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Zambia: Letter of Intent, Memorandum of Economic and Financial Policies and Technical Memorandum of Understanding

December 9, 2005

The following item is a Letter of Intent of the government of Zambia, which describes the policies that Zambia intends to implement in the context of its request for financial support from the IMF. The document, which is the property of Zambia, is being made available on the IMF website by agreement with the member as a service to users of the [IMF](#) website.

December 9, 2005

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

Dear Mr. de Rato:

Since June 2004, the Government of Zambia has been implementing a financial and economic program with support from the Fund under the Poverty Reduction and Growth Facility (PRGF). The second review of the program was completed on April 8, 2005. The attached Memorandum of Economic and Financial Policies (MEFP) and Technical Memorandum of Understanding (TMU) reviews progress in implementing the program during 2005 and outlines the policies that the Government of Zambia will pursue in 2006. In the context of the new National Development Plan, scheduled to be launched in early 2006, the government's development strategy and policies will continue to focus on achieving high rates of pro-poor economic growth through the maintenance of sustainable macroeconomic policies and acceleration of the pace of structural reforms to support private sector growth, improve public expenditure management and accountability and the delivery of public services, and enhance competitiveness.

The Government requests the completion of the third review and the fifth and sixth disbursements under the PRGF arrangement in the amounts of SDR 5.502 million each. With regard to the sixth disbursement, the Government requests the IMF Executive Board to grant a waiver for the nonobservance of the end-September 2005 performance criterion on net domestic financing (NDF). The ceiling on NDF was breached by a small amount owing to emergency outlays for food relief in drought-affected areas, and higher-than-programmed expenditures on preparations for elections and the constitutional review process. The Government is making every effort to contain its net domestic financing requirements within program limits, in part, by soliciting additional external support for food relief.

The Government also requests two modifications to the program under the PRGF arrangement. First, the Government requests an upward adjustment to the end-December 2005 ceiling on NDF of up to K120 billion for the sole purpose of clearing domestic arrears to road contractors and consultants. These additional resources, combined with available resources from the 2005 budget allocation for arrears and a supplementary allocation financed from identified budgetary savings, would allow the Government to clear the bulk of the outstanding arrears to road contractors. This would facilitate the completion of ongoing contracts and the implementation of new contracts for essential infrastructure projects.

Second, the piloting of the Integrated Financial Management and Information System (IFMIS) has encountered further delays owing to difficulties in the procurement process. The contract

for the installation of IFMIS had to be retendered after serious flaws with the preferred bidder emerged. The time table for selecting the winning bidder, signing the contract, and piloting the project is now expected to extend beyond that envisaged in the program. The Government thus requests that the IMF Executive Board modify the end-January 2006 performance criterion on the piloting of the IFMIS. The Government plans to undertake the piloting of the IFMIS by end-September 2006. Notwithstanding this delay, the Government has continued to strengthen current public expenditure management systems, including the computerized Commitment Control System and the Financial Management System (FMS). Site preparations are also being done at various ministries to facilitate the fast introduction of the IFMIS when it is ready for implementation.

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

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

Sincerely yours,

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

Attachment

ZAMBIA

Memorandum of Economic and Financial Policies of the Government of Zambia for 2006

I. Performance Under the Program Supported by the Poverty Reduction and Growth Facility (PRGF) in 2005

1. The Zambian economy has continued to perform well overall in 2005, although supply-side shocks have resulted in lower real GDP growth and higher inflation than was projected under the program. Real GDP growth is projected to be 4.3 percent, compared with 5.0 percent under the program (and 5.4 percent in 2004). A strong expansion in construction—driven by a robust demand for housing and large-scale investment in the copper sector—and solid growth in the tourism and cash crop sectors has been only partly offset by a drought-related shortfall in maize production and a relatively weak performance in mining. Zambia's copper production capacity increased significantly with the start-up of the Kansanshi mine in 2005, however its initial production was lower-than-expected. In addition, output growth in the sector was weakened by a variety of temporary setbacks, including a serious mine accident, labor disputes, and a fuel shortage caused by an extended shutdown of the country's oil refinery (Indeni). More broadly, Indeni's production problems and the ensuing severe fuel shortages disrupted activity throughout the economy during the second half of the year. Inflation has increased somewhat during 2005, owing in part to strong pressure on food and fuel prices. End-year inflation is expected to be 19.0 percent, compared with 17.5 percent in 2004 and the program objective of 15 percent.

2. **Fiscal performance has been broadly satisfactory through September 2005.** Government revenue collection was above the program target, with buoyant tax revenue collection largely offsetting a shortfall in nontax revenue. In October, to alleviate the impact of the fuel shortages, the Government reduced import and excise duties on petroleum products for the remainder of the year, which is expected to lower tax revenue by K 35 billion (about 0.1 percent of GDP). Nevertheless, for the year as a whole, revenues are expected to be in line with the program target. Through September, total recurrent expenditure was lower than programmed because of savings realized in domestic and external interest payments. However, government has had to resort to a bridge loan from the BoZ to cover a recurring mismatch in liquidity. Repayment of this loan and supplementary budget expenditures suggest a significantly tighter fiscal position in the fourth quarter of the year.

3. **The growth of broad money has decelerated steadily, in line with the objectives of containing inflation pressures.** On a year-on-year basis, the increase in broad money declined from 30.2 percent in December 2004 to 9.1 percent in August 2005. Owing largely to the difficulty in coordinating the management of liquidity, progress in slowing down the growth of reserve money was uneven. The control of liquidity was complicated by the sharp reduction by commercial banks of their holding of foreign assets to avoid balance sheet losses associated with the appreciation of the kwacha.

