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EBS/04/44

March 23, 2004

To: Members of the Executive Board

From: The Secretary

Subject: **Zambia—Staff Report for the 2003 Article IV Consultation and Request for an Extension of the Staff-Monitored Program**

Attached for consideration by the Executive Directors is the staff report for the 2003 Article IV consultation with Zambia and Zambia's request for an extension of the staff-monitored program. This paper, together with the ex post assessment for Zambia (SM/04/97, 3/22/04), is tentatively scheduled for discussion on **Wednesday, April 7, 2004**. At the time of circulation of this paper to the Board, the Secretary's Department has not received a communication from the authorities of Zambia indicating whether or not they consent to the Fund's publication of this paper; such communication may be received after the authorities have had an opportunity to read the paper.

Questions may be referred to Mr. Basu, AFR (ext. 37856) and Mr. Kincaid, PDR (ext. 37356).

Unless the Documents Section (ext. 36760) is otherwise notified, the document will be transmitted, in accordance with the procedures approved by the Executive Board and with the appropriate deletions, to the WTO Secretariat on Wednesday, March 31, 2004; and to the African Development Bank, the Common Market for Eastern and Southern Africa, and the European Commission, following its consideration by the Executive Board.

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ZAMBIA

Staff Report for the 2003 Article IV Consultation and Request for Extension of the Staff-Monitored Program

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

Approved by Anupam Basu and G. Russell Kincaid

March 22, 2004

- Discussions for the 2003 Article IV consultation were held in Zambia from October 28 to November 12, 2003. The staff team met with Mr. Magande, Minister of Finance and National Planning (MoFNP), Mr. Fundanga, Governor of the Bank of Zambia (BoZ), other senior officials, representatives of the private sector and civil society, and members of the diplomatic and donor community. A delegation visited Washington from December 12 to 19, 2003 to continue discussions.

- The staff team comprised Mr. Andrews (head), Mr. Thugge, Mr. Tharkur, Mr. Bagattini (all AFR), Mr. Staines (PDR), Mr. Fassina (FAD), and Mr. Kakoza (Resident Representative). The mission worked closely with World Bank staff.

- In concluding the 2002 Article IV consultation on November 27, 2002, Directors welcomed the improvement in Zambia's economic performance but noted that the situation remained fragile. Directors expressed concern over the composition of budgetary expenditures. They urged the authorities to increase poverty-reducing spending and stabilize the wage bill as a share of GDP. Directors emphasized the importance of public expenditure management, macroeconomic stability, and structural reforms for growth and sustained poverty reduction.

- Discussions for the 2003 Article IV consultation focused on sources of growth and medium-term prospects for growth; policies to support private sector development; the fiscal outlook and sustainability; public sector reform and expenditure management; the medium-term external outlook; and financial sector development issues.

- Zambia's last PRGF arrangement expired in March 2003. After consideration of a new three-year PRGF arrangement was precluded by a large projected budget overrun, the authorities requested a staff-monitored program (SMP) covering the period July-December 2003.The mission found that early performance under the SMP had not been satisfactory and discussed an extension of the SMP through June 2004. Discussions were concluded in early February. The government's program and a request for the staff to monitor the program are included in this report.

- Since his election in 2001, President Mwanawasa has increased his slim majority in parliament by appointing opposition members to cabinet and winning by-elections. The government's anti-corruption campaign has resulted in the prosecution of former Zambian President Chiluba on charges of corruption and misuse of public resources.

- Zambia has had two ESAF/PRGF arrangements. An ex post assessment is being issued as a background paper to this report.

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Executive Summary

Recent Developments

- In 2003, Zambia's economic performance continued to improve. Real GDP is estimated to have increased by about 4 percent, making 2003 the fourth consecutive year of uninterrupted growth in over three decades. Inflation, at about 17 percent, declined to its lowest level in two decades.

- However, this good performance reflected favorable exogenous developments that masked serious shortcomings in policy implementation. In particular, there was a sharp deterioration in fiscal performance owing to overruns in the wage bill and ad hoc policy decisions which raised expenditures markedly. As a result, the targets under the SMP for July-December 2003 were missed by a wide margin. Progress on structural reforms was mixed.

The Medium-Term Outlook

- Zambia's economy remains fragile. The government's medium-term strategy, articulated in the PRSP, involves increased diversification of the economy, and targets real GDP growth of at least 4½ percent; an inflation rate in single digits; and a strengthening of the international reserves position.

The Macroeconomic Program for 2004

- In light of the fiscal slippages in 2003, understandings were reached on a macroeconomic program for 2004 whose implementation could establish a track record for moving to a new PRGF arrangement. Consistent with the medium-term objectives, the program is based on real GDP growth of 3.5 percent, and inflation of 20 percent. Achieving these objectives hinges on the authorities' capacity to implement prudent financial policies, in particular the 2004 budget.

- Fiscal adjustment will focus mainly on expenditure restraint. It is therefore crucial that the government refrains from unbudgeted spending, improves public expenditure management and holds the wage bill to 8 percent of GDP. The domestic deficit is projected to narrow by 2.2 percent of GDP, which should permit domestic financing to decline by 3 percent of GDP, thereby reducing pressures on prices and domestic interest rates.

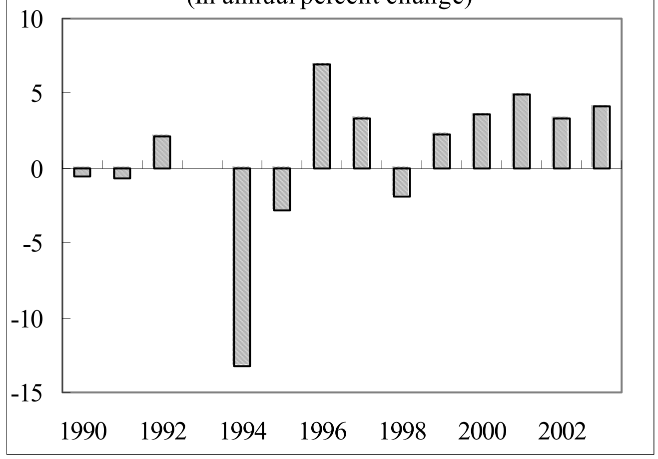
- The government's agenda for structural reforms includes: financial sector reforms, including measures to deal with insolvent NBFIs; completing the privatization of ZNCB; completing the commercialization of ZESCO; improving public expenditure management and governance; and implementing policies to improve the environment for private sector development.

- The implementation of the proposed 2004 budget, which is broadly in line with the SMP, should be sufficient to help Zambia avoid an unsustainable spiral of higher domestic debt and interest payments. Satisfactory performance under the SMP is crucial if Zambia is to move to a PRGF arrangement and to reach the HIPC completion point.

I. Recent Economic Developments and Performance Under the SMP

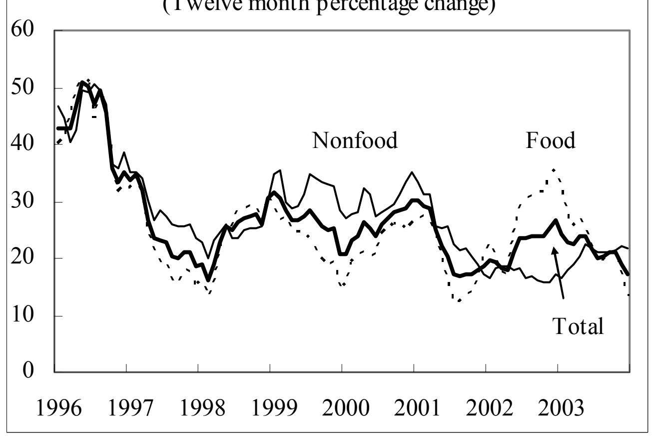
1. **Zambia's economic performance has improved significantly in the last four years.** After more than two decades of economic decline and inflation averaging over 50 percent, growth has averaged about 4 percent per annum since 2000, and inflation has been sharply reduced (Figures 1 and 2). However, macroeconomic stability remains fragile, and faster sustained growth is essential to tackle pervasive poverty.

Figure 1. Zambia: Real GDP Growth, 1990-2003
(In annual percent change)



2. **In 2002, real GDP grew by 3 percent despite difficulties in the mining sector and the impact of the severe drought on agricultural output** (Table 2). Drought-induced food shortages also pushed inflation to 26.7 percent in the 12 months to December 2002. The overall deficit of the central government narrowed to 6.3 percent of GDP from 8.1 percent in 2001. In the external sector, the current account deficit, after grants, narrowed to 6.5 percent of GDP from 10.8 percent in 2001, despite a sharp slowdown in the growth of copper exports. Gross international reserves at the Bank of Zambia (BoZ) rose to 2.2 months of imports in 2002 from 0.9 month at end-2001.

Figure 2. Zambia: Inflation, January 1996-December 2003
(Twelve month percentage change)



3. **In the face of strong pressures to increase public sector wages, fiscal policy implementation deteriorated sharply in 2003.** In April, the authorities granted large wage increases and introduced a new housing allowance. If paid in full, total remuneration of government employees would have exceeded the budgeted figure of 8 percent of GDP by 2½ percent of GDP. Against this background, to facilitate the resolution of this issue and the transition to a new Poverty Reduction and Growth Facility (PRGF) arrangement, understandings were reached on a staff-monitored program (SMP) for the period July to December 2003 in which the macroeconomic framework was modified to accommodate part

of the higher payments to government employees, while seeking to minimize inflationary pressures and protect priority expenditures on poverty reduction.[1]

4. **In 2003, the overall fiscal deficit (after grants) and domestic financing are estimated to have exceeded the SMP target by 1½ percent of GDP and 2 percent of GDP, respectively (Tables 3 and 4).** Through end-August, performance was broadly in line with the SMP, but from September onward there were large unbudgeted outlays. These included security-related spending and payment of retrenchment benefits and wage arrears of 0.8 percent of GDP to facilitate the sale in December of the Luanshya mine, the Roan Antelope Mining Company of Zambia (RAMCOZ) (see para. 6 of the MEFP). Expenditures on poverty reduction strategy paper (PRSP) priority projects again fell short of budgeted levels. Wage payments were broadly in line with the SMP, and the government reached agreements with some unions to reduce housing allowances awarded in 2003 by two-thirds. Domestic arrears continued to accumulate, mostly as a consequence of penalties and an increase in the kwacha value of foreign currency-denominated arrears.

5. **Despite the fiscal slippages, growth picked up and inflation declined in 2003, aided by a recovery in agricultural production.** The increase in real GDP in 2003 is now estimated at 4.2 percent, slightly lower than the 4.5 percent projected in the SMP, reflecting slower growth in mining production. The 12-month inflation rate of 17.2 percent in December 2003 also exceeded the target of 13 percent in the SMP as a result of some relaxation in financial policies (see below). Although inflation reached its lowest level since 1982, this outcome was due more to favorable food price developments (Figure 2) than policy implementation.

6. **Monetary policy was initially tightened in 2003 to remove a monetary overhang.** After expanding by 49 percent in 2002, the growth of reserve money was limited to 17 percent in the first nine months of 2003, and the BoZ observed the corresponding ceiling on net domestic assets (NDA) and the floor on gross reserves (Tables 5 and 6). During the same period, broad money grew by 12 percent, in line with the SMP. In combination with the government's significant financing needs, this monetary restraint kept interest rates on treasury bills in the range of 30-35 percent for most of the year. However, in the final months of 2003, interest rates declined sharply in response to a reduction in the cash reserve requirement (effective October 31) from 17.5 percent to 14 percent. Growth in broad money of 23.4 percent in 2003 exceeded the SMP target of 17 percent.

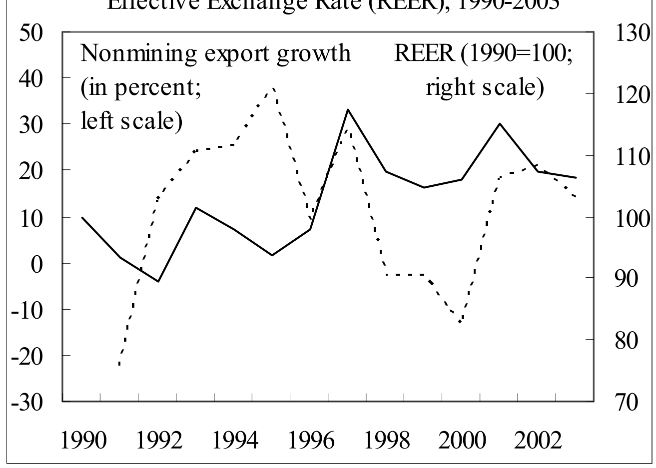
7. **The overall balance of payments position through end-December 2003 is estimated to be better than expected under the SMP.** Boosted by a sharp increase in copper prices in 2003 and further strong growth in nontraditional exports, total exports grew by an estimated 22 percent, while total imports grew by 15 percent (Table 7). The current

[1] Zambia—Request for a Staff-Monitored Program (EBS/03/139; 10/09/03).

account deficit (after grants) and overall balance of payments deficit are estimated to have narrowed to 5.9 percent and 7.6 percent of GDP, respectively, compared with 7.5 percent and 8.8 percent in the SMP. The BoZ met the adjusted end-December 2003 reserve target under the SMP.

8. **The relatively stable trend in the real effective exchange rate since the mid-1990s has continued to support the growth of nontraditional exports** (Figure 3). During 2003, the real effective exchange depreciated slightly as a result of a 15 percent depreciation of the nominal effective exchange rate. However, there were diverse movements against individual currencies. The kwacha depreciated by only 7 percent against the U.S. dollar, compared with 29 percent against the South African rand and 19 percent against the euro.

Figure 3. Zambia: Nonmining Exports and Real Effective Exchange Rate (REER), 1990-2003



9. **Progress in implementing structural reforms was mixed during 2003.** A medium-term expenditure framework (MTEF) was discussed with stakeholders in preparation of the 2004 budget. The BoZ also introduced an interbank foreign exchange market. However, effectiveness of the strengthened commitment control system was undermined by cash releases for unbudgeted expenditures and, to a lesser extent, by weak enforcement of the sanctions on accounting officers. Procurement of hardware and software for an integrated financial management and information system (IFMIS) and the preparation of a multiyear plan for clearing domestic arrears were also delayed. The authorities completed a draft Financial Sector Development Plan (FSDP), which was posted on the BoZ's website for comments in February 2004. Progress was made in developing plans to deal with three insolvent nonbank financial institutions. Negotiations with the preferred bidder, for the sale of 49 percent shares and management rights of the Zambia National Commercial Bank, are continuing.

10. **The authorities have made some progress toward reaching the floating completion point under the enhanced Initiative for Heavily Indebted Poor Countries (HIPC Initiative) (Table 8).** Measures have been implemented in the areas of health and education; the privatization of the ZNCB; agreement on the commercialization of the Zambia Electricity Supply Corporation (ZESCO); the preparation and implementation of the MTEF; and the preparation of the PRSP progress report, a draft of which is being finalized. A key outstanding area is the maintenance of a stable macroeconomic environment, as evidenced by a satisfactory performance under a PRGF arrangement. Satisfactory progress under the extended SMP could serve as a bridge to a new PRGF arrangement.

11. Zambia's core economic database is largely adequate for program monitoring, although the quality and timeliness of key monetary, fiscal, and external trade data need to be improved. Zambia's relations with the Fund and the World Bank Group are summarized in Appendices II and III, respectively. Statistical issues are described in Appendix IV, and social and demographic indicators are provided in Appendix V.

II. Policy Discussions

A. Medium-Term Outlook and Key Policy Issues

12. **Drawing on the ex post assessment of Zambia's performance under Fund-support programs (Box 1),[2] the discussions focused on policies to attain the objectives established in the government's poverty reduction strategy (PRSP).[3]** This medium-term strategy aims to sustain the recent momentum in the growth of per capita income to reduce the poverty headcount from 73 percent in 1998 to 65 percent by 2004. Key macroeconomic objectives underlying this medium-term strategy are to achieve real GDP growth of at least 4 percent per annum during 2004-05 and at least 5 percent thereafter; reduce the rate of inflation to around 10 percent in 2006 and to single digits thereafter; increase gross international reserves significantly by end-2006, and reduce the external current account deficit (including grants and debt relief on interest payments) to a sustainable level.

Zambia: Medium-Term Indicators, 2003-06
(In percent of GDP, unless otherwise indicated)

	2003 Prel.	2004 Proj.	2005 Proj.	2006 Proj.
Real GDP (annual percentage change)	4.2	3.5	4.5	5.0
Consumer prices (percentage change, end of period)	17.2	20.0	15.1	10.1
Revenue (excluding grants)	18.1	19.0	19.0	19.0
Expenditures (excluding interest)	27.3	24.5	24.9	24.7
Overall balance, cash basis	-6.6	-4.0	-2.5	-1.4
Domestic financing	5.1	2.0	1.5	1.0
External current account balance, incl. grants and debt relief	-5.9	-6.1	-4.8	-4.0
Gross official reserves (in months of imports)	1.3	1.5	1.7	2.2

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

[2] See background paper, Ex Post Assessment of Zambia's Performance Under Fund-Supported Programs (SM/04/97).

[3] The Transitional National Development Plan (TNDP), comprises the full PRSP and sectors that were previously not covered in the PRSP, such as the judiciary, defense and foreign affairs.

Box 1. Key Points From the Ex Post Assessment

Past performance

- Program implementation under the ESAF arrangement approved in 1995 was poor, but generally improved under the PRGF arrangement approved in 1999. Growth resumed, but fell short of targets. Fiscal outcomes were not strong enough and inflation remained above 20 percent. Delays in privatization of the copper company, ZCCM, generated large fiscal costs. Fiscal slippages, including excessive wage increases, put pressure on interest rates and prevented increases in priority social spending. Progress in monetary management was more encouraging. Zambia's relatively open and liberal exchange regime and a flexible exchange rate have supported private sector activity including growth of nonmining exports.

- Progress in structural reforms was mixed. Improvements in public expenditure management were slower than expected and undermined by poor expenditure policy. There were repeated delays in the privatization of the insolvent commercial bank ZNCB, and nontransparent processes have adversely affected mining sector privatizations. After the elections in 2001, the new government launched a policy of "zero tolerance" of corruption, but fundamental weaknesses in budgetary processes remain an obstacle to good governance.

- Zambia's mixed record of implementation, including delays in privatizations and weakness in expenditure management and policy, have been indicative of incomplete program ownership. Implementation also suffered from limited capacity and lapses in coordination.

- The growth target in the ESAF-supported program may have been too optimistic. Given the record of fiscal slippages, the initial program targets to reduce inflation to 4 percent over three years appear overambitious. Assumptions for external assistance may also have been too optimistic; policy slippages often led to shortfalls in donor support and higher recourse to domestic borrowing.

Looking ahead

- A further PRGF arrangement is needed to assist Zambia in addressing challenges in the Fund's core areas of responsibility. A strong track record of implementation would allow Zambia to reach the HIPC completion point and catalyze higher aid flows for progress towards the MDGs.

- Fiscal policy must bear a greater burden of adjustment to facilitate a sustainable reduction in real interest rates and support private domestic investment. Development and implementation of public sector reforms to support tight control of the wage bill and improvements in PEM will be crucial to fiscal consolidation and a reorientation of spending to poverty reduction. It is also essential to strengthen budgetary processes to improve governance. A consistent policy for the granting of tax exemptions is needed to avoid ad hoc treatment and to preserve the relatively strong revenue base.

- Completion of the privatization program is essential to improve economic efficiency and protect the budget. Accelerating growth will also require the removal of obstacles to private sector development. Financial sector reform should follow through on the conclusions of the FSAP, including resolving government-owned nonbank financial institutions and improving rural banking services.

- Avoidance of ad hoc spending decisions and strict enforcement of budgetary procedures will be key tests of ownership. Public advocacy of the chosen policy path will also be important in demonstrating ownership at the highest levels of government. Monitoring of implementation needs to be strengthened through improved coordination within government.

The authorities agreed with many of the points made in the assessment, but argued that more needed to be done to support private sector growth, particularly through improvements in infrastructure.

Sources of growth and the medium-term macroeconomic outlook

13. **In the medium term, agriculture, mining, manufacturing, and tourism are expected to be the main sources of growth**. The authorities expect agricultural growth to moderate in 2004 after the strong recovery from drought in 2003, but to pick up steadily to 4 percent by 2006; this growth will be bolstered by support to small-scale farmers and the privately managed outgrower schemes for export crops. The mining sector is expected to play a key role, as a result of higher private investments and the positive outlook for copper prices (Box 2). The government expects the manufacturing sector to benefit from higher demand from mining and agricultural sectors, and also sees good prospects in the tourism sector, particularly in the Livingstone area, spurred by infrastructure improvements and the upgrading of the airport for international flights. The authorities also noted that Zambia would continue to benefit from the regional trade agreements, as well as from the U.S. African Growth and Opportunity Act.

Zambia: Sectoral Growth
(In annual percentage change)

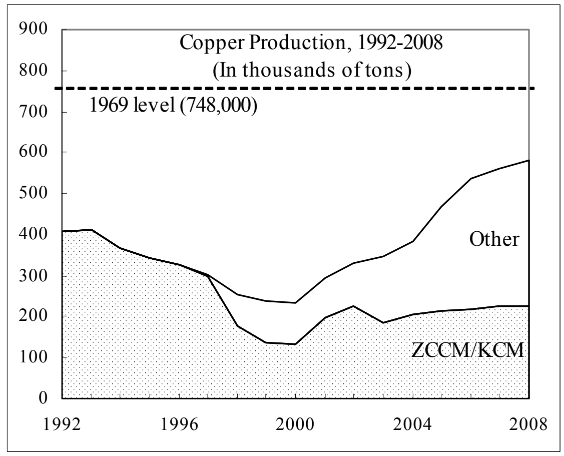
	Share of GDP	2000	2001	2002	2003		2004	2005	2006
	(In percent)				SMP	Prel.	Proj.	Proj.	Proj.
Real GDP	100.0	3.6	4.9	3.3	4.5	4.2	3.5	4.5	5.0
Agriculture	15.3	1.6	-2.6	-1.7	6.8	5.1	2.5	3.0	3.9
Mining	7.8	0.1	14.0	16.4	5.1	3.3	6.0	12.0	8.7
Manufacturing	10.7	3.5	4.2	5.1	4.3	4.5	3.5	4.0	4.6
Restaurants and hotels	2.3	12.3	24.4	4.3	4.7	5.0	5.0	5.0	8.7
Other	63.9	4.3	5.5	2.7	3.9	4.0	3.5	4.0	4.7

Sources: Zambian authorities; and staff projections.

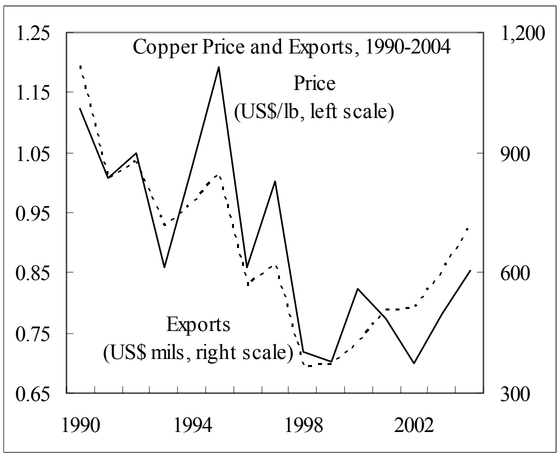
14. Staff analysis indicates that the increase in GDP growth since 2000 reflects a turnaround in total factor productivity (TFP) growth,[4] which can be attributed to improved macroeconomic management and greater private sector participation in the economy, especially in the mining sector, following the privatization of the Zambia Consolidated Copper Mines (ZCCM). The staff and the authorities agreed that the medium-term growth

[4] G. Bagattini, "Sources of Growth in Zambia," in Zambia: Selected Issues and Statistical Appendix.

