International Monetary Fund

Zambia and the IMF

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IMF Executive Board Completes Fifth Review Under ECF Arrangement with Zambia and Approves US$28.3 Million Disbursement
December 10, 2010

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

November 24, 2010

REF: MFAL/102/12/932

November 24, 2010

Mr. Dominique Strauss-Kahn
Managing Director
International Monetary Fund
Washington, D.C. 20431
USA

Dear Mr. Strauss-Kahn,

The attached Memorandum of Economic and Financial Policies (MEFP) reviews recent economic developments and progress in implementing the Government of the Republic of Zambia's macroeconomic and structural program under the country's three-year arrangement under the Extended Credit Facility (ECF), approved by the IMF Executive Board on June 4, 2008. It also sets out macroeconomic policies and structural reforms the government will pursue for the remainder of 2010 and for 2011.

The Government requests that the sixth disbursement be made available upon completion of the fifth review by the Executive Board of the IMF. All of the performance criteria for the fifth review under the ECF arrangement were met. We request a waiver for the nonobservance of the end-December 2009 nonconcessional debt ceiling.

Structural reforms are progressing well. The structural benchmark for end-September 2010 on the review of tax administration and policy was met, and we are requesting a modification of the definition (but not the substance) of the end-December 2010 benchmark on the Treasury Single Account owing to a change in our approach. We are requesting a one-month delay in the timing of the benchmark for the planning and budgeting act to end-January 2011, in order to allow for further consultations. While the lender-of-last resort framework was in place by end-June 2010 (thus meeting that portion of the related benchmark), the submission of relevant draft legislation on the financial sector contingency plan will take more time to allow a full set of consultations with stakeholders. We are now aiming to submit the draft legislation to parliament by end-May 2011.

The Government believes that by adhering to the policies and measures set forth in the attached MEFP, it is well placed to achieve the objectives of the program. We updated the economic program for the remainder of 2010 to take into account recent developments, including the government's role in the purchase of the surplus maize, and we request modifications to the end-December 2010 performance criteria. The policies and measures detailed in the MEFP for 2011 are solid and consistent with achieving the objectives of the program. We request that the ceiling on nonconcessional borrowing be shifted from a project basis to a sectoral basis.

The Government is firmly committed to the objectives of the program and will promptly take any additional measures necessary for their achievement. The Government remains committed to regular consultations with the IMF—at our own initiative or whenever the Managing Director of the IMF requests such a consultation—on the adoption of these measures and in advance of revisions to the policies contained in the MEFP, in accordance with the Fund's policies on such consultations.

The Government authorizes the IMF to publish this letter, the attached Memorandum of Economic and Financial Policies, and the related Staff Report, including placement of these documents on the IMF website subject to the removal of market-sensitive information, following the IMF Executive Board's conclusion of the review.

Yours sincerely,

/s/

Dr. Situmbeko Musokotwane
Minister of Finance and National Planning

Attachments:
- Memorandum of Economic and Financial Policies
- Technical Memorandum of Understanding for the 2010–11 Extended Credit Facility (ECF) arrangement

ATTACHMENT I. ZAMBIA: MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES

1. This memorandum reviews recent economic developments and outlines policies that the government of the Republic of Zambia will pursue for the remainder of 2010 and for 2011 under the Extended Credit Facility (ECF) arrangement.

2. The ECF supports the implementation of the second half of the Fifth National Development Plan 2006–10 (FNDP). The FNDP underscores the need to create an environment conducive to private sector growth through sustained macroeconomic stability, public sector efficiency and accountability, and investments in infrastructure and social sectors. The program is consistent with these principles and objectives, and has focused on maintaining macroeconomic stability; creating fiscal room for investments in the roads, energy, and social sectors; and removing constraints to private sector-led growth and to economic diversification away from copper mining.

3. The government expects to launch its Sixth National Development Plan 2011–15 (SNDP) by end-December 2010. The areas of emphasis under the SNDP are the two main binding constraints to growth and poverty reduction: inadequate infrastructure and human development. Investments in these areas will be increased in line with the government's strategic objectives of accelerating economic diversification and meeting its Millennium Development Goals. The SNDP will also improve the effectiveness of government planning and spending by taking on board lessons gained from the implementation of the FNDP.

I. RECENT ECONOMIC DEVELOPMENTS

4. **Growth in the Zambian economy is expected to be higher than projected earlier.** Revised projections indicate that real GDP growth in 2010 will be 6.6 percent on the back of the continued strength of the agriculture, mining, and construction sectors, and a rebound in the tourism sector. The 2010 agricultural harvest was the highest recorded in history. Mining benefitted from higher-than-expected copper prices, which were more than 41 percent higher than in 2009. Tourism, aided by recovery in the world economy, the FIFA World Cup in South Africa, and the reduction in visa fees, experienced a strong rebound from the negative growth in 2009. Gross international reserves are expected to rise to above US$1.9 billion (net of encumbered reserves) at end-2010, equivalent to 3½ months of prospective imports. The growth in reserves largely reflected net proceeds from the sale of Zamtel and increased mining receipts. Inflation has largely remained under control as a result of lower food prices. Zambia remains on track to achieve its end-year inflation target of 8 percent, although there remain some downside risks as a result of non-food inflationary pressures arising from an increase in energy prices.