4. **On the external side**, record high world copper prices and expanding non-traditional exports of goods and services, including tourism, have contributed to strong growth in export receipts. Imports have grown even more strongly, in part because of high world petroleum prices and strong investment activity in the mining sector. On balance, however, the current account deficit (including grants) is expected to widen from 5.4 percent of GDP in 2004 to 6 percent in 2005. External budget support is expected to double between 2004 and 2005, to US\$134 million, or 1.9 percent of GDP.

5. **All quantitative PRGF program targets were met for June and all but one for September (Table 1).** Of note, the floor on gross international reserves and the ceiling on net domestic assets of the Bank of Zambia (BoZ) were met by wide margins. The ceiling on government domestic financing was met by a comfortable margin in June, owing to a delay in the conclusion of wage negotiations with public sector labor unions, but it was narrowly missed in September. Similarly, the Government's wage bill was well below the benchmark ceiling for June, while the September benchmark was met by a narrower margin.¹

6. **Under the structural program, both performance criteria were observed and, despite some delays, most benchmarks were implemented (Table 2).** In August, the Investment and Debt Management Department (IDM) of the Ministry of Finance and National Planning (MoFNP) produced the first quarterly update of debt-service projections based on the validated end-second quarter debt stock. Also, the Government continued to refrain from extrabudgetary expenditures that were not legally binding. In August, a list of supplementary expenditures (of about 0.5 percent of GDP) was approved by Cabinet. These expenditures, which included supplementary spending on emergency food relief, were limited to resources available from the contingency account and identified budgetary savings—mainly lower-than-budgeted interest payments on domestic and external debt. While there have been delays, all but one of the measures related to Public Expenditure Management and Financial Accountability (PEMFA) were implemented. With regard to the outstanding measure, new financial regulations and revised accounting manuals for the new Finance Act are being prepared and are expected to be issued by end-March 2006. The quarterly report on budget execution was published in a timely manner, but it was incomplete because some ministries had not yet provided the necessary information. All ministries have since reported.

7. **In the financial sector**, the government adopted the Bank of Zambia's (BoZ) proposed action plan for the Zambia National Building Society (ZNBS) in August, and the National Savings and Credit Bank (NSCB) and Development Bank of Zambia (DBZ) submitted initial drafts of their plans for incorporation under the Companies Act to the BoZ in April and May, respectively. The BoZ is working with the NSCB, DBZ, and Government (the principal shareholder), to finalize the action plans, including necessary resource allocations in the 2006 budget. The amendments to the acts governing the building societies, NSCB, and DBZ, which align these acts with the Banking and Financial Services Act and gives the BoZ

¹ Agreements were reached in June 2005, which provided for a 25 percent wage increase retroactive to April 1, 2005, and 13 percent effective April 1, 2006. The wage bill in 2005 is expected to slightly exceed budget projections.

clear supervisory responsibility for these institutions, were enacted in October. Furthermore, the Zambia Privatization Agency (ZPA), has selected Rabobank as the favored bidder for a controlling 49 percent stake in the Zambia National Commercial Bank (ZNCB) and negotiations are expected to begin before the end of the year. The Government will make another 25.8 percent of the shares in ZNCB available for purchase by the general public through the Stock Exchange.

II. Proposed Modification to the Program for 2005

8. **While fiscal and monetary developments have largely been in line with program objectives through the first three quarters of the year, the Government may exceed the end-year program ceiling on domestic financing in order to pay down a larger amount of arrears to domestic road contractors and consultants (RCCs) than envisaged in the budget.** Re-establishing a good payments record with the RCCs is essential to assure the smooth implementation of road development, which is a key element of the draft National Development Plan (NDP) and for reducing poverty. The Government intends to borrow up to K 120 billion (0.3 percent of GDP) through the issuance of government securities during the fourth quarter that will be combined with other available budgetary resources for immediate payment of the bulk of these outstanding arrears.² Government will seek significant discounts in the claims to be paid off and the selection of RCCs to be paid will be done in a transparent manner. Given the availability of credit in the banking system and the demand for government securities from the non-bank public, the issuance of additional government securities is not expected to greatly impinge upon credit to the private sector. Government therefore will seek an adjustor to the December 2005 program ceiling on its domestic financing of up to K 120 billion for the sole purpose of clearing arrears beyond the amount possible with currently available resources.³

III. Medium-Term Objectives

9. **In line with the forthcoming National Development Plan (NDP), expected to be finalized in early 2006, and the medium-term expenditure framework (MTEF), Government aims to implement a macroeconomic policy framework and an agenda of structural reforms that will support strong economic growth and a substantial reduction in poverty.** While the NDP considers policy alternatives to accelerate growth and poverty reduction, which would require additional resources, the MTEF is based on current projections and resource commitments. Under this current scenario for the MTEF period, 2006–2008, Government aims to:

- Achieve real GDP growth of 6 percent a year;

² Arrears to road contractors and consultants stood at K 298 billion as of end-March 2005.

³ The adjustor is defined in paragraph 7 of the technical memorandum of understanding. Available resources amount to K 108 billion from a budget allocation of K 35 billion and identified savings of K 73 billion.

- Bring down end-year inflation to 10 percent in 2006 and 5 percent in 2007 and 2008;
- Reduce domestic borrowing to 1.6 percent of GDP in 2006, 0.7 percent of GDP in 2007, and 0.5 percent of GDP in 2008 to strengthen the domestic debt position and limit the crowding out of credit to the private sector;
- Increase the coverage of official gross international reserves to at least 1.5 months of imports in 2006, 1.8 months in 2007, and 2.2 months in 2008; and
- Remain current with foreign debt service.

