

AFRICAN DEVELOPMENT FUND



**PROGRAMME : SECOND POVERTY REDUCTION
BUDGET SUPPORT (PRBS II)**

COUNTRY : ZAMBIA

APPRAISAL REPORT

SEPTEMBER 2008

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Currency Equivalents
(As of June 2008)

Currency Unit Zambia = Kwacha

1 UA	=	1.5637.22 Kwacha (ZMK)
1 UA	=	1.62069 US\$
1 UA	=	1.04507 EURO

Weights and Measures

Metric System

1 metric tonne	=	2204 pounds(lbs)
1 kilogramme (kg)	=	2.200 lbs
1 metre (m)	=	3.28 feet (ft)
1 millimetre (mm)	=	0.03937 inch (“)
1 kilometre (km)	=	0.62 mile
1 hectare (ha)	=	2.471 acres

Fiscal Year

January 1 - December 31

Acronyms and Abbreviations

ADF	African Development Fund
BSL	Budget Support Loan
CEM	Country Economic Memorandum
CFAA	Country Financial Accountability Assessment
CPAR	Country Procurement Assessment Review
CSP	Country Strategy Paper
DFID	Department for International Development
CPs	Cooperating Partners
DSA	Debt Sustainability Assessment
FMS	Financial Management System
FNDP	Fifth National Development Plan
FSDP	Financial Sector Development Plan
FY	Financial Year
GDP	Gross National Product
HIPC	Heavily Indebted Poor Countries
IFMIS	Integrated Financial Management Information System
IMF	International Monetary Fund
MDG	Millennium Development Goals
MDRI	Multilateral Debt Relief Initiative
MTEF	Medium Term Expenditure Framework
MTR	Mid -Term Review
OAG	Office of the Auditor General
PAC	Public Accounts Committee
PAF	Performance Assessment Framework
PEFA	Public Expenditure and Financial Accountability
PEMFA	Public Expenditure Management and Financial Accountability
PRGF	Poverty Reduction and Growth Facility
PFM	Public Finance Management
PRBS	Poverty Reduction Budget Support
SFTA	Support for Fiscal Transparency and Accountability
UA	Unit of Account
US\$	United States Dollars
WB	World Bank
ZNTB	Zambia National Tender Board

LOAN INFORMATION

Client's Information

BORROWER : Government of Zambia

EXECUTING AGENCY : Ministry of Finance and National Planning

Financing Plan (2008-2010)

Source	USD Amount	Instrument
ADF	24.0 million (UA 15.0 m)	Loan
World Bank	40.8 million	Loan
IMF	79.2 million	Loan
Ireland	16.0 million	Grant
Norway	104.0 million	Grant
Netherlands	40.6 million	Grant
UK	168.7 million	Grant
Finland	28.5 million	Grant
Sweden	61.0 million	Grant
EU	298.9 million	Grant
Germany	20.7 million	Grant

ADF Financing Information

Loan	15.0 million Unit of Account
Interest type	fixed
Interest rate spread	1% from 11 th 20 th year and 3% thereafter
Commitment fee	0.5% on undisbursed amount
Other fees (service charge)	0.75% on disbursed and Outstanding amount
Tenor	50 years
Grace Period	120 months (10 years)

Programme Timeframe-Main stepping stones (expected)

Concept Note approval	June 2008
Appraisal mission	June 2008
Board Presentation/Approval	October 2008
Effectiveness	December 2008
Completion	December 2010
Last repayment	October 2058

ZAMBIA BUDGET SUPPORT RESULT-BASED LOGICAL FRAMEWORK

HIERARCHY OF OBJECTIVES	EXPECTED RESULTS	REACH	PERFORMANCE INDICATORS	INDICATIVE TIMEFRAME	ASSUMPTIONS/ RISKS
<u>Goal</u> To contribute to economic growth and poverty reduction	<u>Impact</u> Reduced poverty and improved living standards	<u>Beneficiaries</u> Zambians	<u>Impact Indicator</u> GDP growth rate Per capita income Poverty level	<u>Progress anticipated in the long term</u> Middle income status (per capita income of US\$1000 by 2030) Poverty reduction to 32.2% by 2015	<u>Assumption Statement</u> The current economic and political management continues
<u>Project Purpose</u> 1. Create an enabling environment for private sector development. 2. Improve public finance management through improved budget preparation and execution and capacity and reforms in public finance management.	<u>Outcomes</u> (i) Conducive and cost effective business environment. 2(a) Efficient budget execution and public expenditure management. 2(b) Transparent and accountable public financial management system.	<u>Beneficiaries</u> Zambians Business persons, rural communities	<u>Outcome Indicators</u> 1. 1Number of days to register a business 1.2 Number of days to import and export products 2 (a) Expenditure variance 2(b) Public accounts management.	<u>Progress anticipated in the medium term</u> 1.1 Number of days to start a business reduced to 10 in all regions by 2009 from 35 days in 2006 and 10 days in Lusaka region. 1.2 Number of days to export and import reduced by half from 33 and 16 days in 2007 to 16 and 7 days in 2009. 2 (a) Expenditure outturn deviations from budget reduced to less than 10% by 2009 from 12.3% in 2007 . 2 (b) PEMFA programme executed efficiently in 2009 and 2010	<u>Assumption statement</u> Resources are made available to implement the ongoing policy reforms and plans
<u>Inputs and Activities:</u> <u>Activities:</u> Negotiation, approval and loan signature Implementation of activities included in the PRBS II PAF matrix Implementation of PEMFA work programme Supervision mission Annual assessments <u>Inputs: (2008-2009)</u> U15.0 million; ADF 24.0 m World Bank 40.8 m IMF 79.2 m Ireland 16.0m Norway 104.0 m Netherlands 40.6 m UK 168.7 m Finland 28.5 m Sweden 61.0 m EU 298.9 m Germany 20.7 m	<u>Outputs:</u> 1. Implementation and completion of PRBS II 2. Effective and efficient business management 3. Improved and effective public finance management	<u>Beneficiaries:</u> Zambians people	<u>Output indicator:</u> 1. PRBS II PCR 2..PSD reports and private sector contribution to the economic growth 3. Reduced expenditure deviations from budget outturn timely release of public accounts and budget	<u>Progress anticipated in the short term:</u> <u>Timeframe:</u> 1. PRBS II resources disbursed and utilised. 2. Implementation of the PRBS in 2008 and 2009 3. Implementation of the PEMFA in 2008 and 2009	<u>Assumption statement:</u> The expected revenue from the mining taxation should be used in capacity and institutional building. <u>Risks</u> (i)Weak implementation capacity (ii) fiduciary risks which could lead to weak accountability (iii) increased public expenditure without corresponding revenue (iv) high oil and commodity prices (v) political stability

PROGRAMME EXECUTIVE SUMMARY

1. The Second Poverty Reduction Budget Support Loan (PRBS II) for Zambia is a three year programme aimed at assisting the country to implement the Fifth National Development Plan (FNDP). The programme will be supported by a budget support loan amounting to UA15.0 million to be disbursed in two tranches of equal amounts. The expected outcomes are: a conducive and cost effective business environment and improved efficiency, effectiveness and accountability in the management and use of public financial resources.

2. The PRBS II objective is to support the Government's development agenda within the context of the FNDP. PRBS II will focus on the following focus areas: (i) business enabling environment; and (ii) public financial and expenditure management. An enabling business environment will be created in order for the private sector to take the lead as an engine of economic growth. Financial Management reforms in the areas of budget execution will consolidate efforts of the PRBS I programme and improve capacity in budget preparation and execution across government. The Bank's assistance strategy and ability to monitor progress have been considered in the selection of the focus areas.

3. The PRBS II programme is suited for the country based on the challenges and proposed interventions outlined in the FNDP. The programme will reinforce the use of the country system and continue reforms in collaboration with other donors in the context of the two frameworks funded by Cooperating Partners (CPs) namely Poverty Reduction Budget Support (PRBS) and Public Expenditure Management and Financial Accountability (PEMFA). They are complementary and address important areas for the development of the country.

4. Zambia has several opportunities that provide a conducive environment for Cooperating Partners (CPs) to continue providing the much needed development assistance to the Government in order to address poverty and economic development, namely: continued stable political environment; vibrant civil society groups; good relations with the donor community; existence of a comprehensive donor coordination framework; improved macroeconomic policy management in recent years which resulted in additional fiscal space created by the debt cancellations of the Heavily Indebted Poor Countries (HIPC) and the Multi-lateral Debt Relief Initiative (MDRI), and national commitment to attainment of MDGs.

5. The Bank is suited for the programme because it has supported similar programmes in the past, PRBS I and Support for Fiscal Transparency and Accountability (S-FTA). The programme is based on the lessons learnt from the previous as well as ongoing programmes funded by the Bank. The Bank is also able to use best practices at its disposal to improve identified weaknesses. The Bank will use the Country Office to follow up on the activities of the programme and monitor progress with other cooperating partners.

1. THE PROPOSAL

1.1 We submit the following Report and Recommendation on a proposed budget support loan to Zambia for UA15.00 million (Fifteen Million Units of Account) from ADF XI resources to finance the Second Poverty Reduction Budget Support (PRBS II). It is a general budget support programme and will be implemented for three years from 2008 to 2010. The programme was appraised from 16-27 June 2008. The programme results from a request of the Government dated 18 December 2007 and subsequent Bank missions and is in line with the Bank Country assistance strategy for Zambia (2007-2010). It will consist of the following components: Private Sector Development and Public Finance and Expenditure Management which will include capacity building and reform programme in the public finance management sector.

1.2 The programme goal is to contribute to economic growth and poverty reduction. Its policy objectives are to create an enabling environment for private sector development, improve budget preparation and execution and improve capacity and reforms in public finance management. It has the following expected outcomes: (i) conducive and cost effective business environment for the private sector, with efficient services in business regulation and trade facilitation; and (ii) effective and accountable management and use of public finance resources.

