GDP).

Figure 1. Zambia: Selected Macroeconomic Indicators

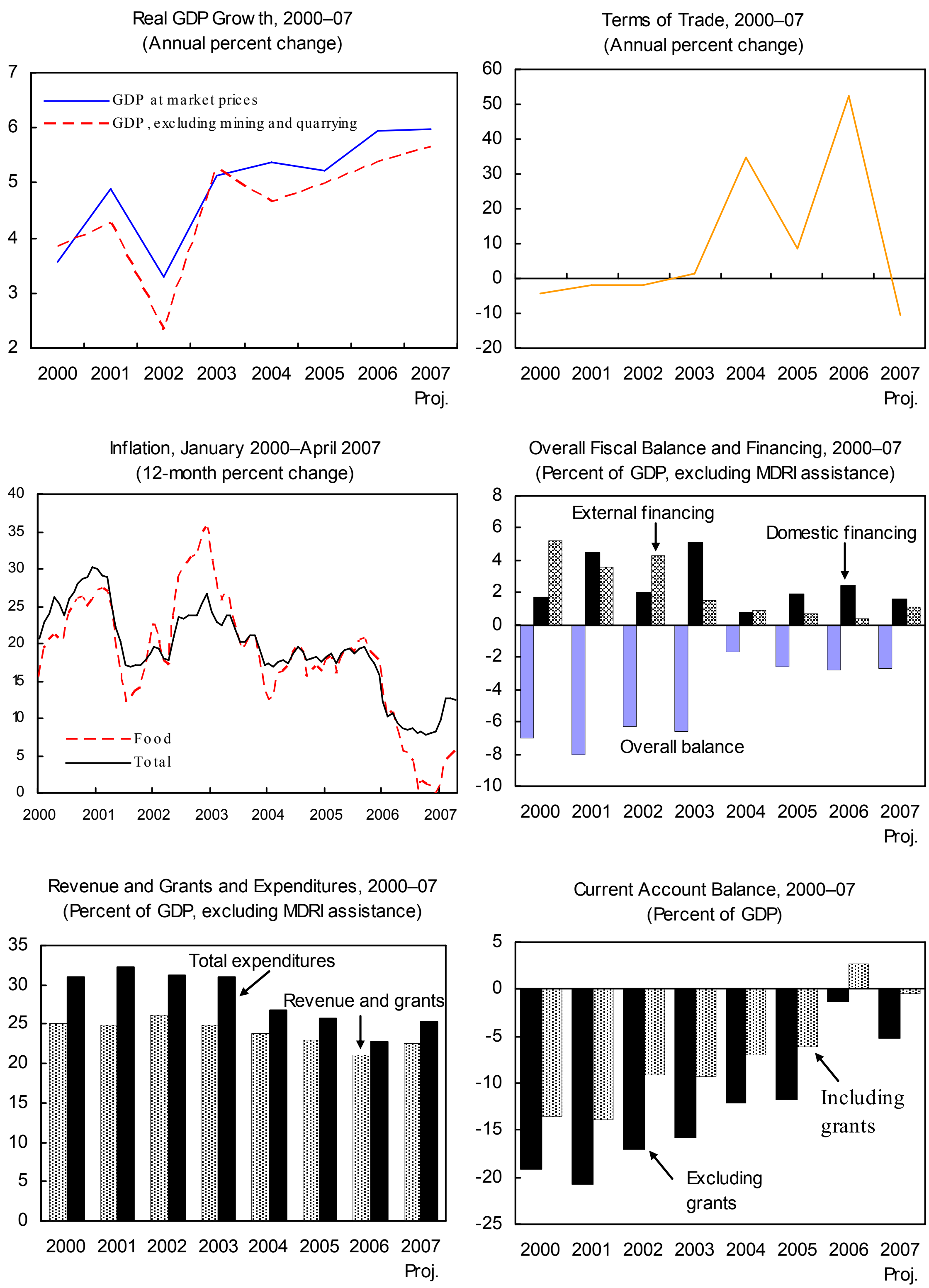
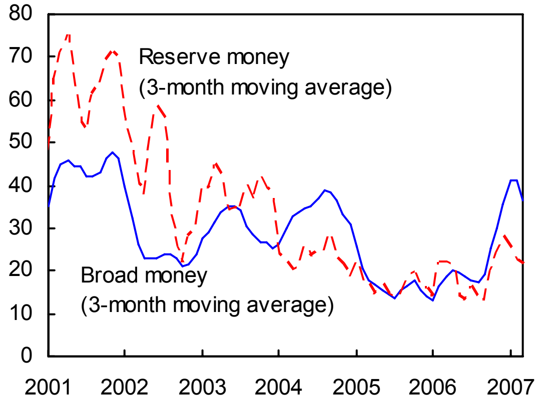
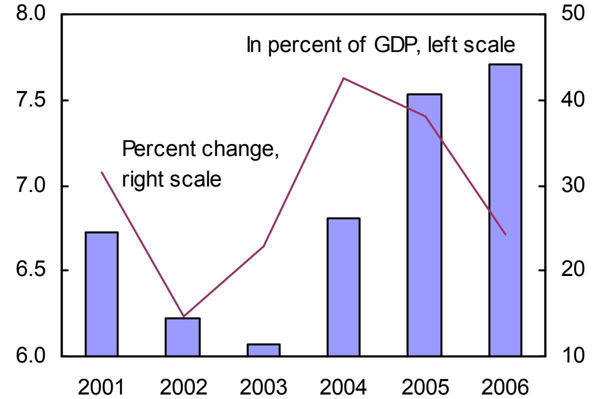


Figure 2. Zambia: Selected Financial Market Indicators

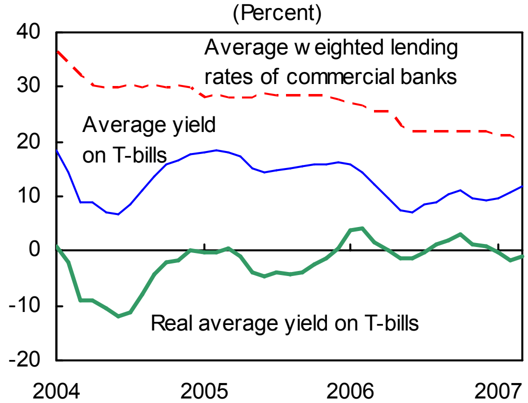
Reserve Money and Broad Money
Excluding Foreign Currency Deposits,
January 2001–February 2007



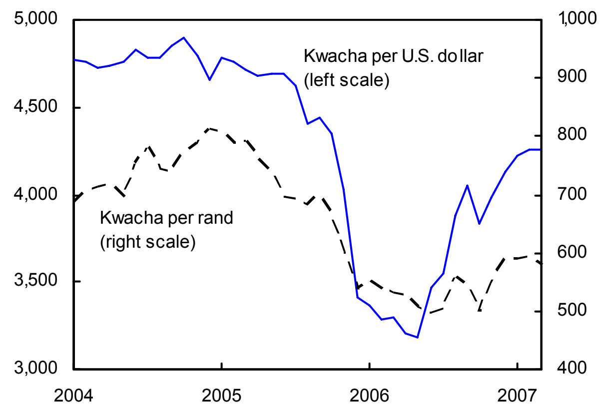
Private Sector Credit, 2001-2006
(Annual average)



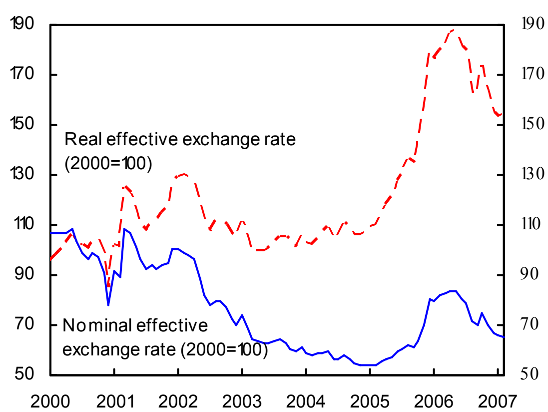
Treasury Bill Yields and Average Weighted Lending
Base Rates of Commercial Banks,
January 2004–March 2007
(Percent)



Exchange Rates,
January 2004–March 2007

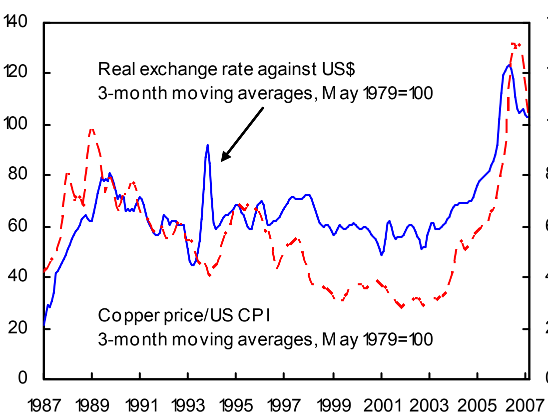


Effective Exchange Rates,
January 2000–February 2007[1]



[1] Excludes Zimbabwe.

Real Exchange Rate and Copper Prices,
January 1987–March 2007



GDP) containing budgetary releases made in 2005 that were not spent until 2006. To address the adverse impact on budget execution and monitoring of large carryovers of unspent budgetary releases from one fiscal year to the next, the government took a number of corrective measures. Notably, releases for capital projects after end-October 2006 were only made when payment was due. This and other measures successfully reduced the carryover of unspent budgetary releases into 2007 to 0.4 percent of GDP (1.1 percent of GDP lower than in the previous year), which explains almost entirely the 1.2 percent of GDP overfinancing of the 2006 budget. The large decline in the carryover, made it difficult to meet the NDF target at end-December 2006.

- Monetary policy was much more expansionary than envisaged particularly late in 2006 (Tables 4). Reserve money grew by about 30 percent during the year, as the Bank of Zambia (BoZ) was unable to fully sterilize the sizeable foreign exchange purchases made possible by a substantial improvement in the trade account. The range of monetary policy instruments was broadened in late 2006 with the conversion of the BoZ's claims on the government into tradable securities. In the first few months of 2007 monetary policy was brought back on track by a more active sterilization policy.

Monetary Policy Performance
(In billions of kwacha; unless otherwise indicated; valued at program exchange rates)

	2006						2007
	End-June		End-Sep.		End-Dec.		End-Mar.
	Prog.	Actual	Indicative Target	Actual	Prog.	Actual	Actual
Ceiling on increase in net domestic assets of the BoZ	-161	-274	-372	-137	-302	-453	-435
Floor on increase on gross international reserve of the BoZ (US$ million)	56	51	145	197	155	224	56
Reserve money (indicative target)	1,915	1,889	1,952	2,361	2,092	2,390	2,239

Source: Zambian authorities

- Yields on government securities fluctuated widely during 2006 as changes in sentiment toward emerging market assets and uncertainty about the elections affected investor interest in treasury paper. In the first four months of 2007, average yields rose as liquidity conditions tightened, but real yields remained slightly negative.

- The kwacha depreciated against the U.S. dollar by 21 percent in 2006, reversing part of the appreciation from 2005. This coincided with a change in market sentiment toward commodity currencies as copper prices came off their historic highs. Since the beginning of 2007 the kwacha has fluctuated in a narrow range; the average daily rate in April was 0.7 percent more depreciated than in December 2006.

- The current account deficit, excluding grants, narrowed by over 10 percentage points of GDP to 1.4 percent of GDP, as high copper prices and an expansion in the volume of copper exports boosted the value of exports (Table 5). Gross international reserves rose to 2.2 months of imports in 2006.

3. **Performance under the PRGF-supported program was broadly satisfactory.** All but two of the June and all but one of the December quantitative performance criteria were observed (MEFP, Table 1). Specifically, the ceiling on NDF was exceeded in June and December, and the accumulation of gross international reserves (GIR) fell short of the program floor by a small margin in June. Corrective measures have brought NDF and GIR back on track compared to the proposed quantitative targets for March 2007 agreed with the authorities during the review mission in October 2006.

4. **All but two of the structural performance criteria through March 2007 were observed (MEFP, Table 2).** Difficulties with contract negotiations delayed the piloting of the Integrated Financial Management and Information System (IFMIS) and the subsequent review (MEFP, ¶6). The contract for the installation of the IFMIS was signed in November 2006 and the fist phase of the pilot began in February 2007. Progress was made in implementing the structural benchmarks. The sale of 49 percent of the shares of Zambia National Commercial Bank was completed, but little progress was made on the resolution of the nonbank financial institutions.