10. **Raising economic growth is a key government objective and a precondition for poverty reduction.** In addition to sound macroeconomic and financial policies, raising economic growth to 6 percent a year would be supported by strong private sector investment, an expansion of energy supplies, and pro-poor growth policies to encourage labor-intensive sectors including small-scale mining, agriculture, manufacturing, and tourism. Recent and ongoing large-scale investment in the copper sector is expected to greatly boost mining sector output over the medium term, while strong growth in both residential and infrastructure construction is expected to continue. Monetary policy—supported by prudent fiscal policy—will focus on achieving price stability. External policies will be centered on maintaining a liberal trade regime, while ensuring a competitive, expanded and diversified export base.

11. **The reduction in Government's domestic borrowing over the medium term is the anchor to Zambia's macroeconomic stabilization effort.** That reduction will be achieved by gradually raising government revenues—by improving tax administration and widening the tax base by further bringing in the informal sector into the tax base—while exercising strict control on government expenditures. In addition, Government will explore the scope for revising the taxation of mining, without violating existing agreements. Expected increases in donor assistance, including in the form of budget support, would provide room for a greater expansion of government spending. A strengthening of budget execution will not only be critical to enable donors to increase budget support, but also to improve public sector service delivery and investment. The government has a large outstanding stock of arrears to the Public Service Pension Fund (PSPF). Over 2006-2008, about 1.5 percent of GDP will be allocated to reducing the stock of pension arrears.

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

IV. The Program for 2006

A. Fiscal Policy

13. **A reduction in the Government's net domestic financing to 1.6 percent of GDP in 2006, while allocating sufficient resources to achieve an increase of at least ½ percent of GDP in spending on PRPs, will be the anchor of the Government's macroeconomic stabilization effort.**⁴ Government will conduct an overall review of tax policy during the first half of 2006, with the aim of rationalizing the tax system and expanding the tax base. In this context, Government is committed to maintaining revenues at a minimum of 17.5 percent of GDP in 2006, which is the projected collection under current policies (that is, excluding the temporary reduction in duties and excises on petroleum products). In addition, the Government will explore options to increase revenues from the mining sector, without violating any existing agreements.⁵ Any tax measures and business incentives that may be introduced during the forthcoming budget deliberations will be accompanied by offsetting revenue measures. On the spending side, Government will seek to contain expenditures associated with an election year, including limiting spending on the general election itself in line with recent experience in neighboring sub-Saharan African countries. In addition to the PRPs, other spending priorities include (i) staying current with pension contributions and paying down outstanding arrears to the Public Sector Pension Fund (PSPF); (ii) net recruitment of [2000] teachers and retention of core health workers; (iii) financial restructuring of parastatals, including the NSCB and DBZ; (iv) timely payment of current terminal benefits. Moreover, it will be important to ensure that spending outcomes reflect budget intentions. In this regard, supplementary spending will continue to be limited to the contingency account and identified additional budgetary resources. The total wage bill in 2006 will respect the indicative ceiling of 8 percent of GDP.

B. Monetary and Exchange Rate Policies

14. **The BoZ will maintain an appropriately tight monetary policy in 2006.** Reserve money growth will be held to 9.8 percent during the year, while broad money, defined to include foreign currency deposits, is expected to expand by 14.3 percent.⁶ The monetary authorities recognize that consistent implementation of the reserve money program is necessary in order to curb entrenched expectations of high inflation. In this regard, a return to normal conditions in the agriculture and fuel sectors would ease inflation pressures. The monetary program is projected to accommodate an expansion of credit to the private sector of

⁴ Government net domestic financing in 2005 could reach 2.2 percent of GDP, if the adjuster for clearance of arrears to road contractors and consultants is fully utilized.

⁵ The expiration at the end of March 2005 of the tax concessions given to Konkola Copper Mines and new mining operations from Kansanshi Mines will increase the revenues from the mining sector.

⁶ As measured using the program exchange rate.

about 20 percent in 2006. In addition, the BoZ expects to continue its buildup of gross international reserves (to at least 1.5 months of imports).

15. **The Bank of Zambia has been successful in maintaining the growth of broad money at below the target under the 2005 program.** However, this has not been without difficulty. In the face of, at times, significant upward pressure on the kwacha, the conduct of policy required a balancing act that was not always successful in achieving of the monetary policy objective. In particular, short-term interest rates came down noticeably in the first half of the year and were increasingly negative in real terms. In the second half of the year, the Bank of Zambia has been pursuing a more clearly tighter monetary stance consistent with the objective of lowering inflation. The recent introduction of long term bonds, in part to help define the yield curve, and efforts to foster the development of the interbank money market, as spelled out in the draft NDP, will form the basis for strengthening the conduct of policy. Close coordination between the BoZ and the MoFNP is important for improving liquidity management and will be intensified. The Government also recognizes the need for operational independence for the BoZ, if the BoZ is to successfully pursue the objective of price stability.

16. **The government remains committed to a flexible exchange rate regime.** The government is cognizant of the potential impact of exchange rate appreciation—caused by a combination of rising export receipts, growing aid inflows, and actual and prospective debt service relief—on the international competitiveness of nontraditional exports and domestic manufacturers. However, competitiveness needs to be secured through the establishment and maintenance of a business environment that is conducive to productivity growth. The government is, therefore, committed to implementing measures—including under the FSDP and the PSD action plan—that will reduce the cost of doing business in Zambia and contribute to the expansion and diversification of the export base, as well as allow domestic manufacturers to flourish.