5. **Fiscal performance in 2010 was broadly in line with expectations, other than the need to address the maize purchase late in the year**. As of end-September 2010, domestic revenues had performed well, and are expected to over perform by 9 percent by the end of the year. This performance is attributed to higher collections under income and value added taxes

arising from the collection of tax arrears and an increase in tax collections from mining companies. Total expenditure was 7 percent higher than budgeted, as Government faced additional expenditure pressures, which included transfers to the Food Reserve Agency (FRA) in order to finance maize purchases, the fuel subsidy early in 2010, which has since been removed, and numerous by-elections. In order to finance these activities, the overall fiscal deficit (including grants) is projected at 3.3 percent of GDP, higher than the program target of 2.5 percent of GDP.

6. **The country recorded an unprecedented maize harvest of nearly 2.8 million metric tonnes in 2010.** The budgetary allocation to FRA was inadequate to buy all the surplus maize from small-scale farmers. As the domestic market could only absorb 2 million metric tonnes, Government (through FRA) decided to buy 800,000 metric tonnes at a cost of K 1,301 billion (about 1.7 percent of GDP), so as to avoid the crop going to waste by remaining unsheltered in the fields with the onset of the rainy season. Purchase of the maize will be financed using K495 billion of mining tax arrears, K 402 billion of additional sales of government securities, K 95 billion using a bridge loan from the Bank of Zambia, K 150 billion from the 2010 budgetary allocation, and K179 billion of FRA borrowing from Commercial Banks. The Bank of Zambia is committed to undertake sterilization operations to ensure that its liquidity injection does not fuel inflation. In order to recover part of these funds, FRA intends to sell the bulk of the maize to deficit countries in the region in 2011 and thereafter, and repay the government.

7. **The implementation of monetary policy during the first half of 2010 was in line with the program, though broad money growth was higher than expected.** Broad money stood at K 16,065 billion at end-June 2010, growing at 24.5 percent on a 12-month basis. The higher broad money growth reflects a recovery in domestic credit and increased net foreign assets of commercial banks consistent with the improvement in external performance. Reserve money stood at K4,183 billion at end-June, growing at 24 percent on a 12-month basis. This was within the indicative target of K 4,277 billion for end-June 2010. By the end of 2010, reserve money is projected to grow by 8 percent to K 4,380 billion from the end-December 2009 level of K 4,054 billion. Growth of credit to the private sector, though sluggish in 2009, began to recover posting a 7.6 percent growth during the first six months of 2010 and is expected to grow by 15 percent during the whole of 2010.

8. **The balance of payments position continued to improve during the first half of 2010, as copper exports remained high.** A current account surplus of US$203.7 million was recorded compared with a deficit of US$284.8 million during the same period in 2009, explained by increased copper and cobalt export volumes and the recovery of metal prices on the international market. The overall balance of payments deficit, however, widened to US$175.7 million from US$121.3 million recorded during the corresponding period in 2009, largely on account of a rise in assets held abroad by the private sector. As a result, the international reserves position stood at US$1.6 billion at end-June 2010, rising further to about US$1.9 billion as of October 21, 2010.

9. **The supply of petroleum products during the year was reliable and stable.** This was on account of Government entering into long-term supply contracts for the supply of fuel. Following the reinstatement of full cost recovery pricing of petroleum products, domestic prices for petroleum products were adjusted twice by an average of 15 percent and 12.2 percent in January and May 2010 respectively. Other developments included the introduction of uniform prices for domestic petroleum products across the country.

10. **The program was on track during the first half of 2010** (Tables 1 and 2). All quantitative performance criteria and indicative targets were met. However, the payment of domestic arrears was less than the indicative target on domestic arrears clearance. Government policy on the payment of arrears stipulates that payment only be made for cases that have cleared the pre-requisite investigation and verification process. As such, the remaining arrears by the Government are for cases that have yet to clear this process. With regard to structural reforms, Cabinet approved the pay policy reform in the first half of 2010. The new policy aims at strengthening payroll management and increasing the productivity of the public sector by putting in place an incentive-based pay structure. The benchmark on electricity tariffs was met (with a modest delay of under 4 weeks), with tariffs being raised by an average of 25.6 percent in July 2010. The benchmark on the establishment of a lender of last resort framework was partly met, with some delays occurring in the preparation of draft legislation governing the financial sector contingency planning in the event of a financial crisis. The delays were on account of the consultation process taking longer than expected. It is expected that the relevant draft legislation will be submitted to parliament by end-May 2011.

II. Medium-Term Macroeconomic Framework

11. **Medium-term growth projections have been revised upwards from earlier estimates, as a result of recent economic developments.** Real GDP growth in 2011 has been revised upwards to 6.4 percent from an earlier projection of 6.0 percent. Growth in 2011 will continue to be driven by the mining sector and aided by continued growth in the construction sector. Investments in the reopened Luanshya Copper Mine have been accelerated and copper production is expected to increase in 2011. The development of another new copper mine is expected to continue in 2011, and there has been an increase in exploration activities for a variety of mineral resources, including copper, nickel and uranium. A revival in manufacturing, which suffered from the effects of the global crisis, is also expected in 2011. Medium-term growth continues to be premised on the attainment of government policy initiatives aimed at promoting economic diversification and dismantling structural constraints to doing business. New energy and mining projects are expected to underpin medium-term growth projections.

12. **In order to finance investments in infrastructure and in the social sectors, the fiscal policy stance will remain broadly unchanged over the next few years.** This stance will remain consistent with debt sustainability, so as to safeguard macroeconomic stability and leave room for private sector borrowing. Over the period 2011–13, the overall fiscal deficit (including grants) is expected to remain broadly unchanged at an average of 3.4 percent of

GDP, compared to 3.3 percent in 2010. In order to address the challenge of increasing revenues to the Treasury, a comprehensive reform of the current tax system will be undertaken (drawing on a review of the tax system) with the aim of increasing compliance and broadening the tax base. The reform will focus both on improving the tax system and modernising tax administration. Some key milestones will include the implementation of an Integrated Domestic Taxes Administration System; development of the Tax Administration Act; and upgrading of communication infrastructure to streamline operations and improve service delivery.