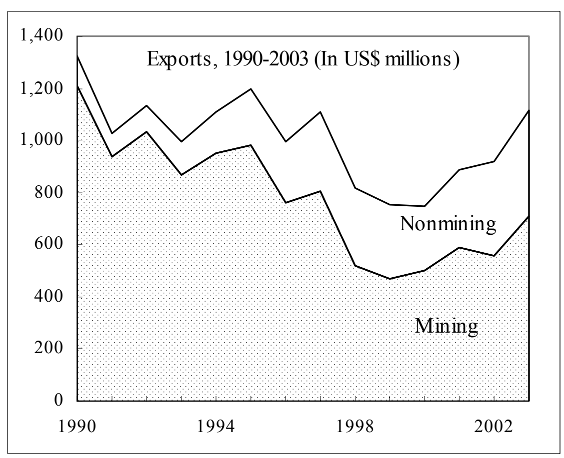
Box 2. Mining Sector Developments and Prospects



Zambia's mining sector, which includes cobalt as a by-product of copper extraction, has suffered three decades of decline. By 2000, copper production had fallen to 234,000 tons, or less than a third of the peak level attained in 1969. This decline was exacerbated by a weakening of copper prices, particularly in the second half of the 1990s, and by the turn of the century, mining accounted for two-thirds of Zambia's merchandise exports, compared with over 90 percent as recently as 1990.



Following the privatization of the Zambia Consolidated Copper Mines (ZCCM) in 2000, copper production rose sharply in 2001 and 2002, to 330,000 tons at the end of 2002. In addition, the outlook for the sector has improved as result of both new investments and higher prices. Developments at the Konkola Copper Mines (KCM)—which include the bulk of the privatized assets of ZCCM—will still play an important role. However, the partial exploitation of the Konkola Deep Mining Project is assumed only to offset declining output from KCM's other mines. KCM's share of total production would therefore decline from two-thirds to about 40 percent over the medium term, as a result of continued expansion of output from other existing mines and the opening of new lower-cost mines, such as at Kanshansi and Lumwana. Total copper production is now expected to reach almost 600,000 metric tons by 2008, a level last attained in the 1980s. In addition, the recovery of the mining sector will also be supported by the higher cobalt production; the projections include the exploitation of substantial cobalt "tailings" at Chambeshi over the near term. However, these projections do not take into account the potential for significant expansion of production of cobalt at Chambeshi and Lumwana or in gemstone mining.



Despite its projected recovery, the mining sector is unlikely to regain its former predominance in the Zambian economy. Although the sector's share of GDP is expected to trend slightly upward, its share of total merchandise exports is expected to remain around two-thirds because of the continued expansion of nonmining exports.

target of 5 percent in the PRSP could be attained with further moderate growth in TFP. However, risks to the long-term growth outlook include exogenous factors, such as drought, a downturn in copper prices, and a worsening of the HIV/AIDS situation.[5]

Contributions to Real GDP Growth, 1995-2009
(In percentage points)

	1995-2000	2001-03	2004-09
Annual real GDP growth	1.8	4.0	4.6
Labor	1.9	1.6	1.5
Capital	1.3	1.9	1.9
Total factor productivity	-1.3	0.6	1.2

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

15. **Raising growth to between 6–8 percent per year to reduce poverty in line with the corresponding Millennium Development Goals (MDGs) would require stronger TFP growth and higher employment rates.** To reach this goal, the staff stressed the importance of increasing the execution of poverty-reducing spending and accelerating the implementation of the structural reform agenda in public expenditure management (PEM), the financial sector (including privatizing the ZNCB and improving access to financial services for rural areas), governance, and removing obstacles to private sector development (see below). The authorities noted, and the staff agreed, that achieving the MDGs would also depend on improved access to industrial countries' markets, especially for agricultural products, textiles, and clothing. The staff observed that, for Zambia to be able to take advantage of such a reduction in trade barriers, it would be important for it to continue to maintain an open trade regime, as well as implementation of the complementary policies, including an appropriate exchange rate.

Private sector development issues

16. **The staff stressed the importance of removing obstacles to private sector development**. Over 90 percent of land is under customary ownership, with control exercised by traditional leaders. The remainder is state lands, for which long-term leases or "titles" can be issued to private individuals. The authorities confirmed that lands under the customary system could not be used as collateral for loans. There was agreement that the limited

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[5] HIV/AIDS is estimated to reduce growth over the medium term by 1–2 percent per annum. See Sgherri and Kahwa Douoguih, "The Implication of HIV for the Zambian Economy" in Zambia: Selected Issues and Statistical Appendix (SM/01/319; 10/22/01).

availability of state lands could ultimately constrain commercial agriculture. The government emphasized the immediate priority of improving the governance and administration of state-controlled lands and providing infrastructure for the development of farming blocks. A consultative process has begun on the conversion of more traditional lands to state lands. In addition, the World Bank is undertaking a poverty and social impact analysis (PSIA) of the reform of land ownership.

17. **The government plans to revise the Industrial and Labor Relations Act** to streamline bargaining and to reduce illegal strikes and lockouts. The government is also considering modifications to current legal provisions to reduce retrenchment costs, which discourage permanent hiring and have proved costly to the government in meeting retrenchment costs of privatized entities. The staff urged the government to avoid provisions requiring employers to provide housing or housing allowances for workers, and to avoid undue restrictions on the hiring of skilled foreign workers. While welcoming the government's intention to strengthen the Zambia Investment Center (ZIC) as a facilitator of foreign direct investments, the staff urged the government to seek private sector views in revising the Investment Act. In particular, the staff noted concerns over recent public statements that were seen as inimical to foreign investment and stressed the important role that higher private investment could play in enhancing growth.

18. **The authorities emphasized the importance of good governance**. In this context, they reiterated their determination to continue with the policy of "zero tolerance" of corruption, and to strengthen key governance institutions, notably the Anti-Corruption Commission and the Office of the Auditor General. To improve the transparency of its operations, the government will continue to undertake regular auditing and publication of its accounts and the operations of the public enterprises. While supporting the authorities' governance program, the staff stressed that addressing fundamental weaknesses in budgetary processes was crucial to strengthening governance.

Fiscal outlook and sustainability

19. **The discussion focused on the urgent need for fiscal adjustment to break the unsustainable cycle of rising domestic debt and interest payments in recent years**. To illustrate the risks, the staff team presented alternative scenarios.[6] Under an adjustment scenario consistent with higher external support and move in 2004 to a PRGF arrangement with the HIPC completion point reached soon after, it would be possible to achieve a gradual phasing out of domestic financing, which would be eliminated in 2008. This should result in a gradual decline in the domestic debt from 21.9 percent of GDP in 2003 to below 14 percent of GDP in 2008 (Figure 4), declining real interest rates, and sharply lower domestic interest

[6] S. Fassina, "Zambia Government Debt and Expenditure Composition," in Zambia: Selected Issues and Statistical Appendix.

payments (from a peak of 3.7 percent of GDP in 2004 to 1.8 percent of GDP in 2008 (Figure 5). This adjustment, supported by effective public sector and PEM reforms, would allow a steady increase in poverty-reducing spending from 2.4 percent of GDP in 2003 to 5.4 percent of GDP in 2008 (Figure 6). In a scenario without fiscal adjustment, domestic financing would double from 4.9 percent of GDP in 2004 to 10 percent of GDP in 2008, entailing an unsustainable rise of domestic debt and interest payments and a sharp reduction in all components of primary spending (Figure 7).

Figure 4. Stock of Domestic Debt 2002-08
(as a share of GDP)

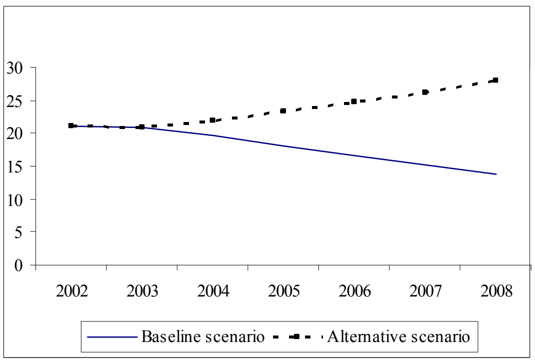


Figure 5. Domestic Interest Payments, 2002-08
(as a share of GDP)

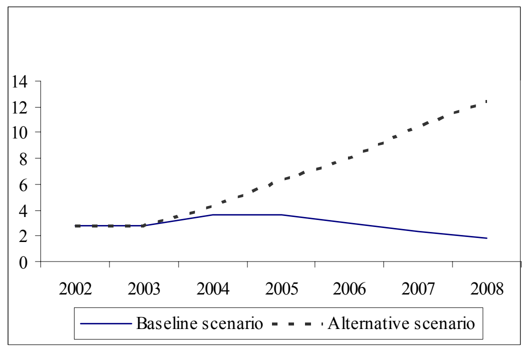


Figure 6. Expenditure Composition–
Baseline Scenario (as a share of GDP)

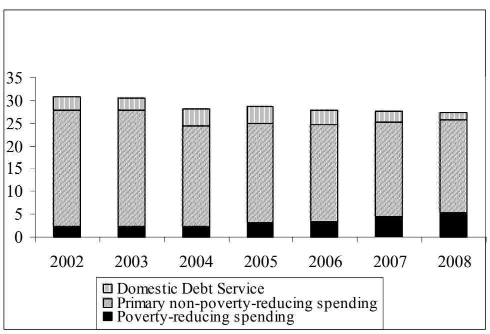
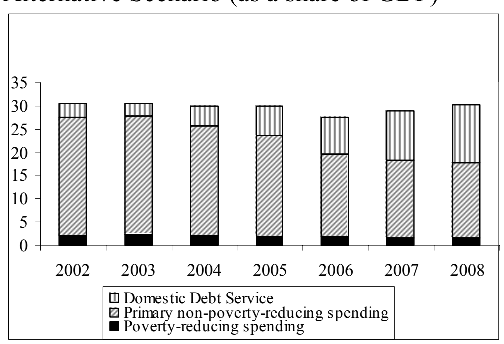


Figure 7. Expenditure Composition–
Alternative Scenario (as a share of GDP)



20. **Against this background, the staff stressed that a firm fiscal policy in 2004 would be crucial to establish a sustainable path for domestic debt.** The staff also noted the risk that without prompt action, the approach of national elections in 2006 could lead to a costly delay in the required fiscal adjustment. The authorities agreed with the staff's assessment and shared the view that concerted efforts were needed to implement a budget in 2004 geared to restraining domestic borrowing, limiting the wage bill to no more than 8 percent of GDP, and protecting priority social spending. The authorities also agreed on the need to phase out domestic financing over the medium term, and reorient spending toward poverty-reducing programs.

21. **The staff also emphasized the need to maintain the good performance of Zambia's tax revenues.** While revenue collections have generally been in line with budget targets and above the average levels seen in the region, the staff expressed concern that exemptions could undermine this performance. The authorities recognized this risk and indicated that they would carefully assess the potential budgetary effects of recent initiatives on tax incentives for investment before their full implementation (see para. 19 of the memorandum of economic and financial policies (MEFP)) and seek to develop a consistent policy in this area. In addition, the authorities agreed with staff recommendations that raising budgetary revenues as a share of GDP by expanding the tax base and improving efficiency of the tax system should remain a pillar of the planned fiscal adjustment.

Public sector reform and expenditure management

22. **The authorities acknowledged that further public sector reforms were needed to contain the wage bill while improving efficiency.** Despite an ongoing reform plan supported by the World Bank since 2001, progress was disappointing, especially in implementing the pay reform strategy. Weaknesses remained in procedures for wage negotiations and in managing the establishment register and the payroll. The staff stressed the importance of a new round of public sector reforms on which discussions are underway with the World Bank and other donors (para. 17). These reforms over the period 2004-08 should aim to "right size" government operations and to complete the pay reform strategy. The staff urged that, as well as improving the efficiency of the government's operations, these reforms should be geared to reducing the wage bill to below the level of 8 percent of GDP projected in the MTEF, so as to provide more room for priority spending.

23. **The authorities agreed that progress in strengthening public expenditure management had been undermined by unbudgeted expenditures.** This experience of recent fiscal slippages and the adverse implications of large domestic borrowing underscored the need to reinforce the budget's role in the definition and execution of spending policy. The HIPC Initiative expenditure-tracking Assessment and Action Plan (AAP), carried out jointly by the World Bank and the IMF in December 2003, also concluded that only limited progress had been made in strengthening PEM (Box 3).

Medium-term external outlook and policy issues

24. **The authorities and staff concurred that, with the support of domestic fiscal adjustment and attainment of the completion point under the HIPC Initiative, medium-term external prospects were generally positive.** Based on discussions with government and with the key mining companies, copper exports are projected to rise by 20 percent a year over 2004-06, due to higher prices and a continued expansion of production, including new mines in Kansanshi and Lumwana; in 2006, production is expected to be about half a million metric tons, a level last reached in the mid-1980s. The authorities and staff agreed that this outlook was vulnerable to weaker copper prices (see Box 4) and the continued uncertainty concerning the sale of a majority share of the Konkola Copper Mines (KCM) (Box 5).

Box 3. Implementation Status of Actions to Strengthen Tracking of Poverty-Reducing Public Spending

No.	Actions	Timing (S/M) 1/	Status (FI/II/ NS) 2/	Date Achieved	Comments
Actions to strengthen budget formulation					
1	Improve reporting on donor activities.	S	NS		No action has been taken, although Government of the Republic of Zambia is working with donors.
2	Short-term expert to analyze 1999 and 2000 accounts, and 2001 budget; and to establish bridge tables for a functional classification at the second-digit level.	S	II		Bridge tables available for social sectors.
3	Component of public service delivery capacity building program (PSCAP); improve classification to meet requirements of integrated financial management information system (IFMIS).	M	FI	11/2003	Activity-Based Budget Chart of Accounts approved. New classification introduced in 1/2004.
4	Tag expenditures financed from HIPC resources through previously unused budget code at the level of subhead.	S	FI	3/2002	Started with the 2002 Yellow Book.
5	Activity-based budgeting: classification exercises under way for four pilot ministries, and in the education sector.	S	FI	2003	Piloted in five ministries in 2003.
6	Medium-term expenditure framework: component of PSCAP.	M	II		Macrofiscal framework for 2004-06 was published and discussed in fall 2003. Further development under way.
Actions to strengthen budget execution					
7	Enforce compliance with regulations on commitments to control better expenditure path and arrears.	S	II		Still not enforced and undermined by ad hoc spending decisions taken at political level.
8	Implement IFMIS.	M	II		Procurement to begin in early 2004.
9	Strengthen internal audit through redirection of resources to system audits, random checks, etc.; and training.	S	II		System remains severely underresourced.
10	Establish subaccount (#49) of main government account in which all monies saved due to the HIPC Initiative are being channeled, and make it operational.	S	FI	12/2000	
12	Improve reporting on own resources of departments and appropriations in aid.	S	II		Appropriations in aid are reflected in the budget documents. In general, there is no breakdown of spending.
Actions to strengthen budget reporting					
13	Enforce compliance with monthly reporting requirements.	S	II		Monthly reporting improved significantly in 2003 but compliance is not yet universal. Sanctions for non-compliance are not applied systematically.
14	Strengthen Auditor General Department; improve resources and training.	S	II		Norwegian Agency for Development Cooperation (NORAD) has begun a capacity-building program, but resources remain severely constrained.
15	Conduct public expenditure-tracking surveys (PETS).	M	NS		An expenditure and service delivery survey (ESDS) on education was carried out by the World Bank in 2002.

1/ S=Short-term action; M=medium-term action.
2/ FI=fully implemented, II=Implementation initiated, NS=Not started.

Box 4. External Debt Sustainability

External debt sustanability and alternative scenarios, percent of GDP unless otherwise stated, 2003-2012
Excluding new PRGF disbursements

	2003 Est.	2004 Proj.	2005 Proj.	2006 Proj.	2007 Proj.	2008 Proj.	2009 Proj.	2010 Proj.	2011 Proj.	2012 Proj.
Baseline scenario										
Financing gap (surplus +)	0.0	-4.1	-2.5	-2.3	-2.1	-1.6	-1.2	-1.2	-1.2	-1.2
Gross official assistance	9.5	9.6	10.3	9.8	9.9	10.0	10.1	10.1	9.7	9.9
Copper price ($/lb)	0.79	0.86	0.88	0.89	0.89	0.90	0.90	0.90	0.90	0.90
Exports (3-yr average) US$m	1150	1291	1509	1719	1896	2028	2114	2203	2282	2368
Debt service, percent of exports	14.2	16.3	11.3	4.5	5.4	6.3	5.3	6.5	7.0	6.7
NPV of debt, percent of exports /1	182	160	133	120	110	103	100	97	95	94
Higher debt composition										
Debt service, percent of exports	14.2	16.3	11.4	4.6	5.5	6.5	5.5	6.8	7.3	7.1
NPV of debt, percent of exports /1	182	162	138	127	119	114	114	114	115	117
Lower copper price scenario										
Financing gap (surplus +)	0.0	-5.9	-4.8	-4.8	-4.4	-3.9	-3.2	-3.0	-2.8	-2.7
Copper price ($/lb)	0.79	0.78	0.80	0.80	0.80	0.81	0.81	0.81	0.81	0.81
Exports (3-yr average) US$m	1150	1264	1448	1620	1785	1910	1994	2082	2161	2247
Debt service, percent of exports	14.2	17.2	12.0	4.8	5.7	6.7	5.6	6.9	7.4	7.1
NPV of debt, percent of exports /1	182	166	143	134	125	119	116	113	112	111
Higher donor support scenario										
Gross official assistance	10.0	13.7	12.8	12.2	15.0	14.7	14.3	14.3	14.0	14.2
Debt service, percent of exports	14.2	16.3	11.4	4.6	5.6	6.5	5.6	6.8	7.3	7.0
NPV of debt, percent of exports /1	182	160	133	120	111	107	104	102	101	102
HIPC DP document										
Copper price ($/lb)	0.94	0.97	1.00	1.01	1.01	1.02	1.02	1.03	1.03	1.03
Exports (3-yr average) US$m	1386	1508	1606	1712	1824	1943	2071	2207	2351	2505
Debt service, percent of exports	10.0	13.2	11.8	5.3	6.2	6.3	6.2	5.7	5.7	5.7
NPV of debt, percent of exports	161	148	140	136	131	125	121	117	113	111

1/ Including additional financing, above gross financing indicated, to close the financing gap.

The baseline scenario assumes that Zambia reaches the HIPC completion point by end-2004 and implements strong fiscal adjustment through the medium term. External debt service is expected to decline substantially in 2006 as the large repayments due to the Fund, related to the 1995 arrears clearance, come to an end. Debt-service payments are then projected to trend upwards because of repayments on new PRGF disbursements since 1999, but will remain below 7 percent of exports. Payments to other creditors will remain relatively low due to the longer maturities on their lending.

The NPV of debt at end-2003, using decision point discount rates, is tentatively estimated to be 182 percent of exports—and therefore above the 150 percent sustainability threshold. This is also higher than projected at the end-2000 decision point mainly because of weaker copper prices. However, the NPV of debt is projected to trend down to about 94 percent of exports by the end of the projection period. This is less than projected at the decision point, mainly because of a stronger than expected shift in the composition of external assistance towards grants. The share of loans in gross external financing fell from about half in 2000 to about 30 percent in 2003 and, in keeping with current donor sentiments, is projected to trend further down to about 20 percent. Under the first alternative scenario, which assumes that half of the assistance is in the form of loans, the debt burden by the end of the projection period is higher than under the baseline scenario.

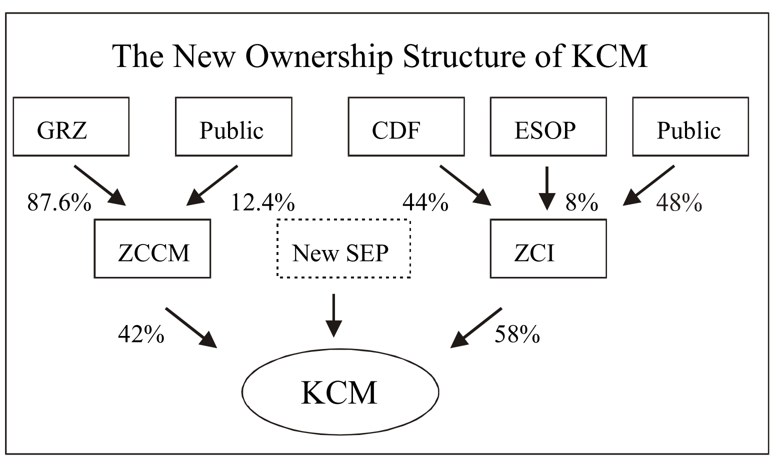
The baseline assumes that copper prices will rise from an average of 78 cents/lb in 2003 to 89 cents/lb in 2008. In the second alternative scenario, a 10 percent reduction in the copper price from 2004 relative to the baseline would increase the NPV of debt at the end of the projection period to about 110 percent of exports.

The third scenario takes into account the potential need for higher assistance to help meet the poverty reduction targets. Although the extent of the increase in assistance required is difficult to gauge, the scenario assumes that gross assistance would need to be about 3 percentage points of GDP higher than in the baseline starting from 2007—after allowing for additional financing to close the financing gap. In this scenario, gross financing rises to over 14 percent of GDP over 2007-12. Assuming that the additional assistance is more heavily tilted toward loans than under the baseline scenario, but that the overall share of loans nevertheless declines to about 25 percent, the NPV of debt at the end of the projection period would remain over 100 percent of exports.

Box 5. Ownership Structure of Konkola Copper Mines

After the state-owned copper mines were privatized in March 2000, Konkola Copper Mines (KCM) emerged as the largest mining company, accounting for about two-thirds of copper production. The consortium that took over KCM was led by the private sector holding company, Zambia Copper Investments (ZCI), whose equity stake in KCM was 65 percent. Anglo American (AA) owned 51 percent of the ZCI. The remaining 35 percent of KCM's equity was accounted for by two development agencies (the IFC and the CDC), which each owned 7.5 percent, and by the government's holding company, the Zambia Consolidated Copper Mines (ZCCM) (20 percent). Although the ZCCM was a minority shareholder in KCM, the government held a golden share, giving it the right to veto KCM's involvement in areas unrelated to mining. In early 2002, AA decided to exit from KCM, citing weak world copper prices and the high cost of developing the Konkola Deep Mining Project. Subsequently, the two development agencies also chose to exercise their options to exit KCM and have their original investments refunded by AA.

Until a new strategic equity partner (SEP) is found for KCM, a transitional ownership structure will be kept in place, as illustrated below. Temporarily, KCM now has two major shareholders, the ZCI and the ZCCM, and, although the ZCCM remains the minority shareholder, its equity stake has increased significantly to 42 percent. Moreover, the stakeholders in both the ZCI and the ZCCM have been significantly changed. Aside from the previous minority shareholders in the ZCI (mostly European), whose stake has been increased, AA's stake in the ZCI has now been taken over by two new stakeholders. These are the independent Copperbelt Development Foundation (CDF) and KCM's employees, through an employee share ownership scheme (ESOP) designed to provide incentives to the management and employees. The CDF will use any income from the ZCI to invest in projects aimed at diversifying the economy of the copperbelt and mitigating the social impact of the eventual closure of the KCM mines. The government continues to be the main stakeholder in the ZCCM, with a golden share in KCM, but a minority stake in the ZCCM will now be held by private investors. Once a new strategic equity partner has been found to invest in KCM, it is expected that the SEP will acquire control of at least 51 percent of KCM outside of both the ZCI and the ZCCM. This tripartite ownership structure would be accommodated by a dilution of the equity shares held by the ZCI and the ZCCM.



The strong growth in nonmining exports is projected to continue, though at a more modest pace of about 10 percent per year. The authorities noted the potential for significant growth in electricity and tourism. On this basis, the external current account deficit (after grants and debt relief on interest) is projected to trend down to 4 percent of GDP in 2006 from about 6 percent in 2003.

