June 2008
IMF Country Report No. 08/187

Zambia: Request for a Three-Year Arrangement Under the Poverty Reduction and Growth Facility—Staff Report; Staff Statement; Press Release on the Executive Board Discussion; and Statement by the Executive Director for Zambia

In the context of a request for a three-year arrangement under the Poverty Reduction and Growth Facility, the following documents have been released and are included in this package:

- The staff report for the Request for a Three-Year Arrangement Under the Poverty Reduction and Growth Facility prepared by a staff team of the IMF, following discussions that ended on February 27, 2008, 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 8, 2008. 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 staff statement of June 4, 2008, updating information on recent developments.

- A Press Release summarizing the views of the Executive Board as expressed during its June 4, 2008 discussion of the staff report that completed the review.

- A statement by the Executive Director for Zambia.

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

Letter of Intent sent to the IMF by the authorities of Zambia*
Memorandum of Economic and Financial Policies by the authorities of Zambia*
Technical Memorandum of Understanding*

*Also included in Staff Report

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

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INTERNATIONAL MONETARY FUND

ZAMBIA

Request for a Three-Year Arrangement Under the Poverty Reduction and Growth Facility

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

Approved by Sharmini Coorey and G. Russell Kincaid

May 8, 2008

Fund Relations. Zambia's last three-year PRGF arrangement, which expired on September 30, 2007, was fully disbursed (SDR 220.1 million; 45 percent of quota). The authorities are requesting a new PRGF in the amount of SDR 48.9 million (10 percent of quota) with a first disbursement of SDR 7.0 million.

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

Mission Dates. Discussions were initiated during the 2007 Article IV discussions on September 12–26, 2007 and completed during the mission of February 13–27, 2008.

Interlocutors. Hon. Ng'andu P. Magande, Minister of Finance and National Planning; Dr. Caleb Fundanga, Governor of the Bank of Zambia; other senior officials; and representatives of civil society, donors, and the business community.

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EXECUTIVE SUMMARY

The Zambian authorities are requesting a low-access, three-year arrangement under the Poverty Reduction and Growth Facility (PRGF). The arrangement, which would succeed the PRGF arrangement successfully completed in September 2007, would continue to support Zambia's efforts to further raise economic growth and reduce poverty while safeguarding macroeconomic stability.

The Zambian economy has performed well in recent years and the medium-term outlook is favorable, with real GDP expected to grow at 6–7 percent annually. However, this projection could be undermined by a sharper drop in copper prices than expected and continued electricity outages.

Under the new program macroeconomic policies will be geared to maintaining a sound fiscal position while creating space to increase spending on infrastructure and human resources; gradually lowering inflation further; and keeping external debt at a sustainable level. A flexible exchange rate regime will be maintained and international reserves are projected to increase to levels that would allow Zambia to better weather external shocks.

The fiscal position is expected to strengthen as revenues increase substantially over the medium term following the introduction of a new fiscal regime for mining. The increased resources will be used over time to finance high-priority projects identified in the Fifth National Development Plan, taking into consideration project implementation capacity and the economic impact of additional spending.

The structural reform program will complement the medium-term macroeconomic framework. Efforts to improve expenditure management and budget execution, and revenue collection, will continue. Reforms will also strengthen monetary operations and deepen the financial sector, especially through developing the secondary market for government securities. The authorities will introduce measures to ensure an adequate and reliable supply of electricity, among them raising electricity tariffs to cover the cost of service and increasing the operational efficiency of the public electric power utility company.

I. Introduction

1. **In the attached Letter of Intent the Zambian authorities request a three-year arrangement under the Poverty Reduction and Growth Facility (PRGF) in the amount of SDR 48.91 million (10 percent of quota).**[1] The new arrangement will support Zambia's efforts to further raise economic growth and enhance employment and income opportunities, especially for the poor, while maintaining macroeconomic stability. The authorities have set out their economic program in the attached Memorandum of Economic and Financial Policies (MEFP).

2. **The performance of the Zambian economy has improved markedly over the past several years.** This reflects strengthened macroeconomic policies and a favorable external environment. While the economic expansion has been broad-based, it has benefited particularly from the revival of mining in the wake of privatization and from much higher world prices of copper. The public finances have improved significantly, especially since 2004, which, combined with a prudent monetary policy and an appreciating exchange rate, lowered inflation to single digits in 2006 for the first time in three decades. Zambia's external position has benefited from the higher copper export receipts and from extensive debt relief through the Heavily Indebted Poor Countries and Multilateral Debt Relief Initiatives, bolstering investor confidence in the economy. This has contributed to a substantial real appreciation of the exchange rate and a buildup in international reserves.

3. **Though it has been reduced, poverty remains exceptionally high, particularly in rural areas.** The incidence of poverty fell from 73 percent of the population in 1998 to 64 percent in 2006; however, in rural areas it remains at about 80 percent. Progress has been made in the social sectors and human development, but the achievement of the Millennium Development Goals remains a challenge.

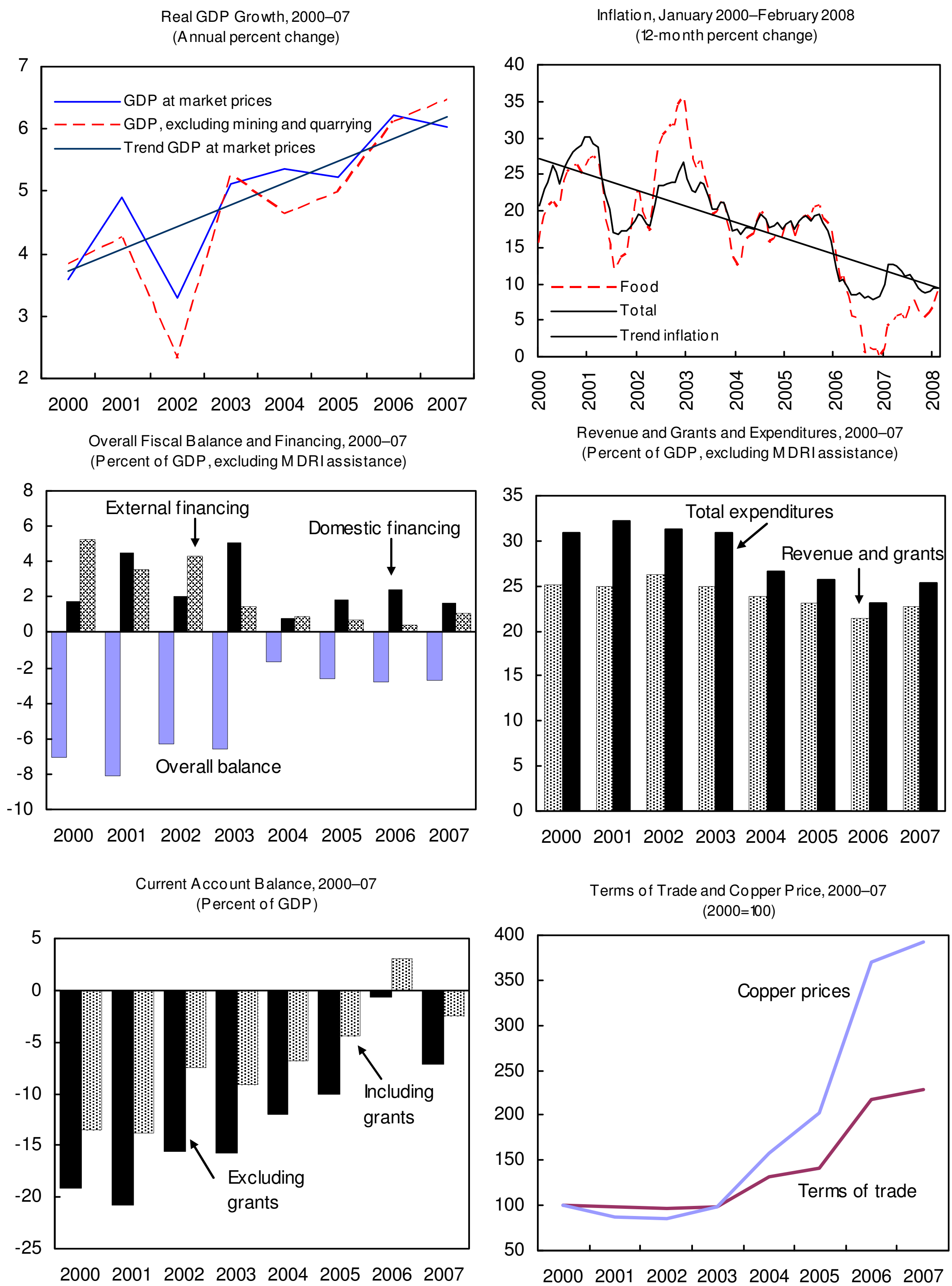
II. Recent Economic Developments

4. **Economic performance was broadly positive in 2007:**

- **The economy continued to grow robustly and inflation remained subdued** (Table 1 and Figure 1)**.** Real GDP grew by an estimated 6 percent, led by solid expansions in construction, telecommunication, and services. Although inflation rose early in the year, tighter monetary conditions, especially during the first half of 2007, and appreciation of the kwacha brought the 12-month rate down to 8.9 percent in

[1] The low-access under the proposed PRGF arrangement is a standard Fund response for countries with limited balance of payments needs.

Figure 1. Zambia: Selected Macroeconomic Indicators



December. Seasonal increases in food prices boosted inflation to 9.8 percent in March 2008.

- **The fiscal stance was tighter than budgeted** (Tables 2 and 3)**.** Revenues exceeded target, mainly because of unexpectedly large income tax payments from mining companies, whereas capital spending fell short owing to delays in completing tendering procedures. The underspending led to a large build up of government deposits at the Bank of Zambia (BoZ) through much of the year, but these balances were lowered substantially in the last two months as spending picked up.[2] The deficit (excluding grants) was 4.9 percent of GDP, about 2.5 percentage points of GDP less than budgeted.

- **Monetary expansion slowed, but still substantially exceeded the target** (Table 4 and Figure 2)**.** The BoZ found it difficult to fully sterilize its net purchases of foreign exchange, and the reduction in the statutory reserve ratio from 14 percent to 8 percent in October provided commercial banks additional liquidity. On the other hand, velocity fell further. Nominal and real interest rates on government securities trended upward in 2007; the average real yield on T-bills went from slightly negative at the beginning of the year to 3 percent at year-end.

- **The banking sector remains sound.** Banks are generally well capitalized, profitable and liquid, and the loan portfolio quality has improved (Table 5).

- **The exchange rate continued to fluctuate in response to shifts in market sentiment and movements in copper prices.** The effective exchange rate ended the year up 2.1 percent in nominal terms and 5.5 percent in real terms.

- **Notwithstanding a large deterioration in the current account (excluding grants), the BoZ continued to accumulate foreign exchange reserves** (Table 6)**.** The surplus on merchandise trade narrowed significantly because the big increase in imported investment goods for mining was only partially offset by the increase in the value of copper and other exports. The volume of copper exports was flat, as production was adversely affected by flooding in the early part of the year and power shortages later. The deficits in the service and income accounts widened owing to increased payments for construction services and profit remittances by mining companies, but foreign direct investment in the mining sector rose steeply, to 8.6 percent of GDP. Gross international reserves rose to the equivalent of 2.5 months of imports.

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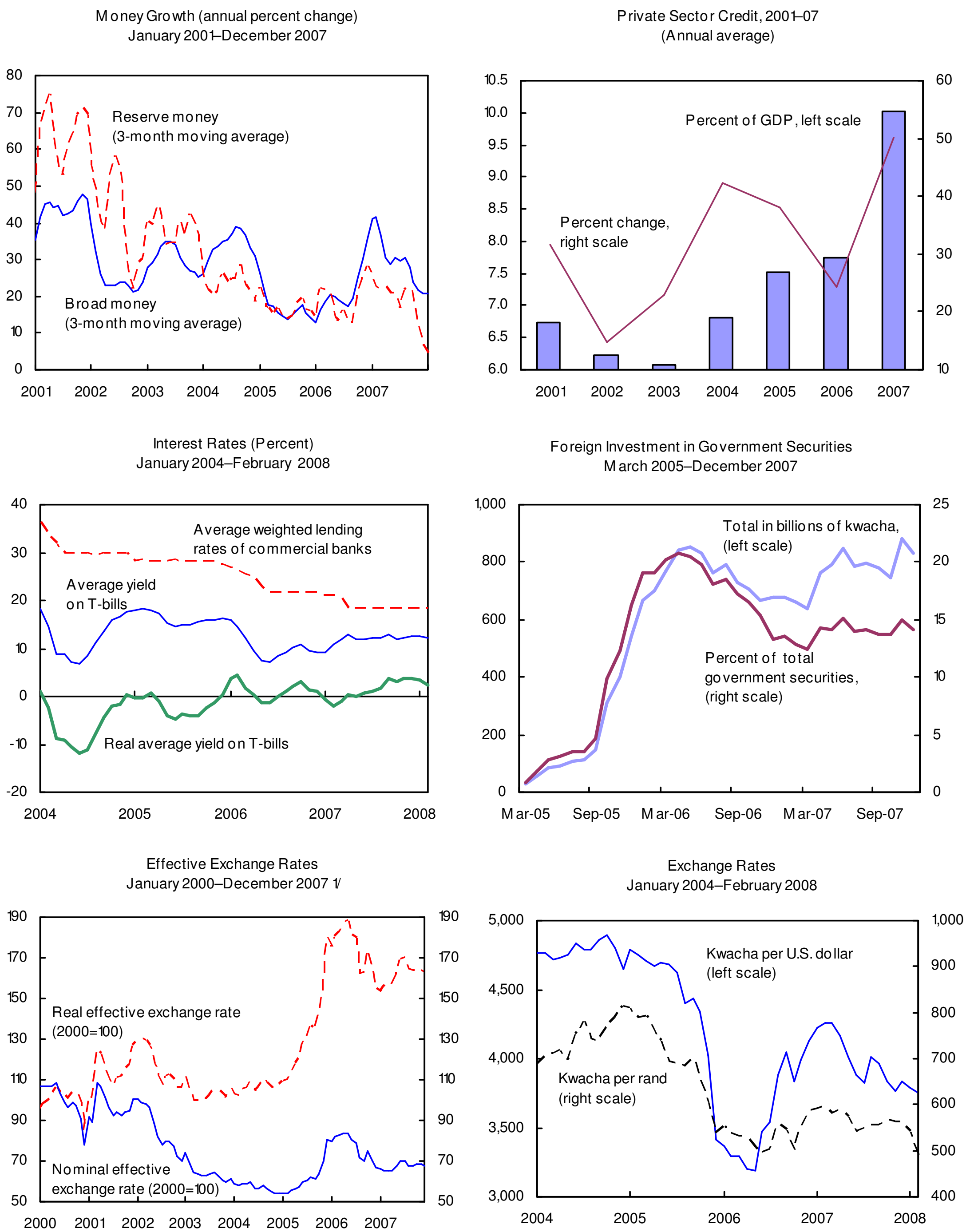
[2] The bulk of the discrepancy in the fiscal accounts (1 percent of GDP) is explained by check float; carryover of expenditures into 2008 was, relatively small.

Figure 2. Zambia: Selected Financial Market Indicators



[1] Excludes Zimbabwe.

