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**FOR
AGENDA**

EBS/00/134
Correction 1

CONFIDENTIAL

July 25, 2000

To: Members of the Executive Board

From: The Secretary

Subject: **Zambia—Staff Report for the 2000 Article IV Consultation, Review of the First Annual Program, and Request for Second Annual Program Under the Poverty Reduction and Growth Facility**

The attached revised draft decision of EBS/00/134 (7/11/00) is for consideration by the Executive Directors tomorrow, Wednesday, July 26, 2000.

Att: (1)

Other Distribution:
Department Heads

52. **Zambia's external debt burden is unsustainably high.** Despite the anticipated improvement in external performance and the programmed increase in reserves, Zambia's external position, including capacity to repay the Fund, will be fragile for years to come. **The Enhanced HIPC Initiative presents a unique opportunity for debt relief that would reduce the country's debt burden to sustainable levels.** But first, Zambia must establish a track record of good performance to move rapidly to a HIPC decision point. The authorities also need to use this opportunity to prepare a realistic strategy for poverty reduction that addresses the minimum needs of the population.

53. **There are a number of risks associated with the program.** First, expenditure pressures, including those associated with the elections in 2001, if unchecked, could undermine the attainment of program targets. Second, poor expenditure control and budget management pose a threat to effective budget implementation. In the past, the authorities failed to impose effective sanctions to offenders and made only limited progress in controlling of expenditure commitments. Third, governance issues continue to threaten to erode the confidence of the public and the donor community alike and thwart progress in stabilizing the economy. The authorities must move quickly to implement their structural reform agenda, particularly privatization and restructuring of the banking system. Moreover, the authorities will need to show a clear commitment to address existing weaknesses in the statistical system in order to facilitate program monitoring and policy design. Despite these risks, the authorities' program for 2000 represents a credible effort, which has been buttressed by recent actions, particularly the privatization of ZCCM. If the Zambian authorities make a determined effort to improve policy coordination and implementation, the program will substantially improve economic performance and provide a solid foundation for poverty reduction. The staff recommends approval of the second annual program under the PRGF.

54. It is recommended that Zambia remain on the 12-month consultation cycle.

VII. PROPOSED DECISION

The following draft decision, which may be adopted by a majority of votes cast, is proposed for adoption by the Executive Board:

1. Zambia has consulted with the Fund in accordance with paragraph 2(e) of the three-year arrangement for Zambia under the Poverty Reduction and Growth Facility (PRGF) (EBS/99/35, Supplement 1) and paragraph 3 of the letter dated March 10, 1999 from the Minister of Finance and Economic Development of Zambia, in order to review program implementation and reach understandings regarding the phasing and conditions for disbursements during the second year of the arrangement. Zambia has also requested that the undisbursed amounts during the first year of the arrangement in an amount equivalent to SDR 30 million be rephased over the remaining period of the arrangement.

2. The letter from the Minister of Finance and Economic Development of Zambia dated June 30, 2000 shall be attached to the three-year PRGF arrangement for Zambia, and the letter dated March 10, 1999 from the Minister of Finance and Economic Development of Zambia shall be read as supplemented by the letter dated June 30, 2000.

3. Accordingly, the PRGF arrangement for Zambia shall be supplemented as follows:

(a) the following shall be added as a new paragraph 1(cc):

“During the second year of this arrangement:

(i) the third disbursement under the arrangement, in an amount equivalent to SDR 10 million, will be available on November 15, 2000, at the request of Zambia and subject to paragraph 2 below; and

(ii) the fourth disbursement, in an amount equivalent to SDR 24.94 million, will be available on February 15, 2001, at the request of Zambia and subject to paragraph 2 below.”

(b) the following shall be added as a new paragraph 1(dd):

“The phasing of, and conditions for, disbursements during the remaining period of this arrangement shall be established during the second review contemplated in paragraph 2(ee) below.”