III. Fiscal Space for Economic and Social Infrastructure Investment

5. **Zambia's key medium-term objectives are to further raise growth and enhance income opportunities for the poor.** The Fifth National Development Plan (FNDP)—which serves as Zambia's Poverty Reduction Strategy Paper (PRSP)—sets out the policy framework for meeting these objectives. The FNDP focuses on creating an environment that encourages private sector growth through macroeconomic stability, public sector accountability, and investments in infrastructure and human resources.

A. Macroeconomic Framework

6. **The medium-term outlook for the Zambian economy is favorable.** Real GDP in 2007–09 is projected to grow by 6–7 percent a year supported by major ongoing investments in the mining, manufacturing and electricity sectors. Sustained prudent fiscal and monetary policies will ensure a decline in inflation to the low single digits. The balance of payments is expected to weaken due to declining copper prices, but international reserves are still expected to increase to three months of imports by 2009.

7. **Fiscal space is required to increase poverty-reducing spending and improve infrastructure.** While pressing for more substantial scaling up of donor inflows than is currently projected, the authorities intend to improve revenue collection and restrain nonpriority spending. Revenues are expected to rebound to about 18 percent of GDP in 2009, reflecting higher collections from the mining sector and improved tax administration. Capital

spending is projected to recover to about 7 percent of GDP, while the fiscal deficit, excluding grants, is targeted to decline moderately to 6.3 percent of GDP in 2009.

B. Policies for 2007

Fiscal and monetary policies in 2007 will aim to consolidate macroeconomic stability while scaling up pro-poor spending in line with the FNDP.

Fiscal policy

8. **In keeping with the government's objective of lowering domestic debt and crowding-in private sector investment, net domestic financing of government will be reduced to 1.6 percent of GDP from 2.4 percent in 2006.** The overall budget deficit will remain roughly unchanged, but excluding grants will, widen somewhat, to 7.5 percent of GDP, reflecting a pickup in external financing. Revenues are projected to increase by about 1 percentage point, to 17.7 percent of GDP, because of higher company income tax (mainly from mining), higher excise and trade taxes (supported by a lower exchange rate), and enhanced tax compliance (supported by increased funding to the ZRA to increase staff and boost enforcement activities). There is a risk, however, that the yield from the additional resources to strengthen tax compliance will be smaller than envisaged. The fiscal program is consistent with the approved budget, except for capital spending, which is lower, notwithstanding the rebound, reflecting lower projected donor project loans. Nonetheless, capital spending, which was significantly curtailed in 2006, will rebound as the FNDP gets underway.

9. **The authorities will continue reforming the tax system and administration.** The aim is to build a modern tax system with a broad base, moderate and uniform tax rates, and a minimum of exemptions and preferences. As positive steps, the Government introduced in April 2007 a new tax framework for the mining sector and is committed to continue the modernization of ZRA (MEFP paragraphs 11–13). The Mines and Minerals Act will also be amended to avoid any fiscal terms in future development agreements. The authorities expressed their interest in participating in the Extractive Industries Transparency Initiative. The Government, however, intends to reintroduce tax holidays for companies operating in defined priority sectors and the multi-facility economic zones (MFEZs). The staff warned that these measures could undermine the revenue base over time, but the authorities emphasized their commitment to strictly circumscribe the granting of tax holidays.

10. **Poverty-reducing spending on infrastructure, agriculture, education and health will expand substantially.** Domestically financed, poverty-related spending is budgeted to rise significantly as the FNDP begins to be implemented. To ensure effective monitoring and evaluation of the increased capital expenditure, the government has developed a set of key performance indicators and will submit periodic reports to Cabinet on the implementation of FNDP projects.

Public expenditure management

11. **Public expenditure management and financial accountability (PEMFA) will be strengthened.** To enhance treasury and cash management and start moving towards establishing a treasury single account, the Ministry of Finance will create a Treasury Department and consolidate government accounts in commercial banks into a small number of accounts at the Bank of Zambia (MEFP, ¶15). Further, during the implementation phase of the IFMIS pilot, the authorities will enhance the existing financial management system. In particular, improvements to the commitment control system and cash flow management are critical for stemming the creation of new domestic arrears (MEFP, ¶17). Also, it is essential to advance the budget cycle so that the budget is approved before the start of the fiscal year.

Monetary and exchange rate policy

12. **The authorities will adopt a firm monetary stance in 2007 in support of the aim of reducing inflation to 5 percent over the medium term.** Reserve money growth is targeted at 6 percent in 2007. Taking into account the excess liquidity outstanding at end-2006, this would allow for a robust expansion in credit to the private sector. In view of inflation developments in the early months of the year, inflation is likely to subside slowly, but with the tightening of monetary policy that has already taken place and food prices remaining stable, it should be possible to achieve an end-year inflation rate of around 9 percent.

13. **Exchange-rate policy will continue to be based on a market-determined floating exchange rate.** The BoZ will continue to confine its foreign exchange operations to maintaining orderly market conditions and avoiding excessive exchange rate fluctuations, and rely on sterilized purchases to meet its international reserves target.

Financial sector development

14. **The authorities will renew their efforts to implement the Financial Sector Development Plan.** Several measures are planned aimed at enhancing the stability of the financial system and expanding access to financial services. Progress on a resolution of the state-owned nonbank financial services has lagged partly because of lack of resources (MEFP, ¶21).

Other structural policies

15. **A more conducive environment for doing business in Zambia is essential to sustain high economic growth.** Implementation of the private sector development initiative has focused on the creation of the Zambian Development Agency. While supporting the creation of a one-stop facility for investors, staff cautioned against the introduction of cost-ineffective tax incentives. In this regard, it noted that Zambia’s tax incentives are already regionally competitive. Strengthened corporate governance of state-owned enterprises,

notably those in telecommunications, electricity, and transportation, should improve the delivery of infrastructure services. While further liberalization of the telecom sector is needed to strengthen delivery of cost effective communication services, the authorities have been reluctant to change ZAMTEL's dominant position.

External debt

16. **The authorities are committed to strengthening debt management.** As a result of recently granted debt relief, Zambia's external public sector debt burden is benign.[2] In their effort to keep public debt at a sustainable level, the authorities have begun preparing a comprehensive debt management strategy (MEFP, ¶26).

17. **The authorities stepped up their efforts to reach understandings with official bilateral creditors on HIPC debt relief.** The authorities reported that a protocol was signed with China, an agreement with Russia is forthcoming, and Brazil and Bulgaria were recently contacted. Of the three commercial creditors that resorted to litigation on payment arrears, two have already been settled and the remaining one, Donegal International, was recently awarded US$15.4 million. The award potentially reduces resources available for poverty-reducing spending. The staff is of the view that the authorities are making a good-faith effort to settle external arrears to private creditors stemming from the past imposition of exchange controls.

C. Program Monitoring

18. **Quantitative performance criteria and structural performance criteria and benchmarks have been set through June 2007** (MEFP, Tables 1 and 2)**.**

IV. Staff Appraisal

19. **The authorities have done a creditable job of pursuing sound macroeconomic policies that have sustained robust growth and brought inflation down.** This was particularly difficult in an election year in which fiscal pressures were compounded by a large carryover of 2005 budgetary releases. But while macroeconomic stability was maintained, budget execution was problematic, and spending on PRPs was below target. Recent measures, however, have greatly reduced the carryover of unspent budget resources which should improve future budget management.

20. **The immediate challenge for the authorities is to reinforce macroeconomic and financial policies to consolidate macroeconomic stability and advance structural**

[2] See the debt sustainability analysis in the 2005 Article IV staff report (Country Report No. 06/39).

reform. The launch of the FNDP and the prospect of increased donor support together offer an opportunity for renewed efforts.

21. **Reforming the tax system to make it more buoyant, simpler, and equitable will be essential to create fiscal space for poverty-reducing spending.** More tax revenue will be needed over the medium term for the spending on infrastructure, agriculture, and the social sectors. Tax incentives that would narrow the tax base should be eschewed. The new fiscal regime for the mining sector is welcome.

22. **Better management of public expenditure is essential to ensure high returns on government spending.** The authorities are encouraged to step up implementation of the comprehensive PEMFA reform program. In particular, establishing a treasury single account and implementing the IFMIS will be key to further strengthening budget management and ensuring the continuation of a low level of carryover. It will also be critical to bring forward the budget cycle and have the budget approved ahead of the start of the fiscal year.

23. **Monetary policy will need to hold firm in 2007 to keep inflation subdued.** The BoZ should strengthen liquidity management and enhance the scope for sterilized intervention in the foreign exchange market.

24. **There has been notable progress in the implementation of the financial sector reforms,** but the difficulties of the state-owned NBFIs must be addressed more resolutely.

25. **The authorities are working to strengthen debt management.** Their approach to external borrowing is appropriately cautious, relying on highly concessional loans and ensuring that any new borrowing does not undermine debt sustainability.

26. **The private sector development initiative needs to be implemented more vigorously.** Constraints on doing business such as the cost of telecommunications and transportation must be eased. Improving corporate governance and the transparency of the parastatals that provide infrastructure will be important for ensuring that projects chosen have high returns.

27. **Staff recommends that the fifth and sixth reviews of the PRGF arrangement and the financing assurances review be completed.** Staff further recommends that the request for waivers for the nonobservance of five performance criteria be approved in view of the corrective actions taken.

Table 1. Zambia: Selected Economic Indicators

	2004	2005	2006 Prog.	2006 Prel.	2007 Proj.	2008 Proj.	2009 Proj.
	(In percent changes; unless otherwise indicated)						
National account and prices							
GDP at constant prices	5.4	5.2	6.0	5.9	6.0	6.2	6.1
GDP deflator	20.5	18.6	14.2	14.6	9.8	3.8	2.7
GDP at market prices	25,997	32,456	39,299	39,388	45,821	50,510	55,036
(in billions of kwacha)							
Consumer prices (average)							
Headline	18.0	18.3	9.2	9.1	11.3	5.7	5.0
Underlying (excluding food)	19.8	18.1	…	13.5	16.7	5.6	5.0
Consumer prices (end of period)	17.5	15.9	9.0	8.2	9.0	5.0	5.0
External sector							
Terms of trade (deterioration -)	38	9.5	18.3	57.9	-13.5	-21.8	-18.2
Average exchange rate (kwacha per U.S. dollar)	4,779	4,464	3,232	3,601	4,209	4,238	4,318
(in percentage change; depreciation -)	-1.0	6.6	27.6	19.3	…	…	…
Real effective exchange rate (depreciation -)[1]	3.0	24.1	…	32.3	…	…	…
Money and credit (end of period)							
Domestic credit to the private sector	47.7	18.7	15.4	54.7	18.0	…	…
Reserve money	21.1	10.2	10.3	29.5	6.0	…	…
M3	30.3	0.4	14.6	45.1	6.0	…	…
	(In percent of GDP)						
National accounts							
Gross investments	23.0	22.5	23.5	22.6	24.1	24.1	23.1
Government	8.7	7.0	4.8	3.9	6.0	6.4	7.0
Private	14.3	15.5	18.7	18.7	18.1	17.7	16.1
National savings	16.0	16.4	19.7	25.4	23.7	19.7	17.6
Gross foreign savings	7.0	6.1	3.8	-2.8	0.4	4.4	5.5
Central government budget[2]							
Overall balance	-1.7	-2.6	18.6	18.5	-2.7	-2.0	-1.9
(excluding grants)	-7.2	-8.2	-6.9	-7.1	-7.5	-6.4	-6.3
Revenue	18.2	17.4	16.8	16.8	17.7	17.9	18.0
Grants	5.5	5.6	25.5	25.7	4.8	4.4	4.5
Total expenditure[3]	25.4	25.6	23.7	23.9	25.2	24.3	24.3
External sector							
Current account balance							
(including official grants)	-7.0	-6.1	-3.8	2.8	-0.4	-4.4	-5.5
(excluding official grants)	-12.2	-11.8	-7.9	-1.4	-5.2	-8.8	-10.0
NPV of external public debt (including IMF)	176	80	13	12	12	14	17

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

[1]Excludes Zimbabwe.

[2]Grants in 2006 include MDRI debt cancellation amounting to 21.4 percent of GDP.

[3]Including discrepancy.