C. External Prospects and Policies

17. **The external outlook for 2006 is favorable.** Notwithstanding an anticipated easing of copper prices from their record levels of 2005, metals exports are expected to rise by 11 percent, owing to stepped up production from Chambishi and Kansanshi mines. Nontraditional exports, including tourism, are also expected to continue to record healthy growth, resulting in total growth of goods and services exports of 10 percent in U.S. dollar terms. The oil import bill is also likely to rise further as a result of continued high oil prices and the need to restore inventories drawn down in 2005, including the possible initiation of a strategic petroleum reserve to guard against temporary supply shocks. Total goods and services imports are therefore projected to rise by 10 percent in U.S. dollar terms. On this basis, the current account deficit (including grants) is projected to remain steady at about 6 percent of GDP in 2006.

18. **Somewhat lower external budget support is programmed for 2006 than was received in 2005, while external debt service is projected to decline sharply.** Based on commitments from donors under the Harmonization in Practice (HIP) program, external budget support is conservatively estimated to be US\$121 million (1.5 percent of GDP), with more than four-fifths in the form of grants. On the other hand, external debt service charged to the budget

is projected to decline to US\$81 million (1 percent of GDP), from US\$129 million (1.9 percent of GDP) in 2005 with the full implementation of the debt-service relief under the HIPC Initiative. On this basis, the program for 2006 is fully financed.

19. **The government is committed to an open trade regime that is supportive of export development and diversification of the economy.**

D. Structural Measures

20. **Structural reforms in 2006 will continue to focus on public expenditure management and financial accountability (PEMFA), debt management, financial sector development, and governance and transparency.** These reforms are critical to support macroeconomic stability and growth. Table 4 presents the specific measures proposed for inclusion in the PRGF-supported program for 2006 as structural performance criteria and benchmarks

Public Expenditure Management

21. **Important advances in the PEMFA reform program will be implemented in 2006.** In addition to hiring a contractor for installation of and training for an integrated financial management and information system (IFMIS), Government will take steps to strengthen existing expenditure management systems. The Accountant General will issue rules and procedures for implementing and enforcing the new cash management system and will prepare reports for Cabinet on compliance with the commitment control system by ministry, province, and spending agency. To enhance transparency with regard to proposed budgetary allocations, starting with the 2006 budget, the MoFNP will issue summary tables using the activities based budgeting classification and identifying poverty-reducing programs. To strengthen planning and budget preparations the MoFNP will submit the initial draft of the 2007–2009 MTEF (“Green Paper”) to Cabinet by end-August 2006. Also, Government will issue new regulations and revised accounting manuals for the new Finance Act by end-March 2006, which would improve procedures for treasury management at the MoFNP.

22. **Progress is being made toward implementation of IFMIS, albeit with some delays.** In line with the World Bank’s procurement guidelines, the Government has re-tendered the contract for installation and training of IFMIS, including the piloting of the system in at least three line ministries by end-September 2006. It is expected that a list of pre-qualified bidders will be submitted to the World Bank in December 2005, and that negotiations with a preferred contractor could be concluded by end-April 2006. However, this is a complex process, involving a series of reviews by Government, bilateral donors, and the World Bank, and is subject to delays. The Government anticipates that a report on the findings of a preliminary review of the piloting exercise will be available by end-March 2007.

Debt Management

23. **The government will continue to strengthen its debt management capacity.** With the support of the World Bank, the government is implementing a multi-year debt management reform and capacity building program. The initial focus of the program is on strengthening

back office functions in the IDM Department of the MoFNP. Major progress has been achieved in the validation of the external debt database and the initiation of the preparation of quarterly projections of debt service for the coming three years. The Government will validate the stock of onlending agreements by end-June 2006, with a view to ensuring that these agreements are effectively enforced, and will validate the stock of contingent external liabilities by end-December 2006. The Government will also prepare by end-June 2006 an annual report on external debt management operations during 2005. In addition, the IDM Department will strengthen the data base on Government's outstanding domestic obligations, beginning with the quarterly reporting of outstanding obligations to the Public Service Pension Fund (PSPF).

Financial Sector Development

24. **The government has continued to make progress in implementing the action plans for the problem nonbank financial institutions (NBFIs).** With the necessary legal framework in place, the way is now clear to pursue the resolution options for which preliminary work has been done. As regards the DBZ, the Government will, in accordance with understandings reached with the World Bank, explore options for expanding the lending resources of the DBZ in the light of the coming in of a new investor and the offer of a substantial line of credit. The Government expects that progress in this regard will pave the way for the registration of the DBZ under the Companies act and subsequent licensing under the Banking and Financial Services Act. The Government remains firm in its commitment to reduce its shareholding in the DBZ to 25 percent. As for the NSCB, the immediate tasks are to conclude the ongoing account reconciliation exercise, and implement the bank's Institutional Development Plan (IDP) involving the installation of a new computer system, with the IFAD's assistance. It is expected that with the completion of the review of the IDP, IFAD will formalize its participation in the bank and release funds to the NSCB. To this end Government in September, paid in its counterpart funds to the NSCB. This will open the way for registration and subsequent licensing of NSCB. Regarding the ZNBS, the Government has made a decision on the resolution of the institution and the BoZ is working on the modalities for its implementation. The resolution of the ZNBS will be effected by end-June 2006.

25. **A key element of the Government's Financial Sector Development Plan is the establishment of credit reference bureaux (CRB), to foster the availability of credit to support growth.** In this regard, the government will submit to cabinet a proposal for the legal framework establishing a credit reference bureau. The BoZ has completed preliminary studies and expects to issue interim guidelines for CRBs by the end of the year. These guidelines will serve as the basis for regulating CRBs until a legal framework is established.