25. **The authorities noted the significant expansion in trade with countries in the Common Market for Eastern and Southern Africa (COMESA) and the Southern African Development Community (SADC),** which now accounted for about one-third of Zambia's exports, compared with less than 10 percent a decade ago. This expansion has been facilitated by the creation of the COMESA free trade area in 2000 and the continuing tariff reduction in the SADC. The authorities also anticipate that the creation of the COMESA common external tariff (CET) in 2004 will lead to additional gains in trade. The authorities noted that access to industrial countries' markets had been also important to the strong growth in nonmining exports and stressed that a further expansion of access would be helpful to support continued growth in this area.

26. **The trade regime remains open and supportive of export development.** The simple average nominal tariff on imports is estimated to have declined in 2003 by 2 percentage points to 11.5 percent as a result of the reclassification of some goods within the four tariff bands (0, 5, 15, and 20 percent). The authorities affirmed the absence of nontariff barriers. Import bans introduced against selected imports from Zimbabwe in 2002 were removed in mid-2003 when agreement was reached through COMESA to permit these goods to be evaluated for tariff purposes at the market exchange rate rather than at the official exchange rate. Based on the simple average tariff and the virtual absence of nontariff barriers, Zambia's trade regime would continue to carry a rating of 2 under the Fund's trade restrictiveness index, which ranges from 1 to 10, with a rating of 10 being the most restrictive. Zambia has been selected to participate in the Integrated Framework for Trade-Related Technical Assistance to Least Development Countries.[7]

27. **The staff and the authorities agreed that Zambia's floating exchange rate regime was appropriate,** given the country's vulnerability to external shocks. The successful introduction of the interbank market for foreign exchange in July 2003 was seen as an important step toward improving the efficiency of the market. To date, the market has operated well, and the authorities suggested that its wider coverage had contributed to somewhat greater short-term stability of the kwacha. The staff also agreed with the authorities that the external value of the kwacha was broadly appropriate and had supported competitiveness and growth in

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[7] This initiative, begun in 1997 by the six core UN agencies, including the Fund, aims to assist countries to mainstream trade policies in their poverty reduction strategies and to help coordinate the delivery of trade-related technical assistance.

nontraditional exports.[8] Although Zambia had received significant amounts of aid, this was not seen as exerting strong upward pressure in the kwacha because of its high import content and because of the accumulation of external reserves since the late 1990s. Any future fiscal slippages, with their potential for triggering higher inflation and increases in real interest rates were, however, viewed as posing a serious risk to competitiveness. Similarly, competitiveness will also deteriorate if public sector wage increases continue to put pressure on private sector labor costs.

28. **The authorities recognized that achieving medium-term debt sustainability and meeting PRSP objectives would depend critically on a demonstrated commitment to sound economic policies, which in turn should permit Zambia to reach the completion point under the HIPC Initiative.** Reaching the completion point would also allow Zambia to meet the large debt-service obligations due to the Fund through end-2005. External debt-service obligations are projected to drop sharply in 2006, once repayments to the Fund related to the 1995 arrears clearance under the rights accumulation program (RAP) have been completed.

29. **The authorities and staff agreed that significant levels of external donor support would be needed for Zambia to meet its poverty reduction targets**. The authorities shared staff's concern that policy slippages had jeopardized this support over the near term. A significantly improved record of policy implementation will be needed to gain higher levels of donor support. The authorities stressed the need for external support to be provided in the form of grants, noting that, on current projections, debt-service obligations (including to the Fund) would fall significantly in 2006 but would start to increase again toward the end of the decade. However, on the basis of existing data, which would be revised for a new debt sustainability analysis prior to the HIPC completion point, debt-service payments would remain below 7 percent of exports and the net present value (NPV) of debt would continue to trend downward to below 100 percent of exports.

Financial sector development

30. **The discussion of financial sector issues took place against the background of generally sound indicators of the health of the banking system, but low levels of financial intermediation.** The staff emphasized the importance of a prompt selection of a private strategic investor for the ZNCB, noting that the poor performance of this bank had been a barrier to efficient banking operations. With the exception of the ZNCB, all banks have continued to meet their minimum capital requirements. Asset quality remains satisfactory, with interest earning assets accounting for 74 percent of total assets; however, investments in government securities continue to account for a large share of banks assets, at 29 percent. The quality of the banks' loan portfolio remains satisfactory, with nonperforming loans declining to

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[8] N. Staines, "The External Value of the Kwacha," in Zambia: Selected Issues and Statistical Appendix.

8.6 percent of total loans, and provisioning has been adequate. However, for the financial system as a whole, the ratio of private sector credit to GDP is one of the lowest in sub-Saharan Africa at 6 percent. Moreover, the state-owned nonbank financial institutions (NBFIs), which were set up to channel funds to specific sectors, such as housing, long-term project financing, and rural banking services, are insolvent.

31. **The Financial Sector Assessment Program (FSAP) undertaken jointly with Bank staff noted the need for decisive plans to tackle the problem of insolvent NBFIs.** The government has produced a draft financial sector development plan (FSDP) that seeks to address this and other issues raised in the FSAP. The authorities concurred with the staff assessment that the first priority was to address the issue of the insolvent NBFIs, which continued to expose the budget to additional liabilities (progress in this area would be monitored under the SMP). The plan also stresses the need to strengthen the independence of the BoZ, especially in matters of banking supervision. The government has also drafted regulations to support the development of the microfinance sector that are expected to come into force in 2004. The draft regulations aim to strengthen the governance of the sector through increased availability of information and better supervision of corporate governance.

B. The Extended SMP and Economic Prospects for 2004

32. **The authorities recognized that performance under the SMP for July-December 2003 did not provide a strong basis for an early transition to a PRGF arrangement**. Discussions, therefore, focused on a revised fiscal framework for 2004, whose implementation, including upfront actions to support the required fiscal adjustment, could be monitored under a SMP extended through June 2004. Growth in 2004 is now projected at 3.5 percent, while inflation is targeted to be 20 percent by end-December 2004. Gross international reserves are expected to reach 1.5 months of import cover at end-2004. The authorities were aware that, only with satisfactory progress—first under the extended SMP, and then under a PRGF arrangement, as well as further progress on the HIPC Initiative triggers—could Zambia reach the HIPC Initiative completion point.

33. **The budget framework relies on expenditure restraint and revenue increases to attain the required adjustment.** Overall, domestically financed primary expenditures are expected to decline by 1.8 percentage points of GDP, while revenues are expected to increase by 1 percent of GDP (see MEFP, paras. 13-20). As a result, domestic financing would be limited to 2 percent of GDP, thereby, preventing a further rise in domestic debt as a share of GDP and easing pressure on interest rates.

34. **On the expenditure side, the adjustment will focus on the wage bill and recurrent department charges.** The wage bill is to be reduced by 0.5 percentage point to 8 percent of GDP in 2004 by avoiding a general wage increase for government employees—except for the police and immigration and prison service personnel—and the payment of a modest housing allowance. Savings are also envisaged in ordinary recurrent departmental charges and in domestically financed capital spending. Priority poverty-reducing expenditures are budgeted at

2 percent of GDP, or close to double the outcome for 2003. The avoidance of ad hoc spending decisions during the fiscal year and progress on PEM reforms are key conditions for executing the budget (paras. 29-36 of MEFP).

35. **On the revenue side, measures focus on broadening the tax base and increasing the efficiency of the system**. Specifically, the value-added tax (VAT) has been significantly reformed. First, unprocessed agricultural goods, medical supplies, and drugs, currently zero rated, have been exempted. Second, the possibility of voluntary registration has been eliminated. Third, the threshold for mandatory registration has been doubled to K 200 million per year. For businesses below the revised VAT threshold, the government has replaced the income tax and the VAT with a 3 percent turnover tax. Revenues from new top personal income tax brackets of 35 percent and 40 percent will more than compensate for lower tax payments by the bulk of taxpayers, who will benefit from a higher threshold for income tax. In combination with higher nontax revenues, including higher receipts from sale of fertilizer,[9] total revenues are expected to rise by 1 percent of GDP in 2004.

36. **The authorities agreed to refrain from introducing any additional tax exemptions, rebates, or preferential tax treatment beyond those already factored in the 2004 budget.** They expressed concern that this could conflict with the operation of the Export Processing Zone Act (EPZA) but agreed to a freeze on all registrants under the act until a study could assess its potential revenue impact. This study would be completed in time for preparing the 2005 budget to allow for revenue measures to be taken to offset any negative impact of tax incentives (paras. 18 and 19 of MEFP).

37. **The staff discussed with the authorities the possible poverty and social impact of some of the proposed fiscal measures.** The exemption from VAT of unprocessed agricultural goods, medical supplies, and drugs means that producers will no longer be able to claim VAT refunds for inputs used, as was possible under the previous regime, with the zero rating of these goods. This change may raise production costs and could lead to some price increases. However, the full execution of poverty-reducing expenditures, which are budgeted to increase by 1 percent of GDP from the outcome in 2003, is expected to mitigate the possible adverse impact of these price increases on the poor. In addition, poor households will also benefit from the authorities' decision to raise the threshold for exempting income from the personal income tax.[10] The staff also suggested that the fiscal adjustment include (i) higher excise duties on petroleum products, with the increase concentrated on gasoline, so as to minimize the impact on the poor of higher diesel prices; and (ii) the introduction of a new top income tax rate of

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[9] The 2004 budget reduced the fertilizer subsidy. Farmers will now pay 75 percent of the cost of fertilizer rather than 50 percent as before. This change implies additional revenue of 0.1 percent of GDP.

[10] The previous threshold—unchanged for several years—implied taxing income just above one U.S. dollar per day.

35 percent. However, in the face of rising import prices for petroleum products, the budget did not raise petroleum excise duties, opting instead for a more progressive income tax. On the issue of the fertilizer subsidy, a preliminary PSIA conducted by Bank staff indicated that, while such a subsidy could benefit the poor, the existing scheme was subject to problems of targeting and efficiency that undermined its effectiveness.

38. **The fiscal adjustment would enable the expansion of broad money to be limited to 18 percent in 2004.** This objective takes into account the monetary overhang at the end of 2003 resulting from the reduction in reserve requirements, while accommodating a substantial increase in credit to the private sector in real terms. The staff cautioned that the sharp decline in interest rates—which brought real yields on treasury bills close to zero in December 2003—was unlikely to be sustainable, given the government's continued financing needs, and it urged the authorities to keep the stance of monetary policy under careful review. The BoZ indicated that it stood ready to tighten monetary policy, including reversing the recent reduction in reserve requirements, if necessary. The flexible exchange rate regime will remain in place, with interventions by the BoZ aimed primarily at smoothing out short-term fluctuations in the market, and in meeting the program's gross international reserve target.

39. **Copper exports are projected to grow strongly in 2004.** However, as a result of large imports for investment in the sector, the external current account deficit is projected to widen slightly to 6.1 percent of GDP. Program loans and grants are expected to remain low, at 1.6 percent of GDP, and the gross international reserves of the BoZ are expected to rise slightly to 1.5 months of import cover by end-2004 (up from an estimated 1.3 months of imports in 2003), provided a PRGF arrangement is in place and the projected donor financing materializes.

40. **Under the program, structural measures are aimed at strengthening budget execution, and expenditures controls, and restructuring the insolvent public NBFIs** (see para. 31 above and Table 4 of the MEFP). The government is also proceeding with the commercialization of the electricity utility company, ZESCO, in line with agreements reached with the World Bank. The commercialization has progressed satisfactorily, with the agreed "entry point" conditions for the commercialization strategy met by end-December 2003. The authorities intend to request a revision of the HIPC Initiative completion point trigger relating to the privatization of ZESCO, to be replaced by the completion of measures specified as benchmarks to reach the interim phase of the commercialization (MEFP, para. 38).

Program monitoring

41. **The implementation of the SMP will be monitored under monthly targets and benchmarks** (Tables 3 and 4 of the MEFP). The staff considers that this close monitoring is required in view of the slippages during 2003. In addition, good performance against monthly targets may enable more rapid progress to a successor arrangement. To further strengthen program monitoring, the government has revived the Interministerial Economic Monitoring Committee, which will now be chaired by the President. The Fund's Resident Representative

will also be invited to attend the meetings of the technical group that will advise the interministerial committee.

Risks to program implementation

42. **Developments during the last year have highlighted the risks posed by unanticipated spending decisions.** It is therefore essential that greater program ownership, developed through extensive discussions in the cabinet on the policy framework for 2004, be supported by rigorous spending controls. Holding the line on wages also poses a key challenge. By reopening discussions on government employees' remuneration in 2003, the authorities demonstrated their resolve to address this issue squarely. The authorities' strong advocacy of the need for wage restraint, and for changes in the income tax code that benefit the majority of government employees, is also supportive of progress in this area. However, the government's strong stance has resulted in strikes by civil servants.

43. **The economy remains vulnerable to climate and terms of trade shocks.** However, the crop early warning system does not point to losses of macroeconomic significance in 2004, despite below-average initial rains in parts of the country. At the same time, copper prices have remained above the average levels assumed in the program.

44. **The reserve position of the BoZ may come under pressure as a result of large financing needs in 2004.** Although reserves of US$196 million at end-2003 were equal to 1.3 months of import cover, they are low in relation to forthcoming debt-service payments, including large obligations (SDR 85 million) due to the Fund in June. The proximity of these payments underscores the importance of strong performance under the SMP to allow an early transition to a new PRGF arrangement.

C. Technical Assistance (TA) and Statistical Issues

45. **Zambia has received significant Fund technical assistance in areas such as tax policy and administration, PEM reforms, and banking and financial sector reforms, as well as in strengthening the capacity of the BoZ.** The implementation of PEM reforms has not had the desired results, owing to continued extrabudgetary expenditures and the circumvention of budget procedures (paras. 29 and 31 of MEFP). In 2002-03, TA in the foreign exchange market resulted in the introduction of an interbank foreign exchange market in July 2003. The joint Bank-Fund Financial System Stability Assessment (FSSA) of 2002 identified key financial sector challenges, which are being addressed through tailored Monetary and Financial System Department (MFD) TA including the preparation of the FSDP, the restructuring of the NBFIs, payments system reforms, and anti-money-laundering legislation. The authorities reaffirmed their interest in a data Report on Observance of Standards and Codes (ROSC) mission in April 2004, which could provide a good diagnosis for further TA to improve the statistical systems in the Ministry of Finance, the Central Statistics Office, and the BoZ. In particular, the authorities agreed that TA was urgently needed to improve the quality and timeliness of national accounts data.

D. Issues Under Fund Jurisdiction

46. **Zambia has accepted the obligations of Article VIII, Sections 2, 3, and 4 of the Articles of Agreement.** Zambia maintains an exchange restriction arising from the external payments arrears accumulated prior to October 1985, which is subject to Fund approval.[11] The introduction of a broad-based interbank foreign exchange market in July 2003 has eliminated the previous multiple currency practice arising from the spreads between the dealing window and interbank rates.

III. Staff Appraisal

47. **The staff concurs with the conclusions of the ex post assessment of Zambia's performance.** A further PRGF arrangement is needed to assist Zambia in addressing challenges in the Fund's core areas of responsibility. The experience from these ESAF/PRGF arrangements also points to the need for fiscal policy to bear a greater burden of adjustment to facilitate a sustainable reduction in real interest rates and support private domestic investment. Development and implementation of public sector reforms to support tight control of the wage bill and improvements in PEM will be crucial to fiscal consolidation and a reorientation of spending to poverty reduction. It is also essential to strengthen budgetary processes to improve governance. Completion of the privatization program is essential to improve economic efficiency and protect the budget. Accelerating growth will also require removal of obstacles to private sector development. Financial sector reforms should follow through on the conclusions of the FSAP, including resolving government-owned nonbank financial institutions and improving rural banking services. Avoidance of ad hoc spending decisions and strict enforcement of budgetary procedures will be key tests of ownership. Public advocacy of the chosen policy path will also be important in demonstrating ownership at the highest levels of government. Monitoring of implementation needs to be strengthened through improved coordination within government. A strong track record of implementation would allow Zambia to reach the HIPC completion point and catalyze higher aid flows for progress towards the MDGs.

48. **The recent and welcome improvement in Zambia's main economic indicators has continued.** Zambia's longest period of uninterrupted economic growth in over three decades was extended to a fourth year in 2003, and inflation declined to its lowest level in over 20 years.

49. **However, over the last year, Zambia has benefited from some favorable exogenous developments that have masked serious shortcomings in the implementation of**

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[11] These arrears include both commercial arrears and arrears with respect to private individuals (see EBD/02/76). Some of these arrears have already been cleared through a buy-back scheme. Regarding the remaining debt, the government is verifying claims and negotiating the settlement of the arrears on substantially the same terms as those for the buy-back scheme or on Paris Club terms.

macroeconomic policies. Real GDP growth of over 4 percent was bolstered by a rebound in agricultural production from the effects of the drought in 2002. At the same time, while the resulting easing of food price inflation also contributed to a decline in headline inflation, nonfood consumer prices rose more rapidly than in 2002. In addition, a recovery in copper prices in 2003 supported relative stability in the exchange rate and strengthened reserve position at the BoZ. In contrast to these positive exogenous developments, 2003 saw a sharp and unsustainable relaxation of fiscal policy, stemming mainly from policy decisions that entailed expenditures well in excess of budgeted levels. These slippages in policy implementation added to the sharp increase in domestic debt, both directly, as expenditures entailed higher borrowing, and indirectly, as they precluded an early consideration of a new PRGF arrangement that would have been a catalyst to greater external financing.

50. **The authorities' budget proposal for 2004 is welcome as it seeks a sharp reduction in domestic borrowing to avert an upward spiral in domestic debt and interest payments.** The focus of fiscal adjustment on expenditure restraint is appropriate. In this context, the staff also welcomes the authorities' intention to bring the wage bill down to 8 percent of GDP in 2004. In addition to its contribution to the overall fiscal adjustment, wage restraint is essential to provide more room for priority expenditures. At the same time, successful implementation of the budget will require tight control of other expenditures. On the revenue side, measures included in the 2004 budget should help to broaden the tax base and improve the efficiency of the VAT system while simplifying its administration. The budget proposal submitted to parliament is in line with the understandings reached with the staff on the extended SMP.

51. **The steps taken by the authorities to improve budget discipline are encouraging**. The recent strengthening of the commitment control system must be supported by tight enforcement of procedures, including sanctions against accounting officers responsible for any overspending and the diversion of funds between budget subheads. However, steps to support stronger public expenditure management must be accompanied by a firm political commitment to avoid unbudgeted spending. In particular, it is essential that the Ministry of Finance and National Planning receives full political backing for strict adherence to the budget, and that there is no repeat of the ad hoc spending decisions in 2003. In this regard, the extensive consultations within the government that culminated in cabinet approval of the budget and the policies set out in the SMP, signal increased policy ownership.

52. **The recent development of a medium-term expenditure framework marks an important step toward strengthening budget preparation and setting expenditure priorities to meet goals established in the PRSP.** In this regard, the intention to contain the government wage bill over the medium term is appropriate. Development and implementation of a medium-term strategy to "right size" government operations and complete the pay reform will be essential to allow priority poverty-reducing expenditures to increase over the medium term. The authorities should continue to work with the World Bank and bilateral donors on the design of this public sector reform program.

53. **The flexible exchange rate regime has been an important element in sustaining the export growth.** Maintaining external competitiveness and export diversification will depend on consolidating gains through the implementation of tight fiscal and monetary policies that restrain domestic inflation pressures. Fiscal consolidation is, therefore, an urgent requirement for achieving sustainable growth, strengthening external viability, and reducing poverty over the medium term.

54. **The completion of the FSDP is a useful first step toward addressing the issues identified in the 2002 FSSA.** The authorities are, however, encouraged to prioritize the challenges and ensure that urgent issues, such as the insolvency of the NBFIs, are addressed in 2004. Progress toward the sale of the ZNCB is warmly welcome.

55. **The authorities should continue to improve the environment for private sector development and foreign investment.** In this regard, the authorities are urged to give serious consideration to private sector views of the reforms that are contemplated for the Investment Act, labor legislation, and any eventual changes to land legislation. The staff also urges the authorities to strengthen the land administration system and step up efforts to make more traditional land available for commercial agriculture.

56. **Policies under the SMP, if implemented, are sufficient to help Zambia avoid an unsustainable spiral of higher domestic debt and interest payments.** Satisfactory performance under the SMP in 2004 is crucial if Zambia is to move to a PRGF arrangement and reach the HIPC Initiative completion point. Given the precarious levels of the BoZ's international reserves, there is little room for further lapses in policy implementation that might undermine Zambia's much needed track record, discourage donor flows, and worsen economic conditions for the Zambia people. Notwithstanding notable progress, efforts will need to be accelerated to ensure more satisfactory progress in meeting the HIPC Initiative completion point triggers.

57. Regarding the exchange restriction evidenced by the existence of external arrears, the staff encourages the authorities to continue with their efforts to resolve the remaining arrears. It is proposed that the next Article IV consultation be held on the 12-month consultation cycle, subject to the provisions of the decision on consultation cycles approved on July 15, 2002.

Table 1. Zambia: Indicators of Fund Credit, 2000-12
(In millions of SDRs, unless otherwise specified)

	2000 Act.	2001 Act.	2002 Est.	2003 Proj.	2004 Proj.	2005 Proj.	2006 Proj.	2007 Proj.	2008 Proj.	2009 Proj.	2010 Proj.	2011 Proj.	2012 Proj.
Outstanding Fund credit, end of period	873	782	747	578	408	238	227	200	153	106	61	22	0
Of which : SAF/ESAF/PRGF 1/	873	782	747	578	408	238	227	200	153	106	61	22	0
Fund credit outstanding (percent of quota)	179	160	153	118	83	49	46	41	31	22	12	4	0
PRGF loan disbursements	20	75	133	0	0	0	0	0	0	0	0	0	0
Total debt service to the Fund	7	173	173	174	173	173	12	29	49	48	47	40	22
Repayments	0	167	168	169	170	171	10	27	48	47	46	39	22
Interest charges on Fund credit and use of SDRs	7	6	5	5	3	3	2	2	2	1	1	1	1
HIPC Initiative assistance	0	117	121	121	83	86	0	0	0	0	0	0	0
After HIPC Initiative assistance	7	56	52	53	90	87	12	29	49	48	47	40	22
Net use of Fund resources	13	19	81	-53	-90	-87	-12	-29	-49	-48	-47	-40	-22
Change in Fund credit outstanding	20	-92	-35	-169	-170	-171	-10	-27	-48	-47	-46	-39	-22
Debt service to the Fund													
As percent of total public external debt service	6	50	55	39	54	64	21	39	53	60	61	21	12
As percent of exports of goods and services	1	7	6	6	9	7	1	2	3	3	3	2	1
As percent of GDP	0	2	2	2	3	3	0	1	1	1	1	1	0
Zambia's quota in the Fund	489	489	489	489	489	489	489	489	489	489	489	489	489

Sources: IMF Finance Department; and Fund staff estimates and projections.

1/ Structural Adjustment Facility / Enhanced Structural Adjustment Facility / Poverty Reduction and Growth Facility.