III. Policies for 2011

A. Fiscal Policy

13. Within the framework of an increased fiscal space, fiscal policy will aim to increase spending on infrastructure and the social sectors. Revenues are projected to increase to 18.4 percent of GDP, mainly on account of an increase in nonmining company tax, withholding tax and VAT on domestic goods and services. VAT will be increased through the introduction of tax measures aimed at increasing compliance and broadening the tax base. Some of the measures will include standard rating of property and casualty insurance, as well as fee based banking services for VAT purposes. The Government believes the current mining tax regime is fair, equitable and buoyant enough to provide adequate revenues to the Government. The Government's focus will now be to fully enforce this tax and ensure that all the mining companies pay in accordance with the current laws. Expenditures will decline by about 2/3 of a percentage point to 23.4 percent of GDP, with 3.6 percentage points financed using foreign grants and loans. The wage bill will remain at 8.3 percent of GDP, with tight limits on new hiring (limited to teachers, medical personnel, and police officers) and a temporary freeze on replacing staff that leave the civil service. Financing for the social sectors and infrastructure development is projected to increase to 50 percent of the budget, compared to a projected outturn of 36 percent in 2010. The overall fiscal deficit (including grants) is projected to decline by 0.1 percentage points to 3.2 percent of GDP, while domestic financing will be limited to 1.4 percent of GDP.

B. Monetary and Exchange Rate Policies

14. **The Government will aim at reducing inflation to 7 percent by the end of 2011.** Broad money is projected to expand by 15 percent, broadly in line with nominal GDP. The money multiplier is expected to increase gradually as the trend decline in ratio of currency in circulation to deposits continues. Consistent with this, reserve money is targeted to grow by 11.7 percent during 2011. Short-term interest rates are expected to return to positive real levels and the yield curve is expected to flatten.

15. The current reserve money-based program will remain in place, while at the same time progress is being made towards the use of interest rates as the main instrument to anchor inflationary expectations. The Bank of Zambia is in the process of developing an operational framework to ensure a smooth eventual migration. The Bank will draw on technical assistance from the IMF to ensure the adoption of international best practices.

16. The government will continue to maintain a flexible exchange rate regime. Interventions in the foreign exchange market will be limited to smoothing excessive fluctuations, while allowing for a gradual build up of international reserves.

C. Structural Policies

Public financial management

17. **The Government remains committed to improving the management of public finances.** Progress has been made in preparing the draft Planning and Budgeting Act for submission to Parliament. A series of consultations with stakeholders is likely to delay its submission to parliament to end-January 2011.

18. **The pilot implementation of the Integrated Financial Management System (IFMIS) has been successful in its first pilot site.** IFMIS has been in use at the Ministry of Finance and National Planning since January 2010, with most financial transactions being processed through the new system. The system is still facing challenges in the funds (budget) management module, which are expected to be resolved by the end of 2010. The rollout of IFMIS to the next seven MPSAs is now scheduled to be done at the beginning of 2011, to coincide with the beginning of the new financial year. This will ease the challenge of financial transactions for the same year being processed in two different systems. The implementation in other MPSAs will be implemented in similar cycles, that is, at the beginning of quarters or half year.

19. **Work is ongoing in implementing the Treasury Single Account (TSA) across all Ministries, Provinces and Spending Agencies (MPSAs).** The implementation of the TSA has been done by expenditure category, instead of by MPSA as initially planned due to challenges faced in the full rollout of IFMIS. The implementation by expenditure category has also permitted the safeguarding of the majority of public expenditure across Government. As at end-September 2010, over 98 percent of the monthly wage bill, as well as grants for the Ministry of Finance and National Planning was paid through the TSA, representing 35 percent of total budgeted expenditure from the Government. Over the next three months, all grants, capital payments and external debt (principal, interest and other related payments) will be processed through the TSA. In this regard, validation of bank accounts for grant aided institutions will be carried out to facilitate payment of grants. Certified certificates of completion of works will also be submitted to the Treasury for processing through the TSA. In view of this new approach to rolling out the TSA, the end-December structural benchmark is being amended to reflect four key categories of expenditure (namely: wages, grant-financed outlays, capital spending, and debt service), representing 67 percent of the total budget. The Government remains committed to the full rollout of the TSA, but this will require the implementation of IFMIS across all MPSAs.

20. **Progress is being made in the development of a successor program to the Public Expenditure Management and Financial Accountability (PEMFA) project.** A full review of PEMFA was recently undertaken, and a number of shortcomings and challenges have been highlighted. Discussions are ongoing with Cooperating Partners to develop a successor program. While details of the draft successor program are still being developed, the new program is expected to continue on the foundations built by the PEMFA project.

Financial sector development

21. **The government remains committed to the development of the financial sector through the implementation of the second phase of the Financial Sector Development Plan (FSDP II), which runs from January 2010 to December 2012.** The FSDP Phase II focuses on three main pillars, namely, (i) enhancing market infrastructure; (ii) increasing competition; and (iii) increasing access to finance. The FSDP Phase II is envisaged to deal with outstanding and long-term issues including the harmonisation of financial sector laws, enhancement of financial education and the formal financial safety net (through development of a Deposit Protection Scheme), establishment of the sovereign credit rating, as well as the implementation of a national switch.

