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[IMF Executive Board
Completes Second
Review Under
Zambia's PRGF
Arrangement and
Approves US\\$8.3
Million Disbursement](#)
March 23, 2005

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

March 23, 2005

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

Lusaka, March 23, 2005

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

Dear Mr. de Rato,

The first review of the economic program supported by Zambia's arrangement with the Fund under the Poverty Reduction and Growth Facility (PRGF) was completed on December 15, 2004. In the attached Memorandum of Economic and Financial Policies (MEFP) and Technical Memorandum of Understanding, we review progress in implementing the program in 2004 and update the program for 2005. The focus of our strategy continues to be on achieving high rates of economic growth and reducing poverty through sustainable fiscal and monetary policies and structural reforms to support fiscal adjustment and a reorientation of spending toward poverty reduction, improve the environment for private sector development, and strengthen governance.

The Government of Zambia requests the completion of the second review and the third disbursement under the PRGF arrangement in the amount of SDR 5.502 million. In this connection, the Government also requests the IMF Executive Board to grant waivers for the nonobservance of two performance criteria. A delay in making debt service payments to Russia resulted in nonobservance of the performance criterion on the accumulation of external payments areas. These payments have now been settled. The government also requests a waiver for the nonobservance of the performance criterion on cabinet approval of a proposal to repeal sections of the Building Societies Act, the National Savings and Credit Bank Act and the Development Bank of Zambia Amendment Act that are conflict with the Banking and Financial Services Act. The government expects that cabinet will approve the proposal in March, as a prior action for completion of the review. We are also requesting modifications to the quantitative performance criteria for 2005.

The Government of Zambia believes that the successful pursuit of the economic program supported by the PRGF arrangement, approved on June 16, 2004, along with the diligent implementation of the Poverty Reduction Strategy Paper in 2004 and the good progress that has been made in meeting the completion point triggers, has laid an excellent basis for us to attain the completion point under the enhanced Highly Indebted Poor Countries (HIPC) Initiative before the end of March, 2005. The debt relief to be provided under the HIPC

Initiative will certainly assist Zambia in reaching its growth and poverty reduction objectives. To make steady progress toward the Millennium Development Goals, Zambia will, however, need additional financial assistance from the international community.

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

The performance criteria and benchmarks for the third review, which is scheduled to be completed in mid-September 2005, will be based on June 2005 targets, and the performance criteria and benchmarks for the fourth review, which is scheduled to be completed in mid-March 2006, will be based on December 2005 targets, as set out in Tables 3 and 4 of the MEFP.

The Government of Zambia authorizes the Fund to make this letter and the attached memoranda available to the public, including through the placement of these documents on the Fund's website, subject to the removal of market sensitive information, following the approval of the Fund's Executive Board of the completion of the second review under the PRGF arrangement.

Yours sincerely,

/s/

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

ZAMBIA

Memorandum of Economic and Financial Policies of the Government of Zambia for 2005

I. RECENT ECONOMIC DEVELOPMENTS

A. Economic Performance in 2004

- 1. Macroeconomic performance continued to strengthen in 2004, surpassing expectations.** Real GDP growth is now estimated to have reached at least 5 percent—compared to the original budget assumption of 3.5 percent—and, despite the sharp increase in fuel prices during the year, the 12-month rate of inflation was contained at 17.5 percent. Strong growth in construction and mining contributed to this favorable outturn, while agricultural output expanded by just over 6 percent.
- 2. Fiscal policy implementation was broadly in line with the program, resulting in a sharp decline in domestic borrowing.** In the final quarter of the year, tax collections strengthened, limiting the shortfall in tax and non-tax revenues to 0.3 percent of GDP. Total spending was 1 percent of GDP less than programmed, mainly reflecting a slower rate of execution of capital spending financed by external project grants and loans. Domestically financed spending (including interest payments) was 0.2 percent of GDP less than programmed. Within this total, the wage bill was 7.8 percent of GDP, as budgeted. Recurrent departmental charges (RDCs) were 0.5 percent of GDP higher than originally budgeted, as a result of supplementary allocations during the second half of the year. These included an increase in military spending and payments made by central government to settle arrears of central and local government to water utilities and ZESCO, as called for in the commercialization strategy for the electricity utility. This higher spending was more than offset by lower interest payments and savings on non priority capital projects. However, government protected releases for expenditures on priority poverty reducing programs which, for the first time in three years, were fully funded as budgeted. Improved fiscal discipline, and the delivery of external budget support in line with program expectations, allowed for a substantial reduction in government's domestic borrowing from over 5 percent of GDP in 2003 to less than 1 percent of GDP in 2004. However, authorized expenditure of about 1 percent of GDP went unexecuted by the end of the year, mainly because more than half of the budget support expected in 2004 (US\$38 million out of US\$65 million) came only in the last few days of December 2004.
- 3. The Bank of Zambia began to tighten liquidity conditions in mid-year but, as a result of exceptional factors, monetary growth surged at the end of 2004.** Through November, the growth of reserve and broad money was 5 percent and 22 percent respectively. However, partly as a result of the large end-year disbursements of donors' budget support and transfers from the Government's accounts in the Bank of Zambia (BoZ)

to its accounts in commercial banks, reserve money rose sharply to bring the end-year increase to 21 percent. Similarly, the 12-month increase in broad money reached 30 percent in December. Large foreign currency deposits by corporations into commercial bank accounts also contributed significantly to the rise in broad money. Interest rates on treasury bills, which had fallen very sharply, from over 30 percent in December 2003 to about 7 percent in June 2004, began to rise in mid-year and stabilized in the final quarter at about 18 percent.

4. **Zambia's external position strengthened in 2004.** Proceeds from copper and other metal exports increased by 65 percent as a result of a solid rise in metals production and an increase of copper prices in excess of 50 percent. The growth of non-metals exports, notably cotton lint and tobacco, also exceeded expectations. Thus, despite an increase in imports of 24 percent, owing mainly to an increase in capital imports for the mining sector and high oil prices, the current account deficit (including grants) narrowed from 7.5 percent of GDP in 2003 to an estimated 4.8 percent in 2004. With somewhat lower-than-projected external debt service payments and larger than anticipated purchases by the BoZ, the buildup of gross international reserves during the year exceeded the program target by US\$35 million; by year-end, gross international reserves reached US\$222 million, for an import coverage of 1.2 months, compared with the program target of 1.1 months. The kwacha appreciated against the dollar during the final quarter of 2004, and for the year as a whole the real effective exchange rate of the kwacha appreciated by about 8 percent.