26. **Outstanding pension liabilities pose a significant risk to fiscal balances over the medium term.** With support and technical assistance from the World Bank, the Government has initiated a pension reform aimed at providing sustainable benefits for retirees. In this regard, Cabinet has approved a proposal to amend the constitution with the aim of ensuring the financial sustainability of the pension system. At the same time, Government will ensure that the investment and asset management capabilities are strengthened at the National Pension Scheme Authority NAPSA. To address the anticipated cash flow deficit in the Public Service

Pension Fund, Government will paydown its outstanding balance on past contributions during 2006–2008.

Private sector development

27. **The Government has taken steps to accelerate the implementation of the Private Sector Development Programme (PSDP).** Most recently, following the fourth meeting of the Zambian Investors Business Advisory Council (ZIBAC) in September 2005, the Ministry of Labour and Social Security is preparing a reform proposal for Statutory Instruments Nos. 1 and 2 of 2002 on separation packages, aimed at reducing the burden of Zambia's costly terminal benefits. Also, the Ministry of Commerce, Trade, and Industry is preparing a cabinet memorandum on the liberalization of the telecommunications international gateway. A decision on the gateway is planned for early-December 2005. With the establishment of the PSD Steering Committee, assisted by a dedicated programme coordinating unit, it is expected that further progress will be achieved throughout the six areas of the PSDP: (i) reform of labor regulations and laws; (ii) business facilitation and economic diversification; (iii) infrastructure; (iv) local empowerment; (v) trade expansion; and (vi) policy environment and institutions.

28. **The electricity sector will play an integral role in supporting the country's economic growth in the years ahead, both through expanded production and contribution to increasing productivity and competitiveness.** At present, Zambia's electricity company (ZESCO), which is in the midst of implementing the first year of its business plan as a commercialized government-owned company, is planning a number of large-scale investments primarily to expand its generation and transmission capacity. Under the plan, ZESCO would incur external debt obligations of about US\$1.5 billion. For Zambia to benefit from this expansion, without exposing the Government to potentially large liabilities, ZESCO's management must demonstrate the highest level of expertise in all aspects of the electricity sector. Upon completion of its fiscal year ending March 31, 2006, ZESCO's management will provide all the necessary financial, technical, and managerial information to the World Bank and the IMF for an assessment of ZESCO's performance under the commercialization process. The information will be provided by end-April 2006. Moreover, to ensure ZESCO's independent operations, the Government will not on-lend or guarantee any external credits to ZESCO.

Strengthening data

29. **The Government will take steps to expand Zambia's capacity to collect and report quality economic data.** At present, there are serious shortcomings in the data for the national accounts, consumer price index, and the balance of payments. To strengthen the role of the Central Statistics Office (CSO) in collecting and compiling data, the Minister of Finance and National Planning will submit to Cabinet a proposal for the revision of the 1964 Census and Statistics Act, with a view to reorganizing the CSO so as to make it more efficient and effective. The CSO will also prepare a comprehensive strategy for improving its data collecting and reporting services.

V. Technical Assistance Needs

30. Over the past year, Zambia has received technical assistance from the IMF in the areas of banking sector statistics, liquidity management, government finance statistics, legislation governing nonbank financial institutions, public sector financial regulations, and tax policy for the mining sector. It is expected that further technical assistance will be requested for follow-up on liquidity management and the payments system, public sector financial regulations, and for training in reporting government finance statistics. In addition, the CSO will likely request assistance on rebasing the consumer price index and the national accounts. When making these requests, the Zambian authority will identify a senior officer who will oversee the technical assistance and a counterpart team that will work directly with IMF staff and the technical experts. The identified senior officer will also participate in the formulation of technical recommendations and be responsible for their implementation.

VI. Program Monitoring

31. Progress in implementing the PRGF-supported program will continue to be monitored quarterly, with semi-annual reviews, based on the quantitative and structural performance measures indicated in Tables 3 and 4. Performance criteria are now proposed through the end of June 2006, as well as indicative targets through the end of December 2006. The fourth review of the program, which is expected to be completed by May 31, 2006, will be based on the performance criteria and benchmarks for end-December 2005. The fifth review of the program, which is expected to be completed by December 15, 2006, will be based on the performance criteria and benchmarks for end-June 2006. In addition, the government requests modification of the performance criterion for end-December 2005 on the ceiling on net government domestic financing, through the introduction of an adjustor related to clearance of arrears to road contractors and consultants. The government further requests that the performance criterion envisaging initiation of the piloting of IFMIS in at least three line ministries by end-January 2006 be modified to envisage initiation by end-September 2006. The quantitative and structural performance criteria and benchmarks are defined in the attached technical memorandum of understanding.

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

	2004	2005										
	Dec. Stocks	March			Jun.			Sep.			Dec.	
		Prog.	Actual	Status	Prog.	Actual	Status	Prog.	Actual	Status	Prog.	Actual
<u>Performance Criteria</u>												
1	6,836	14	-185	Met	182	-41	Met	104	-306	Met	166	...
		94			296			286				
2	3,305	60	168	Met	217	319	Met	301	513	Not met	500	...
		190			374			496				
3	238	232	251	Met	204	275	Met	244	308	Met	246	...
		225			192			194				
4		0	0	Met	0	0	Met	0	0	Met	0	...
5		0	0	Met	0	0	Met	0	0	Met	0	...
6		20	0	Met	20	0	Met	20	0	Met	20	...
7		62	65	Met	100	144	Met	151	220	Met	284	...
<u>Quantitative Benchmarks</u>												
8		593	508	Met	1,236	1,090	Met	1,876	1,782	Met	2,531	...
9		0	0	Met	0	0	Met	0	0	Met	0	...
Memorandum items:												
10		-8	-14		-29	-41		4	-45		13	...
		31	36		41	41		98	64		133	...
		-39	-51		-78	-83		-93	-109		-120	...
			-6			-12			-49			
Program exchange rates												
		4,771										
		1,5478										

1/ The definitions of the indicative targets are contained in the Technical Memorandum of Understanding (TMU).