II. COUNTRY AND PROGRAMME CONTEXT

2.1 Government overall development strategy and medium term reforms priorities

2.1.1 The main development challenges facing Zambia identified by the Fifth National Development Plan (FNDP) are: (i) maintaining sound macroeconomic management and budget governance through improved management of domestic and external resources and the need to accelerate growth beyond the current rate of 6% a year in order to attain middle-income status by 2030; (ii) diversification of the economy away from copper exports which may unlikely create the needed jobs; (iii) prudent management and use of the copper revenues to build productive infrastructure; (iv) sharing the benefits of growth to avoid inequality and unsustainable growth paths that have the potential to lead to political strife and conflict and the need to share growth within and among the rural and urban areas and tackling poverty disparities among all groups including gender issues with targeted interventions; (v) improving competitiveness; (vi) addressing structural constraints, like physical infrastructure, human resources, and institutional capacity; (vii) improving governance, Zambia ranks almost precisely at the midpoint of over 100 low- and middle-income countries in the quality of its checks and balances and bureaucratic institutions; (viii) accelerating decentralization and improving citizens' participation in development; and (ix) improve public financial management with a view to make it efficient, effective, transparent and accountable. The incidence of poverty fell from 73 percent of the population in 1998 to 64 percent in 2006; however, in rural areas it remains at about 80 percent. Progress has been made in the social sectors and human development, but the achievement of the Millennium Development Goals (MDGs) remains a challenge.

2.1.2 Zambia has an abundant resource base comprising land, water and labour, and therefore, efforts will be made during the FNDP implementation period (2006-2010) to utilize them in order to achieve the set objectives. In addition to these resources there are several opportunities in the country that provide a conducive environment for Cooperating Partners (CPs) to continue providing the much needed development assistance to the Government of Zambia in order to address poverty and economic development, namely: continued stable political environment; vibrant civil society groups; good relations with the donor community; existence of a comprehensive donor coordination framework; improved macroeconomic policy management in

recent years which resulted in additional fiscal space created by the debt cancellations of the Heavily Indebted Poor Countries (HIPC) and the Multi-lateral Debt Relief Initiative (MDRI), and national commitment to attainment of MDGs.

2.1.3 The Government's development agenda is articulated in three interrelated planning instruments, defining the long, medium and short term development objectives, namely, the National Vision 2030, the Fifth National Development Plan 2006 – 2010 (FNDP) and the rolling Medium Term Expenditure Framework 2006 -2008. The national long-term planning instrument entitled Vision 2030, prepared in consultation with line ministries, provinces, districts, the donor community and civil society, sets Zambia's long-term vision which reflects the collective understanding, aspirations and determination of the Zambian people to be a 'prosperous middle-income country'.

2.1.4 The FNDP, which constitutes the Government's Medium Term Strategy, represents the first building block for achieving the Vision's objectives. The FNDP's main objectives are to (i) achieve **a broad based wealth and job creation**. FNDP will focus on pro-poor growth-oriented sectors that create employment and income opportunities for the poor, in addition to mining, construction and energy sectors that are expected to continue contributing to overall economic growth. These sectors include rural development, agriculture and manufacturing, which provide a greater opportunity for creating wealth and jobs, thereby rapidly reducing poverty. The FNDP also emphasises the creation of strong linkages between the capital intensive sectors and the rest of the economy so as to enhance broad-based growth. The second objective is to create (ii) **economic infrastructure and human resources development** that will create an environment supportive of private sector growth, macroeconomic stability and skilled human resources. The Plan also focuses on social investment in health and education. For the above goals to be achieved FNDP identified the following interventions:

2.1.5 **Macroeconomic policies:** a) Inflation and interest rate reduction; b) Transparent debt contraction and management; c) Effective public expenditure and revenue management; d) Sound economic governance and transparency; e) A stable and competitive exchange rate; and f) Financial sector policies, including microfinance.

2.1.6 **Social policies:** a) Poverty reduction; b) Public investment in effective HIV and AIDS interventions; c) Housing and water and sanitation improvement; d) Public investment in education and health; e) Social safety nets; and f) Pro-employment economic growth and sound labour administration.

2.1.7 **Rural sector policies:** a) Irrigation development; b) Attainment of food security; c) Provision of microfinance; d) Development and/or rehabilitation of infrastructure, especially feeder and all weather roads; and e) Livestock development.

2.1.8 **Urban sector policies:** a) Housing improvement including revamping urban planning such as upgrading of unplanned settlements; b) Safe water and sanitation; c) Waste management; d) Improved land management; and e) Manufacturing and services sectors growth.

2.1.9 **Structural Policies:** a) Private Sector Development, especially relating to improving the business and investment climate; and, b) Strengthening the financial sector.

Cross-cutting issues: a) Mainstreaming HIV and AIDS; b) Gender mainstreaming; c) Ensuring environmental sustainability; d) Improved land management; and e) Promoting good governance.

2.1.10 The Medium Term Expenditure Framework (MTEF) articulates the short term macroeconomic framework during the period 2006 – 2008, aiming at sustaining and building on

the gains achieved in recent years. The macroeconomic objectives of the MTEF during the period 2006-2008 are to: (a) achieve and sustain broad-based growth; (b) stabilise inflation at single digit level; (c) achieve financial and exchange rate stability; (d) sustain a viable current account position; (e) reduce domestic debt to sustainable levels; and (f) quicken the implementation of structural reforms. The fiscal policy objectives are: (i) prudent fiscal discipline with a projected fiscal deficit of 1.70 % of GDP in 2010; (ii) creation of fiscal space by improving revenue collection through improved tax policy and administration, including renegotiating tax concessions with the large scale mining sector, and to continue to advocate for debt relief and increased receipts of general budget support grants from the cooperating partners.

2.1.11 In April 2007, sixteen Cooperating Partners (CPs) signed a Joint Assistance Strategy for Zambia (JASZ) to manage their development cooperation with the Government of the Republic of Zambia (GRZ) in alignment with the Fifth National Development Plan. The JASZ is also designed to strengthen local ownership of the development process and enhance official development assistance (ODA) effectiveness. The key objectives of the JASZ are to: establish a shared vision and guiding principles for CPs' support to the objectives of the FNDP; articulate priorities for support during the Plan period; replace or better align CPs' country strategies (including resource allocations) with FNDP priorities, targets and country systems; improve aid delivery by achieving a more effective Division of Labour (DoL) and allocation of CPs' resources; deepen the results focus of assistance programmes; simplify aid management and improve aid predictability; and reduce transaction costs for the GRZ.

2.2 Recent economic and social developments, perspectives, constraints and challenges

2.2.1 The Zambian economy continued a robust growth performance in 2007 with a real GDP growth rate estimated at 6% in 2007, led by a solid expansion in construction, telecommunication and services. The 2007 end of year inflation averaged 8.9%. Revenue and grants decreased from 42.9% of GDP in 2006 to 23.4% in 2007 and is expected to reach 26.5% in 2008. Grants reduced from 26.0% of GDP in 2006 driven by debt cancellation of 21.45% including HIPC and MDRI to 4.6% in 2007. It is expected to slightly increase to 5.3% in 2008. Revenue (excluding grants) increased from 16.9% of GDP in 2006 to 18.7% in 2007 and is expected to further increase to 21.2% in 2008 mainly due to increased income tax payments from the mining companies. Total expenditure was 24.6% of GDP in 2007. Overall fiscal balance including grants was 18.6% in 2006 and declined to negative 0.2% in 2007.

2.2.2 According to the IMF PRFG of June 2008 document the gross national investment increased from 22.6% of GDP in 2006 to 24.1% in 2007. The current account deficit including official grants was 3.0% in 2006 and reduced to 2.5% in 2007. Foreign direct investment in the mining sector rose to 8.6% of GDP. The gross international reserves (months of imports) reached 2.5 in 2007.

2.2.3 Zambia's balance of payments (BOP) is being affected by world oil price increases¹ In 2007, the BoP surplus substantially narrowed to US \$266.3 million from US \$821.6 million recorded in 2006, partly due to the MDRI and HIPC debt cancellation. The decline was largely on account of the deterioration in the current account which was not fully offset by improvements recorded in the capital and financial account. However, the country registered a record high accumulation of Gross International Reserves of about US \$913.2 in 2007.

2.2.4 The high oil prices impacted adversely on business, consumers and the government as a net oil importing country. The high oil prices raise the cost of many intermediate inputs which

¹ The Impact of High Oil Prices on African Economies, March 2008 by AfDB.

lead to high production costs. According to IMF's Poverty Reduction and Growth Facility of June 2008, Zambia's terms of trade are projected to deteriorate to 8.7% of GDP in 2008 from a positive balance of 7.9 in 2006. It is expected to further widen to 13.8% and 20.1% in 2009 and 2010 respectively, partly due to oil price increases. The current account balance excluding official grants declined by 7.1% in 2007 and is expected to be constant in 2008 before reaching negative 3.4% in 2009.

2.2.5 Zambia reached the HIPC completion point in April 8, 2005. As a result, the Boards of Directors of the IMF and the World Bank approved a total irrevocable debt relief from multilateral and bilateral creditors amounting to US\$ 2.5 billion in end-1999 Net Present Value (NPV) terms (US\$ 3.9 billion in nominal terms). HIPC paved the way for the country to benefit from the MDRI, which reduced the external debt stock by US\$2, 449 million (62.6%) at decision point. Keeping debt sustainable is a main policy goal of the Government. The total external debt stock increased by 9.5% to US \$2,035.2 million at end 2007 from US \$1,859.3 million at end 2006 mainly on account of an increase in the private and parastatal debt by 16.7% to US \$980.7 million from US \$840.0 million in 2006. The Government's stock of external debt also increased by 3.5% to US \$1,054.5 million in 2007 from US \$1,019.0 million in 2006 mainly on account of an increase in export credits by 80.8 percent. Application of the Low Income Countries Debt Sustainability Analyses (LIC-DSA) framework by the World Bank and the IMF in 2007 indicates that Zambia's debt sustainability outlook has strengthened substantially. The IMF and the World Bank staffs consider that Zambia is at low risk of external debt distress. The external debt indicators remain well below the thresholds in the alternative scenarios and the bound stress tests. The risks to public debt are also low.