5. **The Government has finalized its second PRSP Annual Progress Report (APR), covering the period July 2003 to June 2004.** The Government has also prepared an Addendum to the second APR, which covers progress in the implementation and monitoring and evaluation of Zambia's poverty reduction strategy from July to December 2004 and a supplement to the APR which lays out objectives and policies for 2005.

B. Performance Under the Program Supported by the PRGF Arrangement

6. **All but two of the quantitative and structural performance criteria (PCs) for the second review were observed, as were all quantitative benchmarks** (Tables 1 and 2). In early February, the government settled payments due to Russia that had been due since October. Under the structural program, the PC for January 2005 regarding the adoption of the work program for the Public Expenditure Management and Financial Accountability (PEMFA) reform program was met. The structural performance criterion regarding cabinet approval of a proposal to repeal sections of the Building Societies Act, the National Savings and Credit Bank Act, and the Development Bank of Zambia Act that were in conflict with the Banking and Financial Services Act was not met. This measure is a prior action for the completion of the second review. In addition, Government has continued to refrain from making extra budgetary payments for which it is not legally obligated (a continuous PC), and observed the limits on funding unforeseen expenditures (a continuous benchmark). Quarterly budget execution reports were published, but with a delay of more than the 45 days specified in the benchmark for the third quarter report. Government developed a wider definition of poverty reducing spending that was used in the preparation of the budget. Consultations are

being held with stakeholders to confirm that this definition adequately reflects the priorities set out in the government's PRSP.

II. THE MEDIUM-TERM STRATEGY

7. **The Government has reaffirmed the strategy set out in the PRSP and the November MEFP to promote growth** through diversification while improving the quality of public services. Key macroeconomic objectives include real GDP growth of at least 5 percent a year over the medium term, with annual inflation falling to single digits by 2007. In line with the objective of reducing domestic debt to sustainable levels, the framework calls for a gradual reduction in Government's domestic borrowing over the medium term. Government remains committed to increasing poverty-reducing spending by at least 1.6 percent of GDP between 2004 and 2007 .

8. **As explained in the November 2004 MEFP, the medium term expenditure framework now envisages considerably higher spending to conduct the elections in 2006 and for the constitutional review.** Election related expenditures in 2005 are fully funded in the budget. The government recognizes that the remaining financing gaps in 2006 and 2007 will need to be filled through a combination of additional grants and offsetting measures, including some reduction in the costs of these processes. A technical working group headed by the Ministry of Justice with representatives of the Electoral Commission of Zambia and donors is examining cost estimates, drawing on international experience. At this stage, no firm commitments have been made by donors to the government's request for additional assistance.

III. THE PROGRAM FOR 2005

9. **The Government's economic policy agenda for 2005 also remains essentially unchanged from that presented in the November MEFP.** Owing to the sharp increase in the monetary aggregates in late 2004, however, some adjustments to the monetary program have been necessary to maintain the objective of lowering inflation to 15 percent by end-2005. In addition, quantitative program targets have been set for the second half of 2005 and new structural measures have been introduced for the remainder of the year in the areas of public expenditure management and financial sector development.

A. Fiscal Policy

10. **The budget proposal submitted to Parliament aims to limit domestic financing needs to 1.6 percent of GDP, in line with the framework included in the MEFP of November.** Aggregate revenues are expected to be 18.4 percent of GDP, or 0.1 percent of GDP higher than in the earlier framework. The combination of these higher revenues and the Government's decision to cancel a census costing 0.1 percent of GDP, which had been included in initial spending plans for the constitutional review, will offset increases in other spending, including a small increase in the wage bill. The Ministry of Finance and National Planning (MoFNP) and the BoZ will closely monitor an expected partial unwinding of the

balances at end-December 2004 of government deposits in the BoZ and commercial bank accounts and will ensure its consistency with the program objectives. To accommodate this unwinding in the program, the Technical Memorandum of Understanding (paragraphs 5 and 9) describes an adjustor to net domestic financing of the central government and to net domestic assets of the Bank of Zambia. Additional domestic financing up to 0.3 percent of GDP will be available provided that domestic revenues and expenditures are in line with the budget. The government also reaffirms the commitment to limit the need to authorize supplementary budget allocations during the year to enhance fiscal policy credibility.

11. **The budget includes measures aimed at easing the burden of direct taxation, while broadening the tax base to raise revenues.** The revised personal income tax regime, effective April 1, 2005, increases the threshold for exempting annual income to K 3.4 million (from K 3.1 million) and reduces the highest tax rate of 40 percent to 37.5 percent. These measures are expected to lead to a revenue loss of K 35.7 billion or 0.1 percent of GDP. Several agricultural products, previously exempted, are now standard rated under the VAT regime; when exported, these products will attract VAT at a zero rate, resulting in a revenue loss of K 29.8 billion or 0.1 percent of GDP. Medical supplies and drugs that were previously exempted will be also be zero-rated, yielding a revenue loss of K 2.3 billion. In line with the terms of the recent sale to a strategic investor, the duty free importation of consumables by Konkola Copper Mines will expire on March 31, 2005, yielding K 62.5 billion or 0.2 percent of GDP. In the area of customs duties and excises, several measures have been introduced, including a 25 percent export tax on raw-timber and scrap metal. These two measures are expected to yield K 24.6 billion. Higher customs duties on a few agricultural products should yield an additional K 5.8 billion. Overall, the tax policy measures are expected to raise revenues by 0.1 percent of GDP.

12. **The Government recognizes that containing the wage bill continues to be critical for maintaining sound public finances and macroeconomic stability.** The budget for 2005 limits the wage bill to 8.1 percent of GDP compared with 7.9 percent of GDP envisaged in the November MEFP. This increase will accommodate the hiring of additional teachers in 2005. It had been expected that the payment of terminal benefits to teachers using a grant from the Government of the Netherlands would enable the removal of 7,000 inactive teachers from the payroll, thereby making room for an equivalent number of new hirings. However, an audit identified fewer inactive teachers to be removed from the payroll and consequently additional resources were needed to bring total hirings to 7,000. The Ministry of Health has also been allocated resources to hire nearly 1,455 frontline staff in 2005 and to provide for a retention scheme for nurses and clinical staff.