2/ Adjustors, including for balance of payments support are defined in the TMU.

3/ Excludes HIPC debt relief from the IMF.

4/ The ceiling will be adjusted for changes in the legal reserve requirements.

5/ Cumulative from the end of 2004.

6/ Nonconcessional loans are defined as having a grant element of less than 40 percent.

Table 2. Zambia: Status of Structural Benchmarks and Performance Criteria 1/

Benchmarks and Performance Criteria	Timing	Status
1. Public expenditure management and financial accountability (PEMFA)		
The government will refrain from paying any amounts for which it is not legally liable and which are not included in the budget. 2/	Continuous	Observed
Publication of quarterly budget execution reports using the activity-based budgeting classification, within 45 days of the end of each quarter.	Continuous	Observed. A summary table was prepared for the report for 2005:Q2; however, data from many line ministries were not included in the report. Data for all 46 line ministries were later reported.
In consultation with the PEMFA Technical Working Group, design a cash-flow framework for all line ministries.	May 2005	Completed late. The cash-flow framework was implemented in all line ministries in August. The framework has also been implemented in provinces and spending agencies. Implementation of the framework was done without consultation with the PEMFA Joint Technical Working Group (JTWG), but user manuals were later sent to lead donors in the JTWG.
In consultation with the PEMFA Technical Working Group, finalize a framework for monitoring and evaluating the PEMFA program.	May 2005	Completed late. The framework was completed in July and approved by the PEMFA Steering Committee in August.
Prepare and publish the first draft ("Green Paper") of the Medium-Term Expenditure Framework (MTEF) for 2006-08.	August 2005	Completed late. Cabinet discussed the first draft of the MTEF in early November, after which the MTEF was made public.
Issue new regulations and revised accounting manuals for the new Finance Act.	September 2005	Not completed. An initial draft of the regulations was prepared with technical assistance from an IMF-supported expert in July-August, and was circulated for comments. The MoFNP is drafting the corresponding manual detailing operational procedures. With further assistance from the expert, the regulations and manuals will be finalized in early 2006.
Complete review of the implementation of the PEMFA program.	November 2005	Observed
2. Debt management		
Beginning with the second quarter of 2005, validate end-quarter external debt stock data and, within 45 days, provide updated 3-year schedule of debt service falling due. 2/	Continuous from August 2005	Observed
3. Financial sector reform		
Adoption by the government and the Bank of Zambia of an action plan, finalized in consultation with the World Bank and IMF staff for the resolution of the Zambia National Building Society.	April 2005	Completed late. The Minister of Finance and National Planning approved the BoZ's recommended plan in August.
The National Savings and Cred Bank (NSCB) and the Development Bank of Zambia (DBZ) submit to the BoZ plans for their incorporation in 2006 under the Companies Act.	December 2005	Observed. The BoZ is working with the NSCB and DBZ to finalize the plans and Government has proposed allocating the necessary resources in the 2006 budget to prepare the institutions for incorporation. Both institutions have found investors to help shore up their financial positions and strengthen management.
4. Governance and transparency		
Unbudgeted expenditure requirements will be funded only to the limits of the contingency resources indicated in the budget or only after the cabinet has approved any changes by finding compensatory funding within the approved budget resources.	Continuous	Observed

1/ The definitions of the prior actions, structural benchmarks, and performance criteria are contained in the Technical Memorandum of Understanding (TMU).

2/ Performance criteria.

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

	2006	2006			
	Base	March Prog.	Jun. Prog.	Sep. Prog.	Dec. Prog.
<u>Performance Criteria</u>					
Ceiling on the cumulative increase in net domestic assets (NDA) of the Bank of Zambia 2/ 3/ 4/ 5/ Adjusted ceiling	6,428	-37	65	-68	128
Ceiling on the cumulative increase in net domestic financing (NDF) 2/ 5/ Adjusted ceiling	2,910	136	226	206	589
Floor on the cumulative increase in gross international reserves (GIR) of the Bank of Zambia (In millions of U.S. dollars) 2/ Adjusted floor	312	8	17	61	47
Ceiling on new external payment arrears		0	0	0	0
Ceiling on the stock of short-term debt and on contracting or guaranteeing of nonconcessional debt (In millions of U.S. dollars) 6/		0	0	0	0
Floor on the cumulative payment of domestic arrears of the government 5/ 7/		50	89	155	238
<u>Quantitative Benchmarks</u>					
Cumulative ceiling for the Central Government wage bill 5/		654	1,431	2,242	3,019
Ceiling on the cumulative arrears on the Central Government wage bill		0	0	0	0
Memorandum items:					
<u>Cumulative net balance of payments support (In millions of U.S. dollars)</u>		1.3	6.9	60.5	45.6
Balance of payments assistance		17.8	47.8	118.4	127.0
Central Government debt service obligations (excl. IMF)		-16.5	-40.9	-57.9	-81.4
Shortfall (-)/Excess (+) net BOP support					
Program exchange rates					
Kwacha/US\$	4,550				
US\$/SDR	1.436				

1/ The definitions of the items in the quantitative program are contained in the Technical Memorandum of Understanding (TMU).

Targets for September and December are indicative. All targets for March are benchmarks.