Table 2. Zambia: Selected Economic and Financial Indicators, 2000-06

	2000 Est.	2001 Est.	2002 Est.	2003 Jul. SMP	2003 Prel.	2004 Proj.	2005 Proj.	2006 Proj.
	(Annual percentage change, unless otherwise indicated)							
National income and prices								
Real GDP	3.6	4.9	3.3	4.5	4.2	3.5	4.5	5.0
GDP deflator	27.9	24.3	19.9	19.9	20.1	19.5	14.4	10.1
Consumer prices (annual average)	26.1	21.7	22.2	20.5	21.5	18.5	17.5	12.6
Consumer prices (end of period)	30.1	18.7	26.6	13.0	17.2	20.0	15.1	10.1
External sector								
U.S. dollar value of exports of goods and services	2.1	19.4	2.4	15.8	22.1	12.8	17.5	12.1
U.S. dollar value of imports of goods and services	12.8	23.3	-2.5	13.0	13.0	8.8	12.4	9.1
Export volume	-5.0	26.2	11.2	5.2	8.6	6.8	17.0	12.2
Import volume	2.4	33.8	-4.3	7.2	9.9	9.2	13.1	8.2
Copper export volume	-2.5	26.9	11.3	7.6	5.8	9.3	22.9	14.8
Copper export prices (average, U.S. dollars per pound)	0.82	0.77	0.70	0.75	0.78	0.85	0.88	0.88
Nominal effective exchange rate (annual average)	-16.5	-7.7	-19.3	...	-14.2	...	...	...
Real effective exchange rate (annual average)	1.2	8.5	-5.8	...	-1.8	...	...	...
Terms of trade	-4.4	-2.0	-7.1	1.4	7.0	6.5	1.3	-0.4
Money and credit (change in percent of beginning-of-year M2)								
Net foreign assets	63.9	-6.0	56.0	-13.3	-9.0	12.0	...	...
Net domestic assets	10.2	16.8	-24.5	30.2	32.5	6.1	...	...
Net domestic credit	18.7	26.7	-31.7	23.7	36.6	6.1	...	...
Net claims on government	18.1	19.5	3.3	15.8	27.0	8.7	...	...
Claims on nongovernment	28.6	6.7	6.1	7.9	9.6	9.4	...	...
Broad money	74.1	10.7	31.5	16.9	23.4	18.2	...	...
Treasury bill rate (in percent; end of period)	34.1	52.0	32.5	...	18.2	...	...	...
Central government budget								
Revenue (excluding grants)	47.5	28.4	16.0	28.2	26.5	30.0	19.4	15.5
Grants	-3.7	31.1	79.0	7.0	5.5	5.7	57.9	19.1
Expenditures 1/	42.2	34.9	22.8	20.3	22.5	15.2	21.1	12.0
Domestic expenditures 1/ 2/	52.9	39.2	14.1	18.3	23.9	19.1	21.5	13.7
	(In percent of GDP)							
Investment and savings								
Gross national savings 3/	5.7	9.2	16.5	12.5	17.3	17.9	20.1	18.4
Gross foreign savings 4/	11.4	10.8	6.5	7.5	5.9	6.1	4.8	4.0
Gross domestic investment	17.1	20.1	23.0	20.0	23.2	24.0	25.0	22.3
Public	10.0	11.9	11.8	11.3	11.5	10.3	10.6	10.3
Private	7.1	8.1	11.1	8.7	11.7	13.7	14.3	12.0
Central government budget								
Revenue and grants	25.1	24.9	26.2	25.5	25.1	25.0	26.9	27.1
Revenue (excluding grants)	19.4	19.2	17.9	18.4	18.1	19.0	19.0	19.0
Expenditures (excluding interest) 1/	27.9	29.7	27.8	25.9	27.3	24.5	24.9	24.7
Interest due 5/	3.0	2.5	4.1	4.7	3.9	4.5	4.5	3.8
Domestic expenditures 1/ 2/	21.6	23.1	21.3	20.1	21.0	20.3	20.6	20.3
Overall balance, cash basis	-7.0	-8.1	-6.3	-5.2	-6.6	-4.0	-2.5	-1.4
Domestic balance, cash basis 6/	-3.3	-4.6	-4.1	-1.7	-3.5	-1.3	-1.6	-1.3
Domestic financing	1.8	4.5	2.1	3.0	5.1	2.0	1.5	1.0
Stock of domestic debt (end of period)	...	22.1	21.0	19.2	21.0	19.8	18.0	16.6
External sector								
Current account balance, excl. grants	-19.2	-20.8	-17.3	-16.7	-14.8	-13.9	-14.2	-13.4
Current account balance, incl. grants and debt relief 7/	-11.4	-10.8	-6.5	-7.5	-5.9	-6.1	-4.8	-4.0
	(In percent of exports of goods and services)							
External debt								
External official debt service	15.9	13.5	11.4	15.9	14.2	16.3	11.3	4.5
External program assistance 8/	21.2	7.1	12.8	4.4	4.2	4.7	5.2	4.1
	(In millions of U.S. dollars, unless otherwise indicated)							
Current account balance, incl. grants and debt relief 7/	-369	-394	-246	-304	-251	-271	-215	-185
Overall balance of payments	-416	-399	-383	-358	-321	-292	-211	-215
Gross official reserves (end of period)	114	114	283	155	197	239	312	440
In months of imports of goods and services	1.0	0.9	2.2	1.1	1.3	1.5	1.7	2.2

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

1/ Including contingency reserve and payments of domestic arrears.
2/ Excludes external interest payments and foreign-financed capital expenditure.
3/ Gross national disposable income minus consumption.
4/ Current account balance, including program and project grants.
5/ After enhanced HIPC Initiative debt relief.
6/ Excludes foreign grants, external interest payments, and foreign-financed capital expenditure.
7/ Includes program and budget grants and debt relief on interest payments.
8/ For 2004-06, figures are preliminary projections and do not reflect firm commitments.

Table 3. Zambia: Central Government Overall Operations, 2001-06
(In billions of kwacha)

	2001	2002	2003			2004	2005	2006
			Budget	SMP	Prel.	SMP	Proj.	Proj.
Revenue and grants	3,262	4,259	5,256	5,173	5,104	6,287	8,086	9,423
Revenue	2,509	2,909	3,677	3,729	3,680	4,783	5,710	6,594
Tax revenue	2,449	2,849	3,446	3,498	3,548	4,533	5,412	6,251
Income taxes	977	1,244	1,470	1,558	1,622	2,048	2,445	2,824
Excise taxes	366	423	513	514	482	642	767	886
Value-added tax (VAT)	821	812	1,010	1,014	1,034	1,344	1,605	1,853
Domestic VAT	278	342	423	428	393	632	755	871
Import VAT	544	471	587	586	642	712	850	982
Customs duty	285	367	451	411	409	499	596	688
Nontax revenue	60	60	231	231	132	249	298	344
Grants	754	1,350	1,579	1,444	1,424	1,505	2,376	2,829
Program	107	324	307	246	229	143	334	541
Project	647	1,026	1,272	1,198	1,195	1,362	2,042	2,288
Expenditures	4,212	5,172	6,226	6,223	6,338	7,301	8,839	9,895
Current expenditures	2,578	3,161	3,580	3,927	4,003	4,714	5,646	6,322
Wages and salaries	888	1,301	1,520	1,758	1,728	2,018	2,345	2,638
Public service retrenchment	19	80	115	115	10	33	39	45
Recurrent departmental charges (RDCs) 1/	801	584	453	505	648	686	915	1,137
Arrears clearance	117	147	73	100	52	77	134	178
Other RDCs	562	426	358	385	564	563	756	867
Transfers and pensions	353	412	380	348	361	419	621	717
Domestic interest	207	450	532	658	563	927	1,080	1,052
External interest 2/	124	210	287	299	229	216	265	268
Other current expenditures	178	95	281	234	456	405	371	428
Of which : contingent liabilities	64	0	65	39	209	120	30	35
Contingency	8	29	12	10	6	8	10	35
Capital expenditure	1,557	1,925	2,646	2,295	2,335	2,588	3,193	3,573
Domestically financed	494	417	696	458	507	601	812	989
Foreign financed	1,063	1,508	1,951	1,837	1,828	1,986	2,381	2,585
Net transfers to ZCCM 3/	77	86	0	0	0	0	0	0
Change in balances and statistical discrepancy	-106	-117	0	0	-116	0	0	0
Overall balance	-1,056	-1,031	-971	-1,050	-1,349	-1,014	-753	-472
Domestic balance	-607	-662	-260	-345	-716	-316	-483	-448
Domestic primary balance	-400	-212	272	313	-152	611	597	605
Financing	1,056	1,031	971	1,050	1,349	1,014	753	472
Domestic 4/	589	337	298	618	1,041	504	451	347
Bank	483	90	205	571	979	387	...	...
Nonbank	106	247	93	47	62	117	...	...
External	467	693	673	432	308	510	302	125
Program loans	165	295	278	46	46	257	383	284
Project loans	434	483	732	693	633	657	340	297
Amortization	-132	-84	-337	-308	-371	-404	-420	-456
Memorandum items:								
Priority poverty-reducing spending	186	154	421	280	213	522	601	877
External budget support	272	619	585	293	275	400	717	825
Stock of domestic arrears (end period)	346	602	276	711	...	...	...	...
On housing assistance	...	60		168	...	...	...	...
On other items	...	542	276	542	...	...	...	...
Stock of domestic debt (end period) 5/	2,891	3,408	3,647	3,903	4,263	4,974	5,425	5,769
GDP	13,079	16,252	19,301	20,305	20,338	25,178	30,060	34,716

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

1/ Recurrent Departmental Charges include purchases of goods and service, some allowances and training expenses.
2/ The last Paris Club agreement, providing Zambia with debt relief on Cologne terms, expired at end-March 2003. Zambia will continue to acumulate arrears on rescheduable debt until a new agreement can be reached when a new PRGF arrangement is approved. Projected government debt service payments reflect obligations to Paris Club and other bilateral creditors after the accumulation of these arrears.
3/ Zambia Consolidated Copper Mines.
4/ Until 2003 at face value. From 2004 at cost value. Exclude bonds issued in 2001 in favor of the Bank of Zambia (K 1,646 bn) and in 2002 in favor of the Zambia National Commercial Bank (K 248 bn).
5/ At cost value. Include bonds issued in 2001 in favor of the Bank of Zambia (K 1,646 bn) and in 2002 in favor of the Zambia National Commercial Bank K (248 bn).

Table 4. Zambia: Central Government Overall Operations, 2001-06
(In percent of GDP, unless otherwise indicated)

	2001	2002	2003			2004	2005	2006
			Budget	SMP	Prel.	SMP	Proj.	Proj.
Revenue and grants	24.9	26.2	27.2	25.5	25.1	25.0	26.9	27.1
Revenue	19.2	17.9	19.0	18.4	18.1	19.0	19.0	19.0
Tax revenue	18.7	17.5	17.9	17.2	17.4	18.0	18.0	18.0
Income taxes	7.5	7.7	7.6	7.7	8.0	8.1	8.1	8.1
Excise taxes	2.8	2.6	2.7	2.5	2.4	2.6	2.6	2.6
Value-added tax (VAT)	6.3	5.0	5.2	5.0	5.1	5.3	5.3	5.3
Domestic VAT	2.1	2.1	2.2	2.1	1.9	2.5	2.5	2.5
Import VAT	4.2	2.9	3.0	2.9	3.2	2.8	2.8	2.8
Customs duty	2.2	2.3	2.3	2.0	2.0	2.0	2.0	2.0
Nontax revenue	0.5	0.4	1.2	1.1	0.7	1.0	1.0	1.0
Grants	5.8	8.3	8.2	7.1	7.0	6.0	7.9	8.1
Program	0.8	2.0	1.6	1.2	1.1	0.6	1.1	1.6
Project	4.9	6.3	6.6	5.9	5.9	5.4	6.8	6.6
Expenditures	32.2	31.8	32.3	30.6	31.2	29.0	29.4	28.5
Current expenditures	19.7	19.4	18.5	19.3	19.7	18.7	18.8	18.2
Wages and salaries	6.8	8.0	7.9	8.7	8.5	8.0	7.8	7.6
Public service retrenchment	0.1	0.5	0.6	0.6	0.0	0.1	0.1	0.1
Recurrent departmental charges (RDCs) 1/	6.1	3.6	2.3	2.5	3.2	2.7	3.0	3.3
Arrears clearance	0.9	0.9	0.4	0.5	0.3	0.3	0.4	0.5
Other RDCs	4.3	2.6	1.9	1.9	2.8	2.2	2.5	2.5
Transfers and pensions	2.7	2.5	2.0	1.7	1.8	1.7	2.1	2.1
Domestic interest	1.6	2.8	2.8	3.2	2.8	3.7	3.6	3.0
External interest 2/	0.9	1.3	1.5	1.5	1.1	0.9	0.9	0.8
Other current expenditures	1.4	0.6	1.5	1.2	2.2	1.6	1.2	1.2
Contingency	0.1	0.2	0.1	0.1	0.0	0.0	0.0	0.1
Capital expenditure	11.9	11.8	13.7	11.3	11.5	10.3	10.6	10.3
Domestically financed	3.8	2.6	3.6	2.3	2.5	2.4	2.7	2.8
Foreign financed	8.1	9.3	10.1	9.0	9.0	7.9	7.9	7.4
Net transfers to ZCCM 3/	0.6	0.5	0.0	0.0	0.0	0.0	0.0	0.0
Change in balances and statistical discrepancy	-0.8	-0.7	0.0	0.0	-0.6	0.0	0.0	0.0
Overall balance	-8.1	-6.3	-5.0	-5.2	-6.6	-4.0	-2.5	-1.4
Domestic balance	-4.6	-4.1	-1.3	-1.7	-3.5	-1.3	-1.6	-1.3
Domestic primary balance	-3.1	-1.3	1.4	1.5	-0.7	2.4	2.0	1.7
Financing	8.1	6.3	5.0	5.2	6.6	4.0	2.5	1.4
Domestic 4/	4.5	2.1	1.5	3.0	5.1	2.0	1.5	1.0
Bank	3.7	0.6	1.1	2.8	4.8	1.5	...	...
Nonbank	0.8	1.5	0.5	0.2	0.3	0.5	...	...
External	3.6	4.3	3.5	2.1	1.5	2.0	1.0	0.4
Program loans	1.3	1.8	1.4	0.2	0.2	1.0	1.3	0.8
Project loans	3.3	3.0	3.8	3.4	3.1	2.6	1.1	0.9
Amortization	-1.0	-0.5	-1.7	-1.5	-1.8	-1.6	-1.4	-1.3
Memorandum items:								
Priority poverty-reducing spending	1.4	0.9	2.2	1.4	1.0	2.1	2.0	2.5
External budget support	2.1	3.8	3.0	1.4	1.4	1.6	2.4	2.4
Stock of domestic arrears (end period)	2.6	3.7	1.4	3.5	...	...	...	...
On housing assistance	...	0.4	0.0	0.8	...	...	...	...
On other items	...	3.3	1.4	2.7	...	...	...	...
Stock of domestic debt (end period) 5/	22.1	21.0	18.9	19.2	21.0	19.8	18.0	16.6
GDP (in billions of kwacha)	13,079	16,252	19,301	20,305	20,338	25,178	30,060	34,716

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

1/ Recurrent Departmental Charges include purchases of goods and service, some allowances and training expenses.

2/ The last Paris Club agreement, providing Zambia with debt relief on Cologne terms, expired at end-March 2003. Zambia will continue to acumulate arrears on rescheduable debt until a new agreement can be reached when a new PRGF arrangement is approved. Projected government debt service payments reflect obligations to Paris Club and other bilateral creditors after the accumulation of these arrears.

3/ Zambia Consolidated Copper Mines.

4/ Until 2003 at face value. From 2004 at cost value. Exclude bonds issued in 2001 in favor of the Bank of Zambia (K 1,646 bn) and in 2002 in favor of the Zambia National Commercial Bank (K 248 bn).

5/ At cost value. Include bonds issued in 2001 in favor of the Bank of Zambia (K 1,646 bn) and in 2002 in favor of the Zambia National Commercial Bank K (248 bn).

Table 5. Zambia: Monetary Survey, 2000-04

	2000	2001	2002		2003															2004
					QI	QII	July	July	Aug.	Aug.	Sep.	Sep.	Oct.	Oct.	Nov.	Nov.	Dec.	Dec.		
	Act.	Act.	Act.	Prog. Base	Act.	Act.	Act.	SMP	Act.	SMP	Act.	SMP	Prel.	SMP	Est.	SMP	Est.	SMP	Prog. Base 1/	SMP
	(In billions of kwacha)																			
Net foreign assets 2/	-1,512	-2,843	-957	-1,127	-1,329	-1,458	-1,432	-1,559	-1,486	-1,586	-1,558	-1,631	-1,647	-1,691	-1,609	-1,529	-1,454	-1,608	-1,778	-1,240
Bank of Zambia	-2,440	-3,705	-1,954	-2,255	-2,392	-2,306	-2,272	-2,417	-2,278	-2,455	-2,350	-2,511	-2,446	-2,582	-2,474	-2,431	-2,377	-2,521	-2,766	-2,275
Assets	772	588	1,692	2,000	1,857	1,453	1,487	1,340	1,475	1,300	1,397	1,242	1,301	1,169	1,268	1,319	892	757	978	1,169
Liabilities	-3,212	-4,294	-3,646	-4,255	-4,250	-3,759	-3,759	-3,757	-3,753	-3,755	-3,748	-3,753	-3,748	-3,751	-3,742	-3,750	-3,269	-3,278	-3,744	-3,443
Commercial banks	927	863	997	1,128	1,063	847	840	858	792	869	792	880	799	891	865	902	922	912	988	1,035
Assets	996	956	1,081	1,223	1,162	970	982	...	952	...	969	...	903	...	989	...	1,030	...	1,104	...
Liabilities	-68	-94	-84	-95	-99	-123	-142	...	-160	...	-157	...	-103	...	-124	...	-108	...	-116	...
Net domestic assets	3,998	5,596	4,577	4,747	5,005	5,357	5,280	5,443	5,426	5,549	5,625	5,682	5,716	5,747	5,729	5,757	5,922	5,839	6,246	6,519
Net domestic credit	1,772	2,593	1,784	998	1,229	1,563	1,548	1,649	1,736	1,717	1,944	1,813	2,103	1,841	2,175	1,812	2,323	1,856	2,041	2,314
Net claims on government	952	1,848	1,932	1,768	1,898	2,174	2,138	2,240	2,249	2,288	2,453	2,363	2,578	2,369	2,651	2,318	2,746	2,339	2,563	2,950
Claims on government	1,460	2,666	2,781	2,617	2,828	3,262	3,232	…	3,351	…	3,446	…	3,652	…	3,693	…	3,830	…	3,648	-25
Government deposits	-508	-818	-849	-849	-930	-1,088	-1,094	…	-1,103	…	-993	…	-1,073	…	-1,041	…	-1,085	…	-1,085	387
HIPC account (IMF)	-401	-643	-1,704	-1,929	-1,929	-1,929	-1,929	-1,929	-1,929	-1,929	-1,929	-1,929	-1,929	-1,929	-1,929	-1,929	-1,929	-1,929	-2,067	-2,603
Claims on nongovernment	1,221	1,388	1,556	1,159	1,260	1,318	1,338	1,337	1,416	1,358	1,420	1,379	1,453	1,400	1,453	1,423	1,506	1,446	1,545	1,967
Claims on private sector	862	946	1,019	1,065	1,162	1,216	1,232	1,235	1,325	1,254	1,323	1,273	1,363	1,293	1,358	1,313	1,390	1,333	1,429	1,819
Claims on public enterprises 3/	359	442	537	94	98	102	106	103	91	104	98	106	91	108	95	110	116	113	116	148
Other items (net)	2,226	3,003	2,793	3,749	3,776	3,795	3,732	3,795	3,690	3,833	3,680	3,868	3,613	3,906	3,554	3,944	3,599	3,982	4,204	4,204
Broad money	2,486	2,754	3,620	3,620	3,676	3,899	3,848	3,885	3,939	3,964	4,066	4,051	4,068	4,056	4,121	4,228	4,468	4,230	4,468	5,279
Narrow money	761	1,015	1,323	1,323	1,242	1,416	1,391	…	1,482	…	1,440	…	1,530	…	1,533	…	1,696	…	1,696	…
Quasi money	1,725	1,738	2,296	2,296	2,434	2,483	2,457	…	2,457	…	2,626	…	2,538	…	2,588	…	2,772	…	2,772	…
Foreign exchange deposits	1,171	1,045	1,429	1,429	1,547	1,580	1,546	…	1,504	…	1,619	…	1,552	…	1,555	…	1,619	…	1,619	…
Other	554	693	867	867	888	904	911	…	954	…	1,008	…	986	…	1,033	…	1,153	…	1,153	…
	(Change in percent of beginning-of-year broad money, unless otherwise indicated)																			
Net foreign assets	63.8	-53.5	68.5	…	-5.6	-9.1	-8.4	-11.9	-9.9	-12.7	-11.9	-13.9	-14.4	-15.6	-13.3	-11.1	-9.0	-13.3	…	12.0
Net domestic assets	10.3	64.3	-37.0	…	7.1	16.9	14.7	19.2	18.8	22.2	24.2	25.8	26.8	27.6	27.1	27.9	32.5	30.2	…	6.1
Net domestic credit	18.7	33.0	-29.4	…	6.4	15.6	15.2	18.0	20.4	19.9	26.1	22.5	30.5	23.3	32.5	22.5	36.6	23.7	…	6.1
Net claims on government	18.1	36.0	3.1	…	3.6	11.2	10.2	13.0	13.3	14.4	18.9	16.4	22.4	16.6	24.4	15.2	27.0	15.8	…	8.7
Claims on nongovernment	28.6	6.7	6.1	…	2.8	4.4	5.0	4.9	7.1	5.5	7.2	6.1	8.1	6.7	8.1	7.3	9.6	7.9	…	9.4
Claims on private sector	21.5	3.4	2.7	…	2.7	4.2	4.6	4.7	7.2	5.2	7.1	5.7	8.2	6.3	8.1	6.8	9.0	7.4	…	8.7
Claims on public enterprises	7.1	3.3	3.5	…	0.1	0.2	0.3	0.2	-0.1	0.3	0.1	0.3	-0.1	0.4	0.0	0.5	0.6	0.5	…	0.7
Other items (net)	-8.4	31.3	-7.6	…	0.7	1.3	-0.5	1.3	-1.6	2.3	-1.9	3.3	-3.8	4.3	-5.4	5.4	-4.1	6.4	…	0.0
Broad money	74.1	10.8	31.5	…	1.6	7.7	6.3	7.3	8.8	9.5	12.3	11.9	12.4	12.0	13.8	16.8	23.4	16.9	…	18.2
Program exchange rates																				
Kwacha per dollar	2,632	4,158	3,830	4,334	4,334	4,334	4,334	4,334	4,334	4,334	4,334	4,334	4,334	4,334	4,334	4,334	4,334	4,334	5,018	5,018
Kwacha per SDR	3,612	5,405	4,826	5,634	5,634	5,634	5,634	5,634	5,634	5,634	5,634	5,634	5,634	5,634	5,634	5,634	5,634	5,634	6,975	6,975

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

1/ Beginning in 2004, government securities are recorded at cost rather than at face value.
2/ The difference between the column marked "estimate" and "program base" is due to the use of a program exchange rate.
3/ In 2002, includes the bond issued to the Zambia National Commercial Bank (ZNCB) (K 250 billion) to cover liabilities of the Zambia National Oil Company (ZNOC) and Roan Antelope Mining Company.