13. **The budget for 2005 includes an allocation of K 343 billion for wage increases.** In line with procedures established in 2003, a government team comprised of representatives of the cabinet office and key ministries has commenced negotiations with unions representing government employees. In order to ensure consistency with the budget envelope, no wage agreements will be concluded outside the budget allocation of K 343 billion and this allocation will cover all public service employees.

14. **In the 2005 budget, the Government has broadened the definition of poverty-reducing spending to more closely correspond to the priorities set out in Zambia's PRSP.** Under the new definition, poverty reduction spending now includes a significant share of recurrent spending, including the wages of teachers in basic schools and health workers. On this definition 22.3 percent of domestically financed outlays, including external debt amortization, or the equivalent of 4.9 percent of GDP, are for poverty reduction. More than 80 percent of externally financed project expenditures, are identified as poverty reducing. It is expected that the budget for 2005 will entail an increase in poverty reducing expenditures of at least 0.5 percent of GDP as had been envisaged using the narrow definition. The reclassification of 2004 expenditures using the new definition, which is needed for comparison with the 2005 budget, will be available only after government has, in consultation with stakeholders, formally adopted a revised definition of poverty reducing spending.

15. **The introduction of activity-based budgeting (ABB) has also allowed a more appropriate classification of programs under capital and recurrent expenditures.** As a result in the 2005 budget, RDCs and transfers and pensions have increased by 1.6 percent and 1.9 percent of GDP respectively from the November MEFP, while capital spending and the residual category of other recurrent expenditures have declined by slightly more than the corresponding total amount.

16. **The Government gives high priority to the settling of domestic arrears on statutory payments to public sector employees and to suppliers of goods and services.** The 2005 budget allocates K 65 billion to the payment of arrears on housing allowances, sufficient to pay all remaining arrears from 2002 and a third of the outstanding arrears from 2003. The Government will also repay K 159 billion of pension arrears to public sector employees. In addition, the budget allocates K 76 billion toward the payment of outstanding bills owed to contractors and suppliers, amounting to K 548 billion at end-September 2004 billion, including high penalty interest. As described in the November MEFP the government is seeking to negotiate discounts on these arrears to contractors and suppliers in an orderly and equitable framework. The government is also seeking donor assistance to settle these arrears and is considering the option of issuing medium-term bonds for this purpose. In total, the 2005 budget allocates K 300 billion for clearing arrears.

B. Monetary Policy

17. **The monetary program for 2005 has been tightened to reverse the unanticipated increase in reserve and broad money at the end of 2004.** In January, the BoZ mopped up excess liquidity, withdrawing over K 237 billion from banks' excess reserves and reversing most of the build up in reserve money at the end of 2004. For the year as a whole, the growth in reserve money will be limited to 10.5 percent, with the aim of containing the growth in broad money to 14.8 percent. These growth rates imply that by end-2005, stocks of reserve and broad money will be in line with the targets established in the November MEFP. Despite this slowing of monetary growth, the program will accommodate an expansion of credit to the private sector in real terms as commercial banks are expected to

unwind the extraordinary buildup of foreign assets during December 2004, part of which has been identified as temporary in nature.

C. External Prospects for 2005

18. **The external outlook for 2005 is favorable.** Notwithstanding an anticipated easing of copper prices from their record levels of 2004, metals exports are expected to rise by 17 percent, owing to a jump in copper production from the coming on stream of the Kansanshi copper mine. Non-metals exports are also expected to continue to record healthy growth. With work on the new Lumwana mine intensifying, imports to the mining sector are likely to remain close to their 2004 level. The oil import bill is also likely to remain high as a result of continued high oil prices and the need to restore inventories drawn down in 2004. Total imports are therefore projected to rise by 4 percent in U.S. dollar terms. On this basis, the current account deficit (including grants) is projected to narrow further, to 3.1 percent of GDP in 2005.

19. **Donor support and anticipated debt relief after the completion point ensure that the 2005 program is fully financed.** External budgetary support is now projected to be \$133 million, or about \$15 million higher than at the time of the first review; about two-thirds of the support is expected to be in the form of grants. At the same time, debt service obligations are estimated to be \$15 million higher than at the time of the first review. Based on the experience to date, disbursements under the EU's PRBS for 2004-06 are now expected to be received somewhat earlier than before. Good progress has been made in meeting the conditions for the release of the second tranche of the World Bank's structural adjustment credit. The program does not factor in a possible increase in bilateral grants under the Wider Harmonization in Practice (WHIP) program. Multilateral debt relief after the achievement of the completion point under the HIPC Initiative will contribute importantly to the financing of the 2005 program.

20. **Zambia's trade regime remains open and supportive of export development and the diversification of the economy.** The changes in tariff rates announced with the 2005 budget are minor and have a limited impact on the average nominal tariff on imports, estimated at 11.5 percent. The 25 percent tax on the export of unprocessed timber and scrap metals serves both the purpose of protecting the environment and creating additional employment in certain localities; however, the macroeconomic impact of these taxes, which replace bans on the export of timber and scrap metal, will be minimal. The Government is reviewing the experience of participating in the COMESA free trade area since 2000 and its options regarding a common external tariff. Based on this review, the feasibility of Zambia's membership of a COMESA customs union will be assessed.