5. **A new fiscal regime for the mining sector came into effect on April 1, 2008.** The new regime, which supersedes existing development agreements, will substantially increase the government share of mining profits and rents. The changes include an increase in the mineral royalty to 3 percent (from 0.6 percent), an increase in the corporate income tax to 30 percent (from 25 percent), and introduction of either a variable profit tax when the profit ratio is above 8 percent or a graduated windfall tax (levied on production value) when world copper prices exceed \$2.50 a pound.[3, 4]

III. Policy Discussions

6. **The new three-year PRGF arrangement will support the government's objectives of boosting economic growth and reducing poverty.** The Fifth National Development Plan 2006–10 (FNDP), Zambia's PRSP, sets out the policy framework to meet these objectives.[5] The FNDP underscores the need to create an environment conducive to private sector growth through sustained macroeconomic stability, public sector efficiency and accountability, and investments in infrastructure and the social sectors. Consistent with these principles and objectives, the program will focus on: (i) maintaining macroeconomic stability and debt sustainability, while increasing fiscal space for investment in infrastructure, energy, and human resources; and (ii) diversifying the economy to lessen dependence on mining by improving the conditions for private sector-led growth.

A. Medium-Term Macroeconomic Framework

7. **Zambia's medium-term prospects are good.** The program assumes annual real GDP growth of 6–7 percent over the medium term (Tables 1 and 7). This growth reflects ongoing large-scale investments in mining and manufacturing and sustained growth in other sectors. Fiscal policy will be geared to keeping the fiscal position sustainable, while monetary policy will aim to lower inflation to 7 percent in 2008 and 5 percent in 2009 and beyond.

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[3] The windfall tax is 25 percent when \$2.50/lb $\leq P^* <$ \$3.00/lb; 50 percent when \$3.00/lb $\leq P^* <$ \$3.50/lb; and 75 percent when $P^* \geq$ \$3.50/lb, where P* is the international price of copper. The annual international price of copper averaged \$0.74/lb between 1957 and 2005 and it ranged from \$0.30/lb to \$1.70/lb. It rose sharply in 2006 to \$3.10/lb and rose further in 2007 to \$3.20/lb.

[4] The variable profit tax and the windfall tax will not apply simultaneously. When the windfall tax applies the corporate income tax will be 30 percent.

[5] See the Joint IDA-IMF Staff Advisory Note on the Poverty Reduction Strategy Paper (Fifth National Development Plan—FNDP), IMF Country Report No. 07/277, August 2007.

8. **The modified tax regime for mining creates fiscal space for development spending on infrastructure and human resources.** Revenues are projected to increase substantially over the medium term from 18.7 percent of GDP in 2007 to 21 percent in 2008-10, mainly because of the new fiscal regime for mining. In 2008, the additional mining revenue from the new tax regime will be saved in a separate Mining Resource Account (MRA) at the BoZ. Starting 2009, net inflow to the MRA will be based on the medium-term expenditure framework (MTEF). All revenues, including those channeled through the MRA, and expenditures will be fully integrated into the annual budget and fiscal accounts. The greater resources will make it possible to increase spending over time on high-priority projects identified in the FNDP taking into account macroeconomic conditions and absorptive capacity. The composition of government expenditure will shift gradually toward capital spending. Resources will also be made available to hire more teachers and health workers and to fully clear current domestic arrears by 2009. Spending on goods and services will decline in the medium term as allocations for the constitutional review (0.6 percent of GDP in 2008 and 2009) will not be necessary in 2010, and donor-financed current spending tapers off. Despite higher capital outlays, net savings from accumulated mining taxes are projected to be 5 percent of GDP at the end of 2010. The budget deficit excluding grants is projected at 6.5 percent of GDP in 2008, declining to 4.5–5 percent in 2009–10. Including grants, the budget is expected to be in (small) surplus during 2009–10, obviating the need for domestic financing.

9. **External sector prospects will depend largely on developments in the mining sector and on world copper prices.** The current account deficit is projected to widen somewhat in 2008 but then narrow considerably in 2009 as major new mining projects are completed, suppressing imports of investment goods. Thereafter the current account deficit would again widen as the terms of trade are expected to deteriorate sharply. International reserves are projected to increase steadily to 5.5 months of imports in 2010, on the assumption that a sizable share of mining revenue will be saved. Annual net external support in the form of grants and concessional loans is projected to remain at 5–6 percent of GDP. Zambia's external debt ratios are expected to stay well below standard debt-distress thresholds.

10. **There are two main risks to the medium-term outlook.** Since Zambia remains overwhelmingly reliant on copper, an unexpectedly large drop in copper prices could weaken growth prospects. Also, a prolonged shortfall in electric power would constrain economic activity across the board.

B. Macroeconomic Policies in 2008

Fiscal policy

11. **The fiscal stance will be more expansionary in 2008, but there should be no need for net domestic financing.** Revenues are projected to rise by 2.5 percentage points of GDP based on a marked increase in mining taxes (to 3.2 percent of GDP) and nontax revenue.[6, 7] Grants are expected to increase by 0.6 percentage points to 5.3 percent of GDP. Expenditures are budgeted to rise by 2.8 percentage points due to a rebound in capital spending from the 2007 low; an increase in the wage bill because of social sector hiring and a 2–3 percent real wage increase; and allocations to the constitutional review process and arrears clearance (these will increase spending by 1.1 percent of GDP compared to 2007). Measured from below-the-line, the fiscal deficit, excluding grants, is projected to rise by 1½ percentage points of GDP to 6.5 percent of GDP. However, measured from above-the-line the deficit widens by only 0.3 percent of GDP reflecting an unusually high check float in 2007.[8]

12. **The new fiscal regime for mining increases the average effective tax rate from a level that was significantly below that in other mining countries.** When the international price of copper is at around the historical average, the windfall tax will not apply, and the average effective tax rate would be comparable to that in other countries. When the price of copper is well above the historical average, specifically, above $2.50 per pound, the windfall tax will come into effect and rise progressively with the price of copper.[9] Staff cautioned that while progressivity is desirable, the marginal effective tax rate is very high at very high prices. Staff noted that it could be lowered by making the windfall tax, like royalties, deductible for the purpose of calculating taxable profits. Staff further suggested that, instead of the price-based windfall tax, a more appropriate way of capturing a larger share of the rents when prices are abnormally high would be through a progressive profit-based variable tax that would take into consideration the different cost structures across mines. The authorities argued, however, that they consider the windfall tax a more effective way to capture a sizable share of the rent when prices are exceptionally high and that current income tax provisions do not allow taxpayers to deduct other tax payments.

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[6] Only two quarters of the mining windfall and income tax under the new regime will be collected in 2008—the full-year equivalent increase from the new regime would be twice as high.

[7] Gains from increasing visa, passport and road user fees, more than offset losses from lowering the VAT rate and changing the personal income tax thresholds, in the 2008 budget.

[8] Owing to the authorities' efforts to reduce the size of unspent releases and the check float, cash spending is expected to exceed total releases in 2008, which explains the projected overfinancing in the fiscal accounts.

[9] See footnote 3 above.

Monetary and exchange rate policies

13. **The monetary program aims to reduce annual inflation to 7 percent in 2008.** However, possible increases in fuel and food prices and the increases in electricity tariffs in January 2008 may pose a challenge. Reserve and broad money are projected to grow by 11½ percent in 2008. Given the large inflows of foreign exchange, the BoZ will have to undertake a program of regular sales of foreign exchange during the year, if the aid and other government foreign exchange inflows are to be spent and absorbed. These sales could amount to about 5 percent of total foreign exchange market turnover. However, sterilization through open market operations is expected to be relatively small, avoiding upward pressure on domestic interest rates. Gross international reserves are projected to increase to 3.2 months of imports, from 2.5 months in 2007, reflecting the saving of the additional mining revenue. In view of the limited government financing requirement, credit to the private sector is programmed to expand by a robust 22 percent.

14. **The authorities intend to address the challenge of coordinating fiscal and monetary policies to enable the BoZ to improve liquidity management.** To this end, the Ministry of Finance and National Planning (MoFNP) and the BoZ will establish a formal mechanism for coordination with key line ministries on liquidity management (MEFP, ¶19).

15. **The authorities remain committed to a flexible exchange rate regime.** Staff analysis indicates that the exchange rate is broadly aligned with macroeconomic fundamentals, including the major improvement in the terms of trade in recent years.[10]

C. Structural Policies

16. **Structural policies will complement the medium-term macroeconomic framework** (Table 8)**.** While the government's broader structural reform agenda is articulated in several multiyear programs (MEFP, ¶9), the PRGF program will focus on:

- improving expenditure management and budget execution, including through establishing a treasury single account, creating a Treasury Department, continuing to roll-out of the Integrated Financial Management Information System (IFMIS), and reform of public procurement;

- making revenue collection more efficient and effective, including through implementing the modernization of the Zambia Revenue Authority (ZRA);

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[10] See Box 1 in the IMF Country Report No. 08/41, January 2008.

- strengthening monetary operations and deepening the financial sector, including through improving liquidity management, reducing the need for banks to hold excess reserves at the BoZ, and developing an appropriate supervisory regime for the secondary market in government securities;

- implementing a debt management strategy; and

- strengthening policies in the energy sector to ensure an adequate and reliable supply of electricity for sustained economic growth, including through raising electricity tariffs to cost of service, promoting private investment and competition in the sector, and making the public utility, ZESCO, more efficient.

Public expenditure management

17. **The authorities recognize the need to speed up the reform of public expenditure management** (MEFP, ¶16–17)**.** To strengthen cash management, they are introducing a treasury single account (TSA) and rolling out the IFMIS. While the TSA is not expected to be fully in place before 2009, there has been progress on preparatory work, including the use of real-time-gross-settlement instead of checks for large transactions and initiating the IFMIS pilots. Efforts are also being made to establish a Treasury Department within the MoFNP to harmonize treasury functions and improve coordination between the MoFNP and the BoZ. Execution of capital projects will be improved by amending the procurement framework and increasing related training. Action has already been taken to allow for an earlier start of tender procedures so that ministries are ready to execute capital projects as soon as the budget is passed.

18. **Pension and public sector management reforms are also underway.** Making the public service pension fund (PSPF) financially sound over the long-term will require constitutional amendments to better align benefits with contributions. Meanwhile, the government is committed to allocating sufficient resources to the PSPF to ensure that pension obligations are met in full (MEFP, ¶15). With regard to public sector management reform, a consultant has begun working with government on a new pay policy, with the aim of submitting a draft policy to the Cabinet by year-end (MEFP, ¶16).

Tax administration

19. **The Zambia Revenue Authority is modernizing to make tax administration more effective** (MEFP, ¶14)**.** To this end an integrated and taxpayer-segmented organizational structure will be adopted. Major milestones in 2008 include the establishment of a more capable headquarters and large taxpayer office. Within the large taxpayer office, a specialized team will be created to effectively administer the new fiscal regime for mining.

Financial sector development

20. **The financial sector agenda focuses on strengthening financial sector supervision and regulation and on reforms to facilitate financial sector deepening** (MEFP, ¶21–22)**.** The BoZ is working on a program for risk-based supervision of commercial banks that will go into effect by year-end. Further, to strengthen regulation and supervision of the financial sector as a whole, legislation is being harmonized to minimize the scope for regulatory arbitrage. The licensing of a credit reference bureau in 2006 was an important step in addressing a weak credit culture—a major constraint on bank lending. To further facilitate credit bureau operations and to firm up the legal basis for banks to obtain personal information from their customers, legislation on credit bureau services is expected to be enacted this year. Other key reforms to be implemented are aimed at encouraging the development of the money and capital markets. As a first step toward supporting the development of the interbank money market, the BoZ' s rediscount window facility will be restructured, including by reducing the penal element in its price setting, which should encourage its use and reduce the need for banks to hold excess reserves. A coherent regulatory framework for government debt securities will also be introduced to stimulate the secondary market.

Electricity sector

21. **Development of the electricity sector is vital to achieving sustained high growth and reducing poverty.** An increase in generation capacity is needed to support the envisaged expansion of mining, private sector growth, and the rural electrification program. Profitable investment in the electricity sector is predicated on tariffs that cover the full cost of service. However, notwithstanding the increase in tariffs on January 1, 2008, the average tariff is still well below cost recovery levels, even for current generation capacity, which already falls well short of demand. Furthermore, the tariffs paid by the major mining companies, which consume more than half of the electricity generated, are well below cost, despite a 35 percent increase in early 2008. These tariffs were established several years ago in long-term power agreements. Besides raising tariffs, the public utility, ZESCO, needs to improve its corporate governance and efficiency.

22. **The government recognizes the gravity of the current electricity shortages and the importance of alleviating supply constraints** (MEFP, ¶23)**.** To this end, by June 2008 it will draft a concrete strategy to (i) gradually adjust electricity tariffs to reflect the cost of service; (ii) attract private investment and competition in the sector; (iii) increase the operational efficiency of ZESCO and strengthen its governance; and (iv) ensure that ZESCO has sufficient resources to implement ongoing rehabilitation and new generation projects. The World Bank and bilateral donors have indicated their willingness to extend their engagement in the development of the sector, including through additional financing. Further,

to immediately improve the financial footing of ZESCO, the government will ensure that all its arrears to the utility are paid by year-end.

Trade, debt, and aid

23. **The trade regime will be further liberalized.** In keeping with its commitments as a member of the Southern African Development Community (SADC), Zambia will eliminate its tariff on sensitive products by 2012. Meanwhile, the government will continue working to harmonize the SADC and COMESA trade-related agendas.

24. **The recent gains in external debt sustainability will be preserved.** To the extent possible, the government will continue to rely on grants and concessional external borrowing to finance central government projects and will not provide guarantees to public enterprises. Moreover, the capacity to carry out investment projects remains a key consideration in the decision to contract new foreign loans, even on concessional terms. The government noted that public enterprises generally are incorporated under the Companies Act as limited liability companies with independent boards of directors charged with overseeing that they operate on commercial principles. They further noted that concessional resources may not always be available to public enterprises. In some instances it may be necessary for the government to play a direct role in procuring the financing for essential projects. Currently, only the electricity utility, ZESCO, is seeking nonconcessional financing for three projects to augment much-needed generation capacity (MEFP, ¶24). Only two other public enterprises, the telecommunication company, ZAMTEL, and Zambia Railways, may need to borrow externally in later years. The authorities will closely monitor the borrowing needs of the public sector, which will be a subject of future reviews. Staff and the authorities concurred on the importance of finalizing the debt management strategy and strengthening the oversight of nonfinancial public corporations, including the monitoring of any future external borrowing (MEFP, ¶26).[11] The authorities indicated that they will continue to pursue their efforts to reach agreements with two non-Paris Club creditors (Bulgaria and Iraq) that have not yet provided debt relief under the enhanced HIPC Initiative. They are also making good faith efforts to resolve external arrears to private creditors stemming from the past imposition of exchange controls. These arrears data back to the 1980s when exchange controls were in place. Regarding the arrears owed to commercial enterprises (about US$160 million), the authorities have offered payment terms that are on par with those provided by the Paris Club and in an earlier IDA-supported buy-back. As for the arrears to private individuals (about US$10 million), the authorities are still seeking to verify the claims.

[11] With assistance from the World Bank, the government has embarked on a project to improve corporate governance, transparency (including financial reporting), and the performance (including through performance monitoring) of public enterprises.

25. **Aid efficiency will be enhanced.** The new Aid Policy and Strategy identifies weaknesses in managing aid inflows and proposes measures to enhance aid efficiency. As a first step, the authorities plan to build ministry capacity to assess the viability of investment projects and absorb aid inflows. The reporting and monitoring system will also be improved to increase transparency.