Table 2. Zambia: Fiscal Operations of the Central Government
(In billions of kwacha)

	2005	2006	2006	2007		2008	2009
				Jan-Jun			
		Prog.	Prel.	Prog.	Proj.	Proj.	Proj.
Revenue and grants	7,467	16,635	16,730	5,124	10,306	11,280	12,360
Revenue	5,642	6,622	6,618	3,822	8,125	9,043	9,908
Tax	5,512	6,382	6,317	3,666	7,807	8,683	9,517
Income taxes	2,455	2,993	2,960	1,693	3,491	3,889	4,290
Value-added tax	1,633	1,812	1,792	1,046	2,339	2,627	2,904
Excise taxes	768	936	821	491	1,104	1,217	1,326
Customs duties	656	641	744	436	874	951	997
Nontax	130	240	301	156	318	359	392
Grants	1,825	10,014	10,112	1,302	2,180	2,238	2,452
Budget support	543	310	423	541	582	648	713
Project grants	1,282	1,294	1,279	761	1,598	1,590	1,739
Debt reduction (including MDRI)	0	8,410	8,410	0	0	0	0
Expenditures	8,350	9,248	8,956	5,477	11,546	12,299	13,380
Current expenditures	5,828	7,129	7,167	3,781	8,380	8,830	9,335
Wages and salaries	2,455	2,967	2,833	1,676	3,535	3,971	4,366
Goods and services	1,249	1,652	1,760	786	1,744	1,961	1,898
Interest payments	865	799	749	320	705	654	609
Other	1,259	1,711	1,826	999	2,396	2,244	2,463
Capital expenditure	2,267	1,880	1,542	1,578	2,827	3,225	3,834
Of which: domestically financed	565	766	599	878	1,350	1,816	2,257
Domestic arrears payments	254	238	247	118	339	244	211
Discrepancy (-overfinancing)[1]	30	-50	-476	-162	0	0	0
Overall balance							
Including grants	-852	7,337	7,297	-515	-1,241	-1,019	-1,021
Excluding grants	-2,677	-2,677	-2,814	-1,817	-3,421	-3,256	-3,472
Financing	852	-7,337	-7,297	515	1,241	1,019	1,021
External financing (net)	241	-6,025	-6,225	176	498	413	470
Of which: budget support	84	45	36	0	167	127	130
Of which: debt reduction (MDRI)	0	-6,392	-6,392	0	0	0	0
Domestic financing (net)	611	-1,312	-1,073	339	743	606	550
Bank financing	-102	-1,893	-1,813	46	100	100	100
Of which: BoZ onlending of IMF MDRI relief	0	-2,018	-2,018	0	0	0	0
Nonbank financing	713	581	740	293	643	506	450
Memorandum items:							
Primary balance, including grants	12	8,136	8,047	-195	-536	-364	-412
Poverty-reducing spending[2]	1,995	2,638	2,356	…	4,096	…	…
External budget support	628	355	459	541	750	775	843
Stock of domestic arrears	947	685	878	760	539	295	84
Stock of domestic government securities	5,271	6,010	6,242	6,581	6,984	7,590	8,141
MDRI debt sevice savings	…	92	94	…	245	380	439

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

[1]Discrepancy largely reflects the net change in releases to line ministries that are not fully executed by the end of the year and thus are not reflected in the domestic financing figures until the following year.

[2]Excluding donor financed projects

Table 3. Zambia: Fiscal Operations of the Central Government
(In percent of GDP)

	2005	2006	2006	2007		2008	2009
				Jan-Jun			
		Prog.	Prel.	Prog.	Proj.	Proj.	Proj.
Revenue and grants	23.0	42.3	42.5	11.2	22.5	22.3	22.5
Revenue	17.4	16.8	16.8	8.3	17.7	17.9	18.0
Tax	17.0	16.2	16.0	8.0	17.0	17.2	17.3
Income taxes	7.6	7.6	7.5	3.7	7.6	7.7	7.8
Value-added tax	5.0	4.6	4.5	2.3	5.1	5.2	5.3
Excise taxes	2.4	2.4	2.1	1.1	2.4	2.4	2.4
Customs duties	2.0	1.6	1.9	1.0	1.9	1.9	1.8
Nontax	0.4	0.6	0.8	0.3	0.7	0.7	0.7
Grants	5.6	25.5	25.7	2.8	4.8	4.4	4.5
Budget support	1.7	0.8	1.1	1.2	1.3	1.3	1.3
Project grants	3.9	3.3	3.2	1.7	3.5	3.1	3.2
Debt reduction (including MDRI)	0.0	21.4	21.4	0.0	0.0	0.0	0.0
Expenditures	25.7	23.6	22.7	12.0	25.2	24.3	24.3
Current expenditures	18.0	18.1	18.2	8.3	18.3	17.5	17.0
Wages and salaries	7.6	7.5	7.2	3.7	7.7	7.9	7.9
Goods and services	3.8	4.2	4.5	1.7	3.8	3.9	3.4
Interest payments	2.7	2.0	1.9	0.7	1.5	1.3	1.1
Other	3.9	4.4	4.6	2.2	5.2	4.4	4.5
Capital expenditure	7.0	4.8	3.9	3.4	6.2	6.4	7.0
Of which: domestically financed	1.7	1.9	1.5	1.9	2.9	3.6	4.1
Domestic arrears payments	0.8	0.6	0.6	0.3	0.7	0.5	0.4
Discrepancy (-overfinancing)[1]	0.1	-0.1	-1.2	-0.4	0.0	0.0	0.0
Overall balance							
Including grants	-2.6	18.6	18.5	-1.1	-2.7	-2.0	-1.9
Excluding grants	-8.2	-6.9	-7.1	-4.0	-7.5	-6.4	-6.3
Financing	2.6	-18.6	-18.5	1.1	2.7	2.0	1.9
External financing (net)	0.7	-15.3	-15.8	0.4	1.1	0.8	0.9
Of which: budget support	0.3	0.2	0.1	0.0	0.4	0.3	0.2
Of which: debt reduction (MDRI)	…	-16.3	-16.2	0.0	0.0	0.0	0.0
Domestic financing (net)	1.9	-3.3	-2.7	0.7	1.6	1.2	1.0
Bank financing	-0.3	-4.8	-4.6	0.1	0.2	0.2	0.2
Of which: Onlending of IMF MDRI relief	0.0	-5.1	-5.1	0.0	0.0	0.0	0.0
Nonbank financing	2.2	1.5	1.9	0.6	1.4	1.0	0.8
Memorandum items:							
Primary balance, including grants	0.0	20.7	20.4	-0.4	-1.2	-0.7	-0.7
Poverty-reducing spending[2]	6.1	6.7	6.0	…	8.9	…	…
External budget support	1.9	1.0	1.2	1.2	1.6	1.5	1.5
Stock of domestic arrears	2.9	1.7	2.2	1.7	1.2	0.6	0.2
Stock of domestic government securities	16.2	15.3	15.8	14.4	15.2	15.0	14.8
MDRI debt sevice savings	…	0.2	0.2	…	0.5	0.8	0.8
Nominal GDP (in billions of kwacha)	32,456	39,299	39,388	45,821	45,821	50,510	55,036

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

[1]Discrepancy largely reflects the net change in releases to line ministries that are not fully executed by the end of the year and thus are not reflected in the domestic financing figures until the following year.

[2]Excluding donor financed projects

Table 4. Zambia: Monetary Accounts 1/
(In billions of kwacha; unless otherwise indicated)

	2005	2006				2007	
		Jun. Prog.	Jun. Act.	Dec. Prog.	Dec. Act.	Jun. Prog.	Dec. Proj.
				I. Monetary Survey			
Net foreign assets	-282	1,864	1,666	2,131	3,938	3,924	4,407
Net domestic assets	6,123	4,263	4,623	4,564	4,539	4,145	4,578
Claims on central government (net)	2,416	2,511	2,404	2,541	2,433	2,390	2,533
Claims on private sector	2,437	2,606	2,942	2,812	3,770	3,870	4,449
Claims on public enterprises	230	240	560	224	224	224	224
Other items (net)[2]	1,039	1,126	-1,263	1,181	-1,852	-2,339	-2,627
Money and quasi-money (M3)	5,841	6,127	6,289	6,695	8,477	8,070	8,985
Broad money (M2)	3,860	…	4,281	…	5,763	…	…
Foreign exchange deposits	1,981	…	2,008	…	2,714	…	…
				II. Bank of Zambia			
Net foreign assets	-1,235	1,351	1,283	1,631	2,792	2,778	2,968
Of which: IMF (net)	-3,057	-138	-110	-193	-182	-318	-356
Net domestic assets	3,132	564	645	461	-337	-441	-365
Claims on central government (net)	1,070	877	593	917	789	866	977
Claims on nongovernment	375	435	617	435	320	262	262
Claims on private sector	53	…	52	…	58		…
Claims on public enterprises	96	…	343	…	0		…
Claims on commercial banks	226	…	222	…	262		…
Other items (net)[2]	4,940	-748	-565	-891	-1,445	-1,569	-1,604
Reserve money	1,896	1,915	1,928	2,092	2,455	2,337	2,603
Currency outside banks and cash in vaults	962	…	999	…	1,224	…	…
Commercial bank deposits	926	…	924	…	1,223	…	…
Memorandum items:							
		(12-month percentage change over beginning period broad money)					
Monetary survey:							
Net foreign assets	29.0	83.9	81.3	41.3	72.2	35.9	5.5
Net domestic assets	-28.6	-80.0	-74.6	-26.7	-27.1	-7.6	0.5
Claims on central government (net)	-1.7	-2.3	-5.3	2.1	0.3	-0.2	1.2
Claims on private sector	6.6	-1.9	3.9	6.4	22.8	14.7	8.0
		(In 12-month percentage change; unless otherwise indicated)					
Reserve money	10.2	6.0	1.6	10.3	29.5	21.3	6.0
M3	0.4	3.9	6.6	14.6	45.1	28.3	6.0
Credit to the private sector	18.7	-4.0	8.3	15.4	54.7	31.5	18.0
M3-to-GDP ratio (in percent)	18.0	15.6	16.0	17.0	21.5	17.6	19.6
Money multiplier (M3/reserve money)	3.1	3.2	3.3	3.2	3.5	3.5	3.5
Credit to the private sector (in percent of GDP)	7.5	6.6	7.5	7.2	9.6	8.4	9.7
Gross foreign exchange reserves of the Bank of Zambia (in millions of U.S. dollars)	331	399	393	495	595	678	729
Exchange rate (kwacha per U.S. dollar)	3,509	3,509	3,569	3,509	4,407	4,407	4,407

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

[1]End of period.

[2]Include valuation and HIPC Initiative Account (balances were K3,253 billion and K2,209 billion at end-2005 and end-2006, respectively).

Table 5. Zambia: Balance of Payments
(In millions of U.S. dollars; unless otherwise indicated)

	2005	2006 Prog.	2006 Prel.	2007 Proj.	2008 Proj.	2009 Proj.
Current account	-861	-872	-62	-444	-942	-1,160
Trade balance	10	635	1,183	730	-43	-484
Exports, f.o.b.	2,221	3,374	3,819	3,793	3,268	2,908
Of which: copper	1,486	2,554	2,938	2,894	2,414	2,053
Imports, f.o.b	-2,211	-2,739	-2,636	-3,063	-3,311	-3,391
Of which: oil	-279	-413	-454	-431	-487	-514
Services (net)	-237	-442	-253	-262	-288	-298
Income (net)	-609	-1,067	-1,002	-940	-616	-378
Of which: interest on public debt	-110	-24	-17	-15	-12	-11
Current transfers (net)	-24	2	10	27	5	-1
Sector wide approach grants	0	87	90	117	106	112
Private transfers	-24	-85	-80	-90	-101	-113
Capital and financial account	723	1,469	907	359	909	1,065
Capital account	2,080	2,714	2,654	264	269	291
Project grants	287	311	250	264	269	291
External debt cancellation	1,793	2,403	2,403	0	0	0
Financial account	-1,357	-1,245	-1,746	95	640	774
Foreign direct and portfolio investments	380	438	350	447	411	417
Other investments	-1,737	-1,683	-2,096	-351	229	357
Medium and long-term	-1,737	-1,683	-1,946	-101	229	357
Public sector (net)	-1,882	-1,722	-1,788	79	67	79
Disbursements	136	152	83	111	94	104
Amortization due	-2,018	-1,874	-1,870	-32	-27	-25
Commercial banks (net)	91	13	56	0	0	0
Other sectors	54	26	-214	-180	161	278
Short-term	0	0	-150	-250	0	0
Errors and omissions	-147	0	-150	0	0	0
Overall balance	-284	597	696	-85	-33	-95
Financing						
Central bank net reserves (- increase)	-351	-706	-821	-93	-150	-100
Of which: gross reserve change	-109	-164	-264	-134	-150	-100
Of which: Use of Fund loans	-236	-542	-557	41	0	0
Exceptional financing	480	0	0	0	0	0
Program support	155	109	125	178	183	195
Grants	131	95	116	138	153	165
Loans	24	14	9	40	30	30
Financing gap	0	0	0	0	0	0
Memorandum items:						
Current account including total grants (in percent of GDP)	-6.1	-3.8	2.8	-0.4	-4.4	-5.5
Current account excluding grants (in percent of GDP)	-11.8	-7.9	-1.4	-5.2	-8.8	-10.0
Copper export volume (thousands of metric tons)	439	486	476	526	585	640
Copper export price (U.S. dollars per pound)	1.5	2.4	2.8	2.5	1.9	1.5
Net creditor/donor support (in percent of GDP)[1]	6.7	4.8	4.6	6.1	5.1	5.2
Of which: official grants	5.7	4.1	1.9	2.3	2.2	2.2
Gross international reserves (in milions of U.S. dollars)	331	495	595	729	879	979
In months of imports	1.5	1.7	2.2	2.4	2.7	2.9
GDP (in million of U.S. dollars)	7,271	12,160	10,939	10,887	11,919	12,747

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

[1]Defined as disbursements, plus grants, less debt service.