D. Structural Measures

21. **Structural reforms in 2005 will continue to focus on public expenditure management and financial accountability (PEMFA), financial sector reform—especially the resolution of three non-bank financial institutions—and governance.** These reforms,

which are critical to support macroeconomic stability and growth, were elaborated in the last MEFP. The focus will therefore be on areas in which additional steps have been defined in the program

Public Expenditure Management

22. **The work program for the first year of PEMFA, developed with cooperating partners supporting the program, was adopted in January 2005.** Initial disbursements to support activities under this five year program totaling US\$72 million are expected to commence in the first quarter following the adoption of procurement guidelines. Against this background, priority under the PRGF-supported program is to be given to key steps needed to support the implementation of the PEMFA program or areas in which preparatory work is already well advanced. Thus the government will by end-May finalize, in consultation with the PEMFA technical working group, a framework for monitoring and evaluating the PEMFA program. This will draw upon the benchmarks of public expenditure management that are used under the HIPC assessment and action plans to track poverty-reducing spending (HIPC AAP) and the Public Expenditure and Financial Accountability (PEFA) framework. It is expected that the first assessment under this framework will be conducted by November 2005. To further strengthen the commitment control system, the MoFNP, in consultation with the PEMFA technical working group will by end-May design a cash-flow framework for all line ministries. Following the passage of the Finance Act, the government will by September 2005 prepare and issue new financial regulations and revised accounting manuals. By end-August 2005, the Budget Office in the MoFNP will prepare and publish the first draft (Green Paper) of the Medium-Term Expenditure Framework for 2006-08 for consultation with stakeholders. The Government will refrain from paying any amounts for which it is not legally liable and which are not included in the budget. The Government continues to publish quarterly budget execution reports using the activity-based budgeting classification, within 45 days of the end of each quarter. Finally, unbudgeted expenditure requirements will be funded only to the limits of the contingency resources indicated in the budget or only after the Cabinet has approved any changes by finding compensatory funding within the approved budget resources.

23. **The IFMIS component of the PEMFA work program has incurred further delays, arising from complications beyond the Government's control.** After Government modified the contract for the installation of IFMIS hardware and software to address issues raised by World Bank staff, it was learned that the contractor had separated from its parent company and changed its name. This action brought into question whether the new independent firm has the capacity to assure good execution of the contract. As proposed by the World Bank, the Government is exploring the possibility of the firm entering a joint venture with its former parent, in order to address the capacity question and to move ahead with the pilot project as soon as possible. As at the time of the first review, it is anticipated that the piloting of the IFMIS in at least three ministries will begin in June 2005. The Government will report on the findings of a preliminary review of the piloting of the IFMIS in at least three line ministries by end-December 2005.

24. Special audits of the military wage bill and RDCs are being conducted by the auditor general. The increase in the budget allocation to the defense forces in 2005 has been limited to 11 percent. Additional steps will be taken in the light of the findings of these audits, which are expected to be presented to the President of Zambia in April.

25. The Government is committed to strengthening Zambia's debt management capacity. The Government recognizes that its framework and capacity for the management of both external and domestic debt are inadequate in many respects and is actively working with the World Bank under their Debt Reform and Capacity Building Program to design a work program that will address the deficiencies. As part of this program, the Government has committed itself to the preparation of a public debt management reform plan. This plan will involve the establishment of an institutional framework that will centralize the management of debt and borrowing strategy in the Investment and Debt Management Department (IDM) of the MoFNP. A central and immediate need in this area is the continuous maintenance of an updated debt database as is the strengthening of a back office function to ensure the accuracy and comprehensiveness of debt transaction records and punctual payments on outstanding debt based on a reliable debt recording system. Also pressing is the need to strengthen the capacity of the IDM to conduct basic risk analysis to underpin the formulation of a debt management strategy, as well as to provide input into post-completion point borrowing negotiations. The establishment of a best practices debt management framework capacity will require resources and take considerable time. As a first step, the Government has decided that, beginning with the second quarter of 2005, IDM will validate the stock of government's external debt on a quarterly basis. Within 45 days of the end of each quarter IDM will provide the budget office with an updated projection of debt service due over the following three years. From August 2005, this will be a continuous performance criterion under the PRGF-supported program.

Financial Sector Developments

26. In line with the strategy laid out in the November 2004 MEFP (paragraph 35), the government took measures to address three problem non-bank financial institutions (NBFIs). It is expected that cabinet will shortly approve proposals—drafted with technical assistance from the IMF—to repeal sections of the National Savings and Credit Bank Act, the Development Bank of Zambia Amendment Act, and the Building Societies Act which are in conflict with the Banking and Financial Services Act. As a result of these amendments, the regulatory and supervisory powers of the BoZ over NBFIs will be strengthened.

27. Progress was also made under the action plans of the National Savings and Credit Bank (NSCB) and the Development Bank of Zambia (DBZ), as set out in the Memoranda of Understanding (MoU) signed in November. Performance of both the NSCB and the DBZ improved in the last quarter of 2004. Under the transitional provisions of the MoU, the BoZ is exercising strengthened supervisory and regulatory powers over these two institutions. In observance of its commitments to contribute to the recapitalization of the NSCB and following IFAD's decision to participate in the recapitalization plan, the Government cancelled the NSCB's outstanding obligations of K 5.3 billion to the Zambia

Revenues Authority, National Pension Scheme Authority, and the Zambia National Building Society. The Government will inject K 5.8 billion in cash into NSCB, when IFAD's contribution has been received. As detailed in the November MEFP, the DBZ received a capital injection by Ex-Im Bank of India amounting to 34 percent of its total paid up capital. With technical assistance from cooperating partners, DBZ and the NSCB will by June and September 2004, respectively, prepare business plans leading to full compliance with the BFSA and their incorporation under the Companies Act in 2006. The NSCB and the DBZ will submit incorporation plans to the BoZ by end-December 2005 (structural benchmark). In February, the BoZ received and assessed a revised business plan prepared by the Zambia National Building Society (ZNBS). To protect depositors' funds and ensure reduction of operating costs, the BoZ is continuing to monitor ZNBS's operations. By end-April, the Government and the BoZ, in consultation with the staffs of the World Bank and the IMF, will adopt an action plan for the resolution of the ZNBS.

28. **The Government is committed to concluding the sale of 49 percent of the equity in the Zambia National Commercial Bank (ZNCB) to a strategic investor.** To this end, the Zambia Privatization Agency (ZPA), following an international tender, selected a preferred and a reserve bidder to conduct detailed negotiations. The preferred bidder was the Amalgamated Bank of South Africa (ABSA) Group; the reserve bidder was the Africa International Financial Holdings Zambia Limited (AIFHZL). Negotiations with ABSA commenced in September 2003. Although negotiations were substantially concluded with the ABSA negotiation team in August 2004, and despite being given extended time, the ABSA team has failed to secure the approval of their board. In the meantime, in follow-on negotiations with AIFHZL, the ZPA concluded that a satisfactory agreement could not be reached. Apart from the many important new issues that arose after the submission of their bid, the AIFHZL consortium's membership changed raising questions and creating uncertainties about the group's final composition. In light of these developments and the long delays in concluding agreement with the two bidders, Government terminated negotiations. ZPA, will issue, in late March or early April as soon as procedural requirements are met, a new invitation for bids for purchase of the 49 percent equity in ZNCB with management control, in line with Government's privatization and financial sector policies. (This step constitutes a structural performance criterion for end-May). Given the preliminary interest exhibited by some reputable banks operating in the region, it is expected that the selection of new bidders and ensuing negotiations would proceed at a rapid pace. The sale of an additional 25.8 percent of shares in ZNCB to the Zambia Privatization Trust Fund will also proceed.