22. **The Bank of Zambia revised its lender of last resort policy by end-June 2010 to align it with accepted international standards and ensure its effectiveness and relevance.** Progress is also being made towards the implementation of the financial sector contingency plan to address the impact of a system-wide crisis in the financial sector and the broader economy.

Maize

23. **The Government is well aware of the challenges that have arisen from financing this year's maize surplus.** It is therefore determined to handle any future surpluses in a way that minimizes the risk posed to the budget, to private sector credit and to financial stability. In this regard, the Government has appointed a committee of senior officials to examine the current maize marketing, and pricing mechanisms so as to better serve the Zambian people. The committee will specifically establish a pricing system for maize that is reflective of market conditions and will act as an incentive to the farmer, setup a purchasing arrangement for maize in both deficit and surplus times while limiting budgetary exposure, submit a financing plan for maize purchase for 2010/11 and ascertain and document storage capacity in the country. The committee will conduct its business within a period of three months and make recommendations to Cabinet. The submission of the committee's report to cabinet by end-March 2011 will constitute a structural benchmark in the program.

Energy

24. The **Government is committed to making further progress in 2011 towards achieving cost reflective electricity tariffs by 2012.** While Zesco has been given an

indicative tariff increase of 17 percent for 2011, the Energy Regulation Board (ERB) Act requires Zesco to formally apply for the tariff increase each year. The application is subjected to public hearings and evaluation of the company's performance under the ERB/Zesco agreed Key Performance Indicators. The outcome of the two exercises will determine the actual level of increase.

25. **The policy of cost reflective pricing for petroleum will be maintained in 2011.** The Government will adjust the prices of petroleum products to reflect the cost of each shipment. This will enable the Government to avoid the accumulation of deficits.

26. **The development of the Kafue Gorge Lower Project is now expected to commence in mid-2011.** The Government recently signed a Memorandum of Understanding with the Sinohydro Corporation for the development of the project. Work is already underway to develop access roads to the facility, and geotechnical sampling work has commenced. The project will be developed through a public-private partnership, which will involve 35 percent equity participation from the Zambian Government (approximately US$200 million). Generation is expected to come on-stream by 2017 and will add over 600MW of electricity. Work is also continuing on the development of the Kariba North Bank Extension project, which is likely to be completed in 2013. A number of other public and private sector mini-hydro facilities will also be developed over the medium term, with the aim of increasing total power generation and rural access to electricity.

Governance

27. **The Government remains committed to resolving outstanding issues that have delayed the disbursement of Cooperating Partner resources.** In particular, revelations of financial management irregularities, first in the Health sector in 2009, and then in the Roads sector this year, have lead to delays in donor disbursements. As a result, significant shortfalls in donor financing, including budget support, are expected in 2010. The Government has resolved all outstanding issues with Cooperating Partners and expects a resumption of disbursements.

28. **The Government remains committed to fully addressing the governance challenges in the roads sector.** On the basis of the special audit of the Road Development Agency (RDA) by the Auditor General's office, corrective actions to remedy the financing and administrative anomalies have been undertaken. For a start, the Boards of the RDA and NFRA were disbanded and replaced and disciplinary actions taken against some members of staff. Additionally, measures are being undertaken to enhance inter-agency coordination. Further, the Government will, by the end of 2010, enhance capacity in internal audit, procurement, financial management and monitoring activities at the Road Development Agency. Currently, Government is working with Stakeholders to draw-up a bankable ROADSIP II programme.

29. **Government is continuing to make progress under the health sector governance action plan.** After completing a first round of actions that resulted in a partial release of

cooperating partner sectoral funds, progress is being made on indicative medium-term actions that will trigger the disbursement of second tranche funds. These include the strengthening of financial management, accounting and procurement functions. In this regard a financial, procurement, and systems audit was commissioned and is expected to be completed in November 2010. Based on the recommendations of the audit, the Government in collaboration with Cooperating Partners will develop a plan for strengthening accountability and financial controls in the Ministry of Health. In the meantime, the Government is strengthening internal audit, accounting, and procurement functions, including the fiduciary function of management, through constant training of staff in short- and long-term courses. Further, the Audit Committee at the Ministry, with external members, has been constituted and has been having regular meetings to provide financial oversight. The Office of the Auditor General has continued to give support to internal audit by carrying out pre- and postaudit exercises and quarterly review of expenditure.

Debt and debt management

30. **In line with national development priorities, Government will scale up investment in infrastructure in order to keep up with the ever increasing infrastructure demand of its growing economy.** To this end and considering the level of investment required, Government intends to finance projects with high economic and social returns through concessional and nonconcessional external borrowing. Government will ensure that all borrowing is within sustainable limits. In the context of the program, Government would like to shift from nonconcessional borrowing tied to specific projects to a sector-based approach (focusing on electricity and roads), while adhering to the overall ceilings on nonconcessional borrowing in the program, Strengthening debt management and project appraisal capacity will be a key ingredient to this approach.

31. **The Government sees room for improvement in the existing debt management capacity in the debt department and will strengthen it accordingly.** It is therefore taking measures to strengthen its capacity by reorganizing staff in the external debt recording unit and external debt management unit through staff movements. The upcoming restructuring, in 2011, along functional lines into what will become the debt management office will be in line with international best practices. Over the medium term, the staff will be trained and retrained in debt management with the assistance multilateral capacity building institutions. Further, Government will embark on a reconciliation exercise for the electronic and manual debt data to improve accuracy. The Government will consult IMF staff to determine the concessionality of new loans prior to signing.