IV. Program Issues

26. **The program will be monitored semiannually.** Quantitative and structural performance criteria and benchmarks have been set for June and December 2008 and indicative targets for September 2008. Quantitative performance criteria are proposed on (i) net domestic assets; (ii) net domestic financing of the central government; (iii) gross international reserves; (iv) new external arrears; (v) short-term external debt; and (vi) contracting or guaranteeing of external nonconcessional debt by the public sector (MEFP, Table 1). Indicative targets have been set on payment of domestic arrears and reserve money. Structural conditionality focuses on reforms in public expenditure and debt management, tax administration, financial sector development, and policies to strengthen the performance of the electricity sector (Table 8 and MEFP, Table 2). Future program reviews will follow up, where the structural program measures for 2008 only cover the initial steps, with conditionality to ensure final implementation.

27. **Proposed access for the new PRGF arrangement is 10 percent of quota.** This is justified by the strength of Zambia's program, significant external vulnerabilities, low current outstanding use of Fund resources (11.2 percent of quota as of end-2007), and demonstrable capacity to repay the Fund (Table 9). The semiannual disbursements are evenly distributed over the three years (Table 10).

V. Staff Appraisal

28. **The Zambian economy has been performing well.** Economic growth has been robust for several years and poverty, though still widespread, has declined. Prudent fiscal policy has reduced the government's domestic financing need and supported a firm monetary policy. Inflation has been brought down to single digits, aided by a strong kwacha. The external position is markedly better, as exceptionally high copper prices greatly improved the terms of trade and debt relief cancelled the bulk of Zambia's external debt. International reserves have been gradually built up to a more comfortable level.

29. **With sustained sound macroeconomic policies the prospects for continued strong growth and low inflation are favorable.** But the authorities will need to address a number of challenges to foster economic diversification and boost economic growth. Among them are creating fiscal space for spending on infrastructure and the social sectors, enhancing capacity

to undertake public investments, managing the effects of large foreign exchange inflows, and ameliorating the conditions for private sector growth.

30. **Addressing these challenges will require better budget planning and execution, closer coordination between fiscal and monetary policy, and enhancing the competitiveness of nontraditional trade sectors.** A secure and efficient supply of energy will be critical to ensure that economic growth is not constrained by energy shortages and high costs.

31. **The authorities' program is designed to meet these challenges.** Prudent fiscal and monetary policies should keep inflation low while providing for a strong expansion in bank credit to the private sector. The established policy of allowing the exchange rate to be market determined would allow the economy to adjust to persistent real shocks, especially to the terms of trade, while a further buildup of international reserves would enhance Zambia's ability to weather temporary external shocks.

32. **The new fiscal regime for the mining sector will help to create fiscal space for more spending in infrastructure and human resources.** However, in implementing the new regime, the government should be mindful of the need to preserve Zambia's attractiveness for investment in mining. In particular, the authorities should consider making the windfall tax deductible in determining taxable profits.

33. **The structural program complements the medium-term framework.** The program appropriately focuses on improving expenditure management and budget execution, reinforcing debt management, making revenue collection more efficient and effective, strengthening monetary operations and deepening the financial sector, and addressing supply shortages and inefficiencies in the energy sector.

34. **Faster progress towards improving public expenditure management is essential to ensure that it generates high returns.** Steadfast implementation of the public financial management reforms is vital, especially establishing a treasury single account and completing the IFMIS project.

35. **The implementation of the debt management strategy will help to ensure external debt sustainability.** Notably, the authorities' intention to better monitor external borrowing by public enterprises is welcome.

36. **The financial sector policies should further deepen the sector.** The focus is on tighter regulation and supervision and on building money and capital markets. The government's efforts to obtain a sovereign credit rating could also enhance Zambia's attractiveness as an investment destination.

37. **Development of the energy sector is vital to achieving high and sustained economic growth.** To alleviate persistent electricity shortages, there is an urgent need to implement polices to gradually raise tariffs to reflect the cost of service, reform ZESCO, and ensure that sufficient resources are available to complete planned projects to expand hydropower capacity. The government is encouraged to engage the World Bank and other development partners in addressing the problems in the electricity sector.

38. Based on these considerations, staff recommends approval of the authorities request for a new three-year PRGF arrangement.

Table 1. Zambia: Selected Economic Indicators

	2005	2006	2007	2008 Proj.	2009 Proj.	2010 Proj.
	(In percent changes; unless otherwise indicated)					
National account and prices						
GDP at constant prices	5.2	6.2	6.0	6.2	6.3	6.5
GDP deflator	18.6	13.8	9.4	5.0	4.0	2.9
GDP at market prices	32,456	39,223	45,482	50,716	56,051	61,432
(In billions of kwacha)						
Consumer prices (average)						
Headline	18.3	9.0	10.7	8.2	4.4	5.0
Underlying (excluding food)	18.1	13.6	16.3	9.2	5.2	5.0
Consumer prices (end of period)	15.9	8.2	8.9	7.0	5.0	5.0
External sector						
Terms of trade (deterioration -)	10.4	55.2	7.9	-8.7	-13.8	-20.1
Average exchange rate (kwacha per U.S. dollar)	4,464	3,601	4,002	…	…	…
(in percentage change; depreciation -)	6.6	19.3	-11.1	…	…	…
Real effective exchange rate (depreciation -)[1]	24.1	32.3	-7.1	…	…	…
Money and credit (end of period)						
Domestic credit to the private sector	18.7	54.3	43.0	22.2	…	…
Reserve money[2]	16.4	22.6	1.6	11.5	…	…
M3	0.4	45.1	25.9	11.6	…	…
	(In percent of GDP; unless otherwise indicated)					
National accounts						
Gross investments	22.5	22.6	24.1	22.7	22.1	22.5
Government	7.0	4.1	4.1	5.2	5.8	6.8
Private	15.5	18.5	20.0	17.5	16.3	15.7
National savings	18.1	25.6	21.6	20.6	24.1	21.5
Gross foreign savings	4.4	-3.0	2.5	2.1	-2.0	1.0
Central government budget[3]						
Overall balance	-2.6	18.6	-0.2	-1.1	0.9	0.4
(excluding grants)	-8.3	-7.4	-4.9	-6.5	-4.5	-5.0
Revenue	17.4	16.9	18.7	21.2	22.1	21.5
Grants	5.6	26.0	4.6	5.3	5.4	5.3
Total expenditure[4]	25.7	24.3	23.6	27.6	26.7	26.4
External sector						
Current account balance						
(including official grants)	-4.4	3.0	-2.5	-2.1	2.0	-1.0
(excluding official grants)	-10.1	-0.7	-7.1	-7.4	-3.4	-6.3
Gross international reserves (months of imports)	1.5	2.2	2.5	3.2	4.7	5.5
	(In percent of export of goods and services)					
NPV of central government and BoZ external debt	78.3	15.7	11.8	12.8	14.1	16.3

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

[1]Excludes Zimbabwe.

[2]The projected reduction in reserve money for December 2007 reflects the lowering of statutory reserve requirements from 14 to 8 percent on October 1, 2007.

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

[4]Including discrepancy between the above-the-line balance and below-the-line financing.

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

	2005	2006	2007	2008 Proj.	2009 Proj.	2010 Proj.
Revenue and grants	7,467	16,825	10,626	13,444	15,452	16,476
Revenue	5,642	6,618	8,522	10,746	12,411	13,205
Tax	5,512	6,317	8,184	10,051	11,925	12,686
Income taxes	2,455	2,960	3,832	5,162	6,516	6,662
Value-added tax	1,633	1,792	2,231	2,397	2,633	2,919
Excise taxes	768	821	1,205	1,345	1,498	1,666
Customs duties	656	744	916	1,147	1,279	1,439
Nontax	130	301	338	695	486	519
Grants	1,825	10,207	2,104	2,698	3,040	3,272
Budget support	543	423	582	620	744	827
Project grants	1,282	1,374	1,522	2,079	2,297	2,445
Debt reduction (including MDRI)	0	8,410	0	0	0	0
Expenditures	8,350	9,051	11,209	13,906	14,957	16,249
Current expenditures	5,828	7,203	9,045	10,575	11,579	12,089
Wages and salaries	2,455	2,833	3,531	4,256	4,822	5,329
Goods and services	1,249	1,779	2,437	2,830	2,967	2,778
Interest payments	865	749	776	698	737	718
Other	1,259	1,842	2,302	2,791	3,053	3,264
Capital expenditure	2,267	1,601	1,842	2,662	3,276	4,160
Of which: domestically financed	565	599	1,083	1,560	2,221	3,080
Domestic arrears payments	254	247	322	669	101	0
Discrepancy (-overfinancing)[1]	24	-483	474	-111	0	0
Overall balance						
Including grants	-858	7,291	-109	-573	494	228
Excluding grants	-2,683	-2,916	-2,213	-3,271	-2,546	-3,044
Financing	858	-7,291	109	573	-494	-228
External financing (net)	241	-6,225	145	637	326	297
Of which: budget support	84	36	0	165	191	202
Of which: debt reduction (MDRI)	0	-6,392	0	0	0	0
Domestic financing (net)	617	-1,066	-36	-64	-820	-524
Bank financing	-96	-1,806	-431	-728	-1,113	-855
Of which: BoZ onlending of IMF MDRI relief	0	-2,018	0	0	0	0
Nonbank financing	713	740	395	665	292	330
Memorandum items:						
Primary balance, including grants	6	8,041	666	125	1,232	946
Primary balance, excluding grants and mining	…	-2,385	-2,087	-4,213	-4,397	-4,653
Mining taxes	…	219	650	1,640	2,589	2,327
Mining resource account balance	…	…	…	917	2,130	3,085
Poverty-reducing spending[2]	1,995	2,356	3,106	3,573	…	…
External budget support	628	459	582	784	934	1,029
Stock of domestic arrears	947	1,028	753	85	0	0
Stock of domestic government securities	5,271	6,242	6,966	7,820	8,212	8,642
MDRI debt sevice savings	…	94	0	359	0	0

Sources: Zambian authorities; and IMF 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	2007	2008 Proj.	2009 Proj.	2010 Proj.
Revenue and grants	23.0	42.9	23.4	26.5	27.6	26.8
Revenue	17.4	16.9	18.7	21.2	22.1	21.5
Tax	17.0	16.1	18.0	19.8	21.3	20.7
Income taxes	7.6	7.5	8.4	10.2	11.7	10.9
Value-added tax	5.0	4.6	4.9	4.9	4.9	4.9
Excise taxes	2.4	2.1	2.6	2.7	2.7	2.7
Customs duties	2.0	1.9	2.0	2.1	2.1	2.1
Nontax	0.4	0.8	0.7	1.4	0.9	0.8
Grants	5.6	26.0	4.6	5.3	5.4	5.3
Budget support	1.7	1.1	1.3	1.2	1.3	1.3
Project grants	3.9	3.5	3.3	4.1	4.1	4.0
Debt reduction (including MDRI)	0.0	21.4	0.0	0.0	0.0	0.0
Expenditures	25.7	23.1	24.6	27.4	26.7	26.4
Current expenditures	18.0	18.4	19.9	20.9	20.7	19.7
Wages and salaries	7.6	7.2	7.8	8.4	8.6	8.7
Goods and services	3.8	4.5	5.4	5.6	5.3	4.5
Interest payments	2.7	1.9	1.7	1.4	1.3	1.2
Other	3.9	4.7	5.1	5.5	5.4	5.3
Capital expenditure	7.0	4.1	4.1	5.2	5.8	6.8
Of which: domestically financed	1.7	1.5	2.4	3.1	4.0	5.0
Domestic arrears payments	0.8	0.6	0.7	1.3	0.2	0.0
Discrepancy (-overfinancing)[1]	0.1	-1.2	1.0	-0.2	0.0	0.0
Overall balance						
Including grants	-2.6	18.6	-0.2	-1.1	0.9	0.4
Excluding grants	-8.3	-7.4	-4.9	-6.5	-4.5	-5.0
Financing	2.6	-18.6	0.2	1.1	-0.9	-0.4
External financing (net)	0.7	-15.9	0.3	1.3	0.6	0.5
Of which: budget support	0.3	0.1	0.0	0.3	0.3	0.3
Of which: debt reduction (MDRI)	…	-16.3	0.0	0.0	0.0	0.0
Domestic financing (net)	1.9	-2.7	-0.1	-0.1	-1.5	-0.9
Bank financing	-0.3	-4.6	-0.9	-1.4	-2.0	-1.4
Of which: Onlending of IMF MDRI relief	0.0	-5.1	0.0	0.0	0.0	0.0
Nonbank financing	2.2	1.9	0.9	1.3	0.5	0.5
Memorandum items:						
Primary balance, including grants	0.0	20.5	1.5	0.2	2.2	1.5
Primary balance, excluding grants and mining	…	-6.1	-4.6	-8.3	-7.8	-7.6
Mining taxes	…	0.6	1.4	3.2	4.6	3.8
Mining resource account balance	…	…	…	1.8	3.8	5.0
Poverty-reducing spending[2]	6.1	6.0	6.8	7.0	…	…
External budget support	1.9	1.2	1.3	1.5	1.7	1.7
Stock of domestic arrears	2.9	2.6	1.7	0.2	0.0	0.0
Stock of domestic government securities	16.2	15.9	15.3	15.4	14.7	14.1
MDRI debt sevice savings	…	0.2	0.0	0.7	0.0	0.0
Nominal GDP (in billions of kwacha)	32,456	39,223	45,482	50,716	56,051	61,432

Sources: Zambian authorities; and IMF 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	2008 Proj.
		I. Monetary Survey		
Net foreign assets	-281	3,954	4,999	5,808
Net domestic assets	6,122	4,523	5,676	6,100
Claims on central government (net)	2,416	2,440	1,956	1,254
Claims on private sector	2,437	3,760	5,377	6,572
Claims on public enterprises	230	224	379	430
Other items (net)[2]	1,038	-1,901	-2,035	-2,156
Money and quasi-money (M3)	5,841	8,477	10,675	11,908
Broad money (M2)	3,860	5,763	6,769	0
Foreign exchange deposits	1,981	2,714	3,906	11,908
		II. Bank of Zambia		
Net foreign assets	-1,022	2,808	3,743	4,808
Of which: IMF liabilities	-2,361	-237	-361	-399
Net domestic assets	3,029	-348	-1,242	-2,019
Claims on central government (net)	1,070	844	-13	-966
Claims on nongovernment	375	309	235	244
Claims on private sector	53	47	56	56
Claims on public enterprises	96	0	0	0
Claims on deposit money banks (net)	226	262	179	188
Other items (net)[2]	1,584	-1,501	-1,464	-1,296
Reserve money[3]	2,006	2,460	2,500	2,789
Currency outside banks and cash in vaults	962	1,224	1,513	1,925
Commercial bank deposits	1,044	1,236	987	864
Memorandum items:				
	(In 12-month percentage change; unless otherwise indicated)			
Reserve money	16.4	22.6	1.6	11.5
M3	0.4	45.1	25.9	11.6
Credit to the private sector	18.7	54.3	43.0	22.2
M3-to-GDP ratio (in percent)	18.0	21.6	23.5	23.5
Money multiplier (M3/reserve money)	2.9	3.4	4.3	4.3
Credit to the private sector (in percent of GDP)	7.5	9.6	11.8	13.0
Gross foreign exchange reserves of the Bank of Zambia (in millions of U.S. dollars)	331	595	947	1,329
Exchange rate (kwacha per U.S. dollar)	3,509	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).

[3]Figures reflect the lowering of statutory reserve requirements from 14 to 8 percent on October 1, 2007.