2.2.6 In April 2008 a new fiscal regime for the mining sector was introduced and it superseded the old development agreements. It substantially increased the government share of mining profits and rents. The changes included an increase in the mineral royalty to 3 percent (from 0.6 percent), an increase in the corporate income tax to 30 percent (from 25 percent), and introduction of either a variable profit tax when the profit ratio is above 8 percent or a graduated windfall tax (levied on production value) when world copper prices exceed \$2.50 a pound.

2.2.7 The Government of Zambia concluded in June 2008 a new three year Poverty Reduction and Growth Facility (PRGF) with the IMF. Its objective is to support the government's efforts to boost economic growth and poverty reduction. Consistent with the principles of the FNDP the PRGF will focus on: (i) maintaining macroeconomic stability and debt sustainability, while increasing fiscal space for investment in infrastructure, energy, and human resources; and (ii) diversifying the economy to lessen dependence on mining by improving the conditions for private sector-led growth.

2.2.8 According to the IMF's PRGF document, government will continue to rely on grants and concessional external borrowing to finance central government projects and will not provide guarantees to public enterprises. The capacity to carry out investment projects will remain a key consideration in the decision to contract new foreign loans, even on concessional terms. Government has prepared a new Aid Policy and Strategy which identifies weaknesses in managing aid inflows and proposes measures to enhance aid efficiency. In this regard, the authorities plan to build ministry capacity to assess the viability of investment projects and absorb aid inflows. The reporting and monitoring system will also be improved to increase transparency.

III. RATIONALE, KEY DESIGN ELEMENTS AND SUSTAINABILITY

3.1 Link with CSP, country readiness assessment and analytical works underpinnings

3.1.1 According to the FNDP, the main development challenges facing the country in the short to medium term include, among others: (i) high poverty levels, 64% of people living below poverty line; (ii) high incidence of HIV/AIDS at 20% of the population; (iii) high economic dependence on copper; (iv) transitional effects of reorientation of public expenditure towards poverty reduction programmes; (v) institutional capacity problems across the public service; and (vi) poor public infrastructure. The FNDP has been developed to address these constraints under the themes and related policy priorities indicated under sections 2.1.3 to 2.1.9.

3.1.2 The rationale for the proposed Budget Support is therefore based on the FNDP's structural reform agenda and the Bank's strategy predicated on the two pillars of support to infrastructure development and good governance as well as the need to align to the PAF framework. The Public Expenditure Management and Financial Accountability (PEMFA) programme, supported by eleven DPs excluding the Bank, requires support to build capacity and reform the public finance management. It has recorded significant progress, especially in the areas of record keeping, procurement procedures, audit and accountability as well as prudent economic management. The Government is committed to put in place a strong fiduciary framework. There is, however, more effort needed to fully implement the fiduciary reforms. Some components and reforms that have not made much progress include the Integrated Financial Management Information System (IFMIS); regulatory framework, external finance and co-ordination, parliamentary oversight and budget preparation and execution.

3.1.3 A Public Expenditure and Financial Accountability (PEFA) assessment of Zambia's Public Financial Management (PFM) by external consultants and a team of GRZ officials was undertaken in June 2008 using PEFA's 31 Performance Indicators. The overall assessment measured against the six core PFM objectives, namely: (i) Credibility of the budget; (ii) Comprehensiveness and transparency of the budget; (iii) Policy-based budget; (iv) Predictability and control in budget execution; (v) Accounting, recording and reporting; and (vi) External scrutiny and audit, indicates that there has been improvements in a number of areas in recent years which have increased the transparency, comprehensiveness and accountability of fiscal management. The assessment identified some of the weaknesses of the real-time flows of information and resources, both from MoFNP to MPSAs, and vice-versa, which impede efficient budget implementation. The widespread variations and the ex-post regularisation (through the issuance of a supplementary budget towards the end of the year), serves to undermine the legitimacy of original budget plans. Finally, the demand for better fiscal information from the public could provide incentives to improve further budget transparency and budget monitoring.

3.2 Collaboration and coordination with other donors

3.2.1 The CPs in Zambia signed a GRZ I Donor Co-ordination and Harmonisation Memorandum of Understanding on 1st April 2004. The objective is to enhance aid effectiveness through Aid Harmonisation and Co-ordination, for the betterment of the Zambian people, both individually and corporately, in achieving poverty reduction and the Millennium Development Goals (MDGs). The Bank signed the MOU in April 2007. The Bank also signed the JASZ MOU in the spirit of aid coordination and effectiveness. The Bank has not joined the PEMFA programme given the differences in the procurement procedures.

3.2.2 The general budget support programme in Zambia is supported by nine Poverty Reduction Budget Support (PRBS) members who support the national development agenda through a common framework formalized by a Memorandum of Understanding (MOU). The MOU identifies underlying principles which are pre-requisites for provision of budget support. The PRBS dialogue is based on a common Performance Assessment Framework (PAF) which includes benchmarks and indicators monitored and collectively assessed annually by the PRBS members. The PRBS covers three main themes and related policies: (i) Reform Process and Financial Management; public service management, public finance management, domestic taxation, financial sector development, public service pension fund, macroeconomic management; (ii) Wealth Creation; agriculture, infrastructure, private sector development; and (iii) Social Equity: health, education, gender, HIV/Aids, and Environment. Satisfactory achievement of the agreed 32 indicators determines the level of disbursement by the individual Cooperating Partner (CP). (See Annex IV).

3.2.3 The final agreed score of the 2007 PAF was rated at 66.7% (representing a score of 20 out of 30 targets achieved) by the PRBS. The main areas where GRZ performed well against the targets include: Health; Education; HIV/AIDS, as well as Domestic Revenues and Public Finance Management (PFM). Of concern however are the poor results in the areas of Agriculture, Infrastructure, and Private Sector Development (PSD). While capacity constraint is across all sectors, these sectors are affected more than the others. Other areas with less than satisfactory performance include Public Sector Reform and the Public Service Pension Fund. Table 1 below summarises sectors covered by the PAF framework and the result of the PAF 2007 assessment against each sector. Details of each target are in the PRBS PAF of each year.

Table 1: Overview of Government Performance under the PAF 2007

Sector	Targets fully Achieved	Targets partially achieved	Targets not achieved	Score (%)
Public Sector Reform	1	3	0	62.5
Public Finance Management	4	0	0	100.0
Domestic Revenue	1	0	0	100.0 *
Financial Sector Development	0	0	0	--
Public Service Pension Fund	0	0	1	0.0
Agriculture	1	0	2	33.3
Infrastructure	0	3	1	37.5
Private Sector Development	1	0	1	50.0
Health	3	0	1	75.0
Education	3	0	1	75.0
HIV/Aids	3	0	0	100.0
Total	17	6	7	66.7

* No target set for 2007

3.2.4 The Government of Zambia and the Cooperating Partners have established coordination mechanisms that reinforce their cooperation and aid management. Some of these good examples of harmonisations are in box 1 below.

Box 1 – Good practices of harmonisation in Zambia

- In 2006, Zambia's government and CPs established a new sectoral division of labour whereby individual agencies have chosen one of four participatory roles (lead, active, background, not present) within 15 key development sectors. Some CPs have decided to phase out from certain sectors.
- A number of donors, including WB, Norway and the Netherlands have selected to take "silent" positions within a sector, allowing other donors like Ireland, Norway and Sweden to represent their interests.
- The CPs, GRZ and the private sector in 2006 decided upon a joint coordination mechanism in support of the country reforms for private sector development. The approach allows the PSD to select between a variety of assistance modalities to achieve the needed results. Pooled basket funds and project assistance blend together to produce achievements under this arrangement.
- The PSD CP group has opted for a delegated structure of "contact CPs by reform area", such as trade, empowerment, immigration, telecom and mining. The contact CPs monitor the development in their area of responsibility and inform the other CPs. UNDP, WB, EC, Canada, United States, United Kingdom, Sweden, Finland and the Netherlands participate in this division of responsibilities.
- In education and health CPs have pooled funds to support the Ministries of Health and Education. EC Canada, United States, Ireland, United Kingdom, Norway, Sweden Denmark, Finland and the Netherlands participate in (at least one of) these programs. The funds are managed by MoE and MoH, respectively, providing un-earmarked support to the ministries for annual work plans and budgets.
- During the last national tri-partite elections in 2006, CPs established a civil society Election Fund of \$2.9 million. Managed by a separate agency, the fund allowed the CPs to cut administrative costs for both CPs and beneficiaries and focus more on supporting a free and fair election. The fund was supported by United States, Ireland, Norway, Sweden, Finland, the Netherlands and HIVOS-Southern Africa.
- Joint support frameworks have been elaborated for the development of the 5th National Development Plan, the reform of public financial management (PEMFA) and the reform of the public service (PSM).
- Under the JASZ framework, CPs started working with Government on developing national programmes in water and sanitation, decentralisation and environment.

Source: Joint Assistance Strategy for Zambia (JASZ), April 2007.

3.3 Outcomes of past and on-going similar operations and lessons

3.3.1 The programme draws lessons from the previous policy based programmes which included the Economic Recovery Loans I and II which were structural adjustment programmes, the Support for Fiscal Transparency and Accountability (SFTA) programme (Institutional Support Project) and the Poverty Reduction Budget Support (PRBS- 2007). The SFTA programme aimed at contributing to good governance in Zambia by undertaking policy measures and creating the institutional capacity to promote transparency and accountability in fiscal management. Capacity was developed in the Anti-corruption Commission (ACC), Office of the Auditor General (OAG), Zambia National Tender Board (ZNTB), the Governance Development Unit (GDU) and within the Ministry of Finance and National Planning (MoFND). Most of these issues are now covered under the Public Expenditure Management and Financial Accountability (PEMFA) programme. The lessons learnt from the SFTA programme include the need to avoid cascaded conditions (one contingent upon the other) and that conditions should fall within the limits of what government can do. In this regard, the Bank has adopted independent, achievable and realistic conditions with clear means of verifications.