32. **The Government will continue consolidating its capacity in carrying out project appraisals**. It is essential that scarce resources are applied to projects that have a high economic rate of return and have the most social and economic benefit to the people. In addition, Government will continue carrying out feasibility studies to ensure that projects have least impact on the natural environment, and communities. In cases where capacity to carry out

project appraisal and feasibility studies are inadequate, the Government will continue contracting private sector experts. In the medium term, the Government has been offered grant financing by the Development Bank of Southern Africa to assist SADC countries to prepare comprehensive project appraisals for projects identified under the SNDP. This will ensure value for money.

33. **Considerable progress has been made in the capturing and recording of aid data.** As a result of substantial efforts involving both Government and Cooperating Partners, the Government will, in 2010, publish its first Development Cooperation Report, which is expected to provide details on aid flows from Cooperating Partners. The Government is working with Cooperating partners to ensure the accuracy and reliability of the data.

IV. Program Monitoring

34. **Semi-annual disbursements under the ECF arrangement will be based on the observance of quantitative performance criteria.** Completion of the sixth review under the arrangement will be based on the observance of quantitative performance criteria through end-December 2010 (Tables 1 and 2). The sixth review is expected to be completed by end-May 2011.

MEFP Table 1. Zambia: Quantitative Performance Criteria (PC) and Indicative Targets, 2010[1]

(Billions of kwacha, unless otherwise indicated)

	2009	2010										
		March 31			June 30			Sep 30			December 31	
	Prel.	Indicative	Act.	Status	Prog.	Act.	Status	Indicative	Act.	Status	Prog.	Rev. prog.
		CR 10/17			CR 10/208	Prel.					CR 10/208	
		(Cumulative from January 1st, 2010)										
Performance criteria:												
Ceiling on the cumulative increase in net domestic assets (NDA) of the Bank of Zambia[2,3]	1	405	80	Met	447	266	Met	91	-214	Met	240	162
Adjusted ceiling		410			634			370				
Ceiling on the cumulative increase in net domestic financing (NDF)[2]	6,677	321	447	Not Met	825	947	Met	1,386	1,255	Met	1,487	2,000
Adjusted ceiling		152			1011			1,664				
Ceiling on new external payment arrears[5]	0	0	0	Met	0	0	Met	0	0	Met	0	0
Floor on the cumulative increase in gross international reserves (GIR) of the Bank of Zambia (Millions of U.S. dollars)[2,4]	1,758	-2	-22	Not Met	40	-54	Met	126	214	Met	150	150
Adjusted floor		-7			-75			66				
Ceiling on short-term external debt and on contracting or guaranteeing of nonconcessional debt by central government, BoZ, and ZESCO, ZAMTEL, and Zambia Railways Limited (millions of U.S. dollars)[5,6,7]	…	0	0	Met	0	0	Met	0	0	Met	0	0
Ceiling on medium- and long-term external debt and on contracting or guaranteeing of nonconcessional debt by central government, BoZ, and ZESCO, ZAMTEL, and Zambia Railways Limited (millions of U.S. dollars)[5,6,7]	398	600	0	Met	600	0	Met	600	105	Met	600	600
Project-specific												
Electricity[8] and road projects[9]	316	600	0	Met	600	0	Met	600	105	Met	600	--
Other sectors	82	0	0	Met	0	0	Met	0	0	Met	0	--
Sector-specific												
Electricity	--	--	--		--	--		--	--		--	200
Road	--	--	--		--	--		--	--		--	400
Others	--	--	--		--	--		--	--		--	0
Indicative targets (cumulative):												
Floor on payment of domestic arrears of the government	278	59	71	Met	153	128	Not Met	157	167	Met	269	269
Increase in reserve money (end of period)	4,054	239	-134	Met	223	89	Met	264	320	Not Met	394	325
Floor on social spending by the government of Zambia	…	930	971	Met	1875	2055	Met	2,838	3,270	Met	3,938	3,938
Memorandum items:												
Cumulative budget support net of Central Government debt service (U.S. dollars)		61	98		204	117		235	120		224	200
General budget support (Fiscal accounts)[9]		78	108		235	136		288	156		288	265
Cumulative BoP support net of Central Government debt service (U.S. dollars)		61	56		162	75		194	78		182	159
General BoP support		78	66		193	95		246	114		246	223
Central Government debt service obligations (excl. IMF)	…	-17	-11		-31	-20		-52	-36		-64	-64
Program exchange rate (Kwacha per U.S. dollar)[10]	4,832	4,622	4,690		4,641	5,165		4,641	4,846		4,641	4,641

Sources:

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

[2] Adjustors, including for general budget support, are defined in the TMU.

[3] The ceiling will be adjusted for changes in the legal reserve requirements as specified in the TMU.

[4] Reserves are calculated at program exchange rates.

[5] Continuous performance criteria and cumulative from the beginning of 2010.

[6] Nonconcessional loans are those having a grant element of less than 35 percent.

[7] Up until the privatization of ZAMTEL on June 5, 2010.

[8] The electricity projects are: Kariba North bank extension, Itezhi-Tehzi power station, Kafue Gorge Lower;

[9] The road projects are: Mutanda-Chavuma Road, Choma-Chitongo-Namwala Road, Kasama-Luwingu Road.

[10] This exchange rate is not a projection but a rate (fixed at the level of end-2009) that is used for the calculation of program targets, as specified in the Technical Memorandum of Understanding.