Table 5. Zambia: Financial Soundness Indicators
(In percent, unless otherwise indicated)

	2004 Dec	2005 Dec	2006 Dec	2007 Dec
Capital adequacy				
Regulatory capital to risk-weighted assets	22.2	28.4	20.4	18.6
Tier 1 regulatory capital to risk-weighted assets	19.6	26.2	18	15.9
Capital to total assets	9.7	11.6	9.1	9.2
Asset quality				
Past due advances (NPL) to total advances	7.6	8.9	11.3	8.8
Loan loss provisions to nonperforming loans	102.8	90.7	83.3	73.2
Bad debt provisions to advances	7.8	5.4	6.8	6.4
Loan concentration [1]				
Households	13.1	19.5	16.1	15.5
Government and parastatals	5.5	5.5	6.2	9.05
Agriculture	30.3	27.0	23.9	18.35
Mining	4.5	4.0	4.4	4.12
Manufacturing	13.0	12.0	14	10.95
Construction	2.0	2.0	2.4	3.71
Services	8.1	7.0	9.8	13.3
Others	42.0	48.0	45.5	49.57
Earnings and profitability				
Return on average assets	3.1	6.5	5.1	4.7
Return on equity	29.8	46.4	30.6	35.1
Gross interest income to total gross income	78.2	60.9	60.2	63.1
Gross noninterest income to total gross income	46.3	39.1	39.8	36.9
Net interest margin	11.8	11.8	12.8	11.5
Liquidity [2]				
Liquid assets to total assets	66.6	41.0	41.3	37.6
Liquid assets to total deposits	73.7	51.0	49.6	46
Advances to deposits ratio	37.3	44.5	49	57.4
Exposure to foreign currency				
Foreign currency loans to total gross loans	41.2	36.2	34.0	32.5
Foreign currency liabilities to total liabilities	58.4	31.0	61.2	27.1
Net open position in foreign exchange to capital	10.0	2.1	9.4	7.1
Exposure to household debt				
Household debt to GDP	0.0	1.5	1.5	…

Source: Bank of Zambia.

[1] Components do not add up to 100 because loans to households, government, and parastatals are included in loans classified by economic sectors.

[2] Liquid assets were redefined to exclude one-year Treasury bills beginning in 2005.

Table 6. Zambia: Balance of Payments [1]
(In millions of U.S. dollars, unless otherwise indicated)

	2005	2006	2007	2008 Proj.	2009 Proj.	2010 Proj.
Current account	-606	128	-507	-608	-100	-526
Trade balance	118	1,293	983	1,030	1,114	459
Exports, f.o.b.	2,278	3,929	4,594	5,084	4,996	4,564
Of which: copper	1,516	3,029	3,407	3,785	3,653	3,182
Imports, f.o.b	-2,161	-2,636	-3,611	-4,055	-3,882	-4,105
Of which: oil	-312	-454	-493	-703	-739	-777
Services (net)	-199	-359	-636	-558	-389	-396
Income (net)	-632	-1,169	-1,384	-1,700	-1,449	-1,202
Of which: interest on public debt	-110	-17	-13	-13	-9	-6
Current transfers (net)	107	362	530	620	625	614
Budget support grants	131	116	147	158	177	186
Sector-wide approach grants	0	92	156	186	178	167
Private transfers	-24	154	228	276	270	261
Capital and financial account	696	947	957	969	560	926
Capital account	287	2,600	223	342	367	385
Project grants	287	197	223	342	367	385
External debt cancellation	0	2,403	0	0	0	0
Financial account	409	-1,653	734	628	192	542
Foreign direct and portfolio investments	497	654	1,026	668	253	265
Other investments	-88	-2,307	-292	-41	-60	277
Medium and long-term	-88	-1,999	-109	167	6	17
Public sector (net)	-65	-1,779	34	162	77	67
Disbursements	160	91	83	208	121	98
Of which: budget support	24	9	0	42	45	45
Amortization due	-225	-1,870	-49	-47	-44	-31
Commercial banks (net)	83	-49	-67	67	23	0
Other sectors	-106	-172	-76	-61	-94	-50
Short-term	0	-308	-183	-208	-66	260
Errors and omissions	-219	-253	-140	0	0	0
Overall balance	-129	821	310	361	460	401
Financing						
Central bank net reserves (- increase)	-351	-821	-310	-361	-460	-401
Of which: gross reserve change	-109	-264	-352	-382	-481	-421
Of which: Use of Fund loans	-236	-557	42	21	21	20
Exceptional financing	480	0	0	0	0	0
Financing gap	0	0	0	0	0	0
Memorandum items:						
Current account including capital grants (in percent of GDP)	-4.4	3.0	-2.5	-2.1	2.0	-1.0
Current account excluding grants (in percent of GDP)	-10.1	-0.7	-7.1	-7.4	-3.4	-6.3
Copper export volume (thousands of metric tons)	450	492	491	556	626	727
Copper export price (U.S. dollars per pound)	1.5	2.8	3.1	3.1	2.6	2.0
Net creditor/donor support (in percent of GDP) [2]	6.7	4.2	4.9	6.0	5.5	5.4
Of which: official grants	5.7	3.7	4.6	5.3	5.4	5.3
Gross international reserves	331	595	947	1,329	1,810	2,231
In months of imports	1.5	2.2	2.5	3.2	4.7	5.5
GDP (in millions of U.S. dollars)	7,271	10,893	11,364	12,827	13,375	13,930

Sources: Zambian authorities; and Fund staff estimates and projections.
[1] Disbursements and imports related to possible future hydropower projects are not included.
[2] Defined as loan disbursements, plus grants, less debt service.

Table 7. Zambia: Macroeconomic Framework, 2006-2012

	2006	2007	2008 Proj	2009 Proj.	2010 Proj.	2011 Proj.	2012 Proj.
National account and prices			(In percent changes)				
GDP at constant prices	6.2	6.0	6.2	6.3	6.5	6.0	6.0
Consumer prices (average)							
Headline	9.0	10.7	8.2	4.4	5.0	5.0	5.0
Underlying (excluding food)	13.6	16.3	9.2	5.2	5.0	5.0	5.0
Consumer prices (end of period)	8.2	8.9	7.0	5.0	5.0	5.0	5.0
			(In percent of GDP)				
Gross investments	22.6	24.1	22.7	22.1	22.5	23.3	23.7
Government	4.1	4.1	5.2	5.8	6.8	6.8	6.8
Private	18.5	20.0	17.5	16.3	15.7	16.5	16.9
National savings	25.6	21.6	20.6	24.1	21.5	18.8	20.9
Gross foreign savings	-3.0	2.5	2.1	-2.0	1.0	4.5	2.8
Central government budget[1]							
Overall balance	18.6	-0.2	-1.1	0.9	0.4	-3.1	-3.0
(excluding grants)	-7.4	-4.9	-6.5	-4.5	-5.0	-7.9	-7.7
Revenue	16.9	18.7	21.2	22.1	21.5	17.1	17.2
Grants	26.0	4.6	5.3	5.4	5.3	4.8	4.6
Total expenditure[2]	24.3	23.6	27.6	26.7	26.4	25.0	24.8
Money and credit (end of period)			(In percent changes)				
Broad money (M3)	45.1	21.5	11.5	…	…	…	…
Domestic credit to the private sector	54.3	45.7	16.1	…	…	…	…
External sector			(In percent of GDP)				
Current account (including official grants)	3.0	-2.5	-2.1	2.0	-1.0	-4.5	-2.8
Current account (excluding official grants)	-0.7	-7.1	-7.4	-3.4	-6.3	-9.3	-7.4
			(In percent of exports of goods and services)				
NPV of external public debt (including IMF)	16.0	13.7	14.3	17.0	20.1	22.2	22.8
			(In percent changes)				
Exports of goods and services	63.0	17.2	10.4	-1.3	-7.7	-11.7	0.7
Imports of goods and services	22.4	40.4	8.5	-6.6	5.5	3.0	4.6
Terms of trade (deterioration -)	55.2	7.9	-8.7	-13.8	-20.1	-17.5	-5.3
Copper export price (U.S. dollars per pound)	82.7	12.6	-1.8	-14.3	-25.0	-22.2	-5.7
			(In millions of U.S. dollars, unless otherwise indicated)				
Gross international reserves (in US$ millions)	595	947	1,329	1,810	2,231	2,461	2,684
In months of imports	2.2	2.5	3.2	4.7	5.5	5.9	6.2

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

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

[2]Including discrepancy between the above-the-line balance and below-the-line financing.

Table 8. Zambia: Structural Conditionality for 2008

Measure	Timing	Type of condition	Macro Rationale
Public Financial Management			
Submit to Cabinet a proposal to establish a treasury single account.	End-June 2008	Performance criterion	To strengthen public expenditure management and budget execution. In particular, the measures will improve cash flow management and forecasts and therefore improve fiscal and monetary policy coordination.
Submit to Cabinet a proposal to establish a Treasury Department.	End-June 2008	Benchmark	
Tax Administration			
Establish a headquarters functional structure at the Zambia Revenue Authority.	End-September 2008	Benchmark	To modernize the Zambia Revenue Authority and increase tax administration efficiency.
Establish a single large-taxpayer office at the Zambia Revenue Authority.	End-December 2008	Benchmark	
Financial Sector			
The Ministry of Finance and National Planning and the Bank of Zambia will establish a formal mechanism for coordination with key line ministries on liquidity management.	End-June 2008	Benchmark	To strengthen liquidity management, reduce volatility in the money market, and enhance the effectiveness of monetary policy. The introduction of risk based supervision will help maintain a healthy banking system, particularly during a period when credit is expected to expand at a rapid pace. The measures will contribute to financial sector deepening which is vital to achieve Zambia's medium-term growth objectives.
The Bank of Zambia will restructure the operations of its rediscount window.	End-June 2008	Benchmark	
Set up a supervisory regime for the secondary market in government securities.	End-September 2008	Benchmark	
Introduce risk based bank supervision.	End-December 2008	Benchmark	
Debt Management			
Submit to Cabinet a debt management strategy.	End-September 2008	Benchmark	To facilitate cost effective public sector borrowing and maintain a sound debt structure
Energy Sector			
Submit to Cabinet a policy for the electricity sector with specific strategies to (i) gradually adjust electricity tariffs to the cost of service; (ii) attract private investment and competition in the sector; (iii) increase the operational efficiency of ZESCO; and (iv) ensure that ZESCO has sufficient resources to implement the planned rehabilitation and new generation projects.	End-June 2008	Performance criterion	To ensure an efficient and sustainable power supply. Solving the current problems in the energy sector is essential to achieving the growth objectives of the program.

Table 9. Zambia: Indicators of Capacity to Repay the Fund[1]

	2007	2008	2009	2010	2011	2012	2013	2014	2015
		Projections							
Fund obligations based on existing credit (in millions of SDRs)									
Principal	0	0	0	0.6	3.3	7.7	11.0	11.0	10.5
Charges and interest	2.7	2.1	1.9	1.9	1.9	1.9	1.8	1.8	1.7
Fund obligations based on existing and prospective credit (in millions of SDRs)									
Principal	0.0	0	0	0.6	3.3	7.7	11.7	14.5	16.7
Charges and interest	2.7	2.1	2.0	2.1	2.1	2.1	2.1	2.0	1.9
Total obligations based on existing and prospective credit									
In millions of SDRs	2.7	2.1	2.0	2.6	5.4	9.8	13.8	16.5	18.7
In millions of US$	4.3	3.1	3.0	4.0	8.3	15.1	21.3	25.7	29.2
In percent of exports of goods and services	0.09	0.06	0.06	0.08	0.19	0.35	0.48	0.54	0.57
In percent of debt service[2]	6.90	5.3	5.8	10.4	23.2	19.5	31.8	32.1	32.2
In percent of GDP	0.04	0.02	0.02	0.03	0.06	0.10	0.13	0.15	0.15
In percent of Gross International Reserves	0.45	0.24	0.17	0.18	0.34	0.56	0.68	0.85	0.90
In percent of quota	0.55	0.4	0.4	0.5	1.1	2.0	2.8	3.4	3.8
Outstanding Fund credit									
In millions of SDRs	55.0	69.0	83.0	96.4	100.1	92.4	80.7	66.2	49.4
In millions of US$	86.7	103.9	125.5	146.5	153.0	142.1	124.8	103.0	77.4
In percent of exports of goods and services	1.78	1.93	2.36	2.99	3.54	3.26	2.81	2.15	1.50
In percent of debt service[2]	140.66	175.59	240.54	382.52	428.60	184.20	186.49	128.95	85.17
In percent of GDP	0.76	0.81	0.94	1.06	1.07	0.94	0.77	0.59	0.40
In percent of Gross International Reserves	9.15	7.82	6.93	6.57	6.22	5.29	3.98	3.41	2.39
In percent of quota	11.25	14.11	16.96	19.71	20.46	18.89	16.49	13.53	10.11
Net use of Fund credit (in millions of SDRs)	27.5	14.0	14.0	13.4	3.7	(7.7)	(11.7)	(14.5)	(16.7)
Disbursements	27.5	14.0	14.0	14.0	7.0	0	0	0	0
Repayments	0	0	0	0.6	3.3	7.7	11.7	14.5	16.7
Memorandum items:									
Exports of goods and services (in millions of US$)	4,873	5,380	5,310	4,902	4,327	4,359	4,437	4,787	5,165
Debt service (in millions of US$)[2]	62	59	52	38	36	77	67	80	91
Nominal GDP (in millions of US$)	11,364	12,807	13,315	13,853	14,247	15,071	16,151	17,572	19,118
Gross International Reserves (in millions of US$)	947	1,329	1,810	2,231	2,461	2,684	3,139	3,023	3,232
Quota (millions of SDRs)	489.10	489.10	489.10	489.10	489.10	489.10	489.10	489.10	489.10

Sources: IMF staff estimates and projections.

[1]Assumes prospective PRGF disbursements of SDR 48.91 during 2008-11.

[2]Total debt service includes IMF repayments.

Table 10. Zambia: Proposed Schedule of Disbursements Under the PRGF Arrangement[1]

Amount In millions of SDRs	Amount In percent of quota	Availability	Conditions for Disbursement
6.987	1.43	June 4, 2008	Board approval of the three-year PRGF arrangement
6.987	1.43	November 30, 2008	Board completion of the first review based on observance of performance criteria for June 30, 2008
6.987	1.43	May 30, 2009	Board complettion of the second review based on observance of performance criteria for December 31, 2008
6.987	1.43	November 30, 2009	Board completion of the third review based on observance of performance criteria for June 30, 2009
6.987	1.43	May 30, 2010	Board completion of the fourth review based on observance of performance criteria for December 31, 2009
6.987	1.43	November 30, 2010	Board completion of the fifth review based on observance of performance criteria for June 30, 2010
6.988	1.43	May 30, 2011	Board complettion of the sixth review based on observance of performance criteria for December 31, 2010

[1]Total access under the PRGF is SDR 48.91 million (10 percent of quota).