Table 6. 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	1-Aug-06	Board completed the fourth review based on observance of performance criteria for December 31, 2005.
11.0045	2.25	8-Jun-07	Observance of the performance criteria for June 30, 2006 and completion of the fifth review.
11.0045	2.25	8-Jun-07	Observance of performance criteria for December 31, 2006. and completion of the sixth review
5.5024	1.13	31-Aug-07	Observance of performance criteria for June 30, 2007.

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

APPENDIX I
LETTER OF INTENT

May 22, 2007

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

Dear Mr. de Rato,

The Government of the Republic of Zambia has been implementing a financial and economic program with support from the International Monetary Fund under the Poverty Reduction and Growth Facility (PRGF) since June 2004. The fourth review of the program was completed on July 12, 2006. The attached Memorandum of Economic and Financial Policies (MEFP) and Technical Memorandum of Understanding (TMU) reviews progress in implementing the program since the fourth review and sets out the policies that the Government will pursue in 2007 and beyond.

The Government's development strategy and policies will continue to focus on achieving high rates of sustainable economic growth, founded on a stable macroeconomic environment, and reducing poverty through wealth and job creation. In this regard, the Government will continue to implement prudent fiscal and monetary policies and structural reforms to support private sector development, strengthen further expenditure management, financial accountability, debt management, and improve governance and transparency. The resources made available by the Multilateral Debt Relief Initiative (MDRI) will be used to increase spending on priority areas in agriculture, infrastructure, water and sanitation, health, and education, in line with Zambia's Fifth National Development Plan 2006–10.

The Government requests the completion of the fifth and sixth reviews and the eight and ninth disbursements of the PRGF arrangement (each in the amount of SDR 11.0045 million). On the basis of the corrective actions it has taken, the Government requests waivers for the non-observance of the June and December 2006 performance criteria on net domestic financing (NDF) and the June 2006 performance criterion on gross international reserves. The higher NDF is explained by a larger-than-programmed reduction in the carryover of unspent budget resources.

Cognizant of the undermining effects of the large carry-over of unspent balances from one fiscal year to the next on budget execution and monitoring, Government took firm steps to address the problem. In November 2006, the Government introduced a number of measures to enhance Treasury and cash management. While these measures effectively eliminated the carryover of unspent balances at the end of 2006, the reduction in spending budgeted in 2006 that would have been required to meet the NDF ceiling was not possible within the last couple of months of the year.

Looking ahead, the strengthened Treasury and cash management measures will ensure a small carryover of unspent budget resources to the next fiscal year, which, in turn, will markedly improve our control of NDF. Furthermore, the liquidity effects of the NDF overrun in 2006 were mopped up by the Bank of Zambia in the first few months of the year. The small shortfall in the accumulation of official international reserves as of end-June was more than made up in subsequent months and gross international reserves substantially exceeded the program floor at end-December 2006.

The Government also requests waivers for the non-observance of the end-September 2006 and end-March 2007 structural performance criteria on implementation and reporting of the IFMIS pilots. Progress, albeit somewhat delayed, has been made on the IFMIS project. The contract for the installation of the IFMIS was signed in November 2006 and implementation of the pilot program began in January. To ensure a successful piloting and realize sooner the benefits of the project, the number of pilot sites has been increased from three to eight and the required functional training will be advanced. The preliminary review of the piloting of the IFMIS will be undertaken at the end of the pilot implementation phase, which will last about 18 months.

The Government of Zambia believes that the policies set forth in the attached MEFP are adequate to achieve the objectives of its program, and will take any further measures that may become appropriate for this purpose. The Government 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 fifth and sixth review under the PRGF arrangement and this letter and attached memoranda available to the public, including placement of these documents on the IMF website, subject to the removal of market-sensitive information, following the IMF Executive Board’s conclusion of the review.

Yours sincerely,

/s/

Ng’andu P. Magande, MP
Minister of Finance and National Planning

ATTACHMENT 1

Memorandum of Economic and Financial Policies

1. The current economic and financial program of the Government of the Republic of Zambia has been supported by the IMF through a three-year Poverty Reduction and Growth Facility (PRGF) arrangement. This memorandum reviews the performance of the program in 2006 and outlines the policies and targets that the Government will pursue in 2007 and the medium term.

I. PERFORMANCE IN 2006

2. **The Zambian economy continued to grow at a robust pace.** Sound macroeconomic policies and a favorable external environment have been major factors behind the improved performance in recent years. Annual real GDP growth is estimated to have increased to nearly 6 percent in 2006, led by solid expansions in mining and construction and a recovery in agricultural production. The annual average rate of inflation declined from 18.3 percent in 2005 to 9.1 percent in 2006—its lowest point in more than three decades—aided by stable food prices. The current account of the balance of payments recorded a marked improvement to an estimated overall surplus of 2.8 percent of GDP in 2006 from a deficit of about 6 percent of GDP in 2005. This was largely due to a steep rise in the value of copper exports as prices rose to record highs. Gross international reserves increased to 2.2 months of imports at end-2006 from 1.5 months a year earlier.

3. **Progress was made in implementing the PRGF-supported program in 2006.** As regards the quantitative elements of the program, all but two of the June and all but one of the December performance criteria and benchmarks were observed (Table 1). Specifically, the ceiling on net domestic financing (NDF) was exceeded by a large margin in June and December. The accumulation of gross international reserves fell short of the program floor by a small margin in June, but reserves significantly exceeded the program floor in December.

4. **Despite a strong effort to restrain spending, NDF persistently exceeded programmed ceilings by wide margins in 2006.** This was mainly due to the running down of large X-account deposits (which stood at K596 billion on January 1, 2006) for expenditures under the 2005 budget that were carried over to 2006. Cognizant that excessively large carryovers undermine budget execution and monitoring, the Government introduced a number of measures to enhance Treasury and cash management. These were described in circulars issued to all Controlling Officers. These circulars stipulated that releases for new capital projects would stop at end-October, except for capital projects where tender procedures had been completed. For ongoing capital projects, releases would only be made against certificates indicating that payments are due. In addition, efforts were made to front-load current expenditures in December. These and other administrative measures

effectively reduced the carryover at the end of the 2006 budget year, but the reduction in spending required to meet the NDF target was not possible within the last few months of the year. To further support the Government's efforts to strengthen budget execution and treasury management going forward, donors have agreed to disburse their budget support by the end of September. The carryover of unspent releases to the 2006 budget year amounted to 1.5 percent of GDP while the carryover to the 2007 budget year only amounted to 0.4 percent of GDP.[1] Notwithstanding the greater-than-programmed net domestic financing of Government, the fiscal deficit excluding grants declined by 1.1 percentage points to 7.1 percent of GDP in 2006**.** The lower deficit was largely related to a decline in donor-financed spending and interest payments.

5. **The programmed target for net domestic assets (NDA) of the Bank of Zambia (BoZ) was met in June and December 2006, but reserve money expanded at a much faster pace than projected, particularly late in the year.** The BoZ stepped up purchases of foreign exchange in the second half of 2006. As a result, the international reserve target at end-December 2006 was exceeded by about US$70 million, reversing the shortfall experienced at end-June. However, the liquidity generated by the build-up of international reserves and the spending of larger-than-projected resources from external budget support was only partially sterilized, resulting in a surge in reserve money to well above program projections. In part, this reflected the BoZ's limited scope to undertake sterilization operations. This deficiency began to be addressed in November with the agreement to convert a significant portion of BoZ's claims on the Government into marketable securities and to increase the tender sizes of government securities. In the first few months of 2007 the BoZ successfully mopped up the liquidity-overhang.

6. **On the structural program, all but two of the performance criteria through March 2007 were met (Table 2).** Difficulties with contract negotiations and in complying with procurement procedures resulted in slippages in the signing of the contract for the Integrated Financial Management and Information System (IFMIS). Consequently, the September 2006 and March 2007 performance criteria relating to the IFMIS were not observed. Implementation of the pilot program began in January 2007 and is expected to be completed over an 18-month period, at which time an evaluation of the system will be made. However, to maximize earlier realization of the benefits of the project, the number of pilot sites has been expanded from three to eight and functional training was advanced from Phase II to Phase I of the project. Most of the structural benchmarks were either met or met with some delay; however, little progress has been made on the resolution of the nonbank financial institutions because of a lack of budgetary resources. Agreement on the sale of 49 percent of the shares of Zambia National Commercial Bank was reached in December.

[1] The reported carryover of unspent budget releases includes checks that were issued through end-December but were not cleared by the Bank of Zambia until early January.

II. Policy For 2007 and the Medium Term

7. **The Government's key economic objectives are to further raise growth and enhance the employment and income opportunities for the poor.** The recently launched Fifth National Development Plan 2006–2010 (FNDP)—which serves as Zambia's Poverty Reduction Strategy Paper—sets out the policy framework for meeting these objectives. The FNDP emphasizes the need to create an environment that encourages private sector growth through macroeconomic stability, public sector accountability, and investments in infrastructure and human resources.

8. **The medium-term outlook for the Zambian economy is favorable.** Real GDP is projected to grow by 6-7 percent a year through 2010. Major investments in the mining, manufacturing, and electricity sectors are ongoing, while small and medium-sized enterprises are expected to gradually increase their contribution to growth and employment. Strong demand for housing is expected to bolster the construction sector. Furthermore, government policies to support agriculture and tourism, including infrastructure investments, should increase growth in these sectors. With sustained prudent fiscal and monetary policies, inflation is expected to be in the low single digits. The economy nevertheless remains vulnerable to shocks in the terms of trade and variations in rainfall patterns.

9. **Fiscal space needs to be created in the medium term to increase poverty reducing spending, develop infrastructure, and support other FNDP programs.** The Government intends to improve revenue collection and restrain non-priority spending. Revenues are expected to rebound to around 18 percent of GDP, reflecting higher collections from the mining sector and improved tax administration. Planned reforms to broaden the tax base will further increase revenues. Capital spending is projected to recover to about 7 percent of GDP in 2009. Net domestic financing of Government is projected to decline gradually over the medium term to 1 percent of GDP in 2009. This will help to lower interest rates and crowd-in private sector investment. The fiscal deficit excluding grants is projected to decline moderately to 6.3 percent of GDP in 2009. However, greater in-flows of external assistance than are currently projected are required to fully finance the FNDP.

A. Fiscal policies

10. **In 2007, net domestic financing of Government will be reduced to 1.6 percent of GDP from 2.4 percent of GDP in 2006, in part reflecting a pick-up in external financing.** Revenues are projected to increase by about 1 percentage point to 17.7 percent of GDP, owing to higher company income tax (mainly from the mining sector) and higher trade taxes supported by a lower and more stable exchange rate. Revenue is expected to be boosted also by the additional resources being provided to the Zambia Revenue Authority (ZRA) to recruit additional staff and enhance enforcement activities. Expenditures are assumed to rise to 25.2 percent of GDP, almost entirely on account of a rebound in capital spending to

6 percent of GDP. This increase, which is partly financed by additional donor inflows, covers implementation of FNDP projects, particularly in agriculture, education, infrastructure and health. The Government will ensure that proper monitoring and reporting procedures are in place and will submit periodic progress reports to Cabinet on the implementation of the FNDP projects. Further, spending on Poverty Reduction Programs (PRPs) will increase to about 12 percent of GDP in 2007.