2/ Adjustors, including for balance of payments support are defined in the TMU.

3/ Excludes HIPC debt relief from the IMF.

4/ The ceiling will be adjusted for changes in the legal reserve requirements.

5/ Cumulative from the end of 2005.

6/ Nonconcessional loans are defined as having a grant element of less than 40 percent.

7/ This includes K100 billion for the payment of arrears to the Public Service Pension Fund.

Table 4. Zambia: Structural Performance Criteria and Benchmarks for 2006 ¹	
Measure	Timing
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
The Investment and Debt Management Department (IDM) of the MoFNP will validate the stock of onlending agreements with a view to effectively enforcing these agreements. The IDM will report to the Secretary of Treasury on the validation of these agreements.	end-June 2006
Initiate the piloting of an integrated financial management and information system (IFMIS) in at least three line ministries.	end-September 2006
The IDM will validate the stock of government contingent external liabilities, including loan guarantees, and pension obligations. The IDM will report to the Secretary of Treasury on the validation of these liabilities.	end-December 2006
Report on the findings of a preliminary review of the piloting of the IFMIS in at least three line ministries.	end-March 2007
Benchmarks	
<i>Public expenditure management and financial accountability (PEMFA)</i>	
Issue summary tables, developed in consultation with the PEMFA Joint Technical Working Group (JTWG), using activities based budgeting classification and identifying poverty reducing programs.	end-March 2006
Issue new regulations and revised accounting manuals for the new Finance Act.	end-March 2006
In consultation with the PEMFA JTWG, issue (i) accountability rules and procedures under the new cash management framework and (ii) corresponding administrative procedures for enforcement, to ensure the timely release of funds by the Ministry of Finance and National Planning.	end-March 2006
Submit to Cabinet the first draft ("Green Paper") of the Medium-Term Expenditure Framework (MTEF) for 2007-2009.	end-August 2006
<i>Debt management</i>	
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

¹ The definitions of the prior actions, structural benchmarks, and performance criteria are contained in the Technical Memorandum of Understanding (TMU).

Table 4. Zambia: Structural Performance Criteria and Benchmarks for 2006 ¹	
Measure	Timing
The MoFNP will issue an annual report on external debt management operations during 2005.	end-June 2006
<i>Financial sector development</i>	
Execute the action plan adopted by the Government on the resolution of the Zambia National Building Society.	end-June 2006
Submit to cabinet a proposal for the legal framework establishing a credit reference bureau, including the necessary amendments to [privacy laws].	end-June 2006
Incorporate the National Savings and Credit Bank and the Development Bank of Zambia under the Companies Act.	end-December 2006
<i>Private sector development</i>	
ZESCO's management will provide all the necessary financial, technical, and managerial information to the World Bank and the IMF for an assessment of ZESCO's performance in line with the conditions for reaching the evaluation point under the commercialization process.	end-April 2006
<i>Governance and transparency</i>	
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
Publication of quarterly budget execution reports using the activity-based budgeting classification, within 45 days of the end of each quarter, including summary tables developed in consultation with the PEMFA JTWG.	Continuous

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

I. INTRODUCTION

32. This memorandum sets out the understandings between the Zambian authorities and the International Monetary Fund (IMF) regarding the definitions of the quantitative and structural performance criteria and benchmarks for the program for 2006 supported by the PRGF arrangement, as well as the related reporting requirements. The definitions are valid at the start of the program, but may need to be revisited to ensure that the memorandum continues to reflect the best understanding of the Zambian authorities and IMF staff to monitor the program. The memorandum also introduces an adjustor on the end-2005 ceiling on net domestic financing related to the clearance of arrears to road contractors and consultants (paragraph 7).

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

A. Net Domestic Assets (NDA) of the BoZ

33. Net domestic assets (NDA) of the BoZ are defined as the monthly average (based on daily data) of reserve money less net foreign assets calculated at Kwacha 4,550.0 per U.S. dollar (program exchange rate).⁸ Reserve money consists of currency issued, required reserves on Kwacha deposits, required reserves on foreign currency deposits (at the program exchange rate), positive current account balances of banks with the BoZ, and deposits in the BoZ of non-central government institutions. Net foreign assets of the BoZ are defined as gross international reserves (defined below) plus any other foreign assets, including the US\$25 million blocked reserves at the former Meridien Bank (MBZ), minus foreign liabilities (defined below). The Kwacha values are derived from the U.S. dollar values using the program exchange rate.

34. 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.

35. The ceilings on NDA will be adjusted upward by the amount of the shortfall of balance of payments support net of debt service as indicated in Table 3 (item 10) of the

⁸ Unless otherwise defined, program exchange rates for 2006 between the U.S. dollar and other (non-Kwacha) currencies will be equal to the end-September 2005 rates. The U.S. dollar/SDR rate for program purposes is 1.4360. Any other assets (e.g. gold) would be revalued at their end-September 2005 market prices.

Memorandum of Economic and Financial Policies (MEFP), up to a maximum of US\$20 million for the period end-December 2005 to end-December 2006. External disbursements that occur anytime during the month of the test date will be treated as if they were disbursed on the first day of the month.⁹ In the event of excess balance of payments support net of debt service, the ceiling on NDA will be adjusted downward by 100 percent of the additional excess support. However, if part of the excess support is used to reduce the stock of Treasury bills or bonds held by commercial banks and the non-bank sector, then the programmed NDA will be adjusted upward by that amount. In the event of implementation of the MDRI, the ceiling on NDA will be adjusted downwards by 100 percent of the amount of debt to the IMF that is cancelled. The Kwacha value of the cumulative shortfall/excess will be calculated at the program exchange rate.