Table 11. Zambia: Millennium Development Goals

	1990	1994	1997	2000	2003	2005
Goal 1: Eradicate extreme poverty and hunger[1]						
Population below US$ 1 dollar a day (in percent)	64.6	73.6	66.0	....	76.0	64.0
Poverty gap ratio at US$ 1 dollar a day (in percent)	38.9	42.7	34.0	....	36.0	33.0
Percentage share of income or consumption held by poorest 20 percent	...	...	3.3	....	6.0	4.0
Poverty headcount, national (percent of population)	...	...	72.9	....	....	68.0
Prevalence of underweight children (percent of children under 5)	...	...	23.5	....	23.0	....
Population below minimum level of dietary energy consumption (in percent)	...	...	48.0	....	47.0	46.0
Goal 2: Achieve universal primary education[2]						
Net primary enrollment ratio (percent of relevant age group)	79.1	...	64.9	62.6	79.8	88.9
Primary completion rate, total (percent of relevant age group)	...	...	61.6	56.3	66.2	77.5
Percentage of pupils starting grade 1 who reach grade 5 (in percent)	...	...	78.2	98.5	....	....
Youth literacy rate (percent ages 15–24)	81.2	...	...	69.4	....	69.5
Goal 3: Promote gender equality[3]						
Ratio of girls to boys in primary and secondary education (in percent)	...	...	89.7	90.4	92.3	...
Ratio of young literate females to males (percent ages 15–24)	88.1	...	...	...	...	91.2
Share of women employed in the nonagricultural sector (in percent)	29.4	...	...	...	...	...
Proportion of seats held by women in national parliament (in percent)	7.0	...	10.0	10.0	12.0	15.0
Goal 4: Reduce child mortality[4]						
Under 5 mortality rate (per 1,000)	180.0	182.0	...	182.0	182.0	182.0
Infant mortality rate (per 1,000 live births)	101.0	102.0	...	102.0	102.0	102.0
Immunization, measles (percent of children under 12 months)	90.0	96.0	86.0	85.0	84.0	84.0
Goal 5: Improve maternal health[5]						
Maternal mortality ratio (modeled estimate, per 100,000 live births)	...	...	...	750.0	...	...
Births attended by skilled health staff (percent of total)	50.5	...	46.5	47.1	43.4	...
Goal 6: Combat HIV/AIDS, malaria, and other diseases[6]						
Prevalence of HIV, total (percent of population ages 15-49)	...	...	...	16.7	16.9	17.0
Contraceptive prevalence rate (percent of women ages 15-49)	...	48.1	25.9	53.5	34.0	...
Number of children orphaned by HIV/AIDS	...	...	...	570,000	630,000	...
Incidence of tuberculosis (per 100,000 people)	296.8	498.9	575.5	605.0	658.3	600.1
Tuberculosis cases detected under DOTS (in percent)	...	...	...	...	62.0	51.6
Goal 7: Ensure environmental sustainability[7]						
Forest area (percent of total land area)	66.1	...	...	60.1	...	57.1
Nationally protected areas (percent of total land area)	...	...	...	...	42.0	...
GDP per unit of energy use (PPP US$ per kg oil equivalent)	1.4	1.3	1.3	1.3	1.4	1.5
CO2 emissions (metric tons per capita)	0.3	0.3	0.2	0.2	0.2	...
Access to an improved water source (percent of population)	50.0	...	...	...	58.0	...
Access to improved sanitation (percent of population)	44.0	...	...	...	55.0	...
Access to secure tenure (percent of population)	...	...	...	...	...	...
Goal 8: Develop a Global Partnership for Development[8]						
Youth unemployment rate (percent of total labor force ages 15–24)	20.9	...	...	...	...	...
Fixed line and mobile telephones (per 1,000 people)	7.8	8.6	8.2	17.0	29.2	89.2
Personal computers (per 1,000 people)	...	...	5.8	6.5	8.4	9.8

Source: *World Development Indicators* Database, April 2008.

Note: In some cases the data are for earlier or later years than those stated.

[1] Goal 1 targets: Halve, between 1990 and 2015, the proportion of people whose income is less than one dollar a day. Halve, between 1990 and 2015, the proportion of people who suffer from hunger.

[2] Goal 2 target: Ensure that, by 2015, children everywhere, boys and girls alike, will be able to complete a full course of primary schooling.

[3] Goal 3 target: Eliminate gender disparity in primary and secondary education preferably by 2005 and to all levels of education no later than 2015.

[4] Goal 4 target: Reduce by two-thirds, between 1990 and 2015, the under-5 mortality rate.

[5] Goal 5 target: Reduce by three-quarters, between 1990 and 2015, the maternal mortality ratio.

[6] Goal 6 targets: Have halted by 2015, and begun to reverse, the spread of HIV/AIDS. Have halted by 2015, and begun to reverse, the incidence of malaria and other major diseases.

[7] Goal 7 targets: Integrate the principles of sustainable development into country policies and programs and reverse the loss of environmental resources. Halve, by 2015, the proportion of people without sustainable access to safe drinking water.

[8] Goal 8 targets: Develop further an open, rule-based, predictable, nondiscriminatory trading and financial system. Address the special seeds of the least developed countries. Address the special needs of landlocked countries and small island developing states.

Appendix I—Letter of Intent

7th May, 2008

Mr. Dominique Strauss-Kahn
Managing Director
International Monetary Fund
Washington, D.C.

Dear Mr. Strauss-Kahn,

The Government of the Republic of Zambia successfully completed a three year economic program with support from the International Monetary Fund under the Poverty Reduction and Growth Facility (PRGF) arrangement in September 2007. The attached Memorandum of Economic and Financial Policies (MEFP) and Technical Memorandum of Understanding (TMU) reviews recent economic progress and sets out the macroeconomic policies and structural reforms that the Government will pursue in the coming years. To support the implementation of the program, the Government requests a new three-year arrangement under the PRGF in a total amount equivalent to SDR 48.91 million (10 percent of quota). We also request that the first disbursement, in an amount equivalent to SDR 6.987 million, be made available after the approval of the PRGF arrangement by the Executive Board of the IMF.

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 strengthen expenditure management and improve the conditions for private sector-led growth.

The Government believes that the policies set forth in the attached MEFP are adequate to achieve the objectives of its program, but it will take any further measures that may become appropriate for this purpose. 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 authorizes the IMF to make the staff report for the new 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

Appendix I—Attachment 1
Zambia: Memorandum of Economic and Financial Policies

1. This memorandum reviews recent economic developments and outlines the government's policies and targets that it will pursue in 2008 and the medium-term under a new Poverty Reduction and Growth Facility (PRGF).

I. Recent Economic Developments

2. **The performance of the Zambian economy has improved markedly since the early 2000s.** This reflects strengthened macroeconomic policies and a favorable external environment. The economic expansion has been broad-based and has benefited from the revival of the mining sector in the wake of privatization and sharply higher world prices of copper. The public finances have improved significantly, especially since 2004, which, combined with a prudent monetary policy and an appreciating exchange rate, lowered inflation to single digits for the first time in three decades in 2006. Higher copper export receipts, as well as extensive debt relief through the Highly Indebted Poor Countries Initiative and Multilateral Debt Relief Initiative, have strengthened Zambia's external position, bolstering investor confidence in the economy. This contributed to a substantial real appreciation of the exchange rate and a buildup in international reserves.

3. **Poverty has been reduced but remains unacceptably high, particularly in rural areas.** The overall incidence of poverty fell from 73 percent of the population in 1998 to 64 percent in 2006, largely on account of a reduction in urban poverty to 34 percent in 2006 from 53 percent in 2004. However, in rural areas it remains at about 80 percent of the population. Progress has been made in the social sectors, such as increased gross enrolments in education, and human development, but the achievement of the Millennium Development Goals remains a challenge.

4. **The positive macroeconomic performance of recent years continued in 2007.** Real GDP grew by an estimated 6.0 percent, led by solid expansion in construction, telecommunication and public services, and annual inflation remained in the single digits at 8.9 percent. The fiscal stance was tighter than envisaged. The overall deficit (excluding grants) was 4.9 percent of GDP, or about 2.5 percentage points of GDP lower than budgeted, owing to a better-than-expected revenue performance and lower-than-planned capital expenditures. Despite the tighter fiscal stance, the rate of monetary expansion exceeded projections, particularly during the latter part of the year, because of BoZ's difficulties in sterilizing foreign exchange inflows. A reduction in the cash reserve requirement from 14 to 8 percent in October injected additional liquidity into the banking system during the last few months of the year. Export proceeds grew by 17 percent, mostly due to higher copper prices,

while imports grew by more than twice as much on account of stronger imports of machinery and equipment by the mining sector. As a result, the current account deficit (excluding grants) widened sharply to an estimated 7.1 percent of GDP. Foreign direct investment in the mining sector reached an estimated record level of about US$1 billion, about double that in 2006. Helped by strong foreign exchange inflows and tight fiscal conditions international reserves rose to 2.5 months of imports at year-end.

II. Medium Term Challenges and Policies

5. **The government's key economic objectives are to further raise growth and enhance the employment and income opportunities, especially for the poor.** The Fifth National Development Plan (FNDP) 2006–10—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 efficiency and accountability, and investments in infrastructure and human resources. The main objectives of the program therefore are to (i) maintain macroeconomic stability and debt sustainability; (ii) increase fiscal space for investment in infrastructure, energy, and human resources; and (iii) diversify the economy to lessen its dependence on mining by improving the conditions for broad-based private sector-led growth.

6. **The medium-term outlook for the Zambian economy is favorable, although not without risk.** Real GDP is expected to continue to expand at 6–7 percent per year over the medium-term on the basis of continued investments in mining, a modest recovery in agriculture, and buoyant construction and telecommunication sectors. However, continued electricity shortages and a sharper-than-assumed drop in copper prices would place these projections at risk. Fiscal and monetary policies will be geared to keeping the fiscal position sustainable and lowering inflation to about 5 percent over the next two years. The public finances are projected to improve markedly in the coming years reflecting an increase in tax collections from the mining sector. The external current account deficit is projected to narrow in the medium-term, as export volume growth from additional mining capacity and a slowing of import growth, mainly linked to completion of large investment projects in the mining sector, will offset a projected decline in world market copper prices. International reserves are projected to increase to 5.5 months of imports by 2010. Annual net external support in the form of grants and concessional loans to the central government is projected to remain at around 6 percent of GDP during 2008–10. Owing to past debt relief, rising export earnings, and a conservative approach to external borrowing, Zambia's external debt is expected to remain sustainable over the long-term.

7. **The government intends to create sufficient fiscal space over the medium term to increase growth-enhancing spending, including investments in infrastructure and other**

FNDP projects. While pressing for scaling up of donor inflows, the government will use other channels to expand fiscal space, including introducing a new fiscal regime for the mining sector, improving revenue administration, restraining non-priority spending, and raising the efficiency of public expenditure. For larger investment projects, particularly in the energy sector, external borrowing on nonconcessional terms could be considered if concessional financing is not available.

8. **Fiscal revenues are projected to increase substantially over the medium term and expenditures will shift towards capital spending.** Mainly reflecting the introduction of the new fiscal regime for mining which recently came into effect, revenues are estimated to increase from 18.7 percent of GDP in 2007 to 21 percent of GDP in 2008–10. The tax estimates for the mining sector assume a decline in world copper prices in the medium-term, in line with the World Economic Outlook projections in February 2008. Reflecting the government's emphasis on investment in infrastructure, the composition of expenditure will gradually shift toward capital spending, which is projected to increase to 6¾ percent of GDP in 2010. Increased resources will also be made available to hire additional teachers and health workers in the coming years. The current stock of domestic arrears, including on pensions, will be paid in 2008 and 2009. In summary, the primary deficit of the central government (excluding mining revenues and grants) is projected at 7–8 percent of GDP in 2008–10 and net savings from accumulated mining taxes are projected at 5 percent of GDP at end-2010.

9. **The structural program complements the medium-term macroeconomic framework.** The government's structural reform agenda is articulated in a number of multiyear government programs, including the Public Expenditure Management and Financial Accountability (PEMFA) program, the Public Sector Management (PSM) program, the Financial Sector Development Plan (FSDP), and the Private Sector Development Initiative (PSDI), as well as the FNDP. The program will focus on (i) improving expenditure management and budget execution; (ii) making revenue collection more efficient and effective; (iii) strengthening monetary operations and deepening the financial sector; (iv) implementing a debt management strategy; and (v) strengthening policies in the energy sector to ensure an adequate and reliable supply of electricity in the future. The reforms in the first year are laid out in Table 2.

10. **The structural program for 2009-10 will build on the first year's reform efforts and continue to focus on measures to support high sustainable economic growth**. On public expenditure management, the implementation of a treasury single account in 2009, the continued roll-out of IFMIS, and reforms to public procurement should strengthen budget execution. Efforts will also be made to improve budget planning by increasing the government's capacity to evaluate projects and adopting lessons learned from the public expenditure tracking surveys planned for the social sectors. On financial sector reform, the agenda will focus on strengthening financial sector regulation and supervision and measures to facilitate financial sector deepening. The regulatory agencies for pension and insurance

sectors will be strengthened and there is need to further harmonize financial sector legislation and improve contract enforcement and auditing and accounting practices. Reforms are also planned to increase access to financial services of the rural sector, poor households and small enterprises. Further measures may be adopted on the basis of Zambia's FSAP update scheduled to be completed in early 2009. On electricity, the government intends to continue implementation of the strategy to address the power shortages, including raising tariffs to fully cover the cost of service, encouraging private sector participation, and reforming ZESCO to ensure a sufficient and cost effective delivery of electricity.

III. POLICIES FOR 2008

A. Fiscal policies

11. **The primary fiscal deficit, excluding grants and mining revenue, is projected to increase to 8.3 percent of GDP in 2008.** Revenues are projected to increase by 2.5 percentage points to 21.2 percent of GDP, reflecting changes to the fiscal regime for mining. Excluding mining, revenue in 2008 should rise somewhat, as losses from the reduced VAT rate and changes to the personal income tax thresholds would be offset by gains from the new export levy on copper concentrate and greater nontax revenues. Grants are expected to increase from 4.6 percent of GDP in 2007 to 5.3 percent of GDP. Expenditures are budgeted to rise from 24.6 percent of GDP in 2007 to 27.4 percent of GDP, reflecting continued hiring in education and health, clearance of domestic arrears, higher capital spending, and short-term allocations to the constitutional review process. The overall financing need would be 1.1 percent of GDP, but net domestic financing would be negative, at 0.1 percent of GDP.

12. **A new fiscal regime for the mining sector came into effect on April 1, 2008.** The new regime will ensure that the government receives a greater share of mining profits and rents, through the introduction of a windfall tax and a variable profit tax, as well as an increase in the mineral royalty. In implementing the new fiscal regime, the government will be mindful of the need to preserve Zambia's attractiveness for investment in mining. To this end, the windfall tax and the variable profit tax will not apply at the same time. When the windfall tax applies the profit tax rate will be the standard 30 percent. With international copper prices projected to decline by about 12 percent in 2008, mining revenue is estimated at 2.8 percent of GDP in 2008, about 1.4 percent of GDP higher than estimated under the old fiscal regime. In 2008, all mining revenue in excess of what would have been collected under the old regime K 722 billion will be saved in a separate government Mining Resource Account (MRA) account at the Bank of Zambia (BoZ). The MRA will be used as a stabilization fund to smoothen expenditures over time taking into account macroeconomic conditions and absorptive capacity. In 2009 and subsequent years, the net inflow to the MRA will be based on the medium-term expenditure framework (MTEF). The funds would be used

to finance high priority projects identified in the FNDP. All revenues, including those channeled through the MRA, and expenditures will be fully integrated in the budget and fiscal accounts.

13. **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 is working towards formally adopting the Extractive Industries Transparency Initiative (EITI) in a participatory process, in line with EITI guidelines.

14. **The ZRA has embarked on a modernization project to strengthen the effectiveness of tax administration.** This will involve the adoption of an integrated and taxpayer-segmented organizational structure. Although many preparatory activities have been completed, including the appointment of senior staff in the newly created management structure, the major elements of the project remain to be implemented. These involve, among others, the establishment of a headquarters functional structure by September 2008 (structural benchmark) and a large taxpayer office by December 2008 (structural benchmark). The headquarters structure should be focused on planning and monitoring activities, strengthening systems and methodologies, setting operational policy, and not perform any operational functions. Within the large taxpayer office, a specialized team will be created to effectively audit mining companies and administer the new fiscal regime.