3.3.2 One of the lessons learnt from the previous operations was that the Bank Group should establish a framework of participation with other donors in coordinating activities to mobilise and engender implementation. The lack of field representation in Zambia at the time affected follow up and coordination with other donors in the past. The Bank should rethink at appraisal the funding structure where institutional support programme is paired with policy support loans like budget support. Fast disbursing programmes can be delayed by programmes or projects whose

disbursement is contingent upon several conditions. The SFTA is a classic case which showed how timely interventions on the policy side could be undermined by poor performance of the institutional support component. To mitigate this, the Bank has adopted where possible a system of separating the operations unless where all the components cover same areas, start at the same time and use the same disbursement method.

3.3.3 Conditions need careful and detailed thought at the preparation and appraisal stages and should be focused with clear deliverables. In negotiating conditions with governments, it is important to delineate conditions that fall in the competences of government. This however, needs further reflection on the objective to be achieved because policy reforms require approval by Cabinet and/or Parliament. In the PRBS I GRZ was required to submit for Cabinet Approval the Debt Strategy which was done but Cabinet rejected it and it is yet to be re-submitted. While the submission was made, the intention was to have a policy document adopted by Government. In SFTA, the GRZ alone could not deliver legislation relating to the revised law on Zambia National Tender Board (ZNTB) or the constitutional change needed to give autonomy to the Office of the Auditor General (OAG). While this cannot be easily avoided, efforts are made when formulating indicators to make them SMART (specific, measurable, achievable, reasonable and timely). The Bank will continue to dialogue with GRZ on the outstanding actions.

3.3.4 In the delivery of consultancy services planned in Appraisal Reports of programmes, the Bank should take keen interest in the delivered outputs. During programme implementation, Governments may not be technically equipped to vet the services they receive under consultancies mandated by the Bank Group. This fate befell the outputs under the domestic debt management consultancy under the SFTA. In the medium term, debt sustainability should be upgraded as a key benchmark for all lending in order to dissuade the Borrower from the 'free rider' problem. To mitigate this, the Cooperating Partners finances the PEMFA programme in order to build capacity.

3.3.5 The objective of the Poverty Reduction Budget Support loan (PRBS I) covered four broad areas of the PRBS, namely, macroeconomic management, public sector reforms, wealth creation and social equity, with 33 indicators and milestones. Apart from jointly focusing on the overall Performance Assessment Framework (PAF) of the PRBS, the ADF also focused on procurement and debt management reforms which were not completed under the SFTA. The 2007 Joint Performance Assessment report gave Zambia a performance rating of 70% (21 indicators met out of 30) on the 2006 PAF. The Project Completion Report (PCR) for the PRBS I has been prepared.

3.3.6 The lessons learnt from the PRBS I point to the need to strengthen the process for the Joint Assessment Review and the PRBS to avoid parallel machinery. In this regard attendance of the Joint Assessment should be at an appropriate level on both sides CPs and GRZ. The National Economic Management Cycle should be revised to be in line with the PRBS and budget cycle for the country. There is need to better integrate the Performance Assessment Framework with the FNDP reporting, and focus on building capacity of the PAF system. Accountability should be improved by incorporating Parliament into the budget cycle and PRBS. Continued involvement by CPs in budget support is needed to press for a stronger planning and budget system, as well as raise the profile of important reforms.

3.3.7 Another lesson is that the selection of targets and indicators for the PAF is complex and will evolve over time. A balance needs to be struck between selecting targets that are feasible, but have little impact, and those that are difficult, but likely to have more impact. The Bank's participation and monitoring will be undertaken by the Country Office (ZMFO) which needs to be strengthened and provided with appropriate staff so that it can effectively and efficiently participate in the dialogue between CPs and GRZ.

Table 2: Summary of Lessons Learnt

PCRs Lessons Learnt	Actions Undertaken
Need to align to the PRBS framework	PRBS II is fully aligned to the PRBS framework.
The Bank should take a keen interest in the delivered outputs of the funded technical assistance	The Bank approves terms of reference for technical assistance for Institutional Support projects.
Conditions should be within the powers of the government	Conditions are limited to the ability of the implementing agencies
Conditions should not cascade or depend on each other	Conditions are SMART.

3.4 Relations to ongoing Bank Operations

3.4.1 The ongoing Bank projects/programmes as of May 2008 when the Country Portfolio was conducted were in agriculture, social sector (education and health), public utilities and multi-sector. A new project for UA3.5 million for a line of credit to Investtrust Plc will be presented to the Board in September 2008. The Investtrust project consists of an integrated assistance package proposal comprising a line of credit (LOC) and technical assistance (TA) support. The LOC aims at providing medium-term financing to Investtrust to enhance Small and Medium Enterprises' (SMEs') access to finance. The project targets growth-oriented SMEs operating in capital-intensive sectors which require financing for project and capital expenditure and trade financing, among other needs. In this way, the project aims to deepen the financial market in Zambia. This project will complement the PRBS II programme's private sector focus area and the increased employment from the SME's sub sector.

3.4.2 The proposed Bank operation will also complement other projects in water, agriculture and social sector through improved financial management of resources, more efficient public service delivery and institutional reforms. Improved private sector performance will also have a positive impact on other projects.

3.5 Bank's comparative advantages

The Bank supported the SFTA programme which targeted public finance management reforms (paragraph 3.3.1) and PRBS I (paragraph 3.3.5). PCRs for the two and lessons learnt have been taken into account when designing this programme. Experience in designing, managing and monitoring the previous programmes gives the Bank an advantage to manage a similar operation. The Bank will concentrate in the selected areas of focus where it has capacity to follow and monitor progress. The PRBS II programme is interlinked to the PEMFA programme and support to both of them will enhance complementarity and foster achievement of intended outcomes.

3.6 Application of good practices principles on conditionality

3.6.1 The Bank is a member of the PRBS and will use the PAF framework for monitoring the operation. The Bank has adopted good practice of conditionality as indicated in the table below.

Box 2 : Good Practice of Conditionality

Principle 1: Reinforce ownership

The proposed programme is fully aligned to the performance assessment framework (PAF), prepared jointly by GRZ officials and the CPs. The PAF is linked to the FNDP, JASZ and the MTEF, which are national documents prepared through a consultative process involving all stakeholders.

Principle 2: Coordinated accountability framework

CPs and GRZ signed the JASZ and PRBS MOU which defines the parameters and modalities to manage the cooperation. These documents were meant to increase aid coordination and reduce transaction cost to Government. The programme is based on the PAF framework agreed by GRZ and CPs.

Principle 3: Modalities for the Bank support

The Bank's support will be part of the overall budget support programme supported by the PRBS. The Bank has selected a subset of focus areas from the PAF policies and targets. The Bank will use the result of the collective annual assessment review for disbursement. This operation will disburse in two tranches of equal amounts in 2009 and 2010.

Principle 4: Conditions for disbursement

While the Bank will use the report of the annual assessment review containing assessment of the underlying principles and targets for a particular year, for its disbursement purposes, the Bank will consider targets relevant to the selected areas of focus for the programme.

Principle 5: Transparent progress review and financial predictability

The Bank informed the Government the ADF XI amount earmarked for budget support and the annual allocation. After the annual performance assessment like all other CPs the Bank will confirm its commitment to be disbursed on the basis of the assessment. The Bank has agreed with GRZ that it will disburse during the first quarter of the year of disbursement using the previous year's assessment hence comply with the PRBS n+1 disbursement principle. The idea is to allow the country more time to spend the money and avoid disbursing during the fourth quarter.

3.7 Application of Bank Group non concessional borrowing policy

Zambia benefits from both HIPC and MDRI and has enjoyed debt cancellation from the Bank. Zambia has just gone out of unsustainable debt and is currently working on a debt strategy policy that will define how it contracts new debts both international and domestic. The Joint IMF/World Bank Debt Sustainability Analysis (DAS) of 2007 under the Debt Sustainability Framework for Low Income Countries¹ concluded that Zambia's risk of external debt distress is low. It further concluded that total public debt is sustainable under all scenarios. Zambia's current policy is to avoid going back to heavy debts. The Bank has not adopted a hardening policy towards Zambia, because at the moment Zambia does not contract non concessional loans.

IV. THE PROPOSED PROGRAMME

4.1 Programme's goal and purpose

The goal of the programme is to contribute to economic growth and poverty reduction. Its purpose is to create an enabling environment for private sector development and improve efficiency, effectiveness and accountability in the management and use of public financial resources.

4.2 Programme's pillars, operational objectives and expected results

4.2.1 The expected outcomes of the programme will result in (i) a conducive and cost effective business environment; (ii) improved budget execution and public expenditure management; and (iii) transparent and accountable financial management.

A. Private Sector development

4.2.2 Zambia had a modest economic growth, low levels of private investment and high levels of inflation that hindered Government's ability to seriously stimulate economic development. Furthermore, the cost of finance, macroeconomic instability, tax rates and administration, regulatory uncertainty, corruption, poor infrastructure and administrative barriers severely constrained the private sectors' ability to meaningfully contribute to job and wealth creation. In response to these issues the Government developed and embarked on a Private Sector Development Reform Programme (PSDRP) prepared in 2005 with the aim of laying the foundation for faster, sustained, private sector led growth by improving the investment climate.

4.2.3 A Private Sector Development Action Plan was developed and identified six ongoing areas of emphasis: (a) improvements in the policy environment and institutions that serve the private sector; (b) improvement of the regulations and laws; (c) infrastructure development; (d) business facilitation and economic diversification; (e) trade expansion; and (f) economic empowerment for citizens.

4.2.4 Government has been engaged in improving Zambia's business environment which it views as crucial for enhancing competitiveness and private sector growth. This started some time back with the commercialization and privatization of some state owned enterprises including some mining conglomerates. The Bank supported through the ERL II (1998-2000) privatization of the Nchanga and Nkana package of the ZCCM, divestiture/sales of the remaining 120 parastatals in the then current portfolio of the Zambia Privatisation Agency; and the transfer of the utilities and larger parastatals to the divestiture portfolio of the ZPA, including Zambia Telecommunications company (ZAMTEL), Zambia Electricity Supply Corporation (ZESCO), as well as parastatals in the hydrocarbon, transport, financial, and gemstone sectors - the Industrial Development Corporation (INDECO).