Table 6. Zambia: Assets and liabilities of the Bank of Zambia, 2000-04
(In billions of kwacha, unless otherwise indicated)

	2000	2001	2002		2003															2004
					QI	QII	July	July	Aug.	Aug.	Sep.	Sep.	Oct.	Oct.	Nov.	Nov.	Dec.	Dec.	Prog.	
	Act.	Act.	Act.	Prog. Base	Act.	Act.	Est.	SMP	Est.	SMP	Est.	SMP	Est.	SMP	Est.	SMP	Est.	SMP	Base 1/	SMP
Net foreign assets 2/	-2,440	-3,705	-1,954	-2,255	-2,392	-2,306	-2,272	-2,417	-2,278	-2,455	-2,350	-2,511	-2,449	-2,582	-2,474	-2,431	-2,377	-2,521	-2,766	-2,275
Assets	772	588	1,692	2,000	1,857	1,453	1,487	1,340	1,475	1,300	1,397	1,242	1,302	1,169	1,268	1,319	892	757	978	1,169
Liabilities	-3,212	-4,294	-3,646	-4,255	-4,250	-3,759	-3,759	-3,757	-3,753	-3,755	-3,748	-3,753	-3,751	-3,751	-3,742	-3,750	-3,269	-3,278	-3,744	-3,443
Of which : IMF (net)	-3,155	-4,229	-3,603	-4,206	-4,206	-3,721	-3,721	-3,721	-3,721	-3,721	-3,715	-3,721	-3,721	-3,721	-3,715	-3,721	-3,242	-3,251	-3,715	-3,438
Net domestic assets	2,996	4,513	3,158	3,459	3,499	3,499	3,432	3,606	3,503	3,668	3,758	3,748	3,730	3,821	3,756	3,722	3,796	3,813	4,185	3,951
Net domestic credit	424	858	-189	-671	-799	-790	-798	-787	-654	-783	-502	-777	-454	-770	-459	-763	-476	-755	-614	-1,084
Net claims on government	638	1,165	1,128	964	893	819	750	819	872	819	1,083	819	1,124	819	1,120	819	1,090	819	1,090	1,090
Claims on government	1,100	1,888	1,865	1,701	1,725	1,741	1,744	…	1,856	…	1,906	…	…	…	1,972	…	1,973	…	…	…
Government deposits	-463	-723	-737	-737	-831	-921	-994	…	-984	…	-822	…	…	…	-852	…	-883	…	…	…
HIPC account (IMF)	-401	-622	-1,704	-1,929	-1,929	-1,929	-1,929	-1,929	-1,929	-1,929	-1,929	-1,929	-1,929	-1,929	-1,929	-1,929	-1,929	-1,929	-2,067	-2,603
Claims on nongovernment	187	315	387	294	236	319	381	322	403	326	343	332	350	339	350	346	363	354	363	429
Of which : claims on banks	82	77	112	112	138	230	278	...	...	...	...	...	...	...	247	...	262	...	...	...
Other items (net)	2,572	3,655	3,347	4,130	4,298	4,289	4,230	4,289	4,156	4,289	4,260	4,284	4,184	4,284	4,215	4,284	4,272	4,284	4,799	4,799
Open market operations	...	...	...	0	...	...	...	104	...	162	...	241	0	307	0	201	0	283	0	236
Reserve money	556	808	1,205	1,205	1,107	1,193	1,160	1,189	1,224	1,213	1,408	1,237	1,280	1,239	1,282	1,291	1,419	1,292	1,419	1,677
Currency in circulation	331	432	479	…	476	542	578	…	602	…	598	…	591	…	608	…	670	…	…	…
Required reserves (kwacha deposits)	88	182	264	…	284	292	297	…	300	…	311	…	321	…	254	…	286	…	…	…
Required reserves (foreign exchange deposits)	101	138	234	…	260	272	251	…	249	…	270	…	259	…	202	…	224	…	…	…
Dollar denominated	0	0	86	…	97	272	251	…	249	…	270	…	259	…	202	…	224	…	…	…
Kwacha denominated	101	138	148	…	163	0	0	…	0	…	0	…	0	…	0	…	0	…	…	…
Current accounts	34	52	222	…	81	83	30	…	70	…	225	…	106	…	213	…	233	…	…	…
Nongovernment deposits	2	4	6	…	7	4	4	…	4	…	4	…	4	…	5	…	6	…	…	…
Memorandum items:																				
Multiplier (broad money/reserve money)	3.8	3.4	3.0	3.0	3.3	3.3	3.3	3.3	3.2	3.3	2.9	3.3	3.3	3.3	3.2	3.3	3.1	3.3	…	3.1
Percent change from end of previous year	...	...	...	49.1	-8.1	-0.9	-3.7	-1.3	1.6	0.7	16.9	2.7	6.3	2.8	6.4	7.2	17.8	7.3	0.0	18.2

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

1/ Beginning in 2004, government securities are recorded at cost rather than at face value.
2/ The difference between the column marked "estimate" and "program base" is due to the use of a program exchange rate.

Table 7: Zambia: Balance of Payments, 2000-06
(In millions of U.S. dollars, unless otherwise indicated)

	2000	2001	2002	2003		2004	2005	2006
	Est.	Est.	Est.	SMP	Est.	Proj.	Proj.	Proj.
Current account balance 1/	-622	-758	-652	-681	-627	-618	-629	-626
Trade balance on goods and nonfactor services	-446	-570	-504	-543	-477	-468	-456	-415
Merchandise trade balance	-221	-342	-259	-307	-242	-216	-178	-110
Exports, f.o.b.	746	884	916	1,051	1,117	1,273	1,509	1700
Metal sector	497	590	560	636	710	818	1,012	1156
Nonmetal	249	295	357	415	407	455	497	544
Imports, f.o.b.	-978	-1,253	-1,204	-1,387	-1,388	-1,520	-1,719	-1876
Services, nonfactor (net)	-225	-228	-245	-236	-235	-252	-277	-305
Receipts	115	144	136	167	168	176	194	210
Payments	-340	-372	-381	-403	-403	-429	-471	-515
Income (net)	-158	-168	-155	-148	-148	-125	-143	-176
Of which: official interest payments	-155	-144	-137	-131	-131	-120	-109	-102
Current transfers (net)	-18	-20	7	10	-2	-24	-31	-36
Capital and financial accounts	202	466	255	361	330	326	418	411
Project grants	153	222	236	240	240	246	316	338
Official loan disbursement (net)	-140	-96	-122	-97	-133	-114	-128	-98
Disbursement	93	136	111	139	109	110	50	40
Amortization (-)	-233	-233	-234	-236	-242	-224	-178	-138
Change in net foreign assets of commercial banks (-increase)	-89	40	-5	50	70	-10	0	0
Private capital (net)	278	301	147	168	153	204	231	171
Errors and omissions, short-term capital	4	-107	14	-38	-24	0	0	0
Overall balance	-416	-399	-383	-358	-321	-292	-211	-215
Financing	416	399	383	358	321	110	101	106
Change in net int. reserves of BoZ (-increase)	-49	-124	-225	-117	-164	-291	-324	-143
Gross official reserves of BoZ (-increase)	-68	0	-169	129	87	-43	-73	-128
BoZ liabilities	-7	-5	-6	-6	-6	-6	-6	0
IMF (net)	26	-119	-50	-239	-244	-243	-245	-15
Disbursements	26	94	173	0	0	0	0	0
Repayments	0	-213	-222	-239	-244	-243	-245	-15
Other foreign assets of the BoZ	30	…	…	…	…	…	...	...
Debt relief	217	436	437	384	391	395	335	167
Non-HIPC 2/	217	170	171	154	154	120	67	19
HIPC, including IMF 3/	...	266	266	230	237	275	237	118
Of which : IMF	...	150	153	164	171	119	123	0
Paris Club 4/	...	65	64	47	16	100	53	55
Possible additional debt relief after HIPC CP 5/	...	...	...	...	...	...	31	30
Other debt-related items 6/	42	-19	21	0	-11	-2	0	0
Net change in arrears (+ increase) 4/	-10	31	12	35	49	-61	0	0
Program support	185	75	138	55	55	70	91	81
Financing gap (+ deficit)	0	0	0	0	0	182	109	110
Memorandum items:								
Current acc't bal., excl. grants (percent of GDP)	-19.2	-20.8	-17.3	-16.7	-14.8	-13.9	-14.2	-13.4
Current acc't bal., incl. grants (in millions of U.S. dollars) 5/	-369	-394	-246	-304	-251	-271	-215	-185
Current acc't bal., incl. grants (percent of GDP) 7/	-11.4	-10.8	-6.5	-7.5	-5.9	-6.1	-4.8	-4.0
Merchandise trade balance (percent of GDP)	-6.8	-9.4	-6.9	-7.5	-5.7	-4.9	-4.0	-2.4
Export volume (percentage change)	-5.7	26.2	11.2	5.2	8.6	6.8	17.0	12.2
Import volume (percentage change)	2.4	33.8	-4.3	7.2	9.9	9.2	13.1	8.2
Terms of trade (percentage change)	-4.4	-2.0	-7.1	1.4	7.0	6.5	1.3	-0.4
Copper volume (thousands of metric tons)	234	297	330	355	349	382	469	538
Copper price (U.S. dollars per pound)	0.82	0.77	0.70	0.75	0.78	0.85	0.88	0.88
Gross official reserves 8/	114	114	283	155	197	239	312	440
(in months of imports)	1.0	0.9	2.2	1.1	1.3	1.5	1.7	2.2
Overall balance (in percent of GDP)	-12.8	-11.0	-10.2	-8.8	-7.6	-6.6	-4.5	-4.3
Balance of payments financing (in percent of exports of goods and nonfactor services)	21.2	7.1	12.8	4.4	4.2	4.7	5.2	4.1
Official debt service, cash payments	139	142	123	194	187	241	196	87
(in percent of exports)	15.9	13.5	11.4	15.9	14.2	16.3	11.3	4.5
Net present value of debt (percent of exports)	214	210	209	194	185	162	134	121

Sources: Bank of Zambia (BoZ); and Fund staff estimates and projections.

1/ Excluding grants and debt relief on interest.
2/ Indicates debt relief that would have been available under the traditional mechanism, relative to 1999 Paris Club rescheduling, comparable treatment from non-Paris Club bilaterals, and the 1997 restructuring of Camdex claim on the BoZ.
3/ Assumes that Zambia reaches the HIPC completion point by end-2004.
4/ The last Paris Club agreement providing debt relief on Cologne flow terms expired at end-March 2003. Zambia is expected to accumulate external arrears until a new agreement can be reached, when a new PRGF arrangement is in place.
5/ Additional debt relief is expected from Paris Club creditors once Zambia reaches the HIPC completion point (CP).
6/ Reconciliation of scheduled debt service after scheduled debt relief with actual cash payments. Item includes overpayments, refunds, debt-service carryover, currency revaluations, and additional debt relief.
7/ Includes project grants, as well as debt relief on interest payments.
8/ Reserves at current exchange rates. Includes balances in the special Bank for International Settlements.

Table 8. Zambia: Status of Key Reform Objectives for Reaching the Floating Completion Point Under the Enhanced HIPC Initiative

Reform Objectives/Measures	Status
Poverty reduction	
- The adoption of a PRSP to be prepared through a participatory process, and satisfactory progress with implementing and monitoring the PRSP for at least one year based on annual report.	The PRSP was prepared, and implementation is ongoing. Preparation of the annual report is underway and completion is expected in the first half of 2004.
Social Sectors	
Progress in combating HIV/AIDS	
-full staffing of secretariat to National HIV/AIDS/STD/TB Council.	Implemented
-integrate HIV/AIDS awareness and prevention programs in the pre-service and in-service programs of at least ten key ministries.	Implemented
Progress in education sector reform as indicated by the following:	
-increasing the share of education in the discretionary budget from 18.5 percent in 1999 to at least 20.5 percent.	The ratio was met in 2001, but it fell to 18 percent in 2002 . Gov't plans to meet this ratio by end 2004.
-raising the starting compensation of teachers in rural areas above the poverty line for a household, as defined by the Central Statistical Office.	Implemented
-an action plan for increasing student retention in northern, eastern, northwestern, and western Provinces, and Luapula Province.	Observed
Progress in health sector reform as indicated by:	
-implementation and scaling up of an action plan for malaria;	Implemented
-procedures and mechanisms for the procurement of drugs reorganized to be fully transparent and efficient;	Implemented
-timely release of complete, detailed, annual health expenditure data; and	Implemented
-actual cash releases to District Health Management Boards shall be at least 80 percent of amount budgeted.	Implemented
Macroeconomic and structural reforms	
-Maintenance of a stable macroeconomic environment, as evidenced by satisfactory performance under a program supported by PRGF arrangement.	Observed for 2002. Agreement on a new PRGF arrangement has been delayed.
-Implementation of an Integrated Financial Management Information System (IFMIS) on a pilot basis for at least three ministries and a midterm review of the pilot program.	Procurement of hardware and software for IFMIS is expected in the first half of 2004. Piloting in three line ministries is expected thereafter.
-Implementation of a Medium-Term Expenditure Framework (MTEF) prepared by MoFED and approved by the Cabinet.	A MTEF for 2004-06 was prepared; Cabinet approved the MTEF along with the 2004 budget parameters.
-Restructuring and issue of international bidding documents for the sale of a majority (controlling) interest in the power company, ZESCO.	Given the new commercialization strategy for ZESCO, a revision of this trigger will be sought before the completion point.
-Issuance of international bidding documents for the sale of a majority (controlling) interest in the Zambian National Commercial Bank.	Implemented. Negotiations for sale to the preferred bidder are continuing.

Source: Zambian authorities and staff assessment.

CONFIDENTIAL

Lusaka

March 16, 2004

Ms. Anne O. Krueger
The Acting Managing Director
International Monetary Fund
Washington, D.C.

Dear Ms. Krueger,

The Government of Zambia requested the staff of the International Monetary Fund to monitor implementation of the government's program covering the second half of 2003. As described in the attached Memorandum of Economic and Financial Policies, the initial implementation of this program fell short of expectations as a result of a significant overrun in nonwage expenditures, which has added to the recent sharp rise in domestic borrowing. Moreover, the Government recognizes that some of the program's end-year targets can no longer be attained.

Therefore, to enable us to develop a track record of performance that would allow us to move to a PRGF arrangement, the Government requests that the period of the staff-monitored program (SMP) be extended through end-June 2004. We consider the policies set out in the attached memorandum for this period, which were endorsed by Cabinet in February 2004, to be sufficient to safeguard macroeconomic stability through a sharp reduction in domestic borrowing, supported by strong initial reforms of the tax system and government expenditures. At the same time, the SMP will continue the implementation of the reform agenda established in the PRSP.

We hope that, with sound implementation of this SMP, and passage of the budget for 2004, we will be in a position to request a new PRGF arrangement in the first half of 2004. Successful implementation of policies supported by a new PRGF arrangement will be essential to allow Zambia to reach the completion point under the enhanced HIPC Initiative during 2004. Not only will this be a key to reducing Zambia's external debt to sustainable levels, it will be crucial to reduce debt-service payments in 2004 and 2005 to manageable levels.

Yours faithfully,

/s/

Hon. Ng'andu Peter Magande, MP
Minister of Finance and National Planning

ZAMBIA

Memorandum of Economic and Financial Policies
For the Period December 2003 Through June 2004

I. Performance Under the SMP And Recent Economic Developments

A. Performance Under the SMP, July-December 2003

1. **The SMP went off track as a result of significant expenditure overruns in September and October, which resulted in net domestic financing exceeding the cumulative adjusted program ceiling by about 1.7 percent of GDP in December (Table 1).** The programmed payment of domestic arrears was also not observed, and the continuous prohibition against the accumulation of external arrears was breached. In addition, the target was not met on the cumulative deposits into the HIPC Initiative account was not met. The targets that were met included the net domestic assets (NDA) of the Bank of Zambia (BoZ); gross international reserves (GIR); the ceilings on external debt, including for the Zambia Electricity Supply Corporation (ZESCO); and the cumulative wage bill. However, arrears were accumulated on the housing allowance whose cancellation was challenged in court by civil service unions.

2. **Progress in implementing structural reforms was mixed (Table 2)**. The strengthened commitment control system, which has been implemented in most ministries, helped to limit the accumulation of arrears to just 0.1 percent of GDP in the second quarter, and the Government has continued to issue quarterly expenditure ceilings. However, cash releases did not conform to these ceilings, because expenditure policy decisions led to the execution of unbudgeted expenditures. Enforcement of the sanctions against over-commitment and virement of funds between budget subheads has been inadequate, despite the improved timeliness of the Monthly Expenditure Reports (MERs). At the same time, the government's commitment to refrain from paying any amounts for which it is not legally liable was not observed, because the Government found it necessary to take on liabilities of mine workers in Luanshya (see paragraph 6). Although a comprehensive database of domestic arrears was completed in June, and only the Office of the Accountant General (OAG) has initiated settlement of such arrears, the preparation of a multiyear plan for clearing domestic arrears has been delayed to 2004.

3. **Progress has been made in containing the wage bill, but structural measures in this area have yet to be implemented.** Between April and November 2003, a total of 2,498 employees in the central administration were retrenched and, by the end of the year, this total was expected to reach 3,500. In line with agreements reached with some trade unions, a circular was issued in September 2003 to reduce the rates of housing allowances payable in 2003.

4. **The development of a Medium-Term Expenditure Framework (MTEF)** for the 2004-06 period and the publication of the Green Paper, discussed with stakeholders and local communities, has been a major step in improving budget preparation. The MTEF consultations that have taken place with politicians, Sector Advisory Groups, the Provincial Development Coordinating Committees, and other stakeholders have enriched the budgeting process and should strengthen stakeholders' ownership of the budget. Government will continue to consult these stakeholders in the process of implementation, monitoring, and evaluation of the MTEF. A draft of a financial sector development plan (FSDP) has been posted on the BoZ website for further comments. At the same time, the Government has refrained from providing further budgetary support to nonbank financial institutions (NBFIs), pending finalization of the FSDP.

B. Recent Economic Developments

5. **Real GDP growth is estimated at 4.2 percent in 2003, not 4.5 percent envisaged earlier, owing to a lower than anticipated growth in mining.** The 12-month inflation rate of 17.2 percent at end-December was above the target of 13 percent in the SMP, reflecting some relaxation of financial policies and some firming of food prices. Zambia's external position through end-December was bolstered by higher copper prices and continued growth in nontraditional exports, which aided the BoZ in meeting the international reserves target.

Fiscal policy

6. **Although revenue was in line with the program, the fiscal deficit for 2003 was about 1.4 percent of GDP larger than programmed as a result of higher expenditures.** This overrun was concentrated in nonwage current and capital spending including recurrent departmental charges (RDCs). The overrun in RDCs included security-related spending, expenditures on travel, workshops for staff, by-elections, and higher spending on fertilizer price support. These excesses were partially offset by lower than programmed HIPC-financed expenditures, and by lower external debt-service payments. Additional expenditure overruns resulted from unbudgeted payments of K 167 billion (0.8 percent of GDP) to the Luanshya mine workers of the Roan Antelope Mining Company of Zambia (RAMCOZ) to meet accumulated wage arrears and retrenchment benefits, to facilitate the sale of the mine to a strategic investor in December. These payments were expected to yield K 20 billion in income tax withholding; K 10 billion in 2003, with the balance collected in 2004. Nevertheless, the overall cash deficit for 2003 is now estimated at 6.6 percent of GDP, thus exceeding the programmed deficit target by about 1.4 percent of GDP. As a result, by end-December net domestic financing exceeded the program target (adjusted for the shortfall in external debt service) by K 354 billion (1.7 percent of GDP).

Monetary policy

7. **Broad money increased by 23.4 percent during 2003, compared with a target of 17 percent in the SMP. The larger than expected** growth in broad money was largely because of the widening fiscal deficit, an easing of monetary policy in late October, when the

BoZ lowered the cash legal reserve requirements from 17.5 percent to 14 percent and a larger than expected buildup of net foreign assets in the banking system. The lowering of the reserve requirement was intended to provide banks with additional liquidity for lending to the agricultural sector. Bank credit to the private sector rose by 31 percent in 2003, with the increase spread over a wide range of sectors including agriculture, manufacturing, transport, and communication.

8. **After depreciating by about 12 percent in the first quarter of 2003, the kwacha strengthened against the U.S. dollar throughout the rest of the year, reducing the depreciation for the year to 7 percent.** However, against the South African rand and the euro, the kwacha depreciated by 29 percent and 19 percent, respectively, through end- December. The introduction of the broad-based interbank foreign exchange market in July 2003 helped to strengthen confidence in the kwacha and was immediately followed by a significant appreciation of the currency. The interest rate on the 91-day treasury bill remained within a narrow band of 32-35 percent throughout most of the year, but declined to below 20 percent in mid-December, mainly as a result of excess bank liquidity, following the lowering of the cash legal reserve requirements.

External sector

9. **Boosted by a 17 percent increase in copper prices since the beginning of 2003, and further strong growth in nontraditional exports, the overall balance of payments position through end-September 2003 was better than expected.** Total exports grew by 17 percent for the first nine months compared with the same period in 2002, while total imports grew by about 11 percent. Thus, the BoZ was able to meet the adjusted end-December reserve target under the SMP by a margin of US$46 million through foreign exchange purchases from the market without putting undue pressure on the exchange rate. The current account and overall balance of payments are expected to record smaller deficits in 2003 than in 2002 and projected under the SMP for 2003.

II. The Revised Macroeconomic Framework for 2004

10. **Following the large expenditure overrun and heavy recourse to domestic borrowing in 2003, a sharp fiscal adjustment is urgently needed in 2004 to address a growing threat to fiscal sustainability**. Moreover, the Government recognized that the framework for the 2004 budget presented in the Green Paper for the MTEF needed to be revised. As a result of the increase in the stock of domestic debt in 2003 and higher interest rates, domestic debt service was expected to be about 1½ percent of GDP higher than projected in the Green Paper, at 3.7 percent of GDP. At the same time, Government recognizes that slippages in implementing the SMP may delay a move to a PRGF, raising uncertainty about the level of external financing available for the 2004 budget.

11. **Government has therefore reformulated the macroeconomic framework for 2004.** The revised framework is designed to break the spiral of rising domestic debt and interest

payments that poses a major risk to macroeconomic stability and growth. In addition, the Government is determined that, through frontloaded reforms, it will set the stage for a sustainable fiscal adjustment and an early return to a PRGF arrangement. To this end, the 2004 budget presented to parliament in February 2004, is based on cautious assumptions for external budget support to mitigate the destabilizing costs of recourse to domestic borrowing should such external financing fail to materialize.

12. **The revised macroeconomic framework for 2004** envisages (i) real GDP growth of 3.5 percent compared with 4.5 percent previously, (ii) a 12-month inflation rate of not more than 20 percent (instead of 13 percent); (iii) a build-up in GIR to about 1.5 months of import cover compared with 1.7 months previously. We recognize that achieving these objectives will require a more resolute adherence to the agreed fiscal and monetary framework, as well as the implementation of key structural reforms in public expenditure management, financial sector reforms and governance.

Fiscal policy

13. **Fiscal policy will be geared to preserving macroeconomic stability, by containing domestic borrowing to reduce pressures on interest rates, prices and the exchange rate.** On the basis of a passive projection drawn from the fiscal framework presented in the Green Paper, and with domestic financing reduced to 2 percent of GDP from 5.1 percent of GDP in 2003, there was a financing gap in the 2004 budget of over 2 percent of GDP (about K 500 billion). This reflected the impact of both higher interest payments and a projected shortfall in external budgetary support. The Government recognized that, in the absence of strong adjustment to cover the gap, use of further domestic financing would have led to a destabilizing spiral of higher debt and interest payments, and a sharp reduction in expenditures on all sectors, including poverty-reducing programs. Therefore, the Government is determined to take far reaching expenditure and revenue measures to ensure that the program's macroeconomic targets are achieved.

14. **The wage bill will be reduced by 0.5 percent of GDP from the expected 2003 outturn.** The nominal wage bill will be constrained by allowing only for a K 40 billion increase for the police, immigration and prison service personnel, who did not receive a raise in the last wage round, an allocation of K 38 billion to cover promotion increases or wage creep, and K 7.2 billion per month for the housing allowance. Aside from these changes, there will be no nominal increase in wages and the total headcount will not exceed the end-October 2003 level for the core civil service. As a result, the wage bill is expected to decline to 8.0 percent of GDP. The Government has begun to negotiate on this basis. With a view to implementing an orderly process of wage negotiations, the envelope available to cover wage increases has been announced and the Public Service Management Division (PSMD) has created a single team to negotiate with all unions, and no wage agreements will be concluded until these have been fully costed by the Ministry of Finance and National Planning (MoFNP) and their implications set out in a report to Cabinet. The Government will expand the campaign to remove ghost workers to noncore civil service areas, including teachers and health workers. The Government

has already withdrawn and revised most of the circulars indicated in the Annex I to this letter, and expects to complete the process shortly.