15. **The government is aware of the financial difficulties of the insolvent Public Service Pension Fund (PSPF).** The PSPF is a defined-benefit scheme that was closed to new entrants in 2000. The actuarial deficit is estimated at about 10 percent of GDP. With a rising number of pensioners, the annual cash-flow deficit is projected to increase in the medium-term before falling as the scheme winds down (the deficit is estimated at ½ percent of GDP over the next few years). The long-term sustainability of the PSPF depends on the constitutional amendments that are required to redesign the defined benefit scheme. In the meantime, the budget will allocate sufficient resources to the PSPF to ensure that pension obligations are met in full.

B. Public Expenditure Management

16. **Stepped up implementation of public expenditure management reforms is critical for increasing the effectiveness and productivity of the public sector.** To this end, a proposal on the establishment of a treasury single account (TSA) system will be submitted to Cabinet by end-June 2008 (structural performance criterion) with the intention of making the TSA effective in 2009. In preparing for the TSA, the government has started to use real-time-gross-settlement in place of checks for large transactions and will continue to consolidate government accounts in commercial banks into a limited number of accounts at the BoZ, and roll-out the Integrated Financial Management and Information System (IFMIS).

To harmonize treasury functions, the MoFNP will submit to Cabinet by end-June 2008 a proposal to establish a Treasury Department within the MoFNP (structural benchmark).

17. **A number of other PEMFA and PSM reforms are underway.** The first pilot sites for IFMIS are expected to be fully functional by mid-2008. To improve the quality and timeliness of reports prior to the full roll-out of IFMIS, which will take at least another two years, enhancements to the existing Financial Management System (FMS) will be completed by end-April 2008. The enhancements include moving to a more stable database to enable budget execution reports to once again be published within 60 days of the end of each quarter. In other PEMFA components, improvements to the procurement framework to facilitate accelerated execution of capital projects will be sought by submitting to Cabinet proposed amendments to the Procurement Act by end-September 2008. Efforts to strengthen procurement planning through increased training will also be made. In regards to PSM reform, government is in the process of developing a pay policy for the public service. A draft policy is expected to be submitted to Cabinet for approval by the end of the year.

C. Monetary and Exchange Rate Policies

18. **Monetary policy will aim to reduce annual inflation to 7 percent in 2008 and 5 percent in 2009.** While volatile food prices and uncertainties about the pass-through effects of higher oil prices pose risks to the inflation outlook, monetary policy will be sufficiently firm to keep inflation on a downward trend. Reserve money is targeted to grow by 11½ percent in 2008. This will accommodate a robust expansion in credit to the private sector of about 20 percent and a buildup of international reserves to 3.2 months of imports by end-2008. Government spending financed from significant foreign exchange inflows will require that the BoZ undertake appropriate measures to contain excess liquidity. To achieve this without undue exchange rate volatility, the BoZ will adopt a program of regular foreign exchange sales for the remainder of 2008.

19. **The government is very aware that fiscal and monetary policies need to be better coordinated**. Uneven and unpredictable budget execution often cause difficulties for liquidity management. The MoFNP and the BoZ intend to establish a formal mechanism for coordination with key line ministries on liquidity management by June 2008 (structural benchmark). This would involve setting up meeting and data submission procedures, including for key line ministries' expenditure plans to the MoFNP and the BoZ.

20. **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, in particular forward market transactions.

D. Financial Sector Development.

21. **Financial sector reforms will build on progress made under the first phase of the FSDP.** The credit reference bureau launched in 2007 has made progress in building the necessary database for its operation, and is expected to begin playing its role in providing credit information to facilitate lending by financial institutions in the period ahead. To support the development of the financial market in Zambia, the government will seek a sovereign rating over the coming months. This would enhance the country's attractiveness as an investment destination as well as provide a benchmark to promote the development of the domestic capital market. Further, to encourage the emergence of a stable interbank money market and a benchmark short-term interest rate, the BoZ will strengthen liquidity management by restructuring its rediscount window operations by reducing the penal element in the pricing of securities and increasing the range of securities eligible for rediscounting to encourage its use by banks (June 2008 structural benchmark). To further stimulate the growth of the secondary market, the government will set up a supervisory regime for the secondary market in government securities by September 2008 (structural benchmark). This will entail the issuance of harmonized regulations to govern trading.

22. **While the banking sector remains sound, more needs to be done to strengthen supervision and ensure stability.** The BoZ is developing a framework for risk-based supervision to be implemented by December 2008 (structural benchmark). The government is committed to undertake legislative changes to strengthen the independence of BoZ.

E. Energy Sector

23. **The government is conscious of the gravity of the current shortage of electric power and the risk it poses to sustained growth.** Development of the electricity sector is vital to achieving sustained high growth and reducing poverty. In particular, greater electricity generation will be needed to support the envisaged expansion of mining, private sector growth, and the planned rural electrification program. There is a need to strengthen policies to ensure that sufficient electricity generation capacity is installed as quickly as possible to meet a rapidly growing demand. To this end, the government will develop policies with specific strategies to (i) gradually adjust electricity tariffs to reflect the cost of service; (ii) attract private investments and competition in the sector; (iii) increase the operational efficiency of ZESCO and strengthen its governance; and (iv) ensure that ZESCO has sufficient resources to implement the planned rehabilitation and new generation projects. Given the urgency, the government intends to complete this action plan no later than June 2008 (structural performance criterion). Further, as a first step to improve the financial footing of ZESCO, the government will ensure that all arrears to ZESCO from ministries, provinces, and spending agencies (MPSAs) are paid by end-December 2008. Moreover, the MoFNP will issue a circular instructing all ministries, provinces, and spending agencies (MPSAs) that (i) all utility bills for each quarter are to be paid from the quarterly budget

funding and (ii) all funds released for payment of utility bills should not be reallocated by MPSAs.

24. **Implementation of the new projects to expand electricity generation will likely require borrowing on nonconcessional terms.** To this end, ZESCO is currently looking for financing to carry out three investment projects (the Kariba North Power Station Extension, the Itezhy-Tezhy Power Station, and completion of the rehabilitation project) in the amount of $450 million. Given the importance of raising electricity supply to achieve the medium-term growth objectives, as well as limited availability of grants or concessional financing, the Government and/or ZESCO may likely need to contract new nonconcessional external borrowing for these three projects in 2008.

F. Trade, Debt, and Aid

25. **The government will continue to pursue an open trade regime.** Zambia has fully implemented the tariff phase down commitment under the Southern African Development Community (SADC) Protocol. About 85 percent of intra- merchandise trade has been liberalized, as tariffs were further reduced in January 2008. The tariff phase down is scheduled to continue during 2008–12, when Zambia is expected to eliminate its tariff on sensitive products (imports that compete with industrial and agricultural domestic products). The government is actively participating in the harmonization of trade related agendas under SADC and COMESA.

26. **The government is committed to improving public debt management.** To maintain debt sustainability, the MoFNP is finalizing Zambia's debt management strategy, which will be submitted to Cabinet by end-September 2008 (structural benchmark). The strategy will provide a clear framework for borrowing, establishing the principles that should guide the debt manager's decision regarding the currency composition, maturity, interest rates, and other risks of the debt portfolio. In addition, the government will continue to work on (i) enhancing and unifying the legal framework of public sector debt contracting and guaranteeing, (ii) strengthening the institutional capacity of IDM so that debt operations are assessed and audited, and (iii) monitoring total public sector debt, including debt to be contracted by public enterprises.

27. **The government will continue to strengthen the management of aid.** In line with the recently launched Aid Policy and Strategy, the government will develop an action plan for aid management. A database on disbursements from traditional donors and creditors has already been established and disbursements from emerging creditors, which are mainly allocated to finance projects, will be captured in the near future.

G. Economic Statistics

28. **The government is strengthening Zambia's capacity to collect and disseminate economic data.** The Central Statistics Office (CSO) is undertaking an economic census and key results are expected to be presented in the latter part of 2008. The census will provide important information about the structure of the Zambian economy and, among other things, will be used to rebase the national accounts. The CSO is testing a new, rebased CPI, which will be published starting in June 2008. Further, balance of payments statistics will be strengthened, drawing on IMF technical assistance.

IV. PROGRAM MONITORING

29. **Semi-annual disbursements under the PRGF program arrangement will be based on the observance of quantitative and structural performance criteria.** Completion of the first and second review of the arrangement will be based on the observance of quantitative and structural performance criteria through end-June 2008 and end-December 2008, respectively (Tables 1 and 2).

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

	2007	2008		
	Dec Level	Jun Prog.	Sep Indicative	Dec Prog.
Performance criteria:				
Ceiling on the cumulative increase in net domestic assets (NDA) of the Bank of Zambia[2, 3]	-1243	-208	-512	-776
Ceiling on the cumulative increase in net domestic financing (NDF)[2]	4,638	567	534	-64
Floor on the cumulative increase in gross international reserves (GIR) of the Bank of Zambia (Millions of U.S. dollars)[2]	947	154	267	382
Ceiling on new external payment arrears[4]		0	0	0
Ceiling on contracting or guaranteeing short-term external debt by the central government, BOZ, ZESCO, ZAMTEL and Zambia Railways Limited[4]		0	0	0
Ceiling on contracting or guaranteeing medium- and long-term nonconcessional external debt by the central government, BOZ, ZESCO, ZAMTEL and Zambia Railways Limited (millions of U.S. dollars)[5]				
Electricity sector projects[6]		450	450	450
Other sectors		0	0	0
Indicative targets:				
Floor on the cumulative payment of domestic arrears of the government		297	527	669
Cumulative increase in reserve money	2500	22	155	289
Memorandum items:				
Cumulative net budget support (millions of U.S. dollars)	73.7	100.7	154.5	141.2
General budget support	135.7	115.2	200.0	200.0
Central Government debt service obligations (excluding IMF)	-62.0	-14.5	-45.5	-58.8
Cumulative revenue from mining		351	1055	1640

[1]The definitions of the items in the quantitative program are contained in the Technical Memorandum of Understanding (TMU).
[2]Adjustors, including for general budget support, are defined in the TMU.
[3]The ceiling will be adjusted for changes in the legal reserve requirements as specified in the TMU.
[4]Continuous performance criteria.
[5]Nonconcessional loans are those having a grant element of less than 35 percent.
[6]The projects are Kariba North Extension, Itezhy-tezhy, and the rehabilitation of Kafue Gorge and Kariba power stations.

Table 2. Zambia: Structural Program for 2008

Measure	Timing
Performance Criteria	
Submit to Cabinet a proposal to establish a treasury single account.	End-June 2008
Submit to Cabinet a policy for the electricity sector with specific strategies to (i) gradually adjust electricity tariffs to the cost of service; (ii) attract private investment and competition in the sector; (iii) increase the operational efficiency of ZESCO; and (iv) ensure that ZESCO has sufficient resources to implement the planned rehabilitation and new generation projects.	End-June 2008
Benchmarks	
Submit to Cabinet a proposal to establish a Treasury Department.	End-June 2008
Establish a headquarters functional structure at the Zambia Revenue Authority.	End-September 2008
Establish a single large-taxpayer office at the Zambia Revenue Authority.	End-December 2008
The Ministry of Finance and National Planning and the Bank of Zambia will establish a formal mechanism for coordination with key line ministries on liquidity management.	End-June 2008
The Bank of Zambia will restructure the operations of its rediscount window.	End-June 2008
Set up a supervisory regime for the secondary market in government securities.	End-December 2008
Introduce risk based bank supervision.	End-December 2008
Submit to Cabinet a debt management strategy.	End-September 2008

Appendix I—Attachment 2

Zambia: Technical Memorandum of Understanding for the 2008–10 Poverty Reduction and Growth Facility (PRGF) Arrangement

I. Introduction

1. This memorandum sets out the understandings between the Zambian authorities and the International Monetary Fund (IMF) regarding the definitions of the quantitative performance criteria and indicative targets for the program supported by the PRGF arrangement, as well as the program adjusters and the related reporting requirements.

II. Quantitative Performance Criteria and Indicative Targets: Definitions and Data Sources

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

2. Net domestic assets (NDA) of the BoZ are defined as the monthly average (based on daily data) of reserve money (as defined below) less net foreign assets of the BoZ calculated at kwacha 3,844.8 per U.S. dollar for 2008.[1] Net foreign assets of the BoZ are defined as gross international reserves (defined in paragraph 8) 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 of net foreign assets are derived from the U.S. dollar values using the program exchange rate.

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

B. Reserve Money

4. Reserve money (monthly average based on daily data) 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.

[1] Unless otherwise defined, program exchange rates for 2008 between the U.S. dollar and other (non-kwacha) currencies will be equal to the end-December 2007 values. The U.S. dollar/SDR rate for program purposes is 1.576 for 2008. All other assets (e.g., gold) would be revalued at their end-December 2007 market prices for 2008.

5. Data on reserve money, including its components, will be reported by the BoZ on weekly and end-month basis.

C. Net Domestic Financing (NDF)

6. Net domestic financing (NDF) is defined as the Central Government's net borrowing from the banking and non-banking sectors (See Table 1).[2] All government-issued securities will be recorded at cost (face value less discount). NDF will be defined as:

(a) the net position of the central 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) kwacha bridge loan (overdraft facility); less (iv) the government's deposits 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 of: Treasury bills; and government bonds.

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

D. 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 (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.

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; and (v) SDR holdings and Zambia's reserve position with the IMF. Gross reserves exclude non-convertible currencies, any encumbered reserve assets including but not limited to reserve assets pledged, swapped or used as collateral or guarantee for third-

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[2] The Central Government includes all the administrations identified by the budget heads listed in the Yellow Book for 2008.

party external liabilities, commercial bank reserve requirements on foreign currency deposits, and the US$25 million deposit in MBZ (in liquidation).

10. For the purpose of this target, as well as those for external debt and arrears, valuation will be in U.S. dollars at actual end-period exchange rates.

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

E. External Payment Arrears

12. 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 30 days beyond the due date and/or the grace period. This definition excludes arrears on debt subject to rescheduling.

13. 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.

F. Official External Debt

14. 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, BoZ, ZESCO, ZAMTEL and Zambia Railways Limited having a grant element of no less than 35 percent. 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. Lending from the IMF will be excluded.

15. 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.

16. Official external non-concessional debt is defined as the contracting or guaranteeing of external debt other than concessional debt as defined in paragraph 14, owed or guaranteed by the central Government, BoZ, ZESCO, ZAMTEL and Zambia Railways Limited.

17. The ceiling on contracting or guaranteeing of medium and long-term non-concessional external debt by the central government, BoZ, ZESCO, ZAMTEL and Zambia Railways Limited excludes: (i) non-concessional loans stemming from the rescheduling of

external debt; and (ii) central government securities issued in domestic currency, placed in the domestic primary or secondary markets, and held by non-residents.

18. Official external short-term debt is defined as the contracting or guaranteeing external debt with original maturity of less than one year, and includes forward commodity sales but will exclude normal trade credit for imports.

19. The term “debt” has the meaning set forth in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt (Decision No. 12274-(00/85) of August 24, 2000; see Annex).

20. Detailed data on all new external debt (concessional and non-concessional) contracted or guaranteed by the central government, BoZ, ZESCO, ZAMTEL and Zambia Railways Limited will be provided by the MoFNP on a monthly basis. Information will include (i) amounts contracted or guaranteed; (ii) currencies; and (iii) terms and conditions, including interest rate, maturity, grace period, payments per year, commissions and fees, and collaterals.

G. Domestic Arrears of Central Government

21. Domestic arrears are defined as: (i) any bill that has been received by a spending ministry from a supplier for goods and services delivered (and verified) and for which payment has not been made within 30 days after the due date of payments; (ii) wage, salary, and any other payment to government employees, including pension contributions and all forms of housing allowances, that were due to be paid in a given month but remained unpaid on the 15th of the following month; and (iii) interest or principal obligations which remain unpaid 30 days after the due date of payment.