MEFP Table 2. Zambia: Targets, 2011[1]

(Billions of kwacha, unless otherwise indicated)

	2010	2011			
		March 31	June 30	Sep 30	Dec 31
	Proj.	Indicative Target	Target[2]	Target[2]	Target[2]
		(Cumulative from January 1st, 2011)			
Targets					
Ceiling on the cumulative increase in net domestic assets (NDA) of the Bank of Zambia[3,4]	162	-337	-129	-319	-567
Ceiling on the cumulative increase in net domestic financing (NDF)[3]	8,677	284	805	1,278	1,221
Floor on the cumulative increase in gross international reserves (GIR) of the Bank of Zambia (Millions of U.S. dollars)[3,5]	1,909	42	64	142	272
Ceiling on new external payment arrears[6]	0	0	0	0	0
Ceiling on short-term external debt and on contracting or guaranteeing of nonconcessional debt by central government, BoZ, and ZESCO, and Zambia Railways Limited (millions of U.S. dollars)[6,7]	…	0	0	0	0
Ceiling on medium- and long-term external debt and on contracting or guaranteeing of nonconcessional debt by central government, BoZ, and ZESCO, and Zambia Railways Limited (millions of U.S. dollars)[6,7]	…	800	800	800	800
Sector-specific					
Electricity	…	400	400	400	400
Road projects		400	400	400	400
Floor on payment of domestic arrears of the government	269	79	150	229	316
Increase in reserve money (end of period)	4,379	-21	318	444	512
Floor on social spending by the government of Zambia	3,938	1,385	2,769	4,154	5,385
Memorandum items:					
Cumulative budget support net of Central Government debt service (U.S. dollars)	170	26	2	26	55
General budget support	223	49	49	104	158
Central Government debt service obligations (excl. IMF)	-53	-22	-47	-78	-103
Program exchange rate (Kwacha per U.S. dollar)[8]	4,641	4,641	4,641	4,641	4,641

Sources:

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

2 These targets are outside of the ECF arrangement period.

3 Adjustors, including for general budget support, are defined in the TMU.

4 The ceiling will be adjusted for changes in the legal reserve requirements as specified in the TMU.

5 Reserves are calculated at program exchange rates.

6 Continuous performance criteria and cumulative from the beginning of 2011.

7 Nonconcessional loans are those having a grant element of less than 35 percent.

8 This exchange rate is not a projection but a rate (fixed at the level of end-2009) that is used for the calculation of program targets, as specified in the Technical Memorandum of Understanding.

MEFP Table 3. Zambia: Structural Benchmarks for 2010-11

Measure	Timing	Macro Rationale	Status
Approval by Cabinet of the pay policy reform	End-June 2010	Strengthen payroll management, and increase productivity of the public sector.	Met
Establish a Lender-of-Last Resort Framework and draft legislation and procedures for a financial sector contingency plan in the event of a crisis.	End-June 2010	Strengthen the Central Bank's crisis preparedness.	Partially Met. Draft legislation expected by end-May 2011
Submit to parliament the Planning and Budgeting Act.	End-June 2010	Strengthen public expenditure management and budget execution, including improving cash flow management and forecasts.	Reset to end-January 2011
Raise the average electricity tariff in 2010 and publicly announce indicative tariffs for 2011 consistent with the policy to reach cost-reflective levels by 2011.	End-June 2010	To ensure an efficient and sustainable power supply. Solving the current problems in the energy sector is essential to achieving the	Met with delay (July 26, 2010)
Prepare a review of tax administration and policy	End-September 2010	Strenghten revenue performance	Met
Adoption of Treasury Single Account so as to cover 60 percent of budgetary expenditures.	End-December 2010	Strengthen public expenditure management and budget execution, including improving cash flow management and forecasts.	
Submit to Cabinet a report on maize pricing policy.	End-March 2011	Preserve macroeconomic stability and minimize disruptions to private sector trading of maize.	

Source: Zambian authorities and IMF staff estimates.

II. Technical Memorandum of Understanding for the 2010–11 Extended Credit Facility (ECF) Arrangement

I. Introduction

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

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

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

1. Net domestic assets (NDA) of the BoZ are defined as the monthly average (based on daily data) of reserve money (as defined below) less the monthly average of net foreign assets of the BoZ calculated at kwacha 4,640.6 per U.S. dollar for 2010 and 2011.[1] Net foreign assets of the BoZ are defined as gross international reserves (defined in paragraph 9) plus any other foreign assets, minus foreign liabilities (defined in paragraph 3).[2] The kwacha values of net foreign assets are derived from the U.S. dollar values using the program exchange rate.

2. Foreign liabilities are defined as short term (one year or less in original maturity) liabilities of the BoZ to nonresidents, plus any outstanding use of IMF credit, plus the stock of SDRs allocations to Zambia, and plus any other medium and long term foreign liabilities of BoZ.

3. Daily data on NDA, including all its components and calculation, will be reported by the BoZ weekly in electronic format and shall be consistent with the Standard Reporting Format (SRF) for monetary accounts.

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[1] Unless otherwise defined, program exchange rates for 2010 and 2011 between the U.S. dollar and other (non-kwacha) currencies will be equal to their end-December 2009 values. For the 2010 and 2011 program, the U.S. dollar/SDR rate is 1.567; the U.S. dollar/GBP rate is 1.624, the U.S. dollar/euro rate is 1.459, and the U.S. dollar/South Africa Rand is 0.133. All other assets (e.g. gold) would be revalued at their end-December 2009 market prices for 2010 and 2011.

[2] Other foreign assets include encumbered reserves and any other foreign assets of BoZ.