4.2.5 The government is pursuing further trade liberalization. In 2008, Zambia will complete the agreed tariff phase-down for 85 percent of the goods traded within the Southern African Development Community (SADC). Tariffs on the remaining sensitive goods will be eliminated during 2009–12. The authorities estimate the revenue impact to be small in the short term because the value of goods that meet the rules of origin requirements is small. To reduce the cost of trading across borders, the authorities intend to streamline procedures to halve the processing time required for exporting and importing goods.

4.2.6 The second pillar of the reform agenda with regard to the PSDRP is the Financial Sector Development (FSD). The Financial Sector Development Plan (FSDP) provides the framework for the development of a stable, sound and market-based financial system that supports economic diversification and sustainable growth. Specific FSDP activities include: (a) harmonization of financial sector legislation in the economy, (b) resolution of weaknesses in the insolvent state-owned financial institutions, and (c) increasing the supply of market knowledge on the supply and demand of financial services in Zambia.

4.2.7 While the banking sector appears sound, more needs to be done to strengthen supervision and broaden the availability of financial services. According to the IMF PRGF programme of June 2008, the Bank of Zambia is developing a framework for risk-based supervision and implementation of the second phase of the financial sector development plan. The second Fin Scope survey on the supply of financial services is being finalized; together with the first survey on demand for financial services, it would provide the basis for policies to expand access to financial services.

4.2.8 The Bank will complement the PRBS members' support to the PSD programme in Zambia. The programme will support policy reforms aimed at improving business climate by reducing the time and cost for registering and managing a business, as well as enhancing Zambia's position in foreign markets, increase access to factors of production especially finance and land through capacity development. The Bank will encourage GRZ to undertake measures to enhance women's participation in the private sector as the PSD work plan is being implemented.

4.2.9 The programme will focus on reducing administrative barriers to starting a business and operations to facilitate movement of goods out and into Zambia. It will also monitor progress in employment creation among micro-small and medium enterprises. The targets will be the number of days taken to register a business and the number of days taken to export and import goods as well as employment created by MSMEs receiving support from the Citizen Economic Empowerment Fund. (See Annex II). Its expected outcome is conducive and cost effective business environment for the private sector, with efficient services in business regulation and trade facilitation.

B. Public Financial Management Reforms

4.2.10 In 2003, the Government of Zambia, with assistance of the World Bank conducted a comprehensive diagnostic Public Expenditure Review (PER) which identified three key challenges affecting the transparency and accountability of the country's public expenditure management system. They included lack of efficiency and effectiveness, poor public procurement systems and inadequate accountability and transparency in the use of public funds. The review further identified twelve key areas of Public Financial Management that required to be addressed, namely, Commitment Control and Financial Management System; Integrated Financial Management Information System, Fiscal Policy and Planning, Budget Preparation and Execution, Debt Management, Internal Audit and control, External Financing, Legal and Regulatory Framework, External Audit; Parliamentary Oversight, Accounting and Regulation, and Public Procurement. These twelve key reform areas now form the main components of the ongoing five year Public Expenditure Management and Financial Accountability programme (PEMFA) which commenced in 2005 and is supported by eleven donors. The aim of the latter is to improve Government's capacity to effectively and efficiently mobilise and use public resources and strengthen financial accountability.

4.2.11 The recent PFM assessments notably the PEFA, a "mini" public expenditure tracking survey at service delivery levels for Education and a Public Expenditure Review for Health, and also the decentralization reform efforts, all point to the need for further planning in the following three areas. (a) Budget preparation and formulation, as the MTEF implementation and structure of budget documents need improvement, (b) Budget execution and cash management, especially to secure timely, balanced and predictable releases to service delivery units, and (c) Decentralization, for the need to build capacity that will serve the under resourced District level government institutions. These needs will be addressed by the IFMIS and enhanced FMS system once they are fully operational. The current plans for the two systems needs to be strengthened in order to address these weaknesses. All the fourteen components of PEMFA have weaknesses that need to be addressed and require resources.

4.2.12 The Government policy in public financial management as outlined in the FNDP is to among others: improve budget execution; strengthen financial accountability and expenditure management systems; strengthen the revenue base; maintain single-digit inflation during the FNDP period; and build institutional capacity across various sectors. The overall aim of the policy is to impact significantly on the quality of public expenditure management in Zambia as a

means to achieve economic growth and poverty reduction and tangible improvements in service delivery. In this regard, Government has implemented in the past with the help of donors programmes aimed at improving transparency and accountability in public finance management (section 3.3). While these programmes contributed positively, Government continues to improve public financial management through the PRBS and the PEMFA programmes. The two programme are interrelated and the PEMFA progress is a prerequisite for the PRBS Group's support of the FNDP.

4.2.13 Second Poverty Reduction Budget Support (PRBS II): The PRBS II programme will address the current public finance management with regard to the deviations between original budget and budget outturns which needs to be curtailed. It is necessary to identify the causes whether it is a result of weak budgeting or lack of comprehensive budget and low absorption capacity. The releases of resources to spending agencies should also correspond to the budget and estimated expenditure. In 2006 28.6 % heads' release were not equivalent to their budgets, the same was true for the expenditures. The PRBS II will support the budget preparation and execution within the public finance expenditure management.

4.2.14 The PRBS Group will base their actual budget support on the progress attained in the implementation of the National Development Plan. Progress will be measured through common agreed performance indicators as described in a Performance Assessment Framework (PAF). The PAF is a multi-annual matrix of priority milestones, targets and indicators based on the National Development Plan, Public Expenditure Management and Financial Accountability reforms under the PEMFA programme and related initiatives. The PRBS II programme will monitor the percentage expenditure variance between original budget and total expenditure. The expected outcome of this focus area is improved budget execution and public expenditure management. Through this programme the Bank will dialogue with the Government to take into account women's position in capacity building and reforms.

4.2.15 Public Expenditure Management and Financial Accountability: PEMFA programme has fourteen components including Centralized Computer Services Department and Monitoring and Evaluation (paragraph 4.2.9). A programme logical framework was developed which indicates the goal, purpose, outputs, objectively verifiable indicators and means of verification (Annex III). An annual work programme and budget is prepared and a performance assessment framework for each year is drawn and agreed with Government. Semi Annual Meetings are held twice a year in November/December where the work programme and budget for the following year is agreed upon. In June, the meeting reviews the annual report of the previous year and progress of the six months period.

4.2.16 The programme had a slow start. However, many deliverables are now making good progress. PEMFA has so far achieved the following among others: financial regulations and manual for GRZ have been drafted; cash flow framework and profiles developed and incorporated into the Financial Management System (FMS); commitment control module developed and included in the FMS system; revised chart of accounts presented; change management strategy developed; a development assistance database developed; draft public procurement legislation prepared; etc. These achievements cannot all be attributed to the PEMFA programme because some of them were started by Government with its own resources or with the assistance of CPs on other programmes. There is need to improve the reporting format under PEMFA so as to clarify the extent of PEMFA support received towards the different activities and outputs.

4.2.17 The Government will be required to provide adequate budgetary allocation from its resources to the PEMFA programme. Progress will be assessed using the annual PEMFA

performance assessment framework. The expected outcomes of the PEMFA programme are efficient and effective transparent and accountable financial management system.

Prior Actions

4.2.18 Significant progress has been made on the policy areas covered by the programme which include: private sector development and public financial expenditure management with emphasis on budget execution as well as transparent and accountable public finance management system. The prior actions for this budget support are indicators relevant to the selected focus areas of the programme. Board consideration of this operation is based on the satisfactory assessment of the prior actions by the Fund confirmed in the PRBS Group report of the annual assessment of the 2007 PAF undertaken in June 2008.

4.2.19 The PAF indicators and targets were selected after a detailed process of consultation between the relevant Cooperating Partners and Sector Ministries, with the final indicators being presented to Sector Advisory Groups (SAGs), and the joint GRZ./Ps steering committee. All indicators selected are closely related to the Key Performance Indicators of the Fifth National Development Plan (FNDP), ensuring that PRBS is fully harmonized and aligned with Government's own plan.

4.2.20 The table below (Table 3) shows a subset of indicators from the 2007 PAF relevant to the PRBS II focus areas. While the programme is fully aligned to the PRBS framework and will use the annual assessment framework, a few areas have been selected by the Bank based on its areas of focus and the need to ensure capacity to monitor progress.