15. Allocations on Ordinary RDCs have been reduced by 0.5 percent of GDP from the 2003 outturn of 2.8 percent of GDP. Savings will be achieved through re-organization of operations and aggressive cutting of discretionary spending. In this area, the Government recognizes that it is essential to demonstrate to the public, including public service unions, that the burden of adjustment is being shared. Thus, the Cabinet Office is preparing a plan for rationalizing government structures in order to reduce costs and government is installing its own internal telephone system to reduce the cost of telephone services with Zambia Telecommunication. In addition to strict enforcement of regulations on breaches of expenditure control (see below under public expenditure management) official travel and other discretionary spending will be reduced. The Government envisages these actions to be a precursor to the launch of a wide-ranging program of civil service reform which is now being discussed with civil society and the donor community, including the World Bank.

16. **Despite this fiscal restraint, Government is committed to increase priority poverty-reducing expenditures financed with HIPC debt relief from 1 percent of GDP in 2003 to 2.1 percent of GDP in 2004.** The Government will continue to make monthly payments into account 49 at the BoZ to cover these expenditures. However, the balances of line ministries' accounts in commercial banks for these expenditures will be monitored closely and funds will be disbursed to these accounts from account 49 only when existing balances are expected to be exhausted during the month. At the same time, execution of some nonpriority domestic capital projects will be rephased, so as to remain within the budget envelope without incurring arrears.

17. **The budget submitted to parliament proposes that revenues in 2004 will be bolstered by reforms that focus on broadening the tax base and further improving the efficiency of the system.** The original structure, coverage and efficiency of the VAT will be restored by exempting most nonexport goods that are currently zero-rated. This measure, which took effect on February 7, 2004, is expected to yield K 95 billion or 0.4 percent of GDP. Increased compliance with the VAT has been facilitated by doubling the turnover threshold for the VAT to K 200 million; at the same time, cancellation of voluntary registration below this threshold should result in savings of K 26.3 billion from VAT refunds. A 3 percent turnover tax, to be introduced by April 1, 2004, replaces income tax and VAT for companies below the VAT threshold, and should yield K 7.3 billion. In addition, the personal income tax has been reformed to alleviate poverty and provide additional resources to the budget. The reform, effective April 1, 2004, increases the threshold for exempting annual income to K 3.1 million (from less than K 2 million) and adds two income brackets (at tax rates of 35 and 40 percent) above the current top rate of 30 percent. These measures should yield K 23.8 billion; a 10 percent excise duty on cell phone airtime, introduced on February 7, 2004, should provide K 15.6 billion; and the removal of the preferential corporate tax rate for companies listed on the Lusaka Stock Exchange should yield K 17.4 billion. In combination, the tax policy measures are expected to raise revenues by 0.7 percent of GDP. Measures on nontax revenues (increase of fees and penalties) and exceptional revenues (reduction of subsidy on sales of

fertilizer) should generate additional resources of 0.4 percent of GDP. Consequently, total revenue collection should reach 19 percent of GDP in 2004. Total grants are estimated at 6.0 percent of GDP and include program grants carried over from 2003 and the first disbursement under a new program from the European Union that would be contingent on approval of a new PRGF.

18. **The Government will, in 2004, complete a review of the potential adverse impact of the Export Processing Zone Act on the revenue base and particularly in the area of direct taxation.** The review will be completed in time for its conclusions to be addressed, if necessary, in the 2005 budget.

19. **The Government is looking into the issue of tax and other incentives for investors, with the aim of developing a consistent and general policy for the granting of tax incentives to avoid ad hoc interventions**. The Government intends to complete this exercise, in conjunction with the review of the EPZ Act, and put in place a new policy in this area in time for the preparation of the budget for 2005. In the meantime, the Government will consider only limited exceptions to the current policy of not granting any new tax reduction, exemptions, rebates or preferential treatment. Such tax incentives would be granted only in the case of new “green field” investments, or for the operation of the Luanshya mine or KCM following their sales to new investors. Moreover, the revenue implications of any such incentives would be assessed and offsetting measures taken to protect revenues.

20. **The domestic primary balance is projected to move from a deficit of 0.7 percent of GDP in 2003 to a surplus of 2.4 percent in 2004 and the overall deficit after grants would similarly narrow to 4.0 percent of GDP.** Net external financing, including small amounts carried over from 2003 and the first tranche of US$20 million under a new IDA structural adjustment operation, would amount to 2.0 percent of GDP. Recourse to domestic financing would therefore be limited to 2 percent of GDP, down from 5.1 percent of GDP in 2003.

Monetary and exchange rate policies

21. **Monetary policy in 2004 will aim to achieve the program’s inflation target while safeguarding the international reserve position.** In line with these objectives, and taking into account a monetary overhang in the third quarter of 2003, the expansion of broad money will be limited to about 18 percent through BoZ’s use of indirect monetary instruments. The proposed monetary framework provides sufficient room for a significant real increase in credit to the private sector in support of the program’s growth objective, and is consistent with the fiscal framework. The BoZ will monitor monetary developments very closely and stands ready to take appropriate action, including, if necessary, raising the legal reserve requirement. The BoZ will continue to explore appropriate market-based avenues for increasing access to domestic credit by farmers and other small-scale enterprises.

22. **The Government continues to be concerned by the high level of commercial bank lending rates and their negative impact on private sector economic activities and on the**

prospects for diversification. The Government recognizes that in order to lower interest rates on a sustainable basis, domestic borrowing requirements need to be sharply curtailed with a view to providing credibility for the disinflation process. In addition, improving the efficiency of the banking sector, including the sale of 49 percent of the shares of the Zambia National Commercial Bank (ZNCB) to a strategic investor, should strengthen the overall banking system, promote competition, and contribute to a further easing of pressures on interest rates. In this context, the BoZ intends to continue to adhere to the treasury bill auction guidelines to ensure that interest rates reflect market conditions. The BoZ is continuing to review measures, including the current volume and price penalties for rediscounting treasury bills, to facilitate banks' liquidity management and reduce banks' intermediation costs.

23. **The exchange rate will continue to be market determined with BoZ intervention in the interbank foreign exchange market aimed at smoothing short-term fluctuations and meeting the program's gross international reserves target, without putting undue pressure on the functioning of the interbank foreign exchange market**. Given that the exchange rate is freely determined, that Zambia has an open trade and exchange regime, and that nontraditional exports have been growing at a rapid pace, the Government is of the view that the current level of the real exchange rate is broadly appropriate for promoting diversification and protecting Zambia's external competitiveness.

External sector policies

24. **Zambia's external prospects are expected to improve further in 2004 due to strong gains in both nonmining and mining exports**. Copper receipts are projected to rise about 20 percent because of stronger prices and increased production, while nonmining exports would increase by over 12 percent. Prospects in the copper sector could be bolstered by the sale of a majority stake in Konkola Copper Mines to a strategic equity partner. These export gains are expected to be offset by stronger imports, mostly because of large capital expenditures in the mining sector, including expenditures on the new Kansanshi copper mine due to start operations in 2005. As a result, the current account deficit (including grants and debt relief on interest payments) is projected to increase to 6.4 percent of GDP from 5.9 percent in 2003.

25. **External program assistance in 2004, projected at US$70 million, is expected to come from the World Bank, the EU, and the AfDB, and mostly in the second half of the year, once a new PRGF arrangement is in place.** Following the expiration of the last Paris Club rescheduling agreement, the Government has contacted the Paris Club requesting forbearance and to allow payments to continue under the same terms until a new PRGF arrangement is in place. The Government intends to reach the completion point under the HIPC Initiative by the end of 2004. The Government is mindful of the need to ensure adequate international gross reserves, which are projected to increase from US$196 million at end-2003 to US$239 million (1.5 months of imports) by end-2004. As a result, the financing gap in 2004 is projected to be about US$182 million. This could be filled by additional donor program support as well as by support under a PRGF arrangement.

III. Structural Reforms, Public Expenditure Management, and Governance

26. **The Government is committed to implementing financial sector reforms, strengthening public expenditure management, and improving the transparency of its operations.** With regard to the financial sector, negotiations for the sale of the ZNCB are at an advanced stage and the Government hopes to conclude the sale and to effect the handover during the first half of 2004. The costs of retrenchment will be paid out of the gross sales proceeds. As earlier envisaged, no interest on the bond to recapitalize ZNCB will be paid before the sale is concluded.

27. **Although a draft of the FSDP was completed in December 2003, some further work is needed to draw up operational plans.** Developing strategies to address insolvent NBFIs is a priority of the FSDP. In line with the draft FSDP, the BoZ has set a deadline of end-March 2004 for the Zambia National Building Society and the National Savings and Credit Bank to reach agreements with the BoZ on time-bound and credible restructuring programs to be monitored against quarterly targets (Table 4). No public monies will be used to recapitalize or restructure these two entities before an appropriate FSDP is completed and agreements have been reached in restructuring plans. Should the proposed restructurings not be considered feasible by the BoZ, appropriate supervisory action will be taken. The Government has made an allowance in the 2004 budget for the expected minimum costs of resolving these institutions. Restrictions have been placed on the Development Bank of Zambia, pending private sector contribution of 60 percent of its capital base. No public money will be used to recapitalize the bank.

28. **As a key part of the FSDP, the BoZ has drafted regulations for the microfinance sector.** Smaller microfinance institutions would be subject to nonprudential supervision, with the onus put on transparency to strengthen the governance of the sector. These regulations will take effect in 2004 and will facilitate the development of private microfinance institutions using banking services provided by a network of rural branches to enhance the delivery of rural financial services and support growth in the agriculture sector.

29. **The Government recognizes the need to reinforce the budget's role in the definition and execution of spending policy.** This is essential to support both public expenditure management and good governance. The Government will therefore avoid policy decisions that would entail expenditures in addition to budget allocations. Unforeseen expenditure requirements will be funded only to the limits of the contingency resources indicated in the budget or only after cabinet has approved any changes by making adjustments elsewhere in the budget.

30. **To strengthen cash management, the Budget Office is issuing quarterly and monthly expenditure ceilings which will be revised monthly on the basis of updated projections of revenue, expenditure, and financing constraints.** Monthly ceilings will be backed by corresponding cash releases, so as to provide Controlling Officers in line ministries, departments, and provinces with reliable limits for commitments.

31. **The MoFNP will strictly enforce sanctions for noncompliance with established spending procedures.** Specifically, on the basis of monthly reports prepared by the OAG, the Budget Department will reduce disbursements to line ministries, departments, and provinces responsible for over-commitment, virement of funds, and expenditures lacking ex-ante written authorization by the MoFNP, as well as failure to report expenditures, as specified in the circulars issued in September 2002. The existing penalties will also be rigorously applied on accounting officers responsible for such unauthorized spending.

32. **The Government has introduced activity-based budgeting (ABB) for the preparation, implementation, and reporting starting with the 2004 budget**. The 2004 budget also includes an annex identifying all poverty-reducing spending allocations. Line ministries, departments, and provinces will report on the execution of spending identified in this annex through a form attached to MERs. The OAG will transfer these forms, on a monthly basis, to the Department of Planning, so as to improve cash management in funding poverty-reducing programs and contribute to the implementation of the PRSP.

33. **Comprehensive quarterly budget execution reports, including full coverage of poverty reducing spending will be published within 45 days of the end of the quarter**, **beginning with the report for the first quarter of 2004.**

34. **The MoFNP will finalize by March 2004 a multi-year plan for clearing the stock of domestic arrears as at end-December 2002.** The plan will prioritize arrears payments by the penalty accruing, the interest rate applied, and exchange rate affecting overdue payments. On the basis of the plan, an inter-ministerial committee, chaired by a MoFNP senior officer, will negotiate with contractors discounts on the payments due. Within the quarterly expenditure ceilings issued by the Budget Department, the OAG will have the exclusive responsibility to settle the discounted amounts due.

35. **The Government remains fully committed to implementing an IFMIS, a key condition for expenditure control and monitoring.** Progress has been made toward implementing the IFMIS, although the procurement of hardware and software, which had been expected to be completed by end-December 2003, is now expected in the second quarter of 2004 because of delays arising from the World Bank's procurement procedures. The MoFNP revised the timeframe for introducing the system and is expected to sign a contract for the procurement of hardware and software by end-April 2004 and start piloting the IFMIS in three line ministries shortly thereafter.

36. **The Government will strengthen the independence of the Office of the Auditor General.** By end-June 2004, the Government intends to submit to Parliament draft legislation to grant autonomy to the Office of the Auditor General.

37. **The Government is committed to bringing forward the budget cycle so that Parliament can approve the budget before the beginning of the fiscal year**. However, since

this requires a constitutional amendment, the Government will present a proposal to this effect to the Constitutional Review Commission (CRC).

38. **The Government is also proceeding with the reform of the electricity utility, ZESCO.** Following the review by Fund and World Bank staff, the commercialization of ZESCO has reached the "entry point" and we intend to expedite implementation of the measures needed to reach the interim point June 2004 and then embark on ZESCO's commercialization according to the agreed detailed framework. Following the signature of a preliminary agreement to settle government's and ZESCO's cross-debts, the Controller of Internal Audit will verify the extent of government indebtedness to ZESCO. The tax liability of ZESCO, as assessed by ZRA, and subject to any revision by the Revenue Appeals Tribunal, will be used to estimate the cross-debts between ZESCO and Government. This process will be finalized before the settlement of any cross-debts between ZESCO and the Government. We envisage requesting a revision to the trigger for the HIPC initiative completion point on ZESCO's privatization to incorporate the completion of measures specified at the end of the interim phase of commercialization. Such measures could include the passage of the proposal to amend the Electricity Act, as well as Cabinet approval of the Ministry of Energy and Water Development's proposals for separate legal acts for private and public partnership. As previously agreed, to provide ZESCO some breathing space to build a track record of credit worthiness, new concessional borrowing by ZESCO guaranteed by the Government will be permitted, subject to cumulative limits of US$20 million to the end of 2004 and US$40 million to June 2005. This limit would be subject to review, in consultation with Bank and Fund staff, in the event that additional concessional resources are required.

39. **The Government remains committed to providing an enabling environment for private sector growth and diversification and recognizes the need to review key land, labor and investment regulations.** To ensure greater access to land, there is need to improve the framework for land administration by finalizing the national land policy with broad stakeholder support. The Government is also seeking to revise labor legislation to reduce the frequency of strike actions and to decrease the high statutory costs of providing permanent employment. The Government will also firmly resist amendments that would require employers to provide housing or housing allowances for workers and that prevent employers from recruiting skilled foreign workers where such local skills are unavailable. The Government also proposes to revise the Investment Act with a view to strengthening the facilitatory role of the Zambia Investment Center.

IV. The PRSP Progress Report, HIPC Triggers, and the MTEF

40. **The Government recognizes that Zambia's external debt overhang is a serious obstacle to more rapid growth and sustainable poverty reduction.** Zambia has made substantial progress in implementing the measures for reaching the floating completion point under the enhanced HIPC Initiative. Specifically, measures have been implemented in the areas of: health and education; the privatization of ZNCB; agreement on the commercialization of ZESCO; the preparation and implementation of the MTEF; the preparation of the PRSP

progress report; and the implementation of the IFMIS on a pilot basis (see above). The key outstanding area is the maintenance of a stable macroeconomic environment as evidenced by a satisfactory performance under a PRGF arrangement. Therefore, the Government is committed to implementing the revised SMP so that it can serve as a bridge to a new PRGF which would pave the way toward the HIPC Initiative completion point.

41. **Preparation of the Government's first annual report on the implementation of the PRSP has been completed and will be formally handed over to co-operating partners in March 2004.** The delay in its completion was partly due to the comprehensive consultative process embarked upon and the need to incorporate a baseline of indicators against which progress in the second annual report can be assessed. The PRSP progress report has been prepared in tandem with the MTEF for 2004-2006. The priorities identified and the lessons learnt as indicated in the progress report have significantly influenced the reprioritization of Poverty Reduction Programs in the 2004 Budget and has ensured consistency with the expenditure profile of the MTEF.

V. Program Monitoring

42. **Progress in implementing the SMP will be monitored monthly under the program, based on the quantitative and structural measures indicated in Tables 3 and 4.** These targets are defined in the attached Technical Memorandum of Understanding. To allow accurate monitoring of spending on the wage bill, the Government will implement all the actions indicated in Annex I to this letter.

43. **The Government has revived the economic monitoring committee for Economic Ministries to monitor implementation of the Economic Program.** The committee is chaired by President Mwanawasa, and meets once every two weeks. Further, the Government has strengthened the existing Economic Management Monitoring Committee at the MoFNP to ensure that this meets at least once a week and that steps are taken to avoid lapses in program implementation. The Fund's Resident Representative will be invited to attend meetings of the Economic Management Monitoring Committee as required.

Annex I: Actions to control the wage bill and related payments

In order to ensure support implementation of the envisaged wage policy, the Government will take the following steps

1. The PSMD will withdraw the circulars PSMD/53/11/1 n. B.9 (June 26, 2002), TS/7/2/20 SEC n. 2, n. 3, and n. 4 (April 16, 2003), and any other related circulars introducing housing allowance.

2. As soon as negotiations with unions are concluded, the PSMD will revise the circulars PSMD/7/2/20 SEC. n. B.8 (April 16, 2003) and TS/7/2/20 SEC. n. B. 4 and n. B. 13 (April 16, 2003) in order to eliminate the voluntary Medical Scheme.

3. In November 2003 the MoFNP issued an instruction introducing the tracking of all payments related to housing assistance (housing allowance and housing rental) for civil service employees. The tracking mechanism will allow reporting on all the payments related to housing assistance executed in 2002 and from January to November 2003. The same instruction will also allow tracking and classifying under PEs all the payments related to housing assistance from November 2003 onwards.

4. By end-December 2003, the MoFNP will set up a unit dedicated to monitoring and reporting on a monthly basis all payments to civil service employees as specified in the attached TMU (paragraph 23).

5. By end-December 2003, the Government will also approve a requirement that the Minister of Finance and National Planning should submit to the Cabinet an analysis of the short and medium-term budget costs of any agreement with government employees before it is finalized.

Table 1. Zambia: Indicative Targets Under the Staff Monitored Program 1/
(In billions of Kwacha, unless otherwise indicated)

	2003																		
	June Est.	July Prog.	July Est.	Status Observed	Aug. Prog.	Aug. Est.	Status Observed	Sept. Prog.	Sept. Est.	Status Observed	Oct. Prog.	Oct. Est.	Status Observed	Nov. Prog.	Nov Est.	Status Observed	Dec. Prog.	Dec. Est.	Status Observed
1 Ceiling on the cumulative increase in net domestic																			
assets (NDA) of the Bank of Zambia 2/3/4/5/	0	107	-12	Yes	169	50	Yes	254	87	Yes	327	183	Yes	228	212	No	319	169	Yes
Adjusted (NDA)		45			105			198			306			47			249		
2 Ceiling on the cumulative increase in net domestic																			
financing (NDF)3/	0	59	11	No	125	119	No	199	348	No	202	503	No	164	568	No	201	624	No
Adjusted (NDF)		-4			60			142			181			233			270		
3 Floor on gross international reserves (GIR)																			
of the Bank of Zambia (In millions of U.S. dollars) 3/ 6/	233	206	238	Yes	197	234	Yes	183	220	Yes	166	200	Yes	201	189	Yes	149	179	Yes
Adjusted GIR		220			211			196			171			185			133		
4 Ceiling on new external payments arrears (In millions of U.S. dollars) 7/	13.0	0.0	4.6	No	0.0	2.9	No	0.0	0.0	Yes	0.0	0.0	Yes	0.0	0.0	Yes	0.0	...	N/A
5 Ceiling on the stock of short-term debt and on contracting or guaranteeing of new medium- and long term nonconcessional debt (In U.S. dollars) 8/	0.0	0.0	0.0	Yes	0.0	0.0	Yes	0.0	0.0	Yes	0.0	0.0	Yes	0.0	0.0	Yes	0.0	0.0	Yes
6 Ceiling on cumulative new concessional loans collateralized or guaranteed by the central Government or the Bank of Zambia for ZESCO.	0.0	10.0	0.0	Yes	10.0	0.0	Yes	10.0	0.0	Yes	10.0	0.0	Yes	10.0	0.0	Yes	10.0	0.0	Yes
7 Floor on the cumulative payment of domestic arrears																			
of the Government 6/	23	34	24	No	44	29	No	62	49	No	74	55	No	87	58	No	100	62	No
Other arrears	23	34	24	No	44	29	No	55	43	No	61	49	No	67	50	No	73	52	No
Housing allowance	...	0	0	Yes	0	0	Yes	7	7	Yes	13	7	No	20	8	No	27	10	No
8 Cumulative ceiling for the central government wage bill 6/	814	967	973	No	1,121	1,126	No	1,281	1,281	No	1,441	1,431	Yes	1,600	1,581	Yes	1,758	1,728	Yes
Monthly wage bill		153	159	No	153	153	No	160	155	Yes	160	150	Yes	158	150	Yes	158	148	Yes
9 Ceiling on the cumulative arrears on the central government wage bill 6/	232	255	255	Yes	278	272	Yes	271	277	No	264	283	No	257	290	Yes	251	...	N/A
10 Floor on the cumulative deposits into the HIPC Account 49 at the BoZ	0	42	0	No	83	42	No	125	84	No	167	126	No	208	126	No	250	167	No
Memorandum item:																			
11 Cumulative net balance of payments support (In US dollars) 6/		-22.0	-7.6		-26.9	-12.1		-35.3	-22.3		-47.9	-43.1		-9.1	-46.1		-24.4	-18.6	
Balance of payments assistance		0.0	0.0		0.0	0.0		0.0	0.0		0.0	0.0		45.8	0.0		45.8	45.3	
Central government debt service obligations (excl. IMF)		-22.0	-7.6		-26.9	-12.1		-35.3	-22.3		-47.9	-43.1		-54.9	-46.1		-70.2	-63.9	
Shortfall (-)/Excess (+) net BOP support 6/			14.4			14.8			13.0			4.8			-37.0				

1/ The definitions of the indicative targets are contained in the Technical Memorandum of Understanding (TMU).
2/ Net domestic assets are equivalent to reserve money minus net foreign assets, calculated at the end-December 2002 U.S. dollar-kwacha exchange rate (US$ 1=K 4334).
3/ Adjustors, including for balance of payments support are defined in the TMU.
4/ Excludes HIPC debt relief from the IMF.
5/ The ceiling will be adjusted for changes in the legal reserve requirements.
6/ Cumulative from the end of 2002.
7/ The injunction against new external payments arrears is continuous.
8/ Nonconcessional loans are defined as having a grant element of less than 40 percent.

Table 2. Zambia: Structural Reforms for the SMP 1/

	Timing	Status at End-June	Status under SMP
Privatization			
Conclude evaluation of bids for the sale of the majority (controlling) interest in the ZNCB, and approve negotiations with the preferred bidders.	End-June 2003	Observed	Observed
Improve Public Expenditure Management:			
-Payments of audited domestic arrears pertaining up to December 2002 would be only made by the Accountant General's Office. Line ministries will not clear any arrears.	Continous	....	Observed
-Complete a computerized database of all outstanding arrears as of end-December 2002 as verified by the Controller of Internal Audit. 2/	End-June 2003	Observed	Observed
-No payment will be made for clearance of arrears other than the items included in the audited list of arrears.	Continuous	Not Observed	Observed
-The government will refrain from paying any amounts for which it is not legally liable, including ZNOC's liabilities on liquidation.	Continuous	Observed	Not Observed
-To improve cash management, issue quarterly expenditure ceilings before the beginning of each quarter and make monthly cash releases accordingly.	Continuous	Observed	Not Observed
-Fully implement the commitment control system (CCS) to all ministries in line with the Treasury Circular of September 2002.	End-July 2003	Observed	Observed
-Award a contract for the procurement of hardware and software for IFMIS.	End-December 2003	On-going	On-going
Strengthen the financial sector and public enterprises:			
-Prepare a comprehensive financial sector development plan to address the weaknesses of the nonbank financial institutions, including institutional structures for providing financial services to rural areas.	End-November 2003	On-going	On-going
-Provide no further budgetary support to the nonbank financial institutions until the financial sector development plan is finalized.	Continuous	Observed	Observed
-Complete the review of entry conditions for the strategy to commercialize ZESCO.	End-September 2003	On-going	Observed with a delay
Improve transparency and governance:			
-Accountant General to submit to the Office of the Auditor General, accounts for 2002, to facilitate timely preparation of final audited accounts as required by law.	End-September 2003	Partially Observed	Observed
Other:			
The abstention from new tax reductions, exemptions, rebates or any other preferential tax treatment.	Continuous	Observed	Observed

1/ The definition of the structural measures are contained in the Technical Memorandum of Understanding (TMU).