B. Reserve Money

4. Reserve money (monthly average based on daily data) is defined as currency in circulation, plus required reserves on kwacha deposits, plus required reserves on foreign currency deposits (at the program exchange rate), plus any positive current account balance of Other depository corporations (ODC) with the BoZ, and plus deposits in the BoZ of sectors other than central government.

5. Daily data on reserve money, including its components, will be reported by the BoZ weekly in electronic format and shall be consistent with the SRF for monetary accounts.

C. Net Domestic Financing (NDF)

6. Net domestic financing (NDF) is defined as the Budgetary Central Government's net borrowing from the banking and nonbanking sectors.[3] All government-issued securities will be recorded at cost (face value less discount). NDF will comprise:

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

(b) BoZ holdings of: (i) Treasury bills; (ii) government bonds; (iii) kwacha bridge loan (overdraft facility); less (iv) the government's deposits at the BoZ; and (v) the donor suspense account; plus (vi) the outstanding amount of the long-term non-transferable security (10-Year Mega Bond) issued against the government's indebtedness to BoZ as at end-2002; plus

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

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

D. Gross International Reserves of the BOZ

8. Unless otherwise noted here, gross international reserves of the BoZ will be defined as reserve assets of the BoZ (See Table 2). Reserve assets are defined in the IMF BOP manual (5th edition) and elaborated in the reserve template of the IMF's special data

[3] The Budgetary Central Government includes all the units identified by the budget heads listed in the Yellow Book for 2010 and listed in Table 1.

dissemination standards (SDDS). They exclude, for example, foreign assets not readily available to or controlled by the monetary authorities, and foreign currency claims on Zambian residents.

9. Gross international reserves consist of: (i) monetary gold; (ii) foreign currency; (iii) unencumbered foreign-currency deposits at non-resident banks; (iv) foreign securities and deposits; and (v) SDR holdings and Zambia's reserve position with the IMF. Gross reserves exclude non-convertible currencies, any encumbered reserve assets including but not limited to reserve assets pledged, swapped or used as collateral or guarantee for third-party external liabilities, other depository corporation reserve requirements on foreign currency deposits, and the US$25 million deposit in MBZ (in liquidation).

10. For the purpose of this target valuation will be in U.S. dollars at program exchange rates.

11. Daily data on gross international reserves, including its components, will be reported by the BoZ weekly.

E. External Payment Arrears

12. The performance criterion on the non-accumulation of new external payment arrears is continuous. Official external payment arrears are defined as unpaid debt service by the central Government and BoZ 30 days beyond the due date and/or the grace period. This definition excludes arrears on debt subject to rescheduling.

13. Data on arrears, at program exchange rates, are compiled jointly by the Ministry of Finance and National Planning (MoFNP) and BoZ and will be reported by the MoFNP on a quarterly basis.

F. Official External Debt

14. Official medium- and long-term concessional external debt is defined as all forms of official debt with original maturity of more than one year contracted or guaranteed by the central Government, BoZ, ZESCO, and Zambia Railways Limited with nonresidents having a grant element of no less than 35 percent, since the beginning of the calendar year. The grant element is the difference between the present value (PV) of debt and its nominal value, and is expressed as a percentage of the nominal value of the debt. The PV of debt at the time of its contracting is calculated by discounting the future stream of payments of debt service due on this debt.[4] The discount rates used for this purpose are the currency-specific commercial

[4] The calculation of concessionality will take into account all aspects of the loan agreement, including maturity, grace period, payment schedule, upfront commissions, and management fees.

interest reference rates (CIRRs) published by the Organization for Economic Cooperation and Development (OECD).[5] For debt with a maturity of at least 15 years, the ten-year-average CIRR will be used to calculate the PV of debt and, hence, its grant element. For debt with a maturity of less than 15 years, the six-month average CIRR will be used. To both the ten-year and six-month averages, the same margins for differing repayment periods as those used by the OECD need to be added (0.75 percent for repayment periods of less than 15 years, 1 percent for 15 to 19 years, 1.15 percent for 20 to 29 years, and 1.25 percent for 30 years or more). Lending from the IMF will be excluded.

15. This minimum grant element applies not only to debt as defined in Point 9 of the Guidelines on Performance Criteria with Respect to External Debt in Fund Arrangements (Decision No. 6230-(79/140), as subsequently amended, including by Executive Board Decision No. 14416-(09/91), effective December 1, 2009, but also to commitments contracted or guaranteed for which value has not been received.

16. Official external nonconcessional debt is defined as the contracting or guaranteeing of debt with nonresidents other than concessional debt as defined in paragraph 15, owed or guaranteed by the central Government, BoZ, ZESCO, and Zambia Railways Limited.

17. The ceiling on contracting or guaranteeing of medium and long-term nonconcessional external debt by the central government, BoZ, ZESCO, and Zambia Railways Limited excludes: (i) nonconcessional loans stemming from the rescheduling of external debt; and (ii) central government securities issued in domestic currency, placed in the domestic primary or secondary markets, and held by non-residents.

18. Official external short-term debt is defined as the contracting or guaranteeing of debt with nonresidents with original maturity of one year or less, and includes forward commodity sales but will exclude normal trade credit for imports, incurred since the beginning of the calendar year. The term "debt" has the meaning set forth in point No. 9 of the Guidelines on Performance Criteria with Respect to External Debt (Decision No. 6230-(79/140), as subsequently amended, including by Executive Board Decision No. 14416-(09/91), effective December 1, 2009.

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

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[5] Available at http://www.oecd.org/dataoecd/21/52/39085945.xls. Where the CIRR is not available, the SDR rate shall be used.