(c) the following shall be added as new paragraphs 2(aa), 2(bb), 2(dd) and 2(ee):

“(aa) Zambia will not request the third disbursement referred to in paragraph 1(cc)(i) above if the Managing Director of the Trustee finds that the data as of September 30, 2000 indicate that any of the ceilings and floors referred to in paragraphs 2(a)(i) to 2(a)(vi) of this arrangement, as specified in Table 3 of the letter from the Minister of Finance and Economic Development of Zambia dated June 30, 2000 and as further defined in Section 2 of the Technical Memorandum of Understanding (TMU) dated July 21, 2000, was not observed. Zambia will not request the fourth disbursement referred to in paragraph 1(cc)(ii) above if the

Managing Director of the Trustee finds that the data as of December 31, 2000 indicate that any of the ceilings and floors referred to in paragraphs 2(a)(i) to 2(a)(vi) of this arrangement, as specified in Table 3 of the letter from the Minister of Finance and Economic Development of Zambia dated June 30, 2000 and as further defined in Section 2 of the TMU, was not observed.

“(bb) Zambia will not request the third and fourth disbursements referred to in paragraph 1(cc) above if the Managing Director of the Trustee finds that Zambia has not carried out its intentions with respect to the structural performance criteria specified in Table 4 of the letter from the Minister of Finance and Economic Development of Zambia dated June 30, 2000.”

“(dd) Zambia will not request the third and fourth disbursements referred to in paragraph 1(cc) above if it has taken any of the actions specified in paragraph 2(c) and (d) above, or if:

- (i) the central government or the Bank of Zambia collateralizes or guarantees at any time any new loans for ZESCO or ZNOC; or
- (ii) new tax arrears by ZESCO or ZNOC to the central government exist as of end-September and end-December, 2000 respectively.

“(ee) Zambia will not request the fourth disbursement specified in paragraph 1(cc)(ii) above until the Trustee has determined that the second review referred to in paragraph 21 of the letter from the Minister of Finance and Economic Development of Zambia dated June 30, 2000 has been completed.”

4. The Fund has reviewed the interim Poverty Reduction Strategy Paper (“Interim PRSP”) submitted by Zambia and concludes that it provides a sound basis for the development of a fully participatory PRSP and for Fund concessional assistance.

5. The Fund decides to complete in principle the first review contemplated in paragraph 2(e) of the PRGF arrangement for Zambia. The completion of the review shall become effective on the date on which the Fund decides that the World Bank has concluded that the Interim PRSP provides a sound basis for the development of a fully participatory PRSP and for Bank concessional assistance. No further understandings will be necessary upon the completion of the review becoming effective in order for Zambia to request the second disbursement specified in paragraph 1(c)(ii) of the arrangement.

6. The three-year commitment period of the PRGF arrangement for Zambia is extended until March 28, 2003.

Table 1. Zambia: Indicators of Fund Credit, 1999-2009
(In millions of SDRs, unless otherwise indicated)

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	Beyond
Outstanding Fund credit (beginning of period)	843.4	853.4	873.4	806.4	738.3	594.7	425.1	254.1	241.1	209.2	160.9	111.1
Of which : PRGF	843.4	853.4	873.4	806.4	738.3	594.7	425.1	254.1	241.1	209.2	160.9	111.1
PRGF loan disbursements 1/	10.0	20.0	99.6	99.6	24.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total debt service to the Fund	6.6	5.8	174.0	174.7	175.2	175.4	175.6	17.2	36.0	52.3	53.5	114.9
Repayments	0.0	0.0	166.7	167.7	168.7	169.7	170.7	13.0	31.9	48.3	49.8	111.1
Charges	6.6	5.8	7.3	7.0	6.5	5.7	4.9	4.2	4.1	4.0	3.7	3.8
Outstanding Fund credit (end of period)	846.8	873.4	806.4	738.3	594.5	425.1	254.4	241.1	209.2	160.9	111.1	0.0
Fund credit outstanding (end of period) in percent of quota	173.1	178.6	164.9	150.9	121.5	86.9	52.0	49.3	42.8	32.9	22.7	0.0
Memorandum item:												
IMF (net): before HIPC	3.4	14.2	-74.4	-75.1	-150.3	-175.4	-175.6	-17.2	-36.0	-52.3	-53.5	-114.9

Sources: IMF Treasurer's Department; and staff estimates and projections.

1/ Indicates proposed rephasing of disbursement under the PRGF arrangement.