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

III. ADJUSTERS

23. The quantitative performance criteria specified under the program are subject to the following adjusters:

General budget support (GBS) net of debt service[3]

(i) The ceilings on NDA and NDF will be adjusted downward (upward) by the full amount of the excess (shortfall) in GBS net of debt service relative to the programmed levels specified in Table 1 of the MEFP.[4, 5]

(ii) The floors on GIR will be adjusted upward (downward) by the full amount of the excess (shortfall) in GBS net of debt service relative to the programmed levels (Table 1 of the MEFP).

(iii) The total adjustment for shortfalls will be limited to US$30 million for January-June and US$35 million for January-December 2008.

Change in reserve requirements

(iv) The ceiling on NDA will be adjusted downward/upward to reflect decreases/increases in the legal reserve requirements on deposits in commercial banks. The adjuster 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.

Revenue from mining

(v) The ceilings on NDA and NDF will be adjusted downward (upward) by the full amount of the excess (shortfall) in revenues from the mining sector relative to the programmed levels (Table 1 of the MEFP).

(vi) The floors on GIR will be adjusted upward (downward) by the full amount of the excess (shortfall) in revenues from the mining sector relative to the programmed levels (Table 1 of the MEFP).

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[3] General budget support consists of grants and loans received by the central Government for financing its overall policy and budget priorities following Zambian budget procedures.

[4] For the purpose of adjusting the NDA ceiling, external disbursements will be treated as if they were received the first day of the month. The targeted NDA will be increased by the amount of the disbursement divided by the number of business days in the month multiplied by the number of business days from the beginning of the month to the day prior to the disbursement.

[5] For purpose of adjusting the NDF ceiling, the cumulative excess/shortfall will be converted to kwacha value using the program exchange rate.

(vii) The total adjustment for shortfalls will be limited to K75 billion (US$19 million) for January-June and K917 billion (US$231.7 million) for January-December 2008.

IMF disbursement

(viii) The floors on GIR will be adjusted upward (downward) for any excess (shortfall) in the disbursements from the IMF (US dollar value) relative to the programmed levels.

BoZ short-term debt

(ix) The floor on GIR will be adjusted upward for any increase in BoZ short-term debt denominated in foreign currency, (see definition of short-term debt above).

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 lessor 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. Zambia: Net Domestic Financing

	2007	2008
	End-Dec.	End-Dec. Program Base
Total domestic financing (program)		
Adjustment		
Adjusted program financing		
Excess/shortfall (- = excess)		
Total domestic financing	4,638	
Bank financing	2,002	
Commercial banks	2,087	
Treasury bills [1]	1,394	
Bonds [1]	1,070	
Loans and advances	118	
less: Support to MBZ	-8	
less: Deposits	-486	
Bank of Zambia	-85	
Treasury bills [1]	557	
Bonds [1]	189	
Kwacha bridging loan	0	
GRZ position	-1,951	
Donor suspense balance	-0.3	
GRZ long-term security IFO BoZ	1,121	
Other	0.0	
Nonbank financing	2,636	
Treasury bills [1]	1,111	
Bonds [1]	1,525	

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[1]
(In millions of U.S. dollars)

	2007 December			2008 June, December				
	12/31/2007= Base			Current			31/12/08	
	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. ZAMBIA: RELATIONS WITH THE FUND
(As of March 31, 2008)

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	8.45	12.73

IV. **Outstanding Purchases and Loans:**	**SDR Million**	**Percent Quota**
PRGF arrangements	55.02	11.25

V. **Latest Financial Arrangements:**

Type	**Approval Date**	**Expiration Date**	**Amount Approved (SDR Million)**	**Amount Drawn (SDR Million)**
PRGF	06/16/2004	09/30/2007	220.10	220.10
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				
	2008	2009	2010	2011	2012
Principal	…	…	0.55	3.30	7.70
Charges/interest	1.51	1.89	1.89	1.88	1.86
Total	1.51	1.89	2.44	5.19	9.56

VII. Implementation of HIPC Initiative

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

VIII. Implementation of MDRI Assistance

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

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

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

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

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

IX. **Safeguards Assessment**

Under the Fund's safeguards assessment policy, Bank of Zambia (BoZ) is subject to an update assessment with respect to the expected arrangement. The necessary information has been requested from the authorities. Previous assessment of the BoZ, completed on October 20, 2004, found that the BoZ had adequate safeguards in several areas, but also identified a number of vulnerabilities. The assessment recommended that the BoZ should:

(i) adopt International Financial Reporting Standards (IFRS) as the basis for financial reporting;

(ii) adopt a formal rotation policy for the appointment of the external auditor;

(iii) amend its accounting policies to ensure that unrealized gains are excluded from profits available for distribution to government;

(iv) as part of a current review of the central bank Act, revise provisions to strengthen the bank's operational independence and accounting practices;

and (v) conduct quarterly reconciliations of GIR and NDA data reported to the Fund with the underlying source accounting data.

X. **Exchange Rate Arrangement**

The currency of Zambia is the kwacha. The exchange rate regime is a managed float with no predetermined path for the exchange rate. The exchange rate is determined in the interbank market; the Bank of Zambia's (BoZ) buying rate is the simple average of the primary dealers' low bid rates, and the BoZ's selling rate is the simple average of the primary dealers' high offer rates. 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 standard 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 December 7, 2007.

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	2002–03	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
MCM	September 2007	Institutional arrangements and operation of the foreign exchange market.
	September 2007	Foreign exchange market
	November 2007	Risk-based supervision
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 2004–February 2005	Assistance on amending legislation on nonbank financial institutions
	May 2005	Strengthening the regulatory framework for 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. Zambia: Relations with the World Bank Group

Partnership for Development

1. ***Poverty reduction strategy.*** World Bank support to Zambia is based upon the country's PRSP, which is prepared through a participatory process led by the government. Zambia's Fifth National Development Plan 2006-10 (FNDP) serves as the country's current PRSP and has been officially launched by the President in early 2007.

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, 2006 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 to specific strategic objectives. World Bank activities have focused 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's new Country Assistance Strategy is scheduled for discussion with its executive Board in May 2008 and will be aligned with the FNDP. A Joint Assistance Strategy for Zambia (JASZ) has also been prepared by the Cooperating Partners, including the Bank 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. The second EMGC/DPO for US$10 million is part of a harmonized approach to budget support and has been appraised in June 2007. The DPO is scheduled to be approved by the Bank's executive Board in May 2008. In addition, an increased access to electricity services project has been developed in the amount of US$33 million accompanied with a GEF Trust Fund grant in the amount of US$4.5 million. This project is scheduled to be approved in May 2008 as well.

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 has been undertaken (FY07) and a PER for the health sector is currently being finalized while an assessment of competition and regulation in Zambia's infrastructure sectors has been initiated. In FY08 a PER for the agricultural sector will be initiated as well as a Public Expenditure Tracking Survey for secondary education. An update of the Investment Climate Assessment is also under way. It is expected that the upcoming CAS will outline an analytical program for the next three to four years.

6. ***Projects under Supervision.*** IDA's active portfolio as of April 2008 contains 12 credits and grants for a total initial commitment of US$382.1 million. In FY06 three projects, the Malaria Booster Project, Public Sector Management Project and Agricultural Development Support Program, were approved by IDA's Board. In FY07, the Board approved a water and sanitation project and additional financing for the Road rehabilitation and maintenance project in the amount of US$25 million. This fiscal year a DPO in the amount of US$10 million and an increased access to electricity project in the amount of US$ 37.5 million, are to be approved by IDA's Board in May 2008.

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 2008)

(in US$ Millions)

Project Name		Strategic Focus	Approval FY	Net Comm Amt	Tot Disb	Undisbursed
ZM-SEED SIL (FY05)	Credit	Pillar 1	07/29/2004	31.0	13.5	16.6
ZM-GEF SEED Biodiversity	Grant	Pillar 2	07/29/2004	4.0	2.4	1.6
Mngt. of Miombo Woodland Ecosystem	Grant	Pillar 2	05/14/2002	0.8	0.6	0.1
3A Southern Africa Power Market	Credit	Pillar 1	07/09/2004	1.1	0.8	0.4
ZM-Road Rehab Maintenance Prj (FY04)	Credit	Pillar 1	03/09/2004	80.5	37.6	40.7
Copperbelt Environment	Credit	Pillar 1	03/20/2003	47.4	19.0	27.0
HIV/AIDS (ZANARA) (IDA GRANT)	Credit	Pillar 2	12/30/2002	54.0	47.8	2.6
ZM-TEVET SIM (FY01)	Credit	Pillar 2	06/14/2001	26.7	18.6	7.0
Regional Trade Fac. Proj. - Zambia	Credit	Pillar 1	04/03/2001	18.3	10.6	6.6
Malaria Booster program	Credit	Pillar 2	11/15/2005	21.0	15.8	5.3
Public Sector Management Program Support Proj.	Credit	Pillar 3	01/05/2006	31.8	11.9	19.9
Agricultural Development Support Program	Grant	Pillar 1	05/16/2006	40.7	5.9	34.5

*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/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. 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 2008.

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 has under taken a government debt management performance assessment report (FY08) and currently assists jointly with the IMF 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 new PRSP in August 2007. Finally, the Fund and the Bank jointly prepared a LIC DSA in

the fall of 2007. 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 development policy operation (the Economic Management and Growth Credit), is consistent.

Table 2: IMF-World Bank Collaboration in Zambia (FY03-FY08)

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) (FY08) 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:*** <u>On-going Portfolio</u>: TEVET(FY01) <u>ESW</u>: 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:*** <u>Ongoing Portfolio</u>: SEED (FY04) Water Sector Improvement Project (FY07): <u>ESW</u>: 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:*** <u>On-going Portfolio</u>: PSMP (FY06), <u>New Lending</u>: EMGC II (FY08), Local Development Project (FY08); <u>ESW:</u> 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:*** <u>On-going Portfolio</u>: PSMP (FY06) <u>New Lending</u>: EMGC II (FY08), Local Development Project (FY08) <u>ESW</u>: PEMFAR(FY03), Governance Survey

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

ANNEX III. ZAMBIA: 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 outstanding data ROSC recommendations. Under a pilot project initiated by the AFR to encourage countries to undertake the compilation of the Statistical Appendix to Article IV staff reports, an STA staff participated in an Article IV mission in September 2007 to provide assistance. The authorities expressed their willingness to compile and publish the Statistical Appendix but indicated the need for further technical assistance. The authorities are yet to post the Statistical Appendix for 2007 on the national website as had been indicated at the end of the mission.

3. As one of 22 countries participating in the Fund's General Data Dissemination System (GDDS) Project for Anglophone African Countries, Zambia has undertaken to use the GDDS as a framework for the development of its national statistical system. Zambia is participating in the national accounts and the GDDS/PRSP modules of the Anglophone Africa project (funded by the U.K. Department for International Development (DFID)). This project aims to assist participating countries to implement plans for improvement identified in the metadata and to meet GDDS recommended statistical practices. Zambia's 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 ongoing. 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. 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 little progress producing one. The authorities have launched 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 has been insufficient to capture changes in consumer expenditure structure on a timely basis. The current index has 1994 as base year with weights derived from the 1993/1994 household budget survey. The authorities plan to launch a new rebased CPI in 2008.

Government finance statistics

8. In 2007, the authorities made progress in improving reporting government finance statistics (GFS) for publication in the *GFSY*. They submitted a consistent time series of GFS data, covering only the budgetary central government, for 2001 through 2007, based on the *GFSM 2001* framework. The transactional coverage of these data is limited to government operations and transactions in nonfinancial assets. Data on transactions in financial assets and liabilities are still unavailable. 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 extra-budgetary 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 May 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. An April–May 2005 monetary statistics mission 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. Monetary data are reported to STA using standardized report forms; these data have been published in the IFS since September 2006.

External sector statistics

12. Balance of payments statistics are compiled and disseminated by the BoZ in accordance with the fifth edition of the Balance of Payments Manual. However, the CSO is legally responsible for compiling all macroeconomic statistics. Reporting of balance of payments statistics for publication by the IMF Statistics Department remains problematic. The most recent balance of payments data reported to STA are for 2000.

13. A technical assistance mission in January 2008, the most recent, found that little progress had been made since the assessment by the 2004 ROSC mission. Data sources remain poor (some items are estimated without reference to current source data) and compilation methods are inadequate. Resources available to balance of payments compilation have been increased but are still inadequate. Coordination between the BoZ and CSO had improved.

14. As a result, significant gaps in data remain in many areas including reinvested earnings, trade in services, and the financial account (including export proceeds held abroad by mining and nontraditional exporters). While the source data are generally adequate in terms of timeliness, they fall short in terms of coverage. As a result the shortcomings in source data coverage, indirect estimation methods are used, some of

which have remained unchanged for many years and are out of date. Source data on private sector foreign assets and liabilities are insufficient to compile an IIP statement.

Zambia: Table of Common Indicators Required for Surveillance
As of April 14, 2008

	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	Mar. 2008	Apr. 11, 2008	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	Sep. 2007	Oct. 15, 2007	W	W	M		
Reserve/Base Money	Jan. 2008	Mar. 17. 2008	W	W	F	LO, LO, LO, LO	LO, O, O, O, O
Broad Money	Jan. 2008	Mar. 17, 2008	M	M	M		
Central Bank Balance Sheet	Jan. 2008	Mar. 17, 2008	M	M	M		
Consolidated Balance Sheet of the Banking System	Jan. 2008	Mar. 17, 2008	M	M	M		
Interest Rates[2]	Jan. 2008	Mar. 17, 2008	W	W	F		
Consumer Price Index	Jan. 2008	Feb. 20, 2008	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 discounts 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 February 1, 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, assessment of source data, statistical techniques, assessment and validation of intermediate data and statistical outputs, and revision studies.

Statement by the IMF Staff Representative
June 4, 2008

1. This statement provides information that has become available since the staff report was issued to the Board. The thrust of the staff appraisal remains unchanged.

2. **Inflation has picked up in recent months, placing the end-year inflation target at risk.** The higher rate of inflation largely reflects increases in food prices. The twelve-month rate of inflation rose from 8.9 percent in December 2007 to 10.9 percent in May 2008, as food prices rose from 6.9 percent to 11.7 percent. Over the same period, nonfood price inflation declined from 11.7 percent to 10.1 percent. In the nonfood component, the recent increases in world oil prices, which have still to be fully passed through, are being offset by the appreciation of the kwacha.

3. **The higher world oil prices than projected in the staff report will have an adverse impact on the balance of payments, but this is expected to be more than offset by higher copper prices.** Based on the most recent WEO oil price projection for 2008, and assuming unchanged import volumes, the balance of payments is projected to deteriorate by 0.9 percent of GDP. However, based on recent increases in copper prices and the prices in futures contracts, and assuming unchanged export volumes, the balance of payments would improve by 2.9 percent of GDP. Thus, overall the balance of payments is expected to improve by about 2 percent of GDP.

BOP Impact of Higher Oil and Copper Prices in 2008

	Staff Report	May Revision	BOP Impact
Oil price assumption (US$/barrel)	95.5	112.0	…
Oil imports (US$ millions)	703	824	-121
(In percent of GDP)	5.5	6.4	-0.9
Copper price assumption (US$/lb)	3.20	3.49	…
Copper export (US$ millions)	3,785	4,161	376
(In percent of GDP)	29.5	32.4	2.9
Total impact (US$ millions)	…	…	255
(In percent of GDP)	…	…	2.0

4. **Zambia is usually self sufficient in staple food crops, and the crop forecast survey for the 2007/08 agricultural season indicates that overall food supplies will remain adequate.** The harvest for the staple food, maize, will be smaller this year, mainly as a result of flood damages in late 2007 and early 2008, but including the stocks carried over from the last agricultural season, the total supply of maize is projected to exceed total national requirements.