11. **The ZRA has embarked on a modernization program to strengthen the effectiveness of tax administration.** The process of adopting an integrated and taxpayer-segmented organizational structure has already begun. A roadmap of reforms has been prepared and key appointments have been made, including a Commissioner for the new Domestic Tax Division (DTD) and a modernization project manager. Measures that will be implemented in the remainder of 2007 include establishing a Large Taxpayer Office, transferring domestic excise administration from customs to DTD, and expediting the roll-out and enhancement of the Integrated Tax Administration System (ITAS) software.

12. **The Government intends to provide incentives, including tax holidays, to priority sectors and for Multi-Facility Economic Zones (MFEZs).** These incentives, which are applied through the recently adopted Zambia Development Agency (ZDA) Act, are expected to have limited effects on revenue collection in 2007, as they apply only to new investments. To avoid significant long-term revenue losses, the Government will strictly circumscribe granting tax holidays and address the administrative challenge of ensuring correct reporting of profits by companies that have operations both inside and outside of the MFEZs. The Ministry of Finance and National Planning will develop a methodology to calculate tax expenditures, with a view to publishing in the future the revenue foregone from granting tax holidays and other exemptions.

13. **The Government will soon start discussions with the mining companies on re-negotiating existing development agreements with the aim of increasing revenues.** These discussions will be based on announced changes in the tax regime for the mining sector, including an increase in the income tax rate from 25 percent to 30 percent and the royalty rate from 0.6 percent to 3 percent of gross value, and withholding tax from 0 percent to 15 percent. Future development agreements will be based on the revised fiscal terms for the sector. The Government will also amend Section 9 of the Mines and Minerals Act to ensure that there shall be no fiscal terms in future development agreements.

14. **Enhancing transparency in the mining sector is important to ensure that available public resources from the sector are realized and used effectively.** To this end, the Government intends to adhere to the standards of the Extractive Industries Transparency Initiative. A working group will be established no later than end-June 2007 to move the process forward.

B. Public Expenditure Management

15. Stepped up implementation of the public expenditure management and financial accountability (PEMFA) program is critical for increasing the effectiveness and productivity of the public sector. To this end, the existing Financial Management System (FMS) will be enhanced given that the IFMIS is not expected to be fully operational in all Ministries, Provinces, and Spending Agencies (MPSAs) for another three years (the first eight pilot sites are expected to be fully functional by April 2008). As an immediate priority, the FMS will be made compatible with the 2007 budget, which is based on the 2001 Government Finance Statistics (GFS) classification. Subsequent enhancements, which will be completed by end-June 2007, include upgrading the software to a network based FMS and integrating the activity-based budgeting, funding, and cash flow forecasts and expenditure modules. The Government will proceed on moving towards establishing a Treasury Single Account (TSA) system, that could be in place by end-2008, to strengthen budget execution and cash management. In preparing for the TSA, the Ministry of Finance and National Planning will gradually consolidate government accounts in commercial banks into a limited number of accounts at the BoZ and create a Treasury Department by end-June 2007.

16. **Budget execution reports will continue to be published quarterly.** Beginning with the first quarter of 2007, the set of reports will include an analysis of budget provision, releases, and expenditures by functional classification, using the streamlined format agreed with the PEMFA JTWG. The usefulness of current reports has been hampered by the failure of various MPSAs to submit accurate monthly expenditure returns in a timely manner. Measures to enforce compliance will be stepped up, including withholding funding to those MPSAs that fail to submit the relevant returns in line with Section 17 of the Public Finance Act. Another issue that will be addressed, in conjunction with cooperating partners, is the need for donor project funding to be channeled through the financial management system. At present, donor project funding is included in the budget provision to MPSAs but excluded from releases and reported expenditure by the MPSAs, which makes it difficult to reconcile data on releases and expenditures with that on provisions.

17. **The Commitment Control System (CCS) and cash flow management will be strengthened in order to prevent the continued buildup of domestic arrears.** Notwithstanding significant payments of arrears in 2006, the stock of arrears was only slightly lower at end-2006 compared to the year before. The new arrears incurred reflected difficulties in cash flow management and shortfalls in releases relative to the agreed quarterly profile. To improve the monitoring of the CCS, the Accountant General will prepare, within 60 days of the end of each quarter, reports for the Secretary to the Treasury on compliance with the CCS by MPSAs. Particular attention will be given to preventing the accumulation of arrears on capital projects, especially roads, which currently accounts for two-thirds of the total stock of arrears. Efforts to ensure that MPSAs stay current on utilities will also be boosted, so as to put an end to the practice of MPSAs incurring arrears with ZESCO and

ZAMTEL and these parastatals in turn incurring tax arrears. In this regard, Government has allocated K36.3 billion to MPSAs for the payment of outstanding bills on utilities.

C. Monetary and Exchange Rate Policies

18. **The BoZ will continue with a firm monetary policy stance aimed at reducing the annual rate of inflation to 5 percent in the medium term.** While food prices and uncertainties about the pass-through effects of higher oil prices and the past depreciation of the Kwacha pose risks to the inflation outlook, tight monetary policy will contribute to keeping inflation on a downward trend. With the stepped up efforts in the first quarter of 2007 to mop up excess liquidity, end-period reserve money is targeted to grow by about 5 percent in 2007. This implies a pickup in reserve money growth for the last three quarters of the year to meet an expected increase in the demand for liquidity associated with the maize harvest and the accelerated implementation of capital projects. It will also accommodate a robust expansion in credit to the private sector of about 18 percent and a buildup of international reserves to 2.4 months of imports by end-2007.

19. **The Government remains committed to a flexible exchange rate regime.** The BoZ will confine interventions in the foreign exchange market to smoothening fluctuations in the exchange rate while allowing a gradual build-up of international reserves. In this regard, the BoZ will seek to continue to improve the operation of the foreign exchange market and encourage the development of hedging instruments. Steps being considered by the BoZ to further enhance stability in the market and primary dealerships and introducing the technological platform for real-time operation of the market.

D. Financial Sector Development

20. **While the banking sector remains generally healthy, banking supervision will continue to be vigilant.** Overall performance indicates that the system remains fundamentally sound. However, performance ratios relating to capital and earnings suffered in 2006 from increased non-performing assets, especially in agriculture as a result of the drought in 2004/2005 and the appreciation of the kwacha in late 2005 and early 2006. Performance so far in 2007 indicates a general improvement compared to end-December 2006. The BoZ is working to finalize risk management guidelines for banks and NBFIs, which would move supervision to a more pro-active framework. These guidelines are expected to come into effect in 2007.

21. **Progress has been made in the implementation of the Financial Sector Development Plan, which enters the second phase in 2007.** The agenda for 2007 includes completing a number of ongoing legislative and other reforms and embarking on some of the core reforms under the second phase of the program. Among these are the enactment of the Payments Systems Bill; the preparation of a law for credit reference bureau services—a follow up to the guidelines under which a credit reference service provider was licensed in

2006; and the finalization of a draft deposit protection law. The second FinScope survey on the supply-side of financial services will also be undertaken. The first, completed in 2006, was on the demand for financial services. These studies are expected to provide valuable input for the expansion of financial services to areas that currently are not being adequately met. As regards the resolution of Government-owned non-bank financial institutions, incorporation of the National Savings and Credit Bank and the Development Bank of Zambia under the Companies Act has been postponed until these institutions are on sounder footing. On the Zambia National Building Society, the BoZ is reviewing a revised strategic plan and will present a report to the Government before end-April 2007.

E. External Sector Outlook and Debt Management

22. **Medium-term prospects in the external sector will be affected by the projected decline in the price of copper.** Although a strong increase in copper export volumes arising from major investments in the sector will dampen the impact of falling copper prices, the deterioration in the terms of trade will result in higher current account deficits. By the end of 2009, official international reserves are envisaged to reach about 3 months of imports. This will help buffer against external shocks.

23. **Central Government foreign financing is expected to increase over the medium term.** Budget support is expected to increase by about US$50 million to US$178 million in 2007, while sector wide approach (SWAP) grants and project support (grants and loans) are projected to increase by about US$70 million to about US$492 million. Baseline projections are based on the assumption that total donor support to Zambia will reach US$652 million and US$702 million in 2008 and 2009, respectively.

24. **The Ministry of Finance and National Planning has prepared an Aid Policy and Strategy aimed at strengthening the efficiency of aid.** The paper has been circulated to the line ministries and will be submitted to Cabinet by end-June, so that implementation can begin later in the year. In line with this strategy, a foreign aid reporting and monitoring system will also be developed. As a first step, MoFNP will create an integrated database on external aid to ensure the reliability and comprehensiveness of the aid financing included in the budget.

25. **The Government will continue to pursue an open trade regime.** In line with the implementation of the SADC Trade Protocol, tariffs were further reduced in January 2007. The tariff phase down is scheduled to be completed by January 2008, when Zambia's imports from the region will be subject to zero tariff.

26. **The Government is committed to improving public debt management.** Following the sizeable improvement in Zambia's public debt indicators from the debt relief received under the Enhanced HIPC Initiative and the MDRI, public debt management will be further strengthened to ensure that a relapse into unsustainable public debt does not occur.

Reforms will continue to focus on implementing the recommendations provided by the World Bank in the 2004 Assessment Report. The following measures will be adopted:

- a comprehensive debt management strategy will be submitted to the Minister of Finance and National Planning by end-June 2007 (performance criterion);

- the public debt database will be improved further—the reconciliation of public external debt at end-2005 and end-2006 with Zambia's creditors on a loan-by-loan basis will be completed by end-June 2007;

- the contracting of non-concessional debt will be avoided until the capacity to assess the implications for debt sustainability is developed; and

- an action plan to deal with the on-lending transactions will be developed.

27. **Efforts to obtain debt relief under the enhanced HIPC Initiative from remaining creditors have been stepped up.** Of the three official bilateral creditors that have not provided HIPC debt relief, two creditors (Brazil and Bulgaria) have recently been contacted and relief from Iraq will be sought shortly. The Government will also seek full relief from India and continue discussions with Russia to obtain full debt cancellation. In February 2007, China signed a Protocol partially cancelling Zambia's Government debt due by end-2005.

F. Other Structural Reforms

28. **The Government is determined to create a more conducive environment for doing business in Zambia for both domestic and foreign investors.** In this regard, the newly established ZDA, which merged five agencies, will focus on streamlining licensing and other administrative procedures to create a one-stop shop for supporting investors in Zambia. At the same time, quality improvements in telecommunications, energy, and transportation infrastructure will be critical for increasing productivity and enhancing competitiveness. Given the role of public enterprises in the provision of infrastructure and other services, the highest standards for corporate governance and transparency will be instituted, including the timely payment of tax obligations and debt service owed to the Government, especially in companies undergoing a commercialization process, notably ZESCO and ZAMTEL.

G. Economic Statistics

29. **The Government will take steps to expand Zambia's capacity to collect and disseminate economic data.** At present, there are shortcomings in the quality of some of the economic statistics. The Central Statistics Office will update and rebase the national accounts and associated price indices in 2007. In support of this work, the pilots for the economic census will be completed in June and the rebasing will be finalized by end-2007. Similarly,

the BoZ and MoFNP will allocate sufficient resources to produce and maintain quality balance of payments and government finance statistics.

III. Program Monitoring

30. The tenth disbursement (in the amount of SDR 5.5024 million) under the PRGF arrangement will be based on the observance of quantitative and structural performance criteria through end-June 2007 (Tables 1 and 2).