Table 3: Prior Actions for the PRBS II (for PRBS Focus Areas)

Indicators	Required Action	Criticality of Indicator	Progress to date (June 2008)
Private Sector Development			
1. Number of days to start (licence) a business.	1. Objective is a reduction in the administrative barriers to starting the operation of a business. For the 2007 and 2008 assessments, a business is said to be started when it has received all of the following (a) Name Clearance (b) Business Registration (c) VAT Registration with ZRA (d) Registration of ID at ZRA (e) Opening a Bank Account (f) Registering with NAPSA The length of time taken is considered to be the sum of the average length of time to get all six of these, in the identified locations.	1. The cost of registering a business in terms of time taken to obtain a licence is important for performance of the private sector. Investors want to have a transparent and quick system and few processes. It is in view of this that Zambia is committed to reducing the time taken to register a business. Private sector is an engine of economic growth and since government cannot do everything there is need to improve service and make conducive conditions for the private sector.	1. The 2007 target was 10 days but the assessment estimates it to 8 days (above the target). The indicator was met.
Financial Management Reforms			
2. % Expenditure Variance between original budget and total expenditure (selected sectors)	1. Expenditure Variance is the summed absolute values from each budget head (administrative classification) as a percentage of the total originally budgeted GRZ expenditure. Original Budget is the originally approved budget by parliament (that is, it excludes	2. Budget execution and management is important in public expenditure management. The variance reveals poor management either in terms of budgeting or expenditure control. It is therefore necessary	2. The variance was slightly lower in 2007 than 2006 (14.4% compared to 15.6%). It is 9.4% for selected sectors (eight key MPSAs for the PAF).

	the supplementary budget). At present, this is based on Government Expenditure only for all expenditure heads. Expenditure is the reported expenditure as presented by Office of the Accountant General. ^{TN4}	to monitor the budget outturns against the original budget. The problem could also be the absorption capacity of implementing entities and therefore appropriate actions could be undertaken.	The target was met.
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4.3 Financing needs and arrangements

Table 4: Mid-Term Expenditure Framework 2008-2010 (budget projections)

Item	2008		2009		2010	
	Billion Kwacha (K)	Billion USD	Billion Kwacha	Billion USD	Billion Kwacha	Billion USD
Total Revenues and grants	11,728.47	2.792	12,794.26	3.046	13,756.99	3.275
Domestic Revenue	9,347.66	2.226	10,429.17	2.483	11,499.44	2.738
Expenditures	12,680.40	3.019	13,759.72	3.276	14,802.99	3.525
Deficit	951.93	226.65	965.46	229.87	1,046.00	249.05
Financing Plan						
Domestic financing	618.71	147.31	566.70	134.93	614.75	146.37
Net External Financing	333.22	79.34	398.77	94.95	431.25	102.68

Source: MTEF 2008-2010, MoFNP. Exchange rate prevailing at the time was 1 USD=4,200K

4.3.1 Total revenue including grants translates to 22.75 percent of GDP in 2008, 22.58 percent of GDP in 2009 and 22.38 percent of GDP in 2010. As a percentage of GDP, the expenditures are projected to decline from 24.59 percent in 2008 to 24.08 percent by 2010 on account of the foreign financed expenditures declining over the medium term. The projected overall deficits in 2008, 2009 and 2010 are 1.85 percent of GDP, 1.70 percent of GDP and 1.70 percent of GDP, respectively

Table 5: External Grant Flows Projections (in K' billions), 2008-2010

	2008 Proj	2009 Proj	2010 Proj
General Budget Support	625.11	707.68	722.24
Sector Wide Approaches (Pool Funding)	402.84	355.48	137.12
Project Assistance	1,352.88	1301.93	1,398.19
Total	2,380.83	2,365.09	2,257.55

Source: Ministry of Finance and National Planning

4.3.2 The expected tax revenue from the copper mining industry may not be enough to offset the deficit, hence the need for continued foreign support. External grants are projected to be declining over the medium term from 4.62 percent of GDP in 2008 to 3.67 percent of GDP in 2010. This is mainly on account of project support which is declining in the outer

years due to the completion of some projects and no new commitments yet by the cooperating partners.

4.4 Beneficiaries of the programme

The PRBS II programme is expected to benefit the Zambian population including business community. Through dialogue and the annual assessment the GRZ officials' capacity will be improved. Citizens will be able to manage businesses in a conducive and cost effective environment and this would increase employment and income for citizens. Improved budget execution and public expenditure management will reduce wastage and ensure that resources are used prudently for the benefit of the nation. A transparent and accountable financial management will also benefit citizens in that the leadership will become more accountable and people will be aware of what is taking place. The expected outputs of the programme are reduced number of days to register a business, export and import of goods and these are beneficial to citizens. Other outputs are reduction in the variance between budget outturn and original budget, improved cash management system, installation of the IFMIS and FMS, as well as additional employment created by SMEs receiving support from Citizen Economic Empowerment (CEE) fund. These outputs will benefit citizens by creating employment and making services accessible. The Bank will take deliberate measures to encourage the Government to enhance gender mainstreaming in all the areas of support for this programme. It is further expected that through the development of the private sector women will be among the beneficiaries.

4.5 Impacts on gender

Government will be encouraged to undertake measures that will include gender responsive programmes in its development planning and implementation. In this regard, it is expected that improved public financial management and business environment as well as budgetary control and transparency, will benefit women as part of the population. The private sector development, especially the SME sub sector, which is dominated by women, will also benefit female headed households. Gender mainstreaming in public expenditure management and budgeting will be encouraged. The Bank will dialogue with Government with a view to introduce gender responsive budgeting in its programmes.

4.6 Environment impacts

This programme has been classified under category 3 of the Bank's environment classification. The programme is not expected to generate any negative impacts on the environment. These include proposals on the rural environment which is the primary source of more than 50% of GDP, on natural resource conservation, sustainable development, disaster prevention, green taxes and accounting, measures to protect the poor and the environment, root causes of lack of gender equity (including women's access to land), environmental health and water and private sector.

V. IMPLEMENTATION, MONITORING AND EVALUATION

5.1 Implementation Arrangements

5.1.1 The Ministry of Finance and National Planning which is the focal point for budget support houses the PRBS Secretariat. Negotiations for PAF policy coverage, formulation of targets and means of verification and annual assessments with CPs are normally chaired by Secretary to Treasury. The CPs have a Chair who coordinates and seek consensus among the CPs

and with GRZ. CPs also have leads in each sector who coordinates and represent CPs in the meeting of the sector. CPs agreed to establish funding arrangements that are compatible with the spirit and provision of the MOU. The annual review of the PAF which assesses the performance of Government on the agreed indicators takes place in June and CPs confirm their commitments for the next year after the assessment. Formulation and confirmation of targets is undertaken in the October/November High Level Forum. The Zambia Country Office represents the Bank in the PRBS, and will follow up on monitoring progress in the Bank's areas of focus.

5.1.2 The disbursement will be based on the annual assessment of the PAF and underlying principles. While assessment is done collectively, some CPs use a two component system for the release of their tranches. The base component is determined by the holistic assessment and the performance component is based on the PAF. For the Bank and the World Bank the disbursement of the tranches are based on the PAF assessment. The Bank unlike others does not use the whole PAF but has selected a subset of the PAF due to the need to be selective and capacity to monitor progress. The Bank in this operation has adopted the n+1 principle which is viewed to be providing predictability of funding releases, because after each annual assessment CPs confirm commitments for the following year. This operation will disburse during the first quarter of each year based on the assessment of the previous year. This was adopted to comply with the budget cycle of the country and to disburse early in the year so that Government has time to spend the resources within the year of release.

5.1.3 The CPs have agreed to use the Auditor General's report for purposes of auditing the budget support programme. Both internal and external audits are being strengthened through the PEMFA programme. The PRBS MOU provides that Government will furnish PRBS Group members with copies of the annual report of the Auditor General on the public accounts of Zambia. If the report is delayed beyond 15 months the PRBS Group may commission through the office of the Auditor General, a financial or performance audit by an independent auditor.

5.1.4 The budget support does not raise any direct issues of procurement, however where there is need to procure goods and services, the country's procurement system will be used as it has been accepted by the PRBS Group.

5.2 Monitoring and Evaluation

5.2.1 The PAF which has targets and means of verification for each year will be used to monitor progress. Sector Advisory Groups (SAGs) play a leading role on monitoring, collecting and verifying information. Sector Advisory Groups include CPs and GRZ representatives and are critical in formulating targets. The lead donors brief CPs on progress and problems on the respective sectors. The SAGs evaluate reports on progress and make an assessment and can verify by going to the field. Annual assessment is undertaken each year in June while targets are formulated in October of each year.

5.2.2 The Bank will monitor the programme in accordance with the PRBS framework. The annual assessment will be used to monitor and review progress. The Bank field office (ZMFO) will take lead in following up on progress and representing the Bank in CPs meetings. The ZMFO officers, Country Programme Officer and Country Economist will form a core team to monitor progress with other CPs officials.

5.2.3 The Government will report to the PRBS on progress achieved on all the targets and indicators. The APR which is also produced annually will be used to report on general performance of all GRZ programmes. The basis for performance monitoring will be the PAF which contain indicators to be met in a particular year. The progress will be assessed at the PAF

Annual Assessment meetings between CPs and Government. Government will prior to the meetings provide progress to the CPs for assessment before the meetings. The Bank will use the PEMFA assessment reports to assess progress on targets under this programme.

VI. RISK MANAGEMENT

6.1.1 Potential risks and mitigation measures have been identified in the following areas: (i) weak implementation capacity which could lead to failure to achieve the objectives of the programme. The PEMFA programme will provide necessary capacity in the area of public finance management to ensure prudent management of public resources and skill development to implement the development agenda of Zambia. (ii) fiduciary risks which could lead to weak accountability will be mitigated by support to the PEMFA programme which is both a capacity building and PFM reform programme; (iii) the risk of increased public expenditure without corresponding revenue will be mitigated by ensuring cost recovery and increased access in energy and improved debt management; (iv) energy shortages resulting from low tariffs and high operational losses of the utility company (ZESCO) which could adversely affect the growth objectives. The energy crises which could affect private sector development have highlighted the need for policy reforms in the energy sector and Government is currently considering options in the sector; and (v) in view of the cyclical nature of commodity prices, copper prices may decline and adversely affect the balance of payments which would together with petroleum prices affect the macroeconomic stability. Continued prudent management of public resources and macroeconomic stability, political stability, accountability and transparency as well as implementation of the reforms and peaceful transfer of power will be needed for Zambia to achieve its vision.

6.1.2 Zambia has shown commitment to ensure macroeconomic stability, accountability, democracy and rule of law, ownership of its development agenda, all of which are necessary for continued development growth and mitigation of the possible risks. The sustainability of the programme will depend on the macroeconomic stability and continued reforms and their implementation. The reforms under PEMFA which include public financial management issues will also improve capacity to implement national programmes. Government is already being cautious in contracting new loans and is working on a debt policy and strategy. Government is also improving the absorptive capacity in order to implement planned and funded programmes. The business environment should continue to improve and revenues collection should also increase to avoid future hardships that may affect the current progress of development. Prudent management of resources including the expected resources from the mining taxes could ensure continued funding and sustainability of the programme. Political stability is also an important aspect for the programme and it is hoped that Zambia will continue to show political maturity it has demonstrated in the recent past.