The authorities have not taken any actions specifically in response to the global food crisis. The import and export of agricultural commodities have since 1994 required permits, which, with the exception of maize exports, have generally been readily granted. Permits for the export of maize are only granted when adequate supplies are available. In early May 2008, as in previous years, the authorities announced that export licenses for maize will not be granted until the food security situation has been fully assessed; likely by the end of June.

5. **Reserve money growth was lower than envisaged in recent months, helped by a strong fiscal outturn.** At end-April 2008, reserve money was about 6 percent below the end-December 2007 level.

6. **Revenue performance was strong through April.** Total revenue was about 1 percent of GDP greater than projected, as income taxes, VAT, and nontax revenue all registered strong performances. Expenditures were broadly as budgeted.

7. **Since the beginning of the year the kwacha has appreciated by about 10 percent against the U.S. dollar, in large part reflecting dollar weakness.** Against the euro, the kwacha has remained broadly unchanged. Official foreign exchange reserves have continued to increase; at mid-May they stood at 2.8 months of imports.

INTERNATIONAL MONETARY FUND
EXTERNAL RELATIONS DEPARTMENT

Press Release No. 08/134
FOR IMMEDIATE RELEASE
June 4, 2008

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Approves US$79.2 Million PRGF Arrangement with Zambia

The Executive Board of the International Monetary Fund (IMF) today approved a three-year, Poverty Reduction and Growth Facility (PRGF) arrangement for Zambia in an amount equivalent to SDR 48.91 million (about US$79.2 million) in support of the country's economic policies aimed at alleviating poverty and sustaining growth. The decision enables Zambia to request the first disbursement in an amount equivalent to SDR 6.987 million (about US$11.3 million).

The new PRGF arrangement succeeds a previous arrangement that was successfully completed in September 2007 (see Press Release No. 07/124).

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

"The Zambian authorities are to be commended for implementing prudent macroeconomic policies, which, in the context of high copper prices and debt relief, contributed to robust economic growth, markedly lower inflation, a reduction of poverty, and a build-up of international reserves.

"The authorities remain committed to maintaining prudent macroeconomic policies and pursuing structural reforms to sustain high economic growth, further reduce poverty, diversify the economy, and preserve macroeconomic stability and debt sustainability. Their new medium-term economic program is a sound basis for achieving these objectives.

"The new tax regime for the mining sector will provide substantial resources to accommodate an increase in high-priority infrastructure and social spending that is compatible with macroeconomic stability and Zambia's absorptive capacity. In implementing the new regime, the authorities are encouraged to ensure that the attractiveness of investment in the mining sector is preserved.

"The prudent conduct of monetary policy has helped to maintain low inflation. To strengthen liquidity management, a formal mechanism to coordinate monetary and fiscal policies will be established. The flexible exchange rate has served Zambia well in enhancing the effectiveness of monetary policy and facilitating the economy's adjustment to shocks.

"The program envisages a cautious policy on foreign borrowing, emphasizing concessional loans and close monitoring of external borrowing by public enterprises. To preserve the recent gains in external debt sustainability, the authorities will give priority to developing and implementing a comprehensive debt management strategy.

"The program's structural policies complement the macroeconomic framework. They appropriately focus on improving expenditure management and budget execution, making revenue collection more efficient and effective, strengthening monetary operations and deepening the financial sector, adopting a debt management strategy to help ensure debt sustainability, and addressing supply shortages and inefficiencies in the energy sector," Mr. Kato said.

The PRGF is the IMF's concessional facility for low-income countries. 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.

ANNEX

Recent Economic Developments

The Zambian economy has performed well in recent years and the medium-term outlook is favorable, with real GDP expected to grow at 6–7 percent annually. However, this projection could be undermined by a sharper drop in copper prices than expected and continued electricity outages.

The fiscal position is expected to strengthen as revenues increase substantially over the medium term following the introduction of a new fiscal regime for mining. The increased resources will be used over time to finance high-priority projects identified in the Fifth National Development Plan, taking into consideration project implementation capacity and the economic impact of additional spending.

The structural reform program will complement the medium-term macroeconomic framework. Efforts to improve expenditure management and budget execution, and revenue collection, will continue. Reforms will also strengthen monetary operations and deepen the financial sector, especially through developing the secondary market for government securities. The authorities will adopt a strategy to ensure an adequate and reliable supply of electricity, including raising electricity tariffs to cover the cost of service and increasing the operational efficiency of the public electric power utility company.

Program Summary

The new three-year PRGF arrangement will support the government's objectives of boosting economic growth and enhance employment and income opportunities, especially for the poor, while maintaining macroeconomic stability. It is a "low-access" program (10 percent of quota), reflecting Zambia's limited balance-of-payments needs.

The Fifth National Development Plan 2006–10 (FNDP), Zambia's Poverty Reduction Strategy Paper (PRSP), sets out the policy framework to meet these objectives (see IMF Country Report No. 07/277). The FNDP underscores the need to create an environment conducive to private sector growth through sustained macroeconomic stability, public sector efficiency and accountability, and investments in infrastructure and the social sectors.

Consistent with these principles and objectives, the program will focus on: (i) maintaining macroeconomic stability and debt sustainability, while increasing fiscal space for investment in infrastructure, energy, and human resources; and (ii) diversifying the economy to lessen dependence on mining by improving the conditions for private sector-led growth.

A flexible exchange rate regime will be maintained and international reserves are projected to increase to levels that would allow Zambia to better weather external shocks.

Zambia: Selected Economic Indicators

	2005	2006	2007	2008 Proj.	2009 Proj.	2010 Proj.
	(In percent changes; unless otherwise indicated)					
National account and prices						
GDP at constant prices	5.2	6.2	6.0	6.2	6.3	6.5
GDP deflator	18.6	13.8	9.4	5.0	4.0	2.9
GDP at market prices	32,456	39,223	45,482	50,716	56,051	61,432
(In billions of kwacha)						
Consumer prices (average)						
Headline	18.3	9.0	10.7	8.6	4.0	5.0
Underlying (excluding food)	18.1	13.6	16.3	9.2	5.2	5.0
Consumer prices (end of period)	15.9	8.2	8.9	7.0	5.0	5.0
External sector						
Terms of trade (deterioration -)	10.4	55.2	7.9	-8.7	-13.8	-20.1
Average exchange rate (kwacha per U.S. dollar)	4,464	3,601	4,002	…	…	…
(in percentage change; depreciation -)	6.6	19.3	-11.1	…	…	…
Real effective exchange rate (depreciation -)[1]	24.1	32.3	-7.1	…	…	…
Money and credit (end of period)						
Domestic credit to the private sector	18.7	54.3	43.0	22.2	…	…
Reserve money[2]	16.4	22.6	1.6	11.5	…	…
M3	0.4	45.1	25.9	11.6	…	…
	(In percent of GDP; unless otherwise indicated)					
National accounts						
Gross investments	22.5	22.6	24.1	22.7	22.1	22.5
Government	7.0	4.1	4.1	5.2	5.8	6.8
Private	15.5	18.5	20.0	17.5	16.3	15.7
National savings	18.1	25.6	21.6	20.6	24.1	21.5
Gross foreign savings	4.4	-3.0	2.5	2.1	-2.0	1.0
Central government budget[3]						
Overall balance	-2.6	18.6	-0.2	-1.1	0.9	0.4
(excluding grants)	-8.3	-7.4	-4.9	-6.5	-4.5	-5.0
Revenue	17.4	16.9	18.7	21.2	22.1	21.5
Grants	5.6	26.0	4.6	5.3	5.4	5.3
Total expenditure[4]	25.7	24.3	23.6	27.6	26.7	26.4
External sector						
Current account balance						
(including official grants)	-4.4	3.0	-2.5	-2.1	2.0	-1.0
(excluding official grants)	-10.1	-0.7	-7.1	-7.4	-3.4	-6.3
Gross international reserves (months of imports)		2.2	2.5	3.2	4.7	5.5
	(In percent of export of goods and services)					
NPV of central government and BoZ external debt	78.3	15.7	11.8	12.8	14.1	16.3

Sources: Zambian authorities; and IMF staff estimates and projections.
[1]Excludes Zimbabwe.
[2]The projected reduction in reserve money for December 2007 reflects the lowering of statutory reserve requirements from 14 to 8 percent on October 1, 2007.
[3]Grants in 2006 include MDRI debt cancellation amounting to 21.4 percent of GDP.
[4]Including discrepancy between the above-the-line balance and below-the-line financing.

Statement by Peter Gakunu, Executive Director for Zambia and Iyambo Mwanawina, Advisor to Executive Director June 4, 2008

Introduction

1. The Zambian authorities remained steadfast in implementing prudent policies and deepening structural reforms, helped by favorable external environment, which contributed to strong economic performance over recent years. Macroeconomic stability strengthened and growth accelerated. While significant gains are being made in employment creation and poverty reduction, the proportion of people living in poverty remains very high, particularly in rural areas, with the economy still vulnerable to exogenous shocks. The authorities are committed to consolidating their positive economic achievements through a resolute implementation of the fifth national development plan (FNDP), with a view to reaching their development objectives set out in the Zambia Vision 2030. The authorities are in broad agreement with the analysis and policy recommendations in the well balanced staff report, and would appreciate the Board's support of their request of a new three-year PRGF arrangement.

Recent Economic Developments

2. Zambia has continued to register commendable economic performance over the last years, supported by sustained economic reforms, favorable international copper prices, and broad-based growth including in agriculture, mining, manufacturing, construction, telecommunications and other services. Real GDP growth was estimated at 6 percent in 2007 and is expected to continue expanding by an annual average of 6-7 percent over the medium-term. Inflation had been contained at single digit since 2006 due to significant improvement in public finances and monetary policies. However, due to high oil and food prices, end-year annual inflation, which stood at 8.9 percent in 2007, has edged marginally above double digits since April 2008. Significant progress has been made in social indicators as reflected in increased enrolments in education and improved human development index. Poverty level was reduced by about 10 percent between 1998 and 2006, but remains unacceptably high and widespread.

3. The fiscal position in 2007 improved with the overall deficit excluding grants being 2.5 percent of GDP lower than planned, thanks to over-performance of revenue largely due to unexpected large income tax payments from the mining sector. In addition, expenditures were lower than planned due to shortfall in capital spending execution, resulting in accumulation of government deposits at the Bank of Zambia (BoZ).

4. Although there was a slowdown in monetary expansion, money growth exceeded the target on account of a reduction in cash reserve requirement in October 2007 and the difficulties faced by the BoZ to fully sterilize its net purchases of foreign exchange. This

resulted in liquidity pressures and, subsequently, the authorities initiated appropriate corrective measures through its open market operations and auctions of government securities to slow down reserve money growth. Financial conditions and performance of the banking sector are broadly satisfactory. Capital and reserves were in compliance with the prudential requirements, and the banking sector was well capitalized, while the asset quality, earnings and liquidity ratios remained at sound levels.

5. The trade surplus narrowed despite higher copper export prices as flooding and electricity shortages adversely affected copper production. The current account deficit, excluding grants, deteriorated by 7 percent of GDP from 1 percent. Nevertheless, the increase in foreign direct investment to 8.6 percent of GDP contributed to an overall balance of payments surplus that resulted in a strengthened accumulation of international reserves and an appreciation in the exchange rate.

6. The exchange rate remained aligned with macroeconomic fundamentals, and domestic and financial policies are consistent with external stability.

Economic Challenges and Policy Framework

7. Zambia's strong economic growth performance still falls short of the level required to substantially reduce poverty, and the authorities are still faced with the challenges of sustaining macroeconomic stability, increasing fiscal space for upgrading infrastructure, expanding the supply capacity in energy, improving human capital development, and diversifying the sources of growth and exports to lessen dependence on mining by improving conditions for private sector-led growth.

8. The authorities are aware of these challenges and are committed to making further progress in the implementation of prudent policies and their structural reform agenda, as set out in several multiyear programs, notably the Public Expenditure Management and Financial Accountability (PEMFA) program, Public Sector Management (PSM) reform program, Financial Sector Development Plan (FSDP), and Private Sector Development Initiative (PSDI). The key areas of focus include improving expenditure management and budget execution, making revenue collection more efficient and effective, strengthening monetary operations and deepening the financial sector, implementing debt management strategy, and strengthening policies in the energy sector.

Fiscal policy

9. The fiscal stance is expansionary in order to meet the authorities' stated objectives, with revenues projected to increase from 18.7 percent in 2007 to 20.8 percent of GDP in 2008. The new fiscal regime for mining sector came into effect in April 2008 and mining revenue is estimated to increase by 2.8 percent of GDP in 2008. This is expected to substantially improve revenue collection to more than 21 percent in the medium-term. All

mining revenue in excess of what should have been collected under the old regime (1.4 percent of GDP) would be saved in a separate Mining Resource Fund (MRF) to be used as a stabilization fund to even out expenditures and finance high priority projects in the FNDP. The new tax regime is considered by the authorities to be competitive, reasonable and balanced. The authorities do not anticipate mining companies' profit to be less than what they had expected when the investment was made.

10. The authorities are appreciative of the formula advanced by staff of using a progressive profit-based variable tax but are skeptical of its appropriateness for countries like Zambia at the moment given their inherent structural rigidities and institutional weaknesses, particularly in that economic agents are prone to evade tax while most prefer to operate offshore accounts. The authorities feel that they should be given time to explore other alternative ways of broadening the tax base that may suit the country's circumstances better.

Monetary and exchange rate policies

11. Monetary policy aims at reducing inflation to the target of 7 percent in 2008 and 5 percent in the medium-term. The authorities agree that the oil price increase and upward adjustment in electricity tariffs further amplifies the challenge they face. In this regard, BoZ will confine itself to smoothening wide fluctuations in the exchange rate while allowing a gradual build up of international reserves. The authorities are agreeable to making NDA a binding performance criterion and reserve money an indicative target. This arrangement had served them well thus far compared to targeting reserve money. In recent years, there does not appear to be a strong and clear empirical relationship between reserve money and inflation, since both the money multiplier and velocity are likely to have shifted.

Structural reforms and issues

12. The authorities are committed to implementing their ambitious structural reform program to complement their medium-term macroeconomic framework and support the successful implementation of the new program. Steady progress is being made to assist the modernization of the Zambia Revenue Authority. The authorities will also remain steadfast in implementing the PEMFA reform programs, including establishing a single treasury account system and completion of IFIMIS project. The second phase of the Financial Sector Development Plan reforms will be implemented in 2008 which aims at tightening financial regulations and supervision, as well as deepening the money and capital markets.

13. Executive Directors who visited Zambia in February this year can attest to the formidable infrastructure bottlenecks the country is experiencing, mainly in the energy and transportation sectors. Electricity supply shortages impose a serious threat to achieving the program objectives. The authorities will implement the necessary policies and strategies to address this problem. In this regard, the authorities are committed to support and ensure adequate availability of resources for the completion of ongoing rehabilitation projects and

expansion of hydropower capacity. The authorities stand ready to support initiatives aimed at improving the regulatory framework required to enhance efficiency and cost effectiveness of their operations through the established channels.

Conclusion

14. The Zambian authorities consider their engagement with the Fund as crucial to help ease their developmental challenges. The new PRGF-supported program would enable them to continue enhancing a conducive environment for private sector investment, while sustaining macroeconomic stability, public sector efficiency and accountability, and creating the necessary fiscal space, and ensuring debt sustainability.