Private sector development

29. **The Government has taken several steps to advance the private sector development initiative (PSDI).** Priorities and institutional arrangements are being established to support the implementation of the initiative, which requires the cooperation and coordination of numerous ministries. In February, the Domestic Business Council (chaired by the President) and the PSDI steering committee (chaired by the deputy secretary to the cabinet) met for the first time. These groups bring together Government officials and

representatives of the business and donor communities to monitor implementation of the PSDI work plan. It is expected that donor assistance will be forthcoming to support this effort. Alongside these steps to put in place an implementation mechanism, initial steps are being focused on areas that are directly under the control of the Ministry of Commerce Trade and Industry, the lead agency in the initiative. Proposals for revisions of the Trade Licensing Act, which would streamline trade licensing procedures, will be submitted to parliament; with approval, implementing regulations could then be established by end-2005. A new proposal to amend the Investment Act, that does not contain tax incentives, will be submitted to Cabinet during 2005. The new proposal would make operational a one-stop center to reduce bureaucratic procedures for investors to obtain required authorizations. The Government intends to establish the Tariff Commission, which includes among others the Ministers of Commerce, Finance and National Planning, and Justice, and representatives of the private sector to review tariff issues.

IV. TECHNICAL ASSISTANCE NEEDS

30. The Government of Zambia and the BoZ have requested further technical assistance from the IMF to strengthen liquidity management operations of the BoZ; to strengthen the Bank of Zambia Act and legislation on the supervision of banks and other financial institutions; to prepare new regulations and revised accounting manuals for the new Finance Act; to enable compliance with the manual for *Government Finance Statistics (2001)*; and to improve data on the monetary survey (follow-up). In addition, the Central Statistical Office will request follow-up technical assistance for the rebasing of data for the national accounts and consumer price index.

V. PROGRAM MONITORING

31. Progress in implementing the PRGF-supported program will continue to be monitored quarterly, based on the qualitative and structural performance measures indicated in Tables 3 and 4. Performance criteria are now proposed through the end of 2005. In addition, the government is requesting modifications to the performance criteria for March and June on net domestic assets of the BoZ and net domestic financing of the Government (and the inclusion of related adjusters), and a modification to the quarterly ceilings on the central government wage bill. These targets are defined in the attached technical memorandum of understandings.

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

5/11/2004 12:59:34 PM	2003	2004						
		Sep.		Status	Dec.		Status Observed	
	Dec. Stocks	Prog.	Act.		Prog.	Act.		
<u>Performance Criteria</u>								
1	Ceiling on the cumulative increase in net domestic assets (NDA) of the Bank of Zambia 2/ 3/ 4/ 5/ Adjusted NDA	6,208	131 174	38	Yes	127 227	126	Yes
2	Ceiling on the cumulative increase in net domestic financing (NDF) 2/ 5/ Adjusted NDF	3,093	577 589	213	Yes	573 520	212	Yes
3	Floor on the stock of gross international reserves (GIR) of the Bank of Zambia (In millions of U.S. dollars) 2/ Adjusted GIR	197	164 161	217	Yes	175 187	222	Yes
4	Ceiling on new external payment arrears		0	0	Yes	0	14	No
5	Ceiling on the stock of short-term debt and on contracting or guaranteeing of nonconcessional debt (In millions of U.S. dollars) 6/		0	0	Yes	0	0	Yes
6	Ceiling on cumulative new concessional loans collateralized or guaranteed by the central government or the Bank of Zambia for ZESCO.		20	0	Yes	20	0	Yes
7	Floor on the cumulative payment of domestic arrears of the government 5/		66	52	No	77	84	Yes
<u>Quantitative Benchmarks</u>								
8	Cumulative ceiling for the Central Government wage bill 5/		1,492	1,479	Yes	2,018	2,012	Yes
9	Ceiling on the cumulative arrears on the Central Government wage bill		0	0	Yes	0	0	Yes
10	Floor on the cumulative deposits into the HIPC Account 49 at the BoZ		383	384	Yes	522	522	Yes
<u>Memorandum item:</u>								
11	Cumulative net balance of payments support (In millions of U.S. dollars)		-63	-65		-60	-49	
	Balance of payments assistance		49	27		69	65	
	Central Government debt service obligations (excl. IMF)		-112	-92		-129	-114	
	Shortfall (-)/Excess (+) net BOP support			-3			11	

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

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

3/ Excludes HIPC debt relief from the IMF.

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

5/ Cumulative from the end of 2003.

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

MEFP: Table 2. Zambia: Prior Actions, Structural Benchmarks, and Performance Criteria 1/

	Timing	Status
Prior Action 2/		
Adoption by the government and the Bank of Zambia of action plans, finalized in consultation with the World Bank and IMF staff, for the resolution of the National Savings and Credit Bank and the Development Bank of Zambia.		Observed
Benchmarks and Performance Criteria		
1. Public Expenditure Management		
The Government will refrain from paying any amounts for which it is not legally liable and which are not included in the budget. 3/	Continuous	Observed
Publication of quarterly budget execution reports using the activity-based budgeting classification, within 45 days of the end of each quarter.	Continuous	Not observed. End-Sept data posted on the website on Dec 29.
Adopt a work program covering the first year of the implementation of the PEMFA reform program. 3/	Jan 2005	Observed
Adopt a definition of poverty reducing spending corresponding to the priorities of the government PRSP and use this in the preparation of the budget for 2005.	Jan 2005	Observed
Initiate the piloting of the IFMIS in at least three line ministries. 3/	June 2005	On going
Report on the findings of a preliminary review of the piloting of the IFMIS in at least three line ministries. 3/	Dec 2005	On going
3. Financial Sector Reform		
Cabinet approval of a proposal to repeal the sections of the Building Societies Act, the National Savings and Credit Bank Act and the Development Bank of Zambia Amendment Act that are in conflict with the Banking and Financial Services Act. 3/	Feb 2005	Not observed. Prior Action for the second review
Adoption by the Government and the Bank of Zambia of an action plan, finalized in consultation with the World Bank and IMF staff, for the resolution of the Zambia National Building Society.	Apr 2005	On going
4. Governance and Transparency		
Unforeseen expenditures will be funded only to the limits of the budget contingency or after Cabinet approval including the identification of savings elsewhere in the budget.	Continuous	Observed

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

2/ The prior action for the completion of the review should be carried out and reported at least five working days prior to the Executive Board discussion.