G. Domestic Arrears of Central Government

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

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

H. Floor on Social Spending

22. Social spending is defined as central government domestically financed expenditure on health and education as listed in the 2010 and 2011 Yellow Book under the functional classification. The corresponding indicative target sets the minimum spending on these sectors combined.

III. ADJUSTERS

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

General budget support (GBS) net of debt service[6]

(i) The ceilings on NDA and NDF will be adjusted downward (upward) by the full amount of the excess (shortfall) in GBS net of debt service relative to the programmed levels specified in Table 1 of the MEFP.[7,8]

> (a) The total adjustment for shortfalls will be limited to US$40 million for January-June 2010 and US$60 million for January-December 2010.

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

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

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

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

Change in reserve requirements

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

IMF disbursement

(v) The floors on GIR will be adjusted upward (downward) for any excess (shortfall) in the disbursements from the IMF (U.S. dollar value at the program exchange rate) relative to the programmed levels.

BoZ short-term debt

(vi) The floor on GIR will be adjusted upward for any increase in the U.S. dollar value at the program exchange rate of BoZ short-term debt, (see definition of short-term debt above).

IV. Reporting Requirement

24. To facilitate monitoring of the program, the information listed in Table 2 below will be reported to the IMF within the timeframe indicated. These data, and any other information needed for monitoring of adherence to program targets, will be provided electronically by email to AFRZMB@IMF.ORG.

Table 1. Administrative units comprising the Budgetary Central Government

Office of the President	Ministry of Finance and National Planning
Office of the Vice President	Ministry of Labour and Social Security
National Assembly	Ministry of Community Development and Social Services
Gender in Development Division	Ministry of Health
Electoral Commission	Ministry of Communications and Transport
Public Service Commission - Office of the President	Ministry of Works and Supply
Office of the Auditor General	Ministry of Science, Technology and Vocational Training
Cabinet Office - Office of the President	Ministry of Tourism, Environment and Natural Resources
Teaching Service Commission - Office of the President	Ministry of Sport, Youth and Child Development
Police and Prisons Service Commission	Ministry of Defence
Zambia Police - Ministry of Home Affairs	Zambia Security Intelligence Services - Office of the President
Commission for Investigations - Office of the President	Ministry of Education
Ministry of Energy and Water Development	Ministry of Lands
Ministry of Mines and Mineral Development	Anti-Corruption Commission
Ministry of Home Affairs	Ministry of Livestock, and Fisheries Development
Ministry of Foreign Affairs	Ministry of Agriculture and Cooperatives
Judiciary	Office of the President - Lusaka Province
Loans and Investments - Local Government and Housing	Office of the President - Copperbelt Province
Loans and Investments	Office of the President - Central Province
Ministry of Information and Broadcasting Services	Office of the President - Northern Province
Public Service Management Division	Office of the President - Western Province
Ministry of Local Government and Housing	Office of the President - Eastern Province
Ministry of Justice	Office of the President - Luapula Province
Ministry of Commerce, Trade and Industry	Office of the President - North-Western Province
Human Rights Commission	Office of the President - Southern Province

Table 2: Reporting Requirements

Data description	Data Freq.	Reporting Agency	Reporting Freq.	Date	Mode
Monetary and financial sector					
Reserve money and its components (NDA and NFA) at current and program exchange rate	D	BoZ	W	T5	E
Excess reserves	D	BoZ	M	T5	E
Overnight interbank rates	D	BoZ	W	T5	E
Treasury bill and BoZ bill auction results	W	BoZ	W	T5	E
Interest rates	M	BoZ	M	T15	E
Holdings of government and BoZ securities by maturity and type of investors (local commercial banks, nonbanks, and foreigners)	M	BoZ	M	T15	E
Monetary survey (and the BoZ, and Other Depository Corporations surveys)	M	BoZ	M	T15	E
Commercial bank lending. Credit to the economy by sector and type of institution	M	BoZ	M	T15	E
Financial soundness indicators by banks	M	BoZ	M	T15	E
External sector					
Exchange rates	D	BoZ	W	T5	E
Gross international reserves, and foreign exchange purchases and sales	D	BoZ	W	T5	E
Copper prices	D	BoZ/CSO	W	T5	E
BoZ foreign exchange cash flow	M	BoZ	M	T10	E
Import and export data	M	CSO	M	T15	E
Balance of payments	Q	BoZ	Q	T30	E
Copper production and exports (quantities, prices and US dollar value)	M	MoF	M	T15	E
Foreign direct investment (actuals and pledges)	M	MoF/ZDA	M	T15	E
Fiscal					
Net Domestic Financing	D	BoZ	W	T5	E
Fiscal table including revenue, expenditure, and financing.	M	MOF	M	T30	E
Real sector					
Consumer price index and monthly statistical bulletin	M	CSO	M	T15	E
National accounts	A	CSO	BA	Mar. 15; Sep. 15	E
Program monitoring					
Report on IMF program performance	Q	MOF	Q	T15	E
Stock of domestic and external payment arrears	Q	AuG	Q	T15	E
Central government domestic borrowing	Q	BoZ	M	T15	E
New external loans contracted or guaranteed by the central government BoZ, ZESCO, ZAMTEL, and Zambia Railways Limited or any other agency on their behalf[1]	Q	MOF	Q	T30	E

D-Daily, W-Weekly, M-Monthly, Q-Quarterly, BA-Bi-annual A-Annual; Tx: x days after the date of the last observation; E-email, H-Hard copy

1 Detailed information on the amounts, currencies, terms, conditions, and purpose (to finance electricity and road projects listed on the quantitative performance criteria table, or other purposes).