VII. LEGAL INSTRUMENTS AND AUTHORITY

7.1 Legal Instruments

The Fund will enter into a Loan Agreement with the Government of Zambia for the purposes of the proposed budget support. Both the Government of Zambia and the Fund will accept all the provisions of the General Conditions Applicable to Loan and Guarantee Agreements of the Fund, dated 23 November 1989, as amended. The total amount of the loan will be UA15.0 million to be disbursed over two years in two equal tranches of UA7.5 million each. The charges and payments arrangements will be according to the policy and financing guidelines

provided in the ADF XI report. The Government will use its procurements system subject to the list of non eligible items.

7.2 Conditions Associated with Bank's Intervention

7.2.1 Entry into force of this loan shall be subject to fulfilment of the provisions of section 5.01 of the General Conditions.

Conditions precedent to first disbursement shall be conditional upon:

- (i) Evidence of the opening of a foreign currency account with the Bank of Zambia to receive budget support resources, including proceeds of this loan.

7.2.2 Conditions precedent to the second disbursement shall be conditional upon:

- (i) Satisfactory performance assessment of the Fund's 2008 PAF focuses areas, confirmed by the report of the joint assessment to be undertaken in 2009 by the PRBS Group.
- (ii) Satisfactory performance assessment by the Fund of the 2008 PEMFA work programme following its review of the report of the Semi Annual Meeting of PEMFA to be undertaken in 2009; and
- (iii) Satisfactory evidence of adequate budgetary allocation by the Borrower for the PEMFA programme in the 2009 and 2010 budgets.

7.3 Compliance with ADF Policies

This programme complies with all applicable ADF policies.

VIII. RECOMMENDATIONS

Management recommends that the Board of Directors approve the proposal for a loan to Zambia in an amount equivalent to UA 15.0 million (Fifteen million Units of Account) in accordance with the terms and conditions set out in this report.

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Letter of Development Policy



Republic of Zambia

MINISTRY OF FINANCE AND NATIONAL PLANNING

OFFICE OF THE MINISTER

[Website: www.mofnp.gov.zm, Email: mtmf@mofnp.gov.zm]

REF:

MFAL/102/16/2

30th September, 2008.

Dr. Donald Kaberuka
President
African Development Bank Group
Temporary Relocation Agency
BP 323, 1002 Tunis Belvedere
Tunisia

Your Excellency,

**LETTER OF DEVELOPMENT POLICY: SECOND POVERTY REDUCTION BUDGET
SUPPORT**

I am writing to request on behalf of the Government of the Republic of Zambia, a loan of UA 15.0 million equivalent from the African Development Fund (ADF) to support the Second Poverty Reduction Budget Support (PRBS II) in the implementation of the Fifth National Development Plan. The PRBS II aims at helping Zambia continue development reforms and sustain the economic gains it has achieved over the last five years and to further enhance capabilities to sustain growth and reduce poverty.

Fifth National Development Plan

In January 2007, Zambia launched the Fifth National Development Plan (FNDP), which is Zambia's second Poverty Reduction Strategy Paper (PRSP) for the period 2006-2010. The FNDP is guided by the National Vision 2030 (NV2030), whose goal is to transform Zambia into "a prosperous middle income country by the year 2030". The FNDP is organized around the theme of "broad-based wealth creation and job creation through citizenry participation and technological advancement" and it focuses on economic infrastructure and human resources development."

The FNDP builds upon the achievements of the first PRSP, which was predicated on strong improvements in macroeconomic performance and progress in public expenditure management. The FNDP has strengthened focus on key issues relevant for Zambia's development, emphasizes achieving tangible results, and includes monitoring and evaluation arrangements. On policies, it continues to place emphasis on the importance of a stable macroeconomic framework, improved domestic revenue collection, good governance, increased production and productivity in agriculture, and strengthened human resource development.

The preparation of the FNDP was highly participatory. All the major stakeholders; civil society, cooperating partners, the private sector, permanent secretaries, members of parliament and the Cabinet, were involved in the preparation of the strategy. The priorities were arrived at through a series of consultative meetings with Sector Advisory Working Groups (SAGs) and other key stakeholders. This consultative process integrated the views of 21 SAGs and included the preparation of 72 district development plans that were approved by the respective Provincial and Development Coordinating Committees. Consequently the FNDP has a high degree of ownership.

The importance of institutional frameworks for implementation, monitoring and evaluation are acknowledged and prioritised by the FNDP. The newly created Planning and Economic Management Division (PEMD) of the Ministry of Finance and National Planning will be the focal point for institutional linkages. This division will institutionalize five year development planning as the means to guide the budget preparation process. With the formal creation of the Monitoring and Evaluation Unit under PEMD during implementation of the first PRSP, the Plan seeks to institutionalize a system to monitor inputs, outputs, outcomes and impacts so that resources are strategically managed and process tracked. In particular, monitoring and evaluation process will provide essential data and insights for drawing lessons, priority setting and informed review of the FNDP implementation. The monitoring system will also include process indicators that are relevant to the implementation of the FNDP at both the macro and sectoral levels. These indicators will be closely linked to the performance assessment framework (PAF) that is currently used in the context of direct budget support.

B. Macroeconomic Environment

Government is aware of the importance that a sound macroeconomic environment has for growth and poverty reduction. In this regard, Zambia's macroeconomic environment has improved significantly over the last three years with inflation in the single digits for the first time in almost three decades and a budget deficit below three percent. The Government is committed to maintaining and building on these achievements, which is an important objective of the FNDP. The IMF has provided assistance to GRZ through its PRGF arrangement to reach this positive position. The last PRGF arrangement expired formally in September 2007 and a new low access three year PRGF arrangement was concluded in May 2008.

C. The Performance Assessment Framework

In line with the Government's aspiration in the Aid Policy and Paris Declaration, Zambia's preferred mode of aid delivery is General Budget Support. In this regard, a number of Cooperating Partners have indicated their willingness to provide funds in this manner, which culminated in the development and signing of a Memorandum of Understanding (MOU) for Poverty Reduction Budget Support (PRBS). At present nine cooperating partners have signed up to this MOU, namely the European Union, DFID, Germany, Norway, Sweden, Finland, the Netherlands, the World Bank, and the African Development Bank while a number of other partners have expressed their interest to join in the short and medium term.

A framework has been developed for assessing performance under the PRBS MOU referred to as the Performance Assessment Framework (PAF). It provides the basis for discussions over the effectiveness of PRBS on a bi-annual basis. The PAF 2008-10 was developed after detailed consultations between the Ministry of Finance and National Planning (MoFNP) and Poverty Reduction Budget Support cooperating partners and representatives from the various sector ministries/institutions. The ministries also engaged in further series of consultations, through the Sector Advisory Groups (SAGs) in their selection of the indicators and areas for inclusion in the PAF.

The Government and the PRBS donors meet twice a year to review performance in relation to the agreed PAF for the previous year, and to agree the contents of the PAF for the next year. The joint review meetings take place each year in June and October.

In the June review, PRBS donors and Government come together and jointly review performance which serves as the basis for commitments for the next budget year. The review is based on the National Development Plan's Annual Review, the annual Public Expenditure Management and Financial Accountability (PEMFA) progress reports, Quarterly Budget Execution Reports and related information, plus the national audits.

The October review meeting focuses on the dialogue on forward planning and budgeting and agreement on the PAF for the next budget year. This dialogue is based on the annual Financial Reports of the previous budget year, the Annual PEMFA Evaluation and ceilings in the annual budget for the next budget year, as specified in Zambia's MTEF Green Paper. During this review meeting, each member of the PRBS Group confirms the volume of its commitment. During this review meeting, Government and PRBS donors agree on the PAF for the next budget year.

There are 33 indicators and milestones included in the PAF 2008 covering four broad areas: Public Sector Reform, Macroeconomic Management, Wealth Creation and Social Equity, 30 of these have been used to assess progress for 2006. The choice of these broad areas is in line with the FNDP theme and strategic focus. Furthermore, the indicators in the PAF are a subset of the monitoring and evaluation framework of the FNDP and are therefore fully consistent with the Key Performance Indicators of the FNDP.

The PRBS Donors support the following areas contained in the PAF and in line with the FNDP.

Public Sector Reform. The Government with assistance of the collaborating partners prepared and adopted an updated and revised Public Sector Reform Programme in 2003. The updated reform programme acknowledges the need to focus on three main aspects of the programme that is: (i) Public Sector Management (PSM); (ii) Public Expenditure Management and Financial Accountability (PEMFA); and (iii) Decentralization as means to improve the accountability, transparency, efficiency and effectiveness of its expenditure programmes and service delivery. For each of these broad areas, strategies have been prepared, implementation plans developed, and institutional structures to monitor and facilitate implementation put in place.

In the area of public service management, the Government has completed the rightsizing of the central line ministries and has now embarked on reviewing the provinces and districts with the aim to strengthen their ability to deliver services. For the restructuring of provincial and district administration, a comprehensive implementation plan was developed. In the first part of 2007, generic plans and structures for provincial and districts administration and local councils have been developed. It is expected that implementation of the plans will commence in 2008.

An important part of our public service reform programme is to institute service delivery charters as a means to ensure that all ministries and spending agencies manage performance effectively within well specified framework. This should assist each of the institutions in question to evaluate their performance and develop plans on how they can bring their service delivery up to the standards set. We expect that by the end of 2008, Service Delivery Charters for four institutions in the public service, especially Ministry of Lands, Department of Immigration, Public Service Management Division, and Department of National Registration, Passport and Citizenship will have developed their respective service delivery charters.

Another important component under public service reform is progress with the preparation and implementation of a comprehensive pay policy. Pay levels for civil servants remain an issue of contention, as they are considered inadequate and inconsistent with performance, hence the public service is unable to attract and retain essential technical and professional staff. A diagnostic study with a focus on these issues has been initiated and will be undertaken and completed in 2008.