3/ Performance criteria.

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

5/11/2004 12:59:34 PM	2004 Dec. Stocks	2005			
		March Prog.	Jun. Prog.	Sep. Prog.	Dec. Prog.
<u>Performance Criteria</u>					
1 Ceiling on the cumulative increase in net domestic assets (NDA) of the Bank of Zambia 2/ 3/ 4/ 5/ Adjusted NDA	6836	14	182	104	166
2 Ceiling on the cumulative increase in net domestic financing (NDF) 2/ 5/ Adjusted NDF	3305	60	217	301	500
3 Floor on the stock of gross international reserves (GIR) of the Bank of Zambia (In millions of U.S. dollars) 2/ Adjusted GIR	238	232	204	244	246
4 Ceiling on new external payment arrears		0	0	0	0
5 Ceiling on the stock of short-term debt and on contracting or guaranteeing of nonconcessional debt (In millions of U.S. dollars) 6/		0	0	0	0
6 Ceiling on cumulative new concessional loans collateralized or guaranteed by the central government or the Bank of Zambia for ZESCO.		20	20	20	20
7 Floor on the cumulative payment of domestic arrears of the government 5/		62	100	151	284
<u>Quantitative Benchmarks</u>					
8 Cumulative ceiling for the Central Government wage bill 5/		593	1236	1876	2531
9 Ceiling on the cumulative arrears on the Central Government wage bill		0	0	0	0
<u>Memorandum items:</u>					
10 Cumulative net balance of payments support (In millions of U.S. dollars)		-8	-29	4	13
Balance of payments assistance		31	49	98	133
Central Government debt service obligations (excl. IMF)		-39	-78	-93	-120
Shortfall (-)/Excess (+) net BOP support					

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

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

3/ Excludes HIPC debt relief from the IMF.

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

5/ Cumulative from the end of 2004.

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

MEFP: Table 4. Zambia: Structural Benchmarks and Performance Criteria 1/

	Timing
Prior Action	
Cabinet approval of a proposal to repeal sections of the Building Societies Act, the National Savings and Credit Bank Act and the Development Bank of Zambia Amendment Act which are in conflict with the Banking and Financial Services Act.	
Benchmarks and Performance Criteria	
1. Public Expenditure Management and Financial Accountability (PEMFA)	
The Government will refrain from paying any amounts for which it is not legally liable and which are not included in the budget. 3/	Continuous
Publication of quarterly budget execution reports using the activity-based budgeting classification, within 45 days of the end of each quarter.	Continuous
In consultation with the PEMFA Technical Working Group, design a cash-flow framework for all line ministries.	May 2005
In consultation with the PEMFA Technical Working Group, finalize a framework for monitoring and evaluating the PEMFA program.	May 2005
Initiate the piloting of the IFMIS in at least three line ministries. 3/	June 2005
Prepare and publish the first draft ("Green Paper") of the MTEF for 2006-2008.	Aug 2005
Issue new regulations and revised accounting manuals for the new Finance Act.	Sep 2005
Complete review of the implementation of the PEMFA program.	Nov 2005
Report on the findings of a preliminary review of the piloting of the IFMIS in at least three line ministries. 3/	Dec 2005
2. Debt Management	
Beginning with the second quarter of 2005, validate end-quarter external debt stock data and, within 45 days, provide updated 3-year schedule of debt service falling due. 3/	Continuous from Aug 2005
3. Financial Sector Reform	
Adoption by the Government and the Bank of Zambia of an action plan, finalized in consultation with the World Bank and IMF staff, for the resolution of the Zambia National Building Society.	Apr 2005
The NSCB and the DBZ submit to the BoZ plans for their incorporation in 2006 under the Companies Act.	Dec 2005
4. Governance and Transparency	
Unbudgeted expenditure requirements will be funded only to the limits of the contingency resources indicated in the budget or only after the Cabinet has approved any changes by finding compensatory funding within the approved budget resources.	Continuous

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

2/ The prior action for the completion of the review should be carried out and reported at least five working days prior to the Executive Board discussion.

3/ Performance criteria.

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

I. INTRODUCTION

1. This memorandum sets out the understandings between the Zambian authorities and the International Monetary Fund (IMF) regarding the definitions of the quantitative and structural performance criteria and benchmarks for the program supported by the PRGF arrangement, as well as the related reporting requirements. The definitions are valid at the start of the program, but may need to be revisited to ensure that the memorandum continues to reflect the best understanding of the Zambian authorities and IMF staff to monitor the program.

II. PRIOR ACTION

2. The prior action described below should be carried out and reported at least five working days before the Fund's Executive Board discussion. The implementation of the prior action shall be conveyed through a written communication from the Minister of Finance and National Planning indicating that the prior actions have been observed, using the language of the prior action itself.

A. Nonbank Financial Institutions

3. Cabinet approval of a proposal to repeal sections of the Building Societies Act, the National Savings and Credit Bank Act, and the Development Bank of Zambia Amendment Act which are in conflict with the Banking and Financial Services Act.

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

A. Net Domestic Assets (NDA) of the BoZ

4. Net domestic assets (NDA) of the BoZ are defined as the monthly average (based on daily data) of reserve money less net foreign assets calculated at Kwacha 4,771.3 per U.S. dollar (program exchange rate).¹ Reserve money consists of currency issued, required reserves on Kwacha deposits, required reserves on foreign currency deposits (at the program exchange rate), positive current account balances of banks with the BoZ, and deposits in the BoZ of non-central government institutions. Net foreign assets of the BoZ are defined as gross international reserves (defined below) plus any other foreign assets, including the US\$25 million blocked reserves at the former Meridien Bank (MBZ), minus foreign

¹ Unless otherwise defined, program exchange rates for 2005 between the U.S. dollar and other (non-Kwacha) currencies will be equal to the end-December 2004 rates. Consequently, the U.S. dollar/SDR exchange rate is set at 1.5478. Any other assets (e.g. gold) would be revalued at their end-December 2004 market prices.

liabilities (defined below). The Kwacha values are derived from the U.S. dollar values using the program exchange rate.