Table 1. Zambia: Quantitative Performance Criteria (PC) and Indicative Targets Under the PRGF Program[1]
(Billions of kwacha, unless otherwise indicated)

	2006	2006						2007		
	Base	Jun			Dec			Base	Jun	Dec
		Prog	Act	Status	Prog.	Act	Status		Prog.	Indicative
Performance Criteria										
Ceiling on the cumulative increase in net domestic assets (NDA) of the Bank of Zambia[2, 4, 5]	2,911	-138	-274	Met	-241	-453	Met	-84	-357	-281
Adjusted ceiling		-161			-302					
Ceiling on the cumulative increase in net domestic financing (NDF)[2]	3,917	439	643	Not met	706	945	Not met	4,674	339	743
Adjusted ceiling		416			645					
Floor on the cumulative increase in gross international reserves (GIR)	342	58	51	Not met	153	224	Met	595	83	134
of the Bank of Zambia (Millions of U.S. dollars)[2, 3]					155					
Adjusted floor		56								
Ceiling on new external payment arrears		0	0	Met	0	0	Met		0	0
Ceiling of short-term debt and on contracting or guaranteeing of nonconcessional debt (millions of U.S. dollars)[6]		0	0	Met	0	0	Met		0	0
Floor on the cumulative payment of domestic arrears of the central government[7]		89	116	Met	238	247	Met		118	339
Indicative Targets										
Central government wage bill		1,385	1,304	Met	2,967	2,833	Met		1676	3535
Ceiling on the cumulative arrears on the Central Government wage bill		0	0	Met	0	0	Met		0	0
Memorandum items:										
Cumulative net balance of payments support (millions of U.S. dollars)		3.6	10.1		42.9	60.2			109.7	134.9
Balance of payments assistance		49.3	43.4		125.6	125.1			128.6	178.3
Central Government debt service obligations (excl. IMF)		-45.8	-33.3		-82.7	-65.0			-19.0	-43.4
Shortfall (–)/Excess (+) net BOP support			6.5			17.3				
Less shortfall in IMF disbursements						15.8				
Program exchange rates										
Kwacha/US$	3,509							4,406.7		
US$/SDR	1.429							1.485		

[1] The definitions of the items in the quantitative program are contained in the Technical Memorandum of Understanding (TMU).
[2] Adjusted for balance of payments support less debt service payments.
[3] The base for 2006 GIR corresponds to end-January 2006 stock; that for 2007 corresponds to end-December 2006 stock.
[4] Excludes HIPC debt relief from the IMF.
[5] The ceiling will be adjusted for changes in the legal reserve requirements.
[6] Nonconcessional loans are those having a grant element of less than 40 percent.
[7] This includes K100 billion for the payment of arrears to the Public Service Pension Fundin 2006 and K112 billion in 2007.

Table 2. Zambia: Structural Program for 2006 and 2007

Measure	Timing	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 in 2006
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 in 2006
The Investment and Debt Management Department (IDM) of the Ministry of Finance and National Planning (MoFNP) will verify the stock of onlending agreements with a view to effectively enforcing them. The IDM will report to the Secretary to the Treasury on validation of these agreements.	End-June 2006	Observed
Pilot an integrated financial management and information system (IFMIS) in at least three line ministries.	End-September 2006	Not observed Contract was signed in November 2006 and the piloting began in January 2007. The number of pilot sites has been expanded to eight.
Complete a diagnostic review of tax policy and administration.	End- December 2006	Observed
The IDM will verify the stock of government contingent liabilities, including loan guarantees, and pension obligations. The IDM will report to the Secretary to the Treasury on their validation.	End- December 2006	Observed
Report on the findings of a preliminary review of the piloting of the IFMIS in at least three line ministries.	End-March 2007	Not observed The review has been postponed since the new pilot will cover eight sites and take 18 months to complete.
Submit to the Minister of Finance a comprehensive debt management strategy	**End-June 2007**	
Benchmarks		
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 in 2006
Quarterly budget execution reports using the activity-based budgeting (ABB) classification will be published within 45 days of the end of each quarter, including summary tables developed in consultation with the PEMFA JTWG.	Continuous	Not observed ABB classification was used for the 2006:Q4 report. However, summary tables have yet to be published.
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	Not observed Format has been finalized and a draft report for 2006:Q4 produced but a final report has yet to be submitted to the Secretary to the Treasurer.

Table 2. Zambia: Structural Program for 2006 and 2007 (concluded)

Measure	Timing	Status
Issue new regulations and revised accounting manuals for the new Finance Act.	End-March 2006	Not observed The regulations were finalized and distributed by end-December 2006. The accounting manuals will be published by the end of June 2007.
Issue summary tables, developed in consultation with the PEMFA Joint Technical Working Group (JTWG), using activities based on budgeting classification and identifying poverty reducing programs.	End-March 2006	Observed with delay
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 MoFNP.	End-March 2006	Observed with delay
The MoFNP will issue an annual report on external debt management during 2005.	End-June 2006	Observed
Execute the action plan adopted by the Government on the resolution of the Zambia National Building Society (ZNBS).	End-June 2006	Not observed Budgeted resources were not sufficient. Resources are being provided in the 2007 budget.
Submit to Cabinet a proposal for laws establishing a credit reference bureau, including necessary amendments to privacy laws.	End-June 2006	Observed
ZESCO's management will provide all the financial, technical, and managerial information the World Bank and the IMF need to assess ZESCO's performance in line with the conditions for reaching the evaluation point under the commercialization process.	End-July 2006	Observed with delay
Submit to cabinet the first draft ("Green Paper") of the Medium-Term Expenditure Framework (MTEF) for 2007-2009.	End-August 2006	Observed
Incorporate the NSCB and DBZ under the Companies Act.	End- December 2006	Not observed Postponed until the finances of the institutions are sounder.

ATTACHMENT 2

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

I. INTRODUCTION

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 remainder of the program supported by the PRGF arrangement, as well as the related reporting requirements.

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

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

1. 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 for 2006 and 4,406.7 per U.S. dollar for 2007.[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 reserve liabilities (defined below). The kwacha values are derived from the U.S. dollar values using the program exchange rate.

2. 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.

3. 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 1 of the Memorandum of Economic and Financial Policies (MEFP), up to a maximum of US$35 million for the

[1] Unless otherwise defined, program exchange rates for 2006 and 2007 between the U.S. dollar and other (non-kwacha) currencies will be equal to the end-December 2005 and end-December 2006 rates, respectively. The U.S. dollar/SDR rate for program purposes is 1.4293 for 2006 and 1.485 for 2007. Any other assets (e.g., gold) would be revalued at their end-December 2005 market prices for 2006 and end-December 2006 for 2007.

period end-December 2006 to end-June 2007. External disbursements that occur anytime during the month of the test date will be treated as if they 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. The kwacha value of the cumulative shortfall/excess will be calculated at the program exchange rate.

4. 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)

5. **Net domestic financing (NDF) 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 outstanding amount of the long-term non-transferable security issued against the government's indebtedness to BoZ as at end-2002; plus

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

6. 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 1 of the MEFP, up to a maximum of US$35 million for the period end-December 2006 to end-June 2007. In the event of excess balance of payments support net of debt service, the ceiling on NDF will be

[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 Yellow Book for 2006 and 2007, respectively.

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.

7. 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

8. 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.

9. 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).

10. 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 1 of the MEFP, up to a maximum of US$35 million for the period end-December 2006 to end-June 2007; (ii) upward by 100 percent of the cumulative excess balance of payments support net of debt service; (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.

11. 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.

12. 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

13. The performance criterion on the non-accumulation of new external payment 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.

14. 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

15. 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. The use of IMF resources will be excluded from this performance criterion.

16. 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 performance criterion excludes non-concessional loans stemming from the rescheduling of external arrears.

17. 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

18. 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 nonconcessional 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).

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

G. Domestic Payment Arrears of Central Government

20. Domestic payment 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 15th 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 payment arrears in 2006 is payment of K 25 billion each quarter and K 26 billion in the first two quarters of 2007 toward Government's arrears on contributions to the Public Sector Pension Fund.

21. 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

22. For the purposes of the wage bill, the definition of Central Government includes all expenditure heads covered in the Yellow Book for 2006 and 2007 respectively. 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.

23. 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

24. The Debt Strategy Working Group, which include high level officials from MoFNP and BoZ, will submit a draft debt management strategy to the Minister of Finance by June 2007, including the following:

- ***Assessment of existing debt***: assessment of stock of public and publicly guaranteed debt as of end-2005 (composition by creditor, by maturity, and by currency) and description of main risks (interest, currency, and refinancing).

- ***Description of debt management practices during 2006*****:** objectives pursued, description of decision process, procedures and regulations for borrowing externally as well as domestically and granting of guarantees; and identification of debt management constraints, particularly on portfolio choice (including market development, lack of access to preferred source of funds, and implementation of monetary policy), and weaknesses.

- ***Identification of options for 2007 and changes envisaged with respect to previous year***: specify procedures and regulations that need to be changed; ways to address weaknesses; explicitly assign responsibilities for directly contracting public debt, guaranteeing public debt, and reporting. Describe the environment for debt management in 2007, including main macroeconomic assumptions used in 2007 budget (i.e.; GDP, interest rates, exchange rates) and 2007 fiscal projections. Determine the composition (external vs. domestic debt), maturity (short- vs. medium-term debt), concessionality, and currency (foreign vs. local) of envisaged 2007 financing operations.

- ***Formulate interim debt management strategy to be applied through 2008*****:** Set out objectives, scope of the interim strategy, role of the institutions involved, ability to borrow and accountability, procedures, and principles that should be taken into account when developing Zambia's medium-term debt management strategy. The strategy should also identify how to ensure high quality debt data and ways to strengthen risk management capacity. In addition, the Working Group should establish a timetable for developing and implementing Zambia's comprehensive medium-term debt management strategy.

ANNEX

Guidelines on Performance Criteria with Respect to Foreign Debt

Excerpt from Executive Board Decision No. 6230-(79/140), as revised on August 24, 2000

(a) For the purpose of this guideline, the term "debt" will be understood to mean a current, i.e., not contingent, liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Debts can take a number of forms, the primary ones being as follows:

(i) loans, i.e., advances of money to the obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans and buyers' credits) and temporary exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements);

(ii) suppliers' credits, i.e., contracts where the supplier permits the obligor to defer payments until some time after the date on which the goods are delivered or services are provided; and

iii) leases, i.e., arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the retains the title to the property. For the purpose of the guideline, the debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement excluding those payments that cover the operation, repair or maintenance of the property.

(b) Under the definition of debt set out in point 9 (a) above, arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt.

TMU Table 1. Zambia: Net Domestic Financing

	2006	2007
	End-Dec.	End-Dec.
		Program Base
Total domestic financing (program)		
Adjustment		
Adjusted program financing		
Excess/shortfall (- = excess)		
Total domestic financing		
Bank financing		
Commercial banks		
Treasury bills [1]		
Bonds [1]		
Loans and advances		
less: Support to MBZ		
less: Deposits		
Bank of Zambia		
Treasury bills [1]		
Bonds [1]		
Kwacha bridging loan		
GRZ position		
Donor suspense balance		
GRZ long-term security IFO BoZ		
Other		
Nonbank financing		
Treasury bills [1]		
Bonds [1]		

Source: BoZ net domestic financing table.

[1] Measured at cost (face value less discount).

TMU Table 2. Zambia: Gross International Reserves [1]

(In millions of U.S. dollars)

	2006 December			2007 March, June, September, December				
	12/31/2006 = Base			Current			31/12/07	
	Amount	Exch rate or price	U.S. dollars	Amount	Exch rate or price	U.S. dollars	Exch rate or price	U.S. dollars
Official reserve assets [2]								
Foreign Currency Reserves								
Securities								
In U.S. dollars								
In U.K. pounds								
In Euro								
Other currencies								
Deposits [3]								
In U.S. dollars								
In U.K. pounds								
In Euro								
In South African Rand								
Other currencies								
IMF reserve position								
SDR (excludes IMF interim assistance under the HIPC Initiative)								
Monetary gold								
Other reserve assets								
Memo: Other foreign currency assets [4]								
Predetermined short-term net drains [5]								
Liabilities to IMF								
Other foreign currency loans and securities								
In U.S. dollars								
In U.K. pounds								
In other currencies								
Aggregate short and long positions in forwards, futures and swaps								
Other								
Contingent short-term net drains								
Contingent liabilities								
Securities with embedded options								
Undrawn, unconditional credit lines								
Aggregate short & long term positions of options								
Memorandum items:								
Short-term domestic currency debt indexed to the exchange rate								
Financial instruments denominated in foreign currency settled by other means								
Pledged assets								
of which: Balance of IMF interim HIPC assistance								
Securities lent and on repo								
Financial derivatives (net, marked to market)								
Derivatives w/ residual maturity > 1 year, subject to margin calls								

[1] As defined in the TMU or IMF, "Data Template on Int'l Reserves and Foreign Currency Liquidity: Operational Guidelines."
[2] Corresponds to gross international reserves for program monitoring.
[3] Excludes deposits at resident banks, unless assets held abroad by the bank are explicitly connected to the foreign exchange deposits of the BoZ and are totally and effectively controlled by BoZ and are available for balance of payment needs.
[4] Includes foreign currency deposits at resident banks.
[5] The program target for gross international reserves will be adjusted as described in the TMU.