Table 3. Zambia: Indicative Targets Under the Staff Monitored Program 1/
(In billions of Kwacha, unless otherwise indicated)

		2004					
		January	February	March	April	May	June
1	Ceiling on the cumulative increase in net domestic assets (NDA) of the Bank of Zambia 2/3/4/5/6	119	81	113	178	185	225
	Adjusted (NDA)						
2	Ceiling on the cumulative increase in net domestic financing (NDF)3/ 6/	133	131	207	272	308	391
	Adjusted (NDF)						
3	Floor on the stock of gross international reserves (GIR) of the Bank of Zambia (In millions of U.S. dollars) 3/ 7/	173	187	187	175	178	46
	Adjusted GIR						
4	Ceiling on the stock of short-term debt and on contracting or guaranteeing of nonconcessional debt (In U.S. dollars) 8/	0	0	0	0	0	0
5	Ceiling on cumulative new concessional loans collateralized or guaranteed by the central Government or the Bank of Zambia for ZESCO.	20	20	20	20	20	20
6	Floor on the cumulative payment of domestic arrears of the Government 6/	4	8	13	19	25	32
7	Cumulative ceiling for the central government wage bill 6/	169	338	506	675	844	1,012
8	Ceiling on the cumulative arrears on the central government wage bill	0	0	0	0	0	0
9	Floor on the cumulative deposits into the HIPC Account 49 at the BoZ	58	87	117	165	205	244
	Memorandum item:						
10	Cumulative net balance of payments support (In millions of U.S. dollars)	-19.0	-4.0	-3.0	-18.0	-18.0	-32.0
	Balance of payments assistance	0.0	17.0	22.0	25.0	29.0	29.0
	Central government debt service obligations (excl. IMF)	-19.0	-21.0	-25.0	-43.0	-47.0	-61.0
	Shortfall (-)/Excess (+) net BOP support						

1/ The definitions of the indicative targets are contained in the Technical Memorandum of Understanding (TMU).
2/ Net domestic assets are equivalent to reserve money minus net foreign assets, calculated at the end-December 2003 U.S. dollar-kwacha exchange rate (US$ 1=K 4,645).
3/ Adjustors, including for balance of payments support are defined in the TMU.
4/ Excludes HIPC debt relief from the IMF.
5/ The ceiling will be adjusted for changes in the legal reserve requirements.
6/ Cumulative from the end of 2003.
7/ Excludes Fund disbursements during 2004.
8/ Nonconcessional loans are defined as having a grant element of less than 40 percent.

Table 4. Zambia: Structural Reforms for the 2003-04 SMP 1/

	Timing
-Submission to Parliament of a budget for 2004 including tax measures specified in paragraph 17 of the MEFP and a wage bill consistent with the macroeconomic framework for the SMP.	End-February 2004
-Preparation of a multi-year plan for clearing the stock of audited arrears identified in the database maintained by the Office of the Accountant General.	End-March 2004
-No payment will be made for clearance of arrears other than the items included in the audited list of arrears.	Continuous
-Submission to Parliament of legislation to grant full autonomy to the Office of the Auditor General.	End-June 2004
-Publication of quarterly budgetary execution reports, including full coverage of poverty-reducing spending.	45 days after the end of each quarter
-Award a contract for the procurement of hardware and software for IFMIS.	End-April 2004
-Creation of a program-monitoring group comprised of key officials from MoFNP, BoZ, and the Cabinet office.	End-December 2003
-Final decisions taken and action plans agreed in consultation with Bank and Fund staff for the resolution of the Zambia National Building Society, National Savings and Credit Bank, and Development Bank of Zambia.	End-March 2004
-Provide no further budgetary support to the nonbank financial institutions until the financial sector development plan is finalized.	Continuous
-The Government will refrain from paying any amounts for which it is not legally liable and which are not included in the budget.	Continuous

1/ The definition of the structural measures are contained in the Technical Memorandum of Understanding (TMU).

Zambia: Technical Memorandum of Understanding for The Staff-Monitored Program (SMP)

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 targets and the structural reforms for the Staff Monitored Program, as well as the related reporting requirements. The definitions are valid at the start of the program, but may need to be revisited to ensure that the memorandum continues to reflect best understanding of the Zambian and Fund staff to monitor the program.

II. Quantitative Targets: Definitions and Data Sources

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

2. NDA of the BoZ are defined as the monthly-average (based on daily data) of the reserve money less net foreign assets calculated at end-December 2003 BoZ mid-exchange rates (program exchange rate).[1] Reserve money includes currency in circulation, 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 of non-central government institutions. Net foreign assets of the BoZ are defined as gross international reserves (defined below) plus any other foreign asset, including the US$25 million blocked reserves at the former Meridien Bank, minus foreign liabilities (defined below). The kwacha figures are derived from the U.S. dollar values using the program exchange rate of K 4,645 per U.S. dollar.

3. Foreign 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 Fund credit.[2]

4. The ceilings on NDA will be adjusted upward by the amount of the shortfall of balance of payments support net of debt service as indicated in Table 3 of the Memorandum of Economic and Financial Policies, up to a maximum of US$16 million for the period end-December 2003 to end-June 2004. External disbursements that occur anytime during the month

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[1] Unless otherwise defined, program exchange rates for 2004 between the U.S. and other (non-kwacha) currencies, including the SDR, will be equal to the end-2003 rates. Any other assets (e.g. gold) would be revalued at end-2003 market price.

[2] The liability to Camdex will continue to be treated as a short-term foreign liability of the BoZ.

of the test date will be treated as if they were disbursed on the first day of the month.[3] In the event of excess balance of payments support net of debt service, the ceiling on NDA will be adjusted downward by 100 percent of the additional excess support. However, if part of the excess support is used to reduce treasury-bills or bonds held by commercial banks and the non-bank sector, then the programmed NDA will be adjusted upward by that amount.[4] The kwacha value of the cumulative shortfall/excess will be calculated at the program exchange rate.

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

6. The ceiling on NDA will also be adjusted upwards by the full extent of payments made in 2004 to settle wage arrears and retrenchment costs relating to Luanshya mine workers, for which the Government assumed responsibility in 2003.

B. Net Domestic Financing (NDF)

7. Net domestic financing (Appendix II, Table 1) is defined as the Central Government's net borrowing from the banking and nonbanking sectors. All government issued securities will be recorded at cost (face value less discount). Net domestic financing will be defined as:

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

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

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

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[3] This implies that for purposes of monitoring the NDA, disbursements during the month of the test date will not be subject to averaging and the targeted NDA will be adjusted to reflect the full amount of the disbursement.

[4] Upon the completion of the computerized domestic arrears database and the establishment of an arrears settlement plan, this adjustor will also apply to the reduction of domestic arrears.

(d) In the event of ZNCB's privatization, the measurement of NDF will exclude the government bond issued to ZNCB in 2002 in the amount of K 249 billion.

8. The NDF ceiling will be adjusted upward by the amount of the shortfall in balance of payments support net of debt service as indicated in Table 3 of the Memorandum of Economic and Financial Policies, up to a maximum of US$16 million for the period end-December 2003 to end-June 2004. In the event of excess balance of payments support net of debt service, the ceiling on NDF will be adjusted downward by 100 percent of the additional excess support. The kwacha value of the cumulative shortfall/excess will be converted at the program exchange rate. The ceiling on NDF will also be adjusted upwards by the full extent of payments made in 2004 to settle wage arrears and retrenchment costs relating to Luanshya mine workers, for which the Government assumed responsibility in 2003.

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

C. Gross International Reserves of the BOZ

10. Unless otherwise noted here, gross international reserves of the BoZ will be defined as reserve assets of the Bank of Zambia (Appendix II, Table 2). Reserve assets are defined in the IMF BOP manual (5th edition) and elaborated in the reserve template of the Fund'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.

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

12. The floor on gross international reserves will be adjusted: (i) downward by the amount in U.S. dollars of the shortfall in balance of payments support net of debt service as indicated in Table 3 of the Memorandum of Economic and Financial Policies, up to a maximum of US$16 million for the period end-December 2003 to end-June 2004; (ii) upward by 100 percent of the cumulative excess balance of payments support net of debt service. However, if part of the excess support is used to reduce treasury bills or bonds held by commercial banks or the nonbank sector, then the programmed reserves buildup will be

adjusted downward by that amount;[5] (iii) downward/upward for any shortfall/excess in the U.S. dollar value of disbursements from the IMF under the PRGF arrangement; and (iv) downward for any increase in BoZ short-term foreign currency denominated debt (to resident and nonresidents), using the definition of short-term debt below.

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

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

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

15. This is defined as all forms of official debt with original maturity of more than one year contracted or guaranteed by the central Government and BoZ having a grant element of more than 40 percent, but excludes debts subject to rescheduling. The grant element is to be calculated by using currency-specific commercial interest reference rates (CIRRs) reported by the OECD; for maturities of less than 15 years, the grant element will be calculated based on six-month averages of CIRRs, and for maturities longer than 15 years, the grant element will be calculated based on 10-year averages. Adjustment lending from the IMF will be excluded.

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

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

E. Official External Short-Term Nonconcessional External Debt

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

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

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[5] Upon the completion of the computerized domestic arrears database and the establishment of an arrears settlement plan, this adjustor will also apply to the reduction of domestic arrears.

F. Collateralizing/Guaranteeing of Loans to ZESCO

20. The Government and the Bank of Zambia shall not extend or guarantee any new commercial debts to ZESCO, including in the form of loans, suppliers credits and leases. New concessional borrowing, as defined above (Paragraph 16), will be subject to a cumulative limit of US$20 million in 2004. The limit on new concessional borrowing will be subject to review, in consultation with Fund and World Bank staff, in the event that additional concessional resources are required.

G. Domestic Arrears of Government

21. Domestic arrears are defined as: (i) any bill that has been received by a spending Ministry from a supplier for goods and services delivered (and verified) and for which payment has not been made within 30 days after the due date of payments; (ii) Wage, salary and any payment to government employees, including any direct or indirect scheme of housing assistance, 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. This definition of domestic arrears excludes changes in the stock on account of interest, penalties and valuation changes.

22. The information 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 Fund staff by the Accountant General within 6 weeks of the end of each quarter.

H. The Central Government's Wage Bill

23. For the purposes of the wage bill, the definition of Central Government includes all heads covered in the 2004 Yellow Book. The Central Government's total wage bill will include payments on wages, salaries, allowances, and all other items specified as personal emoluments in the Yellow Book, and any direct or indirect payments of housing assistance to employees (Appendix II, Table 3). The Government will provide, on a monthly basis and by budget head, the following data: (i) the number of all employees in the Central Government for each budget head; (ii) the basic salary, the allowances and any other personal emoluments released during the month; (iii) the arrears incurred during the month on the basic salary, on the allowances, and on any other personal emoluments; (iv) the number of employees retrenched and the corresponding retrenchment costs; and (v) the number of ghost workers removed from the payroll and the corresponding monthly savings on the wage bill.

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

III. Structural Reforms

A. 2004 Budget and Public Expenditure Management

Submission of the Government Budget for 2004

25. Submit to Parliament the 2004 central government budget by end-February, 2004, consistent with the SMP, including the wage bill ceiling and all the tax measures described in paragraph 17 of the MEFP. The 2004 budget will also contain an annex identifying allocations on all poverty-reducing spending programs, in case the Activity Based Budgeting (ABB) is not in place.

Preparation of a Multi-Year Plan for Clearing the Stock of Domestic Arrears

26. The Office of the Accountant General, in cooperation with the Budget Office and the Department of Debt management, will finalize by March 2004 a multi-year plan for clearing the stock of domestic arrears as at end-December 2002. On the basis of the information contained in the database of audited domestic arrears as at end-December 2002, the plan will prioritize arrears payments by the penalty accruing, the interest rate applied, and exchange rate affecting overdue payments. On the basis of the plan, an inter-ministerial committee, chaired by a MoFNP senior officer, will negotiate with contractors discounts on the payments due. Within the quarterly expenditure ceilings issued by the Budget Office, the Office of the Accountant General will have the exclusive responsibility to settle the discounted amounts due. Line ministries, Departments, and Provinces will not settle any arrears.

Government Liabilities

27. The Government will refrain from making payments for which it is not legally liable, including ZNOC liabilities on liquidation. It will also guide the liquidation process of public enterprises, such as ZNOC, to minimize Government's liabilities consistent with the law.

Publication of Quarterly Budgetary Execution Reports

28. Within 45 days from the end of each quarter, the Office of the Accountant General will publish, in at least two leading newspapers, quarterly reports on budget execution of revenues and expenditures. The reports will detail expenditure execution under RDCs and on the poverty-reducing programs identified in the annex to the 2004 central government budget (see paragraph 26).

Strengthening the Independence of the Office of the Auditor General (OAG)

29. To strengthen the independence of the Office of the Auditor General, the Government will submit to Parliament, by end-June 2004, draft legislation to grant full - autonomy to the OAG.

Procurement of Hardware and Software for IFMIS

30. The Government will award a contract for the procurement of software and hardware of IFMIS by April 2004.

B. Strengthen the Financial Sector and Public Enterprises

31. The Government and the BoZ will take the final decision and adopt an action plan for addressing the weaknesses of the state-owned nonbank financial institutions (NBFIs), including the Development Bank of Zambia (DBZ); the National Savings and Credit Bank (NSCB); the Zambia National Building Society (ZNBS); and the Zambia State Insurance Company (ZSIC); and (ii) designing institutional structures to support the development of financial services to rural areas and other related issues. The Government will collaborate with the IMF and the World Bank in preparing the strategic plan and seek necessary technical assistance.

Budgetary Support to NBFIs

32. The Government will not provide any budgetary support to the state-owned financial institutions until the comprehensive strategic plan for the financial sector is finalized. Moreover, Government will also refrain from taking over liabilities and/or providing guarantees on loans secured by the NBFIs.

C. Program Monitoring

Program Monitoring Group (PMG)

33. The benchmark will be met when the MoFNP sends written confirmation to Fund Staff of the creation of the PMG, indicating the composition of the group and the scheduled frequency of its meetings.

ANNEX

Guidelines on Performance Criteria with Respect to Foreign Debt

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

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

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

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

(iii) leases, i.e., arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the 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. Net Domestic Financing

	2002		2003
	End-Dec.	End-Dec. Program Base	End-Oct. Est.
Total domestic financing (program)	2,405,403	2,241,148	2,861,627
Adjustment for BOP shortfall	0	0	20,842
Adjusted program DF	2,405,403	2,241,148	2,840,785
Excess/shortfall	0	0	-322,100
Total domestic financing	2,405,403	2,241,148	3,162,885
Bank financing	1,932,299	1,768,044	2,578,291
Commercial banks	803,869	803,869	1,543,719
Treasury bills 1/	516,252	516,252	961,926
Bonds 1/	395,676	395,676	696,474
Loans and advances	4,383	4,383	1,762
less: Support to MBZ	-8,423	-8,423	-8,423
less: Deposits	-104,018	-104,018	-108,020
Bank of Zambia	1,128,430	964,175	1,034,571
Treasury bills /	52,539	52,539	24,156
Bonds 1/	1,650	1,650	59,453
Kwacha bridging loan	467,804	0	261,029
GRZ position	-674,406	-674,406	-956,413
Donor suspense balance	-62,351	-62,351	-397
GRZ long-term security IFO BoZ	0	1,646,743	1,646,743
Other	1,343,194	0	0
Nonbank financing	473,104	473,104	584,594
Treasury bills 1/	248,823	248,823	248,069
Bonds 1/	224,281	224,281	336,525

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 thousands of U.S. dollars)

	2004				
	January, February, March, April, May, June				
	Amount	Current Exch rate or price	U.S. dollars	End-2003 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.

Zambia: Relations with the Fund
(As of December 31, 2003)

I. Membership Status: Joined: 09/23/1965; Article VIII

II. General Resources Account:	SDR Million	%Quota
Quota	489.10	100.0
Fund Holdings of Currency	489.10	100.0
Reserve position in Fund	.02	.0

III. SDR Department:	SDR Million	%Allocation
Net cumulative allocation	68.30	100.0
Holdings	0.32	0.46

IV. Outstanding Purchases and Loans:	SDR Million	%Quota
PRGF arrangements	505.19	103.29
SAF loans	72.70	14.86

V. Latest Financial Arrangements:

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
PRGF	03/25/1999	03/28/2003	278.90	237.52
PRGF	12/06/1995	12/05/1998	701.68	661.68
SAF	12/06/1995	12/05/1996	181.75	181.75

VI. Projected Obligations to Fund: (Without HIPC Assistance)
(SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2004	2005	2006	2007	2008
Principal	169.69	170.69	10.49	26.95	47.50
Charges/interest	3.75	2.99	2.24	2.16	1.99
Total	173.44	173.67	12.74	29.11	49.50

VII. **Implementation of HIPC Initiative**:

	Enhanced framework
Commitment of HIPC assistance	
Decision point date	Dec. 2000
Assistance committed (1999 NPV terms)[1]	
Total assistance (US$ million)	2,499.00
Of which: Fund assistance (SDR million)	468.80
Completion point date	Floating
Delivery of Fund assistance (SDR million)	
Amount disbursed	351.60[2]
Interim assistance	351.60
Completion point	…
Amount applied against member's obligations (cumulative) [3]	351.60

VIII. **Safeguards Assessment:**

Under the Fund's safeguards assessment policy, the Bank of Zambia (BoZ) was subject to the transitional procedures with respect to the PRGF arrangement, that was approved on March 25, 1999 and has expired on March 28, 2003. The transitional procedures require a review of only the BoZ's external audit mechanism. The external audit assessment, which was completed on July 2, 2001, concluded that BoZ's external audit mechanism was adequate, as reported in EBS/01/178 (10/24/01). Currently, the BoZ is subject to a full assessment with respect to a new arrangement.

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

[2] Including an additional grant contribution of SDR 16.4 million by the Netherlands to Zambia in the context of the enhanced HIPC Initiative.

[3] The amount applied against Zambia's obligations includes interest income earned on resources while in Zambia's subaccount within the Umbrella Account for HIPC Operations.

IX. **Exchange Rate Arrangement**:

The currency of Zambia is the kwacha. The exchange rate for the kwacha is determined in the inter-bank foreign exchange rate. On February 4, 2003, the Bank of Zambia mid-rate was K 4,796.9 per U.S. dollar. On April 19, 2002, Zambia accepted the obligations of Article VIII, Section 2, 3, and 4 of the Articles of Agreement. However, the Fund urged the authorities to eliminate the exchange restriction evidenced by the accumulation of external payments arrears and the multiple currency practice arising from the spreads between the dealing window rate and the interbank rate, which are subject to approval by the Fund under Article VIII, as soon as possible. Following the introduction of the inter-bank foreign exchange market in July 2003, and the removal of the requirement for exporters to sell their foreign exchange receipts to the BoZ and the auction conducted by the BoZ, the potential for multiple currency practice has been eliminated.

X. **Article IV Consultations**:

Zambia is on the standard 12-month Article IV consultation cycle, subject to the provisions of the decision on consultation cycles approved on July 15, 2002. The last Article IV consultation was concluded by the Executive Board on November 14, 2002.

XI. **FSAP Participation and ROSC**:

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

The Zambian authorities have agreed to the preparation of a 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. Based on the findings of a mission that visited Zambia during May 23-June 5, 2001, the fiscal module of the ROSC was issued to the Executive Board on October 31, 2001 (SM/01/325).

XII. **Technical Assistance (since 1997)**:

Resident advisors

Department	**Dates**	**Position**
MFD	1994- 98	Senior Operations Advisor
	1998- 99	Monetary Advisor on Monetary Policies and Investments
	1998- 99	Advisor on Monetary Operations

FAD	1997-2001	Advisor on Budget Management

Technical assistance missions

Department	**Dates**	**Purpose**
MFD	November 2000	Bank supervision
	June 2001	Bank supervision
	November 2001	Monetary policy, financial sector issues, and payments system
	September 2002	Foreign exchange market
	January and May 2003	Development of foreign exchange interbank market, monetary operations, and reform of the financial system
	September 2003	Monetary operations, reform of the financial system, government securities market, and payments system.
STA	June 1997	Monetary survey (combined STA/AFR mission)
	November 1997	Balance of payments
	March 1998	Monetary survey
	May 2000	Balance of payments
	June 2002	General Data Dissemination System (GDDS)
FAD	March 2000	Budget management
	January 2001	Public expenditure management
	May-June, 2001	ROSC—fiscal transparency module
	August 2001	Tax policy issues
	December 2002	Inspection mission to review the progress in public expenditure management reform

XIII. **Resident Representative**:

A Fund Resident Representative first took up the position in Lusaka in June 1990. Mr. Mark Ellyne was the Resident Representative until July 2003. Mr. Kakoza, the new Resident Representative is expected to be in place in October 2003.

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December 4, 2002

The Acting Chair's Summing Up
Zambia—2002 Article IV Consultation
Executive Board Meeting 02/117—November 27,2002

Executive Directors agreed with the thrust of the staff appraisal. They welcomed the improvement in economic performance since mid-2000, after two decades of high inflation, low economic growth, and declining per capita income. They commended the authorities for the sharply improved fiscal and monetary policies and substantial progress with structural reforms, which contributed to the stronger performance. However, they noted that in 2002 Zambia has been adversely affected by the withdrawal of the copper-mining company Anglo-American plc, declining world copper prices, and a severe drought, all of which curtailed economic growth and increased inflation somewhat, and which illustrated the inherent vulnerabilities facing the economy. In this regard, Directors underscored that important challenges remain in the period ahead—including HIV/AIDS, economic diversification, and food security—and that steadfast implementation of proper policies will be required to improve the investment climate and promote economic growth.

Directors welcomed the authorities' commitment to achieving fiscal sustainability by strengthening their revenue effort and containing overall expenditure. However, they expressed concern about remaining weaknesses in expenditure management. In particular, they regretted overruns in the wage bill in 2002, stemming mainly from wage awards in 2001 to defense and security forces, which have been accommodated by reducing spending elsewhere, especially in the social sectors. While acknowledging that the shortfall in social and HIPC-financed expenditure mainly reflected capacity constraints in line ministries, Directors urged the authorities to strictly implement the fiscal policies agreed under the program, including the resumption of HIPC-financed spending. They stressed that strengthened expenditure control will be essential to ensure adherence to budgetary targets and avoid accumulation of domestic arrears.

Looking ahead, Directors emphasized caution in formulating the 2003 budget in view of the uncertainties related to the food situation—which resulted from the severe drought—world copper prices, and donor assistance. They urged the authorities to increase revenue efforts and welcomed the authorities' commitment to limit the size of the wage bill by adopting the public service pay reform program. Directors also urged the authorities to improve policy implementation to mobilize additional external budget support. They welcomed the government's commitment to increase spending on HIPC-financed programs in 2003, stressing that this is crucial for reducing the high incidence of poverty in Zambia. Directors also considered it essential to vigorously implement reforms that can ensure observance of budget limits and improve public expenditure management more generally. In this connection, Directors stressed the importance of strictly adhering to the commitment to keep the wage bill no higher than 8 percent of GDP. They looked forward to the endorsement of the medium-term expenditure framework by the Cabinet, which can also help to improve the quality of public expenditures. Directors also highlighted the need to reform the pension system, and welcomed the World Bank's efforts in this area.