5. Foreign reserve liabilities are defined as short term (one year or less in original maturity) foreign currency-denominated liabilities of the BoZ to nonresidents and outstanding use of IMF credit.²

6. The ceilings on NDA will be adjusted upward by the amount of the shortfall of balance of payments support net of debt service as indicated in Table 3 (item 10) of the Memorandum of Economic and Financial Policies (MEFP), up to a maximum of US\$20 million for the period end-December 2004 to end-December 2005. External disbursements that occur anytime during the month of the test date will be treated as if they were disbursed on the first day of the month.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 the stock of Treasury bills or bonds held by commercial banks and the non-bank sector, then the programmed NDA will be adjusted upward by that amount. The Kwacha value of the cumulative shortfall/excess will be calculated at the program exchange rate.

7. The ceiling on NDA will be adjusted upward up to a maximum of Kwacha 50 billion, to reflect decreases of the balance at December 31, 2004 of “Group 8 and X” accounts in the Bank of Zambia.⁴ The BoZ Economics Department will provide weekly data on the total balance of “Group 8 and X” accounts.

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

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

³ This implies that, for purposes of monitoring the NDA, the targeted NDA will be increased by the amount of the disbursement divided by the number of business days in the month and multiplied by the number of business days from the beginning of the month to the day prior to the disbursement.

⁴ The total balance at December 31, 2004 of “Group 8 and X” accounts was Kwacha 505 billion.

B. Net Domestic Financing (NDF)

9. Net domestic financing is defined as the Central Government's net borrowing from the banking and nonbanking sectors (Table 1).⁵ All government-issued securities will be recorded at cost (face value less discount). NDF will be defined as:

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

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

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

10. The NDF ceiling will be adjusted upward by the amount of the shortfall in balance of payments support net of debt service as indicated in Table 3 (item 10) of the MEFP, up to a maximum of US\$20 million for the period end-December 2004 to end-December 2005. 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.

11. The ceiling on NDF will be adjusted upward/downward, up to a maximum of Kwacha 100 billion, to reflect decreases/increases of the balance at December 31, 2004 of "Group 8 and X" accounts in the Bank of Zambia and governments accounts in commercial banks.⁶ The calculation of the adjustor nets out any shortfalls/excess in domestic revenues with respect to the amounts indicated in the 2005 budget approved by Parliament.

12. 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.

⁵ The Central Government includes all the administrations identified by the budget heads listed in the 2005 Yellow Book.

⁶ The total balance at December 31, 2004 of "Group 8 and X" accounts was Kwacha 505.1 billion, while the total balance of government accounts in commercial banks was Kwacha 445.7 billion.

C. Gross International Reserves of the BoZ

13. Unless otherwise noted here, gross international reserves of the BoZ will be defined as reserve assets of the BoZ (Table 2). Reserve assets are defined in the IMF BOP manual (5th edition) and elaborated in the reserve template of the IMF's special data dissemination standards (SDDS). They exclude, for example, foreign assets not readily available to or controlled by the monetary authorities, and foreign currency claims on Zambian residents.

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

15. The floor on gross international reserves will be adjusted: (i) downward by the amount in U.S. dollars of the shortfall in balance of payments support net of debt service as indicated in Table 3 (item 10) of the MEFP, up to a maximum of US\$20 million for the period end-December 2004 to end-December 2005; (ii) upward by 100 percent of the cumulative excess balance of payments support net of debt service. However, if part of the excess support is used to reduce the stock of Treasury bills or bonds held by commercial banks or the nonbank sector, then the programmed reserves buildup will be adjusted downward by that amount; (iii) downward/upward for any shortfall/excess in the U.S. dollar value of disbursements from the IMF under the PRGF arrangement; and (iv) downward for any increase in BoZ short-term foreign currency denominated debt (to residents and nonresidents), using the definition of short-term debt below.

16. 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.

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

D. External Payment Arrears

18. The performance criterion on the non-accumulation of new external arrears is continuous. Official external payment arrears are defined as unpaid debt service by the Central Government and BoZ, beyond the due date and/or the grace period, if any. This definition excludes arrears subject to rescheduling. It also excludes the accumulation of external arrears that arise from the transfer to non-residents of foreign currency denominated obligations owed by the Government of Zambia to resident creditors.

19. Data on arrears are compiled jointly by the Ministry of Finance and National Planning (MoFNP) and BoZ and will be reported by the MoFNP on a quarterly basis.

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

20. Official medium- and long-term concessional external debt is defined as all forms of official debt with original maturity of more than one year contracted or guaranteed by the Central Government and BoZ having a grant element of 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.

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

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

F. Official External Short-Term Non-concessional External Debt

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

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

G. Collateralizing/Guaranteeing of Loans to the Zambia Electricity Supply Corporation (ZESCO)

25. The Government and the BoZ shall not extend or guarantee any new commercial debts of the Zambia Electricity Supply Corporation (ZESCO), including in the form of loans, suppliers credits and leases. New concessional borrowing, as defined above (Paragraph 20), will be subject to a cumulative limit of US\$20 million in 2005. The limit on new concessional borrowing will be subject to review, in consultation with IMF and World Bank staff, in the event that additional concessional resources are required.

H. Domestic Arrears of Government

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

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

I. The Central Government's Wage Bill

28. For the purposes of the wage bill, the definition of Central Government includes all heads covered in the 2005 Yellow Book. The Central Government's total wage bill will include payments on wages, salaries, allowances, and all other items specified as personal emoluments in the Yellow Book, and any direct or indirect payments of housing allowances to employees. The Government will provide, on a monthly basis and by budget head, the following data: (i) the number of all employees in the Central Government for each budget head; (ii) the basic salary, the allowances and any other personal emoluments released during the month; (iii) the arrears incurred during the month on the basic salary, on the allowances, and on any other personal emoluments; (iv) the number of employees retrenched and the corresponding retrenchment costs.