ANNEX I. RELATIONS WITH THE FUND
(As of March 31, 2007)

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	8.26	12.09

IV. **Outstanding Purchases and Loans:**	**SDR Million**	**Percent Quota**
PRGF arrangements	27.51	5.62

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	192.58
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				
	2007	2008	2009	2010	2011
Principal	…	…	…	0.55	3.30
Charges/interest	2.04	2.68	2.67	2.67	2.67
Total	2.04	2.68	2.67	3.22	5.97

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

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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.

Date	GRA	PRGF	Total
January 2006	N/A	402.59	402.59

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 authorities have taken the following steps in response to the recommendations made to address the weaknesses identified:

(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.

(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.

(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 market determined, with official foreign exchange intervention aimed at moderating the rate of change and preventing undue fluctuations in the exchange rate. 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); 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 2003)

Resident advisors

Department	**Dates**	**Position**
FAD	2002-2003	Advisor on public expenditure management

Technical assistance missions

Department	**Dates**	**Purpose**
MFD	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	June 2004	Data ROSC
	April–May 2005	Monetary Statistics (GDDS)
	May 2005	Government Finance Statistics (GDDS)
	February 2006	Real Sector (GDDS)
	July 2006	Real Sector (GDDS)
FAD	July–August 2005	Regulations for the Public Finance Act
	November 2005	Fiscal regime for copper mining
	July 2006	Revenue administration
	August 2006	Follow up on fiscal arrangements for the mining sector
	October 2006	Review of tax policy
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. Birgir Arnason has been the Resident Representative since November 2006.

ANNEX II. RELATIONS WITH THE WORLD BANK GROUP

A. Partnership for Development

1. World Bank support to Zambia is based upon the country's PRSP, which is prepared through a participatory process led by the government. The IDA and IMF Boards endorsed Zambia's first PRSP, covering the period 2002-2004, in May of 2002. The PRSP was then incorporated into the Transitional National Development Plan, 2002-2005 (TNDP), which was published in October 2002, by the new government that had taken office at the beginning of the year. The first and the second annual progress reports on the implementation of the PRSP were presented to the IDA and IMF Boards in May 2004 and April 2005, respectively, the latter of which coincided with Zambia's reaching the completion point under the enhanced HIPC Initiative. Zambia's Fifth National Development Plan 2006-10 (FNDP), which will serve as the country's revised PRSP, was approved by the cabinet in November 2006 and has been officially launched soon by the President in early 2007. In preparing the FNDP, the authorities held discussions with local leaders in all of Zambia's 72 districts. Sectoral Advisory Groups (SAGs) chaired by government officials with stakeholder representation were then tasked to draft the comprehensive document, which underwent a review by stakeholders in July 2006.

2. ***Debt relief.*** After reaching the HIPC completion point, Zambia was granted additional debt relief under the Multilateral Debt Relief Initiative (MDRI). Effective July 1, IDA credits that had been disbursed prior to 2004 were cancelled.

B. World Bank Group Strategy

3. 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. 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.

The Bank is in the process of preparing a new Country Assistance Strategy, which is planned to be discussed with its executive Board in the fall of 2007 and will be aligned with the FNDP as well as with the Joint Assistance Strategy for Zambia which is being prepared by the Cooperating partners as a response to the FNDP and the harmonization agenda as articulated in the Paris Declaration.

4. ***Lending operations***. In addition to ongoing Bank's lending operations in the areas of public sector reform, HIV/AIDS, malaria, education, agriculture, infrastructure, support

for diversification with an emphasis on tourism, and the environment, the CAS includes development policy lending (DPL)—the Economic Management and Growth Credit II—which is being prepared and to be presented for approval early next FY.

5. ***Country Diagnostic***. 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 completed are a Country Economic Memorandum (CEM), which was followed by a pro-poor growth study, an Investment Climate Assessment (ICA), an Administrative Barriers study (AB), a collaborative Poverty and Vulnerability Assessment (PVA), an integrated framework study for trade (DTIS), and a Strategic Country Gender Assessment (SCGA). In addition, a Public Expenditure Review for the education and health sector are currently being finalized and an assessment of competition and regulation in Zambia's infrastructure sectors has been initiated.

6. ***Projects under Supervision.*** IDA's active portfolio as of April 2007 contains 12 credits and grants for a total initial commitment of US$319.5 million. During FY05, two 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$37.2 mil.) were approved by IDA's Board. In FY07 a water and sanitation project (US$23 mil.) was approved and additional financing for the Road rehabilitation and maintenance project was approved in the amount of US$25 million.

7. 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.

8. 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

Table 1: Projects under Supervision

(As of April 2007)

(in US$ Millions)

Project Name		Strategic Focus	Approval FY	Net Comm Amt	Tot Disb	Undisbursed
SEED SIL (FY05)	Credit	Pillar 1	07/29/2004	28.2	8.6	20.8
GEF SEED Biodiversity	Grant	Pillar 2	07/29/2004	4.0	1.5	2.3
3A Southern Africa Power Market	Credit	Pillar 1	07/09/2004	1.1	0.8	0.4
Road Rehab Maintenance Project.	Credit	Pillar 1	03/09/2004	75.0	24.6	50.8
Copperbelt Environment	Credit	Pillar 1	03/20/2003	40.0	12.8	31.5
HIV/AIDS-ZANARA	Grant	Pillar 2	12/30/2002	42.0	38.5	11.6
TEVET	Credit	Pillar 2	06/14/2001	25.0	10.4	18.3
Regional Trade Fac. Proj. - Zambia	Credit	Pillar 1	04/03/2001	15.0	8.8	7.7
Malaria Booster program	Credit	Pillar 2	11/15/2005	20.0	2.4	18.2
Public Sector Management Program Support Proj.	Credit	Pillar 3	01/05/2006	30.0	0.4	30.2
Agricultural Development Support Program	Grant	Pillar 1	05/16/2006	37.2	5.6	33.0
Water Sector Performance Improvement Proj.	Credit	Pillar 2	10/05/2006	23.0	0.0	23.5

*Note that Total disbursements plus Undisbursed amounts do not necessarily add up to total commitments due to exchange rate fluctuations.

C. IMF-World Bank Collaboration in Specific Areas

9. 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.

10. The Fund and the Bank share 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

11. 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 with the aim of informing Zambia's next poverty-reduction strategy. For the same purpose, the Bank has undertaken a Poverty and Vulnerability Assessment

12. **HIV/AIDS, Malaria, and health.** At this time, IDA is assisting the Ministry of Health with a US$42 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 is to complete a health sector PER in FY07. 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.

13. **In education**, the Bank is currently supporting the Ministry of Education's efforts 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.

14. **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 has reengaged in the agricultural sector given the priority Zambia attaches to this sector, as set out in the PRSP/TNDP and in the forthcoming FNDP. Indeed, in a stable macroeconomic environment, if supporting infrastructure and adequate agricultural policies 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.

15. Analytical and Advisory Activities (AAA) have been undertaken 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. To support this effort

an Agricultural Development Support Project has been approved in FY06 to assist the Government with these challenges.

16. The Bank supports **economic diversification** directly through its SEED project, which is assisting 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.

17. **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 as well as other donors, 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.

18. In the **infrastructural sectors**, the Bank is assisting the authorities in the commercialization of ZESCO, Zambia's electricity conglomerate as well as its ability to build and maintain roads. 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.

19. **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

20. 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.

21. 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

22. 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.

23. 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. An FSAP update is planned for 2007.

24. 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. The Bank, through its Treasury department, has under taken a debt management and debt market development assessment (FY05) and currently assists the Government in putting the recommended institutional changes in place.

25. 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 Note (JSAN) on the third annual progress report in December 2006 and are in the process of finalizing the JSAN for the Zambia's second PRSP i.e. the Fifth National Development Plan. Finally, the Fund and the Bank jointly prepared a LIC DSA in late 2005. Zambia reached HIPC completion in April 2005 and its completion point document contained also debt sustainability analysis.

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

26. 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 (FY03-FY07)

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 new PRSP, 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), Water Sector Improvement Project (FY07). New Lending: EMGC II (DPL-FY08), and 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) FSAP update (FY07/08), JSAN of PRSP progress report and new PRSP
Goal: Better health and long-term survival, with particular focus on at risk and vulnerable groups			
Subject: Health		Health Sector Expenditure Management.	***Bank:*** On-going Portfolio: ZANARA (FY03), Malaria Booster Project (FY06), Water Sector Improvement Project (FY07); ESW: Health Sector PER (FY07), 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); 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: 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) 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: PSMP (FY06), New Lending: EMGC II (FY08), 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 (FY06) New Lending: EMGC II (FY08), Local Development Project (FY08) ESW: PEMFAR(FY03), Governance Survey

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

ANNEX III. STATISTICAL ISSUES

1. Data are generally adequate for surveillance purposes, but there are serious shortcomings in the national accounts, balance of payments, and consumer prices. 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 National Planning (MFNP), 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.

2. Resource constraints have also hampered the capacity to absorb technical assistance (TA) in statistics. A STA mission visited Lusaka in October 2006 to discuss ways to enhance the effectiveness of technical assistance. Discussions with the authorities and donors focused on the need to implement a number of the 2004 data ROSC mission's recommendations and address the inadequate resources that have hampered the effectiveness of TA, particularly in the area of balance of payments statistics. The authorities committed to augment resources to support the compilation and dissemination of national accounts, prices, balance of payments and government finance statistics (GFS) and implementation of outstanding data ROSC mission recommendations.

3. Zambia participates in the General Data Dissemination System (GDDS) and the GDDS Project for Anglophone African Countries. Metadata were posted on the Dissemination Standards Bulletin Board on November 1, 2002 and partially updated in June 2006.

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 reliable 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. An IMF/DFID GDDS mission that visited Lusaka during February 2006 noted that the CSO had obtained data comprehensive enough to enable it to produce a new benchmark for 2003. A follow-up mission in July 2006, however, found that little progress

had been to produce the new benchmark. The authorities plan to conduct a comprehensive economic census to complete the rebasing of the national accounts in 2007.

6. Current price estimates for both production and expenditure have been derived from the constant price indicators using wholesale price indices (WPIs) and consumer price indices (CPIs) as deflators. However, for the most recent period, the WPI were not available and the CPI components were used throughout the system.

7. The CPI broadly adheres to international methodological standards. The classification system used for compilation closely follows the Classification of Individual Consumption by Purpose. 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.

Government finance statistics

8. The most recent information on public finances provided to STA for redissemination in the *GFS Yearbook 2005* is preliminary data for 1998 and projected data for 1999 covering only the budget of the central government. No monthly or quarterly fiscal data are reported for publication in *International Financial Statistics (IFS)*. The authorities report monthly budget data to AFR for operational use in a timely manner, but the data are often subject to substantial revisions, and data on extrabudgetary institutions and local governments are not available.

9. An IMF/DFID GDDS mission visited Lusaka in March 2003 to provide technical assistance to the MFNP on government finance statistics and to advise on 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 MFNP. 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 (IFMIS) is a long-term project with an expected completion date of 2009.

Monetary and financial statistics

11. In 2003, the BoZ migrated to a new computing system for generating its monthly trial balance, which makes it possible to produce monetary accounts on a timely basis. The BoZ has also eliminated discrepancies between its records and those of the IMF's Finance Department and it now publishes a monetary survey on a monthly basis. And, beginning in January 1993, monetary data are reported to STA using its standardized report forms.

12. A monetary statistics mission in May 2005 found that the authorities had implemented most of the previous recommendations by STA with one notable exception, overdrafts were still being netted against deposits. The institutional coverage of other depository corporations has been expanded to include commercial banks (including three banks in liquidation), building societies, and the National Savings and Credit Bank. Data reported by commercial banks are considered generally adequate, but there are some problems in the sectorization of public sector deposits, resulting in some central government deposits in national and foreign currencies being included in the definition of broad money. Also, some other depository corporations record repurchase agreements as the outright buying or selling of the securities, rather than as collateralized loans. Deposits of three banks that are currently in the process of liquidation are classified as restricted deposits and excluded from broad money.

External sector statistics

13. Balance of payments statistics are compiled and presented by the BoZ in accordance with the fifth edition of the Balance of Payments Statistics Manual. Legally, however, the CSO is legally responsible for compiling all macroeconomic statistics. Reporting of balance of payments statistics for redissemination by the IMF remains problematic. The most recent balance of payments data reported to STA are for 2000. Intentional Investment Position data are not compiled.

14. The 2004 data ROSC mission found data sources poor and unreliable, while compilers were using inadequate methodologies. Furthermore, it found staffing inadequate to ensure absorption of further technical assistance. In October 2006, the authorities agreed to provide more enough staff for the compilation of balance of payments statistics to ensure absorption prior to the provision of additional technical assistance in this area.