Directors considered the monetary policy stance to be broadly adequate to achieve the inflation target. However, they urged the authorities to monitor the situation closely in light of recent inflationary pressure, and to tighten monetary policy if necessary. They noted that over the past year there has been a substantial improvement in the operations of the treasury bill market, but stressed that better coordination between the central bank and the Treasury would enhance liquidity forecasting and improve monetary targeting. There is also a need to reduce borrowing costs for the private sector, by lowering inflation and thus inflationary expectations, but also through improved financial intermediation. Directors supported maintenance of a flexible exchange rate regime to facilitate timely adjustments to changes in Zambia's external environment, and considered that the current rate is broadly appropriate. They welcomed the intended move to create an inter-bank foreign exchange market in 2003.

Directors urged the authorities to follow up vigorously on the implementation of the recommendations of the recent FSAP mission. They noted with satisfaction that the ZNCB was recapitalized recently in preparation for its privatization. Directors considered prompt privatization of ZNCB to be important for financial sector stability and fiscal sustainability. Directors welcomed the authorities' intention to address the weaknesses of the financial sector, consistent with budgetary priorities, and supported the authorities' request for technical assistance in this area. Directors urged the authorities to use effectively technical assistance being provided by the Fund and other donors in this area and in general.

Directors underlined the importance of deepening structural reforms. In particular, they considered that much remains to be done to improve the business climate. In this connection, improving the efficiency and accountability of state enterprises, as well as further privatization to raise the performance of the industrial sector, and regulatory and judicial reform should be high on the reform agenda. Also important will be the implementation of a broad diversification strategy to accelerate economic growth and reduce the economy's vulnerability. Directors commended the authorities for maintaining a liberal trade regime.

Directors emphasized the importance of improving governance by enhancing the transparency and accountability of government operations. They welcomed the launching of an anti-corruption drive, the submission of the cobalt report to the parliament, and the regular publication of information on government budget implementation and use of HIPC Initiative resources. They encouraged the authorities to enact the Anti-Money Laundering Act and to take further action to combat the financing of terrorism.

Directors noted the government's effort to incorporate part of the PRSP priority expenditure in the 2002 budget and the progress made in tracking social and poverty related expenditure. They welcomed the authorities' intention to restore HIPC spending to 2.2 percent of GDP in 2003, noting that the PRSP provides a framework for the allocation of resources freed up under the HIPC Initiative. They emphasized the need to implement the triggers for reaching the completion point under the enhanced HIPC Initiative, especially to improve the level and quality of social sector expenditures.

It is expected that the next Article lV consultation with Zambia will be held on the 24- month cycle, subject to the provisions of the decision on consultation cycles approved on July 15, 2002.

Zambia: Relations with the World Bank Group

A. Partnership for Development

1. The World Bank and IMF Boards endorsed the Government's Poverty Reduction Strategy, covering the period 2002-2004, embodied in its first full PRSP in May of 2002. An Interim Poverty Reduction Strategy Paper (I-PRSP) had been presented to the Board in July 2000. The PRSP was substantially complete when the new Government took office in January 2002. The new Government endorsed the PRSP and went further to expand the PRSP in the Transitional National Development Plan (TNDP) that was published in October 2002.

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

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

4. Since 1995, the Fund has supported Zambia's economic reform program by ESAF and PRGF arrangements. The Government is implementing a staff-monitored program covering the period January-June 2004 which is expected to form a bridge on a new Fund-supported program under the Poverty Reduction and Growth Facility (PRGF). The extended SMP focuses on (i) fiscal consolidation, (ii) reducing inflation, and (iii) maintaining an adequate level of foreign reserves. Successful performance under the extended SMP and subsequently under the proposed PRGF would remove a key constraint to reaching HIPC Completion.

B. World Bank Group Strategy

5. 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 2004-2006 on March 9, 2004. The CAS is explicitly rooted in a results framework that links Zambia's overall goals of the PRSP/TNDP to specific strategic objectives, which are measured by long-term outcomes. The main focus of the planned Bank activities is to improve the enabling environment through interventions that remove obstacles to longer-term strategic development outcomes while paying attention to cause-and-result linkages. Where appropriate, quantitative targets to be reached during the CAS period have been specified. During the CAS period, the Bank will track progress on specific CAS outcomes and intermediate progress indicators that are directly affected by Bank interventions.

6. Bank activities focus on three strategic priorities:

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

In addition to ongoing Bank lending operations in the areas of public sector reform, privatization, health, education, social service delivery, infrastructure, and the environment, the base case of the new CAS includes adjustment lending and support for diversification, while continuing project support for public sector reforms, infrastructure, sanitation, health, education, and a reengagement in the agricultural sector.

7. The Bank continues to undertake substantive country diagnostics, providing a solid base for policy dialogue, design, and implementation of its lending operations in Zambia. A combined Public Expenditure Review (PER), Country Procurement Assessment Review (CPAR), and Country Financial Accountability Assessment (CFAA) was completed in 2003. The main economic sector work currently in preparation are a Country Economic Memorandum (CEM), an Investment Climate Assessment (ICA), an Administrative Barriers study (AB), and a Strategic Country Gender Assessment (SCGA). In addition, a collaborative Poverty and Vulnerability Assessment (PVA) is currently underway.

8. For FY06 a review of labor market regulations, a rural development strategy, a post privatization copper strategy, and a integrated framework study for trade have been planned. In the social sectors, the Bank plans to undertake a public expenditure review of the educational sector in FY06.

9. Zambia concluded the 1999-2003 CAS period in the low case scenario, which has become the departure platform for the current CAS. Given that during the last CAS IDA

commitments were about US$65 million per year (actuals for FY02/03 were US$132 million in total), the proposed resource envelope under the new low case scenario is US$180-240 million for the period FY04-07.

10. The next higher level, the base case scenario, would result in US$70-80 million p.a., or between US$280-320 million in total which would exhaust the current IDA allocation of SDR230 million for FY04-07. If Zambia's performance is sustained and even accelerated with regard to macroeconomic and structural reforms and PRSP implementation, the new high case would call for exceptional allocation of IDA resources during the 2004-2007 CAS period and would be between US$90-105 million p.a. or US$360-420 million in total which would be a 30 percent increase over the current IDA envelope.

11. The Bank's active portfolio as of March 2004 contains 15 IDA credits, including recent approvals, for a total commitment of US$610 million (see Table 1). Three projects were approved during FY03 and two projects were approved during FY04 as of March 2003: (i) Copperbelt Environment in March 2003; (ii) Emergency Drought Recovery Project in November 2003; (iii) HIV/AIDS project (ZANARA) in December 2002; (iv) Southern African Power Pool (Subregional Project) in (December 2003); and (v) Road Rehabilitation and Maintenance Project (RRMP) in March 2004.

Table 1: Summary of World Bank operations

(As Of 02/01/04)
(In US$ millions

Project Name	Fiscal Year	IDA	Undisb.
Basic Educ Sec Inv Prg	1999	40.0	17.2
Copperbelt Environment	2003	40.0	38.4
ERIPTA	1996	40.5	12.4
Emergency Drought Recovery Project	2003	50.0	23.3
HIV/AIDS (ZANARA)	2003	42.0	40.0
Mine Township Services Project	2000	37.7	20.3
Pub Svc Cap (PSCAP)	2000	28.0	9.2
Regional Trade Fac. Proj. – Zambia	2001	15.0	11.0
Social Investment Fund (ZAMSIF)	2000	64.7	35.6
TEVET	2001	25.0	21.3
ZM Railways Restructuring Project	2001	27.0	3.9
ZM National Road	1998	70.0	11.6
Zambia Power Rehab	1998	75.0	25.6
RRMP*	2004	50.0	50.0
South African Power Pool Project*	2004	3.0	3.0
Overall Result		607.9	322.8

* Recent approvals which are not yet effective

12. 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. IFC's most prominent recent project was for US$30 million in the equity of Konkola Copper Mines (KCM) with Anglo-American in 2000. IFC exited in 2002 along with Anglo, in accordance with the terms of the investment agreement.

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

14. 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. MIGA is currently underwriting a project in the infrastructure sector, with anticipated coverage of US$20 million, which is expected to be signed in FY04.

C. IMF-World Bank Collaboration in Specific Areas

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

16. The Fund and the Bank shared joint responsibility in supporting the Government in the preparation of the PRSP and its forthcoming first progress report assessing its implementation. 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 will jointly evaluate Zambia's debt and cash management practices.

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

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

18. **HIV/AIDS and health.** At this time, the Bank is assisting the Ministry of Health with a US$12 million subcomponent under the multi-sectoral AIDS program (ZANARA). In addition, the Bank is carrying out ESW on human resources in the health sector (FY04) and planning a health sector PER in FY06. Building on this, the Bank will provide support 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 improved health outcomes in the areas served.

19. **In education**, the Bank is currently supporting the Ministry of Education's efforts through Adaptable Program Lending (APL). The APL1 Credit enables Bank funds to be devoted to a wide range of purposes in basic education and, following an amendment, to construct two high schools in Eastern Province. The Bank expects that the APL2 Credit, to be committed in FY06, will support the education sector more broadly. The Bank will support the expenditure effectiveness and efficiency and management issues in the sector through a sector focused public expenditure review.

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

21. **In agriculture and rural development**, the Bank's focus is two fold: to improve productivity of the sector and increase overall food security. The Bank is reengaging in the agricultural sector given the priority Zambia itself attaches to this sector as set out in the PRSP/TNDP. Indeed, if the macroeconomic environment can be improved, an improved agricultural sectoral policy defined, and infrastructure support put in place–a major effort could be launched to unleash this growth and poverty reduction potential through well-targeted interventions for both smallholders and commercial agriculture.

22. Advisory, Analytic, and Advisory (AAA) services are planned to support the formulation of an agricultural policy that is consistent with planned and ongoing activities in related sectors such as roads and electricity to remove bottlenecks that prohibit and or make it difficult for farmers to produce for the market. Hence, the policy dialogue with the Government on reform and priorities of public spending for agriculture and rural development will address both short run policy issues holding back the sector, as well as helping formulate a long run strategy to tap the large agricultural export potential of the country, through investment in land development, irrigation, and infrastructure. Balanced treatment of smallholders and commercial agriculture is important for growth and poverty reduction. As a follow-up to the AAA work, an Agricultural Support Project is planned to assist the Government with these challenges.

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

24. The Bank supports **economic diversification** directly through its SEED project, which will support the Government’s 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 the three high potential sectors as well as also investments, primarily in tourism-related infrastructure. The tourism component will work toward making Livingstone the flagship tourism destination in Zambia and strengthen management of national parks, which underpin Zambia’s medium-term tourism development strategy. The interventions in the gemstones and agribusiness components are to strengthen the supply chain that links rural/small-scale producers to local and export markets.

25. **Private sector development.** To improve Zambia’s investment climate, the Bank and IFC will assist 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.

26. In the **infrastructural sectors**, the economic program agreed to as part of the HIPC initiative will assist the need to turn ZESCO around into a financially viable company that operates on commercial terms. Analytical work will assist the Government

with identifying main bottlenecks with regard to competition and effective service delivery in the sector. The policy recommendations and institutional changes would be supported through adjustment operations, while the ongoing and proposed investment projects, Road Rehabilitation and Maintenance Project (RRMP) and the Water Sector Reform Project, would provided financial resources needed to undertake the actual investments. Zambia will also benefit from the Southern African Power Pool Project.

27. **Environmental concerns** are addressed as part of each individual project as laid down in the Bank's safeguard policies and directly through the Bank's environmental project in the Copperbelt, which will assist Government with the cleanup of several hazardous sides in the Copperbelt and Kabwe area. The proposed SEED project will assist the Government with sustainability of tourism in protected areas.

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

28. 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 of public funds. **The public sector reform and restructuring agenda** centers on the need to instill a more productive and efficient public service. The means to achieve this are creating 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.

29. 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

30. 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 (v) progress towards HIPC completion.

31. In the area of **trade policy,** the Bank with collaboration from other partners will undertake the integrated framework exercise. Follow up with regard to the recently

completed FSAP will guide the Bank's policy dialogue and interventions in the **financial sector** in close collaboration with the IMF. The Fund and the Bank recently jointly reviewed the proposed Financial Sector Development Plan for the financial sector in Zambia.

32. Assistance in the areas of central government **debt management and domestic debt market development** from the Bank and the Fund will focus on improving the functioning of these interrelated concepts as a means to reduce vulnerability and the cost of and the need for domestic financing. This work will draw from the Guidelines for Public Debt Management (published in March 2001) and the Handbook on Developing Government Bond Markets (published in July 2001). The Bank and the IMF have recently prepared an accompanying document to the guidelines containing case studies from a range of countries at different stages of economic and financial development, which will feed into this work as well.

33. As one area of truly joined responsibility, the Fund and the Bank are working closely together to review progress with Zambia's PRSP. The Bank and the Fund jointly prepared the JSA for the full PRSP published in May 2002 and are preparing for the JSA of the first progress report of the PRSP that is to be issued by the end of March 2004. Another truly joint responsibility is the Enhanced HIPC Initiative. Zambia reached its decision point in December 2000. The Fund and the Bank jointly prepared the HIPC-AAP document and jointly monitor progress towards HIPC completion.

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

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

Table 2: IMF-World Bank Collaboration in Zambia

CAS Component	Specialized advice from Fund	Specialized advice from World Bank	Key Instruments
Goal: A growth conducive macro economic environment			
Subject: Economic Framework/ Management	Monetary policy; Financial sector consolidation, exchange rate, fiscal policy and wage bill, debt management, balance of payments, economic statistics	Debt management; Wage bill management; Financial sector consolidation	***Bank***: Ongoing Portfolio: Public sector capacity building project (PSCAP) (FY00) New Lending : SAC (FY05) ESW: Debt Management Assessment ***IMF***: SMP and PRGF performance criteria and benchmarks on key monetary and fiscal targets, and structural reforms; benchmark on arrears ***Jointly***: JSA of PRSP progress report
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	***Bank***: Ongoing Portfolio: ERIPTA, Copperbelt Environment Program, ROADSIP, Mine Township Services Project (FY00), Regional Trade Facilitation Project (FY00), Railways Restructuring Project (FY00), TEVET (FY00) Zambia Power Rehabilitation New Lending: SAC (FY05), Support to Economic Expansion and Diversification (SEED) (FY05), PMSP (FY05), Increased Access to Electricity, South Africa Power Pool ESW: Country Economic Memorandum (FY04), Investment Climate Assessment (FY04), ICT Options Study (FY06), Energy Services Delivery ***IMF***: SMP and PRGF performance criteria and benchmarks on key monetary and fiscal targets, and structural reforms. ***Jointly****:* FSAP (FY02) and follow up, JSA of PRSP progress report
Goal: Better health and long-term survival, with particular focus on at risk and vulnerable groups			
Subject: Health		Health Sector Expenditure Management. Provision of sustainable water services in provinces and districts	***Bank:*** Ongoing Portfolio: ZANARA (FY03), ZAMSIF (FY00), Mine Townships Project (FY00) New Lending: Health Sector Support Program (FY07), PRSC Health (FY07) (high case only) ESW: Health Sector PER (FY05), Strategic Country Gender Assessment (FY04)
Goal: Reverse the spread of HIV/AIDS: decrease prevalence among			

Subject: HIV/AIDS		Behavior change education; prevention, care and risk mitigation services.	***Bank:*** Ongoing Portfolio: ZANARA (FY03), ZAMSIF (FY00), Aids Component BESSIP(FY00) New Lending: HIV/AIDS Corridor Project (Sub-regional project) (FY07) ESW: Social Safety Nets and Protection Strategy Note (FY04), Strategic Country Gender Assessment (FY04)
Goal: Better educated populace, with relevant job skills as well as academic training			
Subject: Education		Provision and quality of primary education	***Bank:*** Ongoing Portfolio: BESSIP I (SWAP)(FY99), TEVET(FY01) ZAMSIF (FY00) New Lending: BESSIP II (FY06) (SWAP), PRSC (education) FY06 (high case only) ESW: Education Sector PER(FY05)
Goal: Improved living conditions for poor/vulnerable households in drought prone areas			
Subject: Social Protection/ Risk Mitigation		Social protection and risk management systems	***Bank:*** Ongoing Portfolio: Emergency Drought Recovery Project New Lending: Health/Nutrition Project, Agriculture Project, SEED ESW: Poverty and Vulnerability Assessment, Strategic Country Gender Assessment, Social Safety Nets and Social Protection Strategy Note, Health Sector Review ***IMF***: SMP and PRGF
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	***Bank:*** Ongoing Portfolio: PSCAP I New Lending: PSCAP/PEMFAP II ESW: PEMFAR (FY03) ***IMF***: SMP and PRGF; measures to strengthen the Office of the Auditor General; measures to put in place the IFMIS; multiyear plan for clearing the stock of arrears; and measures to ensure timely reporting of government accounts to Parliament as required by law. ***Jointly***: HIPC AAP expenditure tracking assessment
Goal: A productive and efficient public service			
Subject: Public Sector Reform and Restructuring		Pay reform, public sector restructuring	***Bank:*** Ongoing Portfolio: PSCAP I New Lending: PSCAP/PEMFAP II, SAC (FY05) ESW: PEMFAR(FY03), Governance Survey

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

Zambia: Statistical Issues

Zambia is a participant in the GDDS project for Anglophone African countries and has begun receiving technical assistance in statistics under the project. Zambia's GDDS metadata on the Dissemination Standards Bulletin Board was last updated in February 20042003.

The present arrangements for the compilation of macroeconomic statistics involve duplication of effort and insufficient coordination among the Bank of Zambia (BoZ), the Ministry of Finance, and the Central Statistical Office (CSO). The situation largely reflects resource constraints and organizational weakness within the CSO that have affected its ability to produce economic statistics on a timely basis.

Real sector

An IMF/DFID GDDS mission visited Lusaka from June 24 to July 5, 2002 to provide technical assistance to the CSO on national accounts, focusing on improving the source data (surveys); introducing the phased implementation of the 1993 System of National Accounts *(1993 SNA)*; and developing quarterly GDP estimates. The mission's main findings are summarized below.

Since its inception, the CSO has been compiling and disseminating annual national accounts estimates, using both the production and expenditure approaches. The national accounts estimates are compiled according to the conceptual guidelines of the 1968 SNA, but a phased approach to the introduction of the 1993 *SNA* is planned. Currently, the estimates are released on the basis of a well-established schedule and cover, on the production side, 11 industry groups and 23 subgroups, and, on the expenditure side, the 6 main components, at both constant and current prices. 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. The data that are currently available are mostly quarterly volume or quantity indicators of production. These are used in the construction of quarterly indicators of GDP by economic activity/industry at constant prices. Data that would permit the compilation of the more comprehensive real sector indicators, such as data on total production and intermediate consumption of establishments, are not available. On the expenditure side, there are no current indicators of household consumption, and private final consumption expenditure is derived residually. Source data to estimate gross fixed capital formation and changes in stocks are incomplete.

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

The range of basic source data for national accounts estimates has rapidly eroded in recent years at a time when the economy was subject to major structural changes. This lack of adequate source data to support the national accounts has increasingly detracted from the quality of the GDP estimates. Moreover, even some major methodological improvements within national accounts, such as the adoption of the commodity flow approach to estimate some of the aggregates, have not been adopted. Further, the CSO has not used the results of the input-output table constructed for the period 1994-1999, to improve the estimation process. The authorities' plan to implement the economic census project for 2002 constitutes a major breakthrough in the development of source data for the national accounts.

A follow-up mission visited Lusaka during March 3-19, 2003. The mission noted that the short-term recommendations made during the first mission were not carried out due to lack of staff resources.

Government finance

Zambia has resumed compilation of government finance statistics (GFS) data, and it appears that the quality of the reported data has improved; Zambia's GFS data have been updated to 1998 for final data and to 1999 for forecast data. However, the coverage of the data for 1989-99 is limited to budgetary central government.

The authorities report monthly budget data for the Fund's operational use in a timely manner. However, data are often subject to substantial revisions later in the year. No monthly or quarterly fiscal data are reported for publication in International Financial Statistics (*IFS)*. Local government fiscal data are not available. No data have been reported for the *GFS Yearbook* since 1999.

An IMF/DFID GDDS mission visited Lusaka from March 13-26, 2003 to provide technical assistance to the Ministry of Finance and National Planning on fiscal issues. The expert provided advice on the initial steps toward migration to the methodology of the *Government Finance Statistics Manual 2001 (GFSM2001).*

Monetary accounts

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

In April 2003, the Bank of Zambia fully switched to a new computing system for generating its monthly trial balance, which should enable it to produce its monetary accounts on a timely basis. A July 2003 STA monetary and financial statistics mission recommended the recording of deposits on a gross, rather than on a net, basis; the reporting of central government securities at cost, rather than at face value; and the reclassification of some accounts.

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

Balance of payments

In May 2000, a STA mission found compilation of data on imports, exports, and foreign direct investment to be inadequate and made a number of recommendations to improve the coverage of the data. Since then, the authorities have prepared a work plan to implement the recommendations of the mission, and some improvements have been made in the coverage of the customs data and the methodology for compiling some balance of payments components. However, the quality of balance of payments data continues to be problematic, as data sources are poor and unreliable, while the methodology is inadequate.

There are no sufficient data sources on private sector foreign assets and liabilities required to compile an international investment position statement.

Zambia: Core Statistical Indicators
(As of April 30, 2003)

	Exchange Rates	International Reserves	Central Bank Balance Sheet	Reserve/ Base Money	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	Overall Government Balance	GDP/ GNP	External Debt/ Debt service
Date of latest observation	1/30/04	11/30/03	11/30/03	11/30/03	11/30/03	12/31/04	3/03	2/03	12/02	03/03	2001	02/03
Date received	2/04	1/13/04	1/13/04	1/13/04	1/13/04	1/13/04	4/14/03	4/28/03	2/23/03	4/14/03	7/02	4/14/03
Frequency of data 1/	D	W	M	W	M	W	M	Q	A	M	A	W
Frequency of reporting 1/	D	W	M	W	M	W	M	Q	A	M	A	W
Source of data 2/	N	A	A	A	A	A	A	A	A	A	A	A
Mode of reporting 3/	E	M	M	M	M	E/M	E/M	M/V	M/V	M/V	M/V	M/V
Confidentiality 4/	C	B	B	B	B	C	C	B	B	B	C	B
Frequency of publication 1/	D	M	M	F	M	F	M	A	A	A	A	A

1/ D= daily; W=weekly; F=fortnightly; M=monthly; Q=quarterly; Y=Yearly; V=irregularly.
2/ A = direct reporting by the Central Bank or the Ministry of Finance; N=official publication or press release.
3/ C= cable or facsimile; E=electronic data transfer; M=mail; V=staff visits.
4/ B=for use by the staff and the Executive Board; C= unrestricted use; D=embargoed for specified period.

Zambia: Social and Demographic Indicators

Area (thousand sq. km.)	753
Poverty and inequality (1996)	
Percent of national income	
Highest 20 percent	55
Lowest 20 percent	4
Gini coefficient	0.50
Population below the poverty line (percent)	69
Rural poverty (percent of rural population)	82
Labor force (1998)	
Total participation rate (percent)	62
Percent employed in agriculture	70
Percent in manufacturing	4
Percent in mining	2
Education (1997)	
Gross enrollment rates (percent)	
Primary	89
Secondary	27
Tertiary	3
Illiteracy (percent of adult population)	
Total	38
Men	16
Women	31

Population characteristics (1998)	
Total population (in millions)	10.2
Annual rate of growth (percent) 1980-98	2.9
Population density (per sq. km.)	13
Urban population (percent of total)	39
Proportion in capital city (percent of urban population)	37
Health (1998)	
Life expectancy at birth (years)	43
Infant mortality (per 1,000 live births)	114
Mortality under 5 years (per 1,000)	192
Maternal mortality (per 1,000 live births)	650
Child immunization rate (under 12 months; percent)	70
Child malnutrition (1997) (under 5 years)	
Percent underweight	24
Percent stunted	42
HIV/AIDS prevalence rate (percent)	19
Access to safe water (1998)	
Percent of total population	43
Urban population	64
Rural population	27

Sources: World Bank, *World Development Indicators*, 2000; and for employment data, Zambia Central Statistical Office, *Living Conditions in Zambia,* 1998.