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

IV. STRUCTURAL PERFORMANCE CRITERIA AND BENCHMARKS

A. Public Expenditure Management

30. The Government will refrain from making payments for which it is not legally liable and which are not included in the budget. It will also guide the liquidation and receivership process of public enterprises to minimize the Government's liabilities consistent with the law.

31. The MoFNP will publish quarterly budget execution reports using the classification system of activity-based budgeting within 45 days of the end of each quarter.

32. The MoFNP, in consultation with the Public Expenditure Management and Financial Accountability (PEMFA) program Technical Working Group, will design a cash-flow

framework for all line ministries. The Accountant General will notify, by June 15, 2005, the IMF Resident Representative's Office that the cash-flow framework's design has been completed.

33. The MoFNP, in consultation with the Public Expenditure Management and Financial Accountability (PEMFA) program Technical Working Group, will develop a framework for monitoring and evaluating the PEMFA program. The Accountant General will submit, by June 15, 2005, to the IMF Resident Representative's Office the final framework for monitoring and evaluating the PEMFA program.

34. The Government will initiate the piloting of the Integrated Financial Management and Information System (IFMIS) in at least three ministries as a key step to introduce an effective system in all ministries and provinces. The Accountant General will notify, by July 15, 2005, the IMF Resident Representative's Office the initiation of the piloting.

35. The Government will prepare and publish, by end-August 2005, a first draft of the Medium-Term Expenditure Framework ("Green Paper") for the period 2006-2008.

36. The MoFNP will issue the new regulations and the revised accounting manual needed for the complete and effective operations of the Finance Act approved by parliament in December 2004. The MoFNP will notify, by October 15, 2005, the IMF Resident Representative's Office the issuance of the statutory instrument needed to put in place the new regulations and the publication of the revised accounting manual.

37. On the basis of the monitoring and evaluating framework defined in consultation with the PEMFA Technical Working Group, the MoFNP will complete the review of the implementation of the PEMFA program by November 2005. The review will provide information on progress achieved, possible shortcomings, and specific measures to address weaknesses.

38. By December 2005, the Government will report the findings of a preliminary review of the piloting of the IFMIS in at least three ministries. This preliminary review will lead to the completion of a mid-term review of the pilot program as envisaged in the Enhanced HIPC Initiative completion point document.

B. Debt Management

39. Beginning with the second quarter of 2005, the MoFNP will validate end-quarter external debt stock data and, within 45 days, provide updated 3-year schedule of debt service falling due.

C. Financial Sector Reform

40. Adoption by the Government and the Bank of Zambia of an action plan, finalized in consultation with the World Bank and IMF staff, for the resolution of the Zambia National Building Society.

41. The National Savings and Credit Bank and the Development Bank of Zambia will submit, by end-December 2005, to the BoZ plans for their incorporation in 2006 under the Companies Act.

42. The Zambia Privatization Agency will, by end-May, issue a new invitation for bids for the purchase of 49 percent equity in the Zambia National Commercial Bank with management control. The MoFNP will confirm in writing to Fund staff that this step has been taken, attaching a copy of the invitation for bids.

D. Governance and Transparency

43. Unbudgeted expenditure requirements will be funded only to the limits of the contingency resources indicated in the budget or only after the Cabinet has approved any changes by finding compensatory funding within the approved budget resources.

ANNEX

Guidelines on Performance Criteria with Respect to Foreign Debt

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

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

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

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

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

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

Table 1. Net Domestic Financing

	2004		2005
	End-Dec.	End-Dec. Program Base	
Total domestic financing (program)	3,666,556	3,666,556	
Adjustment	53,325	53,325	
Adjusted program financing	0	0	
Excess/shortfall (- = excess)	307,843	307,843	
Total domestic financing	3,305,388	3,305,388	
Bank financing	2,518,496	2,518,496	
Commercial banks	1,277,128	1,277,128	
Treasury bills 1/	886,980	886,980	
Bonds 1/	841,987	841,987	
Loans and advances	277	277	
less: Support to MBZ	-8,423	-8,423	
less: Deposits	-443,693	-443,693	
Bank of Zambia	1,241,368	1,241,368	
Treasury bills 1/	62,581	62,581	
Bonds 1/	13,819	13,819	
Kwacha bridging loan	409,629	409,629	
GRZ position	-805,121	-805,121	
Donor suspense balance	-86,284	-86,284	
GRZ long-term security IFO BoZ	1,646,743	1,646,743	
Other	0	0	
Nonbank financing	786,892	786,892	
Treasury bills 1/	391,183	391,183	
Bonds 1/	395,710	395,710	

Source: BoZ net domestic financing table.

1/ Measured at cost (face value less discount) starting from end-December 2003.

Table 2. Zambia: Gross International Reserves 1/
(In millions of U.S. dollars)

	2004			2005					
	December			March, June, September, December					
	12/31/2004 = Base			Current		31/12/04			
	Exch rate		U.S. dollars	Amount	or price	U.S. dollars	Exch rate		U.S. dollars
	Amount	or price					or price	U.S. dollars	
Official reserve assets 2/			237.830						
Foreign Currency Reserves			213.067						
Securities	0.0000		0.000						
In U.S. dollars	0.0000	1.0000							
In U.K. pounds	0.0000	1.9198							
In Euro	0.0000	1.3604							
Other currencies	0.0000								
Deposits 3/			213.067						
In U.S. dollars	53.5520	1.0000	53.552						
In U.K. pounds	6.9894	1.9198	13.418						
In Euro	107.3362	1.3604	146.020						
In South African Rand	0.4367	0.1767	0.077						
Other currencies									
IMF reserve position									
SDR (excludes IMF interim assistance under the HIPC Initiative)	15.9984	1.5478	24.763						
Monetary gold	0.0000		0.000						
Other reserve assets	0.0000		0.000						
Memo: Other foreign currency assets 4/	0.0000		0.000						
Predetermined short-term net drains 5/	573.2783	1.5478	887.343						
Liabilities to IMF	0.0000		0.000						
Other foreign currency loans and securities	0.0000		0.000						
In U.S. dollars	0.0000								
In U.K. pounds	0.0000								
In other currencies	0.0000								
Aggregate short and long positions in forwards, futures and swaps	0.0000		0.000						
Other	0.0000		0.000						
Contingent short-term net drains	0.0000		0.000						
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.