15. Significant gaps in data exist in various areas including: reinvested earnings, trade credits, and export proceeds held abroad by mining and nontraditional exporters. Source data are generally adequate in terms of timeliness, but fall short in terms of coverage. Because shortcomings in source data, estimation methods are used, some of which have remained unchanged for many years. Also, data on services, income and transfers are incomplete and there are inadequate valuations of account items. 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 8, 2007

	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	Dec. 2006	Jan. 15, 2007	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	Dec. 2006	Jan. 15, 2007	W	W	M		
Reserve/Base Money	Mar.2007	May 4, 2007	W	W	F	LO, LO, LO, LO	LO, O, O, O, O
Broad Money	Mar.2007	May 4, 2007	M	M	M		
Central Bank Balance Sheet	Mar.2007	May 4, 2007	M	M	M		
Consolidated Balance Sheet of the Banking System	Mar.2007	May 4, 2007	M	M	M		
Interest Rates[2]	Mar.2007	May 4, 2007	W	W	F		
Consumer Price Index	Apr. 2007	Apr. 24, 2007	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				LO, LNO, LNO, LO	LNO, LO, O, O, LNO
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	Dec. 2006	Mar, 2007	M	M	M		
Stocks of Central Government and Central Government-Guaranteed Debt[5]	Dec. 2005	Apr. 21, 2006	M	M	A		
External Current Account Balance	2006	Mar. 2007	A	A	A	LO, LNO, LNO, O	LNO, O, LNO, LO, LNO
Exports and Imports of Goods and Services	Dec. 2006	Mar. 2007	Q	Q	A		
GDP/GNP	2006	Mar. 2007	A	A	A	LO, LO, LO, LO	LNO, LO, LNO, LNO, LNO
Gross External Debt	Sep. 2005	Mar. 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 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 of intermediate data and statistical outputs, and revision studies.

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FOR IMMEDIATE RELEASE
June 8, 2007

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes Fifth and Sixth Reviews Under Zambia's PRGF Arrangement and Approves US$33.4 Million Disbursement

The Executive Board of the International Monetary Fund (IMF) completed the fifth as well as the sixth and final review of Zambia's economic performance under a Poverty Reduction and Growth Facility (PRGF) arrangement. The completion of the reviews enables the release of a further amount equivalent to SDR 22 million (about US$33.4 million).

The Executive Board also approved the request for waivers for the nonobservance of performance criteria in view of the corrective actions taken. These include the end-June 2006 and end-December 2006 quantitative performance criteria on net domestic financing of the central government; the end-June 2006 quantitative performance criterion on gross international reserves of the Bank of Zambia; and the end-September 2006 and end-March 2007 structural performance criteria on the initiation of the piloting of the Integrated Financial Management and Information System (IFMIS).

The PRGF arrangement was approved on June 16, 2004 (see Press Release No. 04/117) in the amount equivalent to SDR 220.1 million (about US$333.6 million). On May 25, 2007 a request to extend the original three-year arrangement to September 30, 2007 was approved by the Board on a lapse-of-time basis.

Following the Executive Board discussion, Mr. Takatoshi Kato, Deputy Managing Director and Acting Chair, said:

"The Zambian authorities are to be commended for pursuing sound macroeconomic policies that have sustained robust economic growth and achieved a marked reduction in inflation. High copper prices and extensive debt relief have helped to strengthen Zambia's external position and allow a build up of international reserves.

"Going forward, the challenge for the authorities is to consolidate macroeconomic stability and implement structural reforms to raise productivity and diversify the economy. Continued prudent fiscal policy is needed to restrain the growth of government domestic debt, while monetary policy will need to remain firm in the months ahead to keep inflation on a downward path. Better coordination between fiscal and monetary policy will help improve liquidity management.

"It will be important to press ahead with tax reform to broaden the tax base while making the tax system simpler, more efficient, and equitable. Higher levels of tax revenue will be required over the medium term to accommodate spending on infrastructure, agriculture and the social sectors as envisaged in the Fifth National Development Plan.

"The public expenditure management and accountability reforms being implemented are essential for the successful implementation of the government's poverty-reducing programs and the effective use of public resources more generally. Budget execution and reporting, which are key elements of the reform, will be greatly enhanced by the planned establishment of a treasury single account and implementation of the integrated financial management and information system. Strengthened debt management will help ensure that new borrowing does not undermine debt sustainability.

"To foster diversification of the economy and boost economic growth and employment, it will be important to implement vigorously the economic reform agenda set out in the Fifth National Development Plan, particularly the measures to stimulate the private sector development," Mr. Kato said.

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.

Statement Peter Gakunu, Executive Director for Zambia and Dieudonne Nintunze, Senior Advisor to Executive Director
June 8, 2007

Introduction

1. Despite the difficulties and challenges of an election year, the Zambian authorities remained steadfast in pursuing prudent economic and financial policies that are fostering macroeconomic stability. The ongoing deepening of structural reforms under the three broad initiatives, namely, the public sector reform, whose important component is the public expenditure management and financial accountability (PEFMA) program; the financial sector development plan; and the private sector development initiative; is translating into the broadening of the sources of growth and employment creation, with marked recovery and expansion in the mining, construction, agriculture, and services sectors.

2. Overall, program implementation supported by the PRGF arrangement remained broadly on track, except for the non-observance of two quantitative and structural performance criteria, but for which the authorities have undertaken corrective measures. The ceiling on Net Domestic Financing (NDF) was exceeded as at end June and end December, despite a strong effort to restrain government spending. This was mainly due to a long standing structural problem in the budget cycle of large carry-overs of unspent budgetary releases from the previous year. The authorities are aware that excessively large carry-overs undermine budget execution and monitoring. They have, therefore, taken corrective measures aimed at enhancing Treasury and cash management, which include specification of the releases deadlines, and strict procedures in certifying due payments. Also, the provisions of the Public Finance Act with regard to idle or excess funds in commercial bank accounts will be strictly adhered to. These measures are yielding results as they contributed to effectively reducing the carry-overs from 1.5 percent of GDP in January 2006 to 0.4 percent in January 2007. As regards to the floor on gross international reserves, there was a marginal shortfall in its accumulation as at end June, but it was more than made up in subsequent months and gross international reserves substantially exceeded the program floor as at end December 2006.

3. The structural performance criteria relating to the implementation and reporting of the Integrated Financial Management and Information System (IFMIS) was not observed through end-March 2007 due to difficulties in complying with procurement procedures. However, the authorities have undertaken convincing steps to ensure earlier realization of the benefits of the IFMIS, including increasing the number of the pilot sites from three to eight, and advancing functional training from phase II to phase I of the project. Most of the structural benchmarks were implemented, although some of them with delays.

4. Given the good performance in program implementation and the credible corrective measures undertaken, the authorities are requesting the Executive Board to grant them waivers and to complete the fifth and the sixth reviews under the PRGF arrangement.

Medium-term outlook and policy issues

5. The medium-term economic outlook is favorable. The Fifth National Development Plan (FNDP) launched recently offers credible policies and reforms necessary to tackle the remaining challenges as it aims at consolidating macroeconomic stability, improving economic productivity and competitiveness. It includes ambitious social programs which will help curb the widespread poverty, improve quality and delivery of social services, increase job creation and help reach the MDGs. Real GDP is projected to grow at an average rate of 6-7 percent annually over the medium-term, and could even grow higher if the expected scaling up of donor support materializes. The authorities believe that their commitment to diversifying sources of growth and revenues over the medium term will help them mitigate the risks from continued dependence on donor support that otherwise could jeopardize the success of the development plan. The projected robust economic growth is expected to be broad based across sectors, including agriculture, mining, manufacturing, construction and infrastructure, as well as tourism. Inflation would be further reduced to lower single digits in the medium-term.

Fiscal policy

6. As highlighted in the FNDP, the fiscal policy objective is to achieve fiscal sustainability in the medium-term and support low inflation targets. The government will continue reducing net domestic financing, while securing appropriate level of spending for growth-enhancing infrastructure and domestically financed poverty-reducing programs. In this connection, domestic revenues in 2007 would increase by one percentage point of GDP above the 2006 performance, as a result of additional revenue collection efforts from company income tax in mining sector, and VAT. The Government has recently conducted a comprehensive review of the tax policy and administration, including tax holidays and mining taxation, with the support of the Fund TA. The main objectives of the review are to have a more buoyant, simpler, broad-based, equitable and well administered tax regime. It is expected that the revised tax regime would substantially increase revenue performance and improve tax compliance. Implementation of the tax review's recommendations has started with the 2007 budget.

7. As regards expenditure, the fiscal space made available from the expected increase in revenue collection and debt relief under the MDRI, will be allocated to priority spending on poverty-reducing programs identified in the FNDP, in particular agriculture, infrastructure, health and education. In this connection, social expenditure will be increased to allow additional recruitment of 6,500 teachers and 1,900 health workers. The authorities are committed to making further progress in improving public expenditure management. To this end, they will consult with cooperating partners on the 2007 work plan of the PEMFA reforms and accelerate its implementation. It is expected that implementation of the PEMFA reforms will increase the effectiveness and productivity of the public sector.

8. An important component of the PEMFA reforms is the IFMIS. Following the signing of the contract with the IFMIS supplier in November last year, the authorities are committed to expedite its implementation. They will expand the pilot phase to more sites

than initially planned, and expect its completion within 18 months. In the meantime, they will enhance the existing financial management system, to continue improving public finance reporting.

Monetary and exchange rate policies

9. The BoZ will continue to monitor inflationary pressures and adopt appropriate measures to keep reserve money in line with program objectives. The managed floating exchange rate regime will be maintained as it has served the economy well. In this connection, the BoZ will limit its interventions in the foreign exchange market to correct disorderly conditions and meet international reserves targets, while preserving the inflation objective. The BoZ will also review its overall intervention strategy to enhance its effectiveness.

Financial sector development

10. The Banking sector is generally sound, and the BoZ will continue enhancing banking supervision. The authorities are committed to implementing the Financial Sector Development Plan (FSDP) with the objectives of strengthening financial system stability and access to credit. The BoZ is working on risk management guidelines for banks, which would move supervision to a more pro-active framework, and on a deposit protection scheme. Moreover, they are establishing a Credit Reference Bureau and creating an enabling environment for microfinance, which would positively change the credit culture and expand credit and other financial services to rural entrepreneurs.

Private sector development and other structural reforms

11. The authorities are aware that sustaining high economic growth rates requires the expansion of private investment, both domestic and foreign. To this end, they are committed to implementing appropriate structural reforms aimed at creating a more conducive environment for doing business in Zambia. To complement the Public Sector Reform and the Financial Sector Development Plan, the authorities are implementing a Private Sector Development Initiative Program involving all stakeholders. In this connection, five agencies supporting private sector development were recently merged in the new Zambian Development Agency (ZDA). The ZDA will focus on streamlining licensing and other administrative procedures, including the creation of a one-stop shop for establishing new businesses. Also, actions will be undertaken to improve quality in telecommunications, energy, and transportation infrastructure as these services are critical for increasing productivity and enhancing competitiveness. Zambia is also in the process of considering its adherence to the standards of the EITI, with a view to enhancing transparency in the mining sector.

12. The Government is determined to promote a more open trade regime. It is playing a leading role in regional integration within COMESA, and will implement the SADC Trade Protocol.

Debt management and statistics issues

13. Debt relief under the HIPC and MDRI initiatives has considerably improved debt sustainability prospects for Zambia. The government is determined to prevent unsustainable build-up of new debt. In this connection, the authorities will continue strengthening public debt management, including the formulation of a comprehensive medium-term debt management strategy, and improvement in public debt database. They will also continue strengthening capacity to collect and disseminate economic data in a timely fashion.

Conclusion

14. Implementation of sound macroeconomic policies and a strong structural reform agenda has started to produce positive results, as reflected in the robust economic performance over the last six years, which has reversed episodes of stagnation of the past decades. Nonetheless, the authorities are aware that the economy is still vulnerable to exogenous shocks and that they have to sustain high economic growth rates to effectively tackle the widespread poverty. To this end, they are determined to consolidate macroeconomic stability and step up implementation of their structural reform agenda. The Zambia's FNDP provides an appropriate framework in this regard. The authorities would appreciate the support of the Board for the completion of Fifth and the Sixth Reviews under the PRGF arrangement, and granting of the requested waivers. They are looking forward to discussing a successor program on the basis of the FNDP.