36. 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 reserves (Kwacha and foreign-currency denominated) at the end of the previous calendar month.

B. Net Domestic Financing (NDF)

37. Net domestic financing is defined as the Central Government's net borrowing from the banking and non-banking sectors (See table 1).¹⁰ All government-issued securities will be recorded at cost (face value less discount). NDF will be defined as:

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

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

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

⁹ 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.

¹⁰ The Central Government includes all the administrations identified by the budget heads listed in the 2006 Yellow Book.

38. The end-December 2005 ceiling on NDF will be adjusted upward by up to K 120 billion solely for the purpose of clearance of government arrears to road contractors and consultants, audited at end-March 2005 at K 298 billion, in excess of the K 108 billion provided for this purpose in the 2005 budget allocation and a supplementary allocation financed from identified budgetary savings.

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

40. 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

41. 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 (5th 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.

42. 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).

43. The floor on gross international reserves will be adjusted: (i) downward by the amount in U.S. dollars of the shortfall in balance of payments support net of debt service as indicated in Table 3 (item 10) of the MEFP, up to a maximum of US\$20 million for the period end-December 2005 to end-December 2006; (ii) upward by 100 percent of the cumulative excess balance of payments support net of debt service. However, if part of the excess support is used to reduce the stock of Treasury bills or bonds held by commercial banks or the non-bank sector, then the programmed reserves buildup will be adjusted downward by that amount; (iii) downward/upward for any shortfall/excess in the U.S. dollar

value of 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; and (v) upward by 100 percent of the amount of debt-service payments to the IMF foregone under the MDRI.

44. 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 rate.

45. 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

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

47. 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

48. 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 OECD; for maturities of less than 15 years, the grant element will be calculated based on six-month averages of CIRRs, and for maturities longer than 15 years, the grant element will be calculated based on 10-year averages. Adjustment lending from the IMF will be excluded.

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

50. 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

51. 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. There will be no new official external short-term debt 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).

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

G. Domestic Arrears of Government

53. Domestic arrears are defined as: (i) any bill that has been received by a spending ministry from a supplier for goods and services delivered (and verified) and for which payment has not been made within 30 days after the due date of payments; (ii) wage, salary and any payment to government employees, including 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 arrears in 2006 is payment of K 25 billion each quarter toward Government’s arrears on contributions to the Public Sector Pension Fund.

54. 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

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

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

III. STRUCTURAL PERFORMANCE CRITERIA AND BENCHMARKS

A. Performance Criteria

Continuous Criterion

57. The Government will refrain from making payments for which it is not legally liable and which are not included in the budget.

Public Expenditure Management

58. By September 30, 2006, the Government will initiate the piloting of the Integrated Financial Management and Information System (IFMIS) in at least three ministries.

59. By March 31, 2007, the government will report on the findings of a preliminary review of the piloting of the IFMIS in at least three line ministries.

Debt Management

60. The Investment and Debt Management Department (IDM) of the MoFNP will validate the stock of onlending agreements with a view to effectively enforcing these agreements. The IDM will report to the Secretary of Treasury on the validation of these agreements by June 30, 2006.

61. The IDM will validate the stock of government contingent external liabilities, including loan guarantees and pension obligations. The IDM will report to the Secretary of Treasury on the validation of these liabilities by December 31, 2006.

B. Benchmarks

Continuous Benchmarks

62. 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.

63. The MoFNP will publish quarterly budget execution reports using the classification system of activity-based budgeting within 45 days of the end of each quarter, including summary tables developed in consultation with the PEMFA JTWG and an annex on compliance with the commitment controls system (CCS) by ministry.

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

Public Expenditure Management

65. By end-March 2006, the Government will include in the budget proposal submitted to parliament ("Yellow Book") summary tables, developed in consultation with the PEMFA Joint Technical Working Group (JTWG), using activities based budgeting classification and identifying poverty related expenditure.

66. By end-March 2006, in consultation with the PEMFA JTWG, the government will issue (i) accountability rules and procedures under the new cash management framework and

(ii) corresponding administrative procedures for enforcement, to ensure the timely release of funds by the MoFNP.

67. By March 31, 2006, the MoFNP will issue the new regulations and the revised accounting manual needed for the complete and effective operations of the Finance Act approved by parliament in December 2004.

68. The Government will prepare and submit to Cabinet, by end-August 2006, a first draft of the Medium-Term Expenditure Framework (“Green Paper”) for the period 2007-2009.

Debt Management

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

Financial Sector Development

70. Before end-June 2006, the authorities will execute the action plan adopted by the Government and Bank of Zambia on the resolution of the Zambia National Building Society.

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

72. Before end-December 2006, the government will incorporate the National Savings and Credit Bank and the Development Bank of Zambia under the Companies Act.

Private Sector Development

73. By April 30, 2006, ZESCO’s management will provide all the necessary financial, technical, and managerial information to the World Bank and the IMF for an assessment of ZESCO’s performance in line with the conditions for reaching the evaluation point under the commercialization process.

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

9. (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.

Table 1. Net Domestic Financing

	2005		2006
	End-Dec.	End- Dec.	
	Program Base		
	End-Dec.	End- Dec.	
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			
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) starting from end-December 2003

Table 2. Zambia: Gross International Reserves
(In millions of U.S. dollars)

	2005			2006				
	December			March, June, September, December				
	12/31/2005 = Base			Current		31/12/05		
	Amount	Exch rate or price	U.S. dollar	Amount	Exch rate or price	U.S. dollar	Exch rate or price	U.S. dollar
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 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 learnt 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: Operations 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 the BoZ and are available for balance of payments 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.