To improve quality and timeliness of the data in the Payroll Management and Establishment Control (PMEC) system, government has embarked on a process of enhancing the PMEC system such that resource officers of spending agencies can access the system directly from their own location and work stations. This enhancement to the PMEC system was rolled out to three agencies (Zambia Police, Public Service Management Division and Ministry of Finance and National Planning) in 2006 and a further three MPSAs have been connected, Ministry of Works and Supply, Ministry of Home Affairs and Ministry of Agriculture and Cooperatives in 2007. The rollout will continue until all spending agencies have been covered.

In the area of public expenditure management, the programme supported by the PRBS donors focuses on budget execution, internal and external accountability, and clearing of arrears to suppliers. These areas are indeed of critical importance and will assist GRZ to strengthen our creditability with regard to budget and are supportive of important areas that are part of our Public Expenditure Management and Financial Accountability (PEMFA) project, which aims to improve our institutional capacity in these areas as well. The PEMFA programme covers also other parts of the public expenditure management system, for example, the implementation of the Integrated Financial Management Information System (IFMIS), the creation of a Treasury Department, strengthening of procurement systems, internal and external audit systems, and our debt management system.

Government has struggled for some time to find the financial resources to clear arrears with its contractors as well as to put in place a commitment control system that would minimize the ability of new arrears arising. The Government programme includes reduction of arrears from a level of ZK533 billion in 2005, which is equal to 1.6 percent of GDP, to zero by 2009. The decline in arrears in 2006 to ZK491 billion, which is equal to 1.2 percent of GDP, was disappointing. However, the budget for 2008 and the MTEF/Green paper for the period 2008-2010, reconfirm Government's commitment to reduce supplier arrears to negligible levels by 2009. To reduce the ability of new arrears to accumulate, the Government has embarked on an implementation plan that will strengthen the commitment control system by integrating the following stand alone financial management modules, the activity based budgeting, funding, and cash flow forecasting and expenditure modules, into the overall Financial Management Information System. We have made some progress but the system is not perfect yet. We expect that once the IFMIS is operational, the occurrence of new arrears will be kept to a minimum.

Financial Sector. To support the positive developments in our macroeconomic environment, the Government in consultation with other stakeholders has prepared a Financial Sector Development Plan (FSDP), which was endorsed by Cabinet in 2004 and which provides for a systematic and coherent action plan that would lead to the realization of a well functioning financial sector in Zambia. Since then the authorities have enhanced the role of micro finance, strengthened the supervision of banking and non-bank financial institutions, and introduced mechanisms to monitor debtor payment history including licensing of the Credit Bureau Africa Limited.

Public Pension Funds. As articulated in the FNDP, the two public sector pension funds, that is, Public Sector Pension Fund (PSPF) and the Local Annuities Superannuation Fund (LASF) are both technically insolvent, although both hold some assets and are owed sizeable amounts in contribution arrears. To correct the imbalance between contributions and benefit accrual rates,

article 124 of the Constitution, which specifically protects accrued benefits, will need to be revised. These needed revisions are included in the proposed amendments to the Constitution prepared by the Constitutional Review Commission (CRC). Once adopted, a revision of benefits would be implemented and PSPF and LASF could be put on a sound financial footing. To ensure that PSPF can continue to pay benefits until the amendments have been adopted, Government has agreed to reduce annually during the 2006-09 period its contribution arrears to PSPF: and not to accumulate any significant new pension arrears. This has been incorporated in the budget for 2008 and the MTEF for 2008-2010.

Wealth Creation. The FNDP articulates programmes in many areas that are relevant for the creation of wealth in Zambia, but I would like to articulate here those that are deemed most important and as such have been incorporated in the PAF. These areas are agriculture, road infrastructure, and private sector development.

Agriculture. Agriculture features prominently in the FNDP and holds great promise for accelerating poverty reduction. The FNDP acknowledges that agricultural productivity is currently being negatively affected by inadequate access to productive assets; limited access to agricultural inputs; high energy and transport costs; lack of mechanisms to mitigate climatic risks; low soil fertility; inadequate access to agricultural service support, such as credit and markets; and disease and pest attacks on both crops and livestock. In addition, HIV/AIDS has had a negative impact on labour supply and has generally undermined the productive capacity of households.

As acknowledged in the FNDP, Zambia needs to improve agricultural productivity and market competitiveness in order to grow out of poverty. Notwithstanding, it should also be noted that the agriculture sector has contributed significantly to Zambia's overall economic diversification, while the sector itself has also diversified and has increased production in a variety of crops such as cotton, coffee, tobacco, and horticultural and floricultural products. It is important to realize that the recent increases in production have mainly been due to support provided to small-scale farmers by private out grower companies and large export oriented commercial farms.

Several actions have been identified in the FNDP to improve the sector's ability to contribute more effectively to growth and poverty reduction. The main milestone identified for inclusion in the PAF are (i) the need to increase the allocation from GRZ's budget to investment programmes of the Ministry of Agriculture and Cooperatives (MACO) from a meager ZK23.3 billion in 2005 to ZK88 billion in 2006, ZK226 in 2007 and ZK193 in 2008; (ii) to improve access to additional land that can be used for agriculture through the provision of infrastructural services such as connection to the electricity grid, roads and water, and irrigation services. The basic infrastructure for this exercise was developed in 2006, opened up an additional 50 thousand hectares annually in 2007 and 2008; (iii) to define the roles and responsibilities of the public and private sector when it comes to Zambia's agriculture marketing system. To accommodate this task, a new Agricultural Marketing Act has been developed. All consultation was concluded in 2006 and implementation of the Draft Act is pending the approval by Cabinet.

Infrastructure. It is clear that for a country as large as ours, which is also landlocked, a well-designed and maintained road network is of critical importance to link its communities and minimize the impact of transport cost on its overall competitiveness. The FNDP, therefore, has put its strategic focus on improving the road network. To improve the predictability of financing and strengthening implementation capacity, three new road agencies, each assigned with a specific task, were created. The National Road Fund Agency (NRFA) is responsible for the coordination and management of the road financing functions, including collection, disbursement, management, and accounting of Zambia's road fund; a Road Development Agency (RDA), which is tasked with the management responsibility of the public/proclaimed network, and which includes planning,

programming, implementation, monitoring and overall supervision of all road works in the country; and a Road Transport and Safety Agency (RTSA), will be responsible for implementing policy on road transport and traffic management, road safety and enforcement of laws regulating road transport, traffic safety, and axle load control in the country. In addition, this agency is responsible for planning, programming, implementation, and monitoring and evaluation of road transport regulations and approved safety programmes.

An important step to have the agencies operate effectively is to ensure that vacancies in the new agencies are filled. Under the PAF, it was agreed that this is a priority and as such basically a 100 percent of all posts have been filled. The FNDP also monitors kilometers of roads upgraded, rehabilitated, and kilometers of unpaved roads maintained and we are committed to ensure in cooperation with donors, that the ambitious targets set for the improvements in our road network will be accomplished.

Government recognizes that improvements are also required in other infrastructural sectors. Therefore, the FNDP puts emphasis on the need to further enhance the performance and access of other infrastructure service delivery sectors such as water and sanitation, electricity and telecommunications. Hence, policy improvements and investments are taking place in these sectors as well. Even though the current PAF does not include indicators to monitor their development partly because of the need to make sure that the process remains manageable for Government. I assure you that Government is committed to implement the plans as articulated in the FNDP.

Private Sector Development. In order to reduce the cost of doing business in Zambia and to increase participation by Zambians in the economic process, Government has taken two legislative initiatives: which are: (i) merging several agencies supporting the private sector in order to reduce bureaucratic procedures for investing and obtaining an appropriate business license and (ii) empowering Zambian citizens through the Citizen Empowerment Act so as to increase employment and participation of Zambians in the economic development process.

The Zambian Development Agency (ZDA) has taken over the responsibility of the Zambia Investment Center (ZIC); Zambia Privatization Agency (ZPA); Zambia Export and Processing Zone Agency (ZEPZA); Small Enterprise Development Board ((SEDB); and the Export Board of Zambia (EBZ). The Act establishing ZDA was passed in 2006 and a work plan was developed for removal of barriers to export and setting up a business. This has to lead to reduction of at least 8 working days in length of time it takes to establish a business by the end of 2007 from a level of 33 days in 2006.

The Citizen's Economic Empowerment Act was passed by Parliament on 12th May, 2006 and a Citizen's Economic Empowerment Authority has been established including putting in place information and communication plan. Key staff has been recruited and a strategic plan has been developed. In 2007, we allocated K70 billion to the Citizens Economic Empowerment trust fund and the 2008 budget has made a provision of K50 billion, it is expected that by the end of 2008, the fund will become operational.

Social Equity

Health Sector. A healthy, well educated population, which is aware of HIV/AIDS prevention and treatment, is critical to ensure positive long-term per capita growth and poverty reduction. To improve the chances of Zambians to live healthy lives several initiatives have been incorporated in Zambia's FNDP. This includes improving the percentage of institutional deliveries, increasing the percentage of fully immunized children under one year of age in the 20 worst performing districts,

improving the utilization of primary health centers facilities, and ensuring that an increasing amount of the health budget is released to the district level.

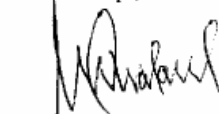
Education. Government implemented a policy of free access to primary education in 2003 and this has resulted in increase in net enrollment for the affected grades 1-7. The results show that this policy has worked. Nonetheless, some districts have not done as well as others. The FNDP acknowledges this issue and Government is targeting those districts that still have Net Enrollment Rate (NER) of less than 80 percent. In 2005, 10 districts out of 72 still had a NER of less than 80 percent. In addition, girls leave schools earlier than boys and pupil teacher ratios in several districts are very high, for example in 2007 in 8 districts pupil teacher ratios stood at over 100. The Government supports actions included in the FNDP to address these shortcomings and to gradually improve completion rate for girls and reduce the number of districts with pupil teacher ratios of over 100 for grade 1-4.

HIV/AIDS The human toll of AIDS for families and communities in Zambia still remains a challenge. Even though levels of infection have stabilized, the number of people living with HIV/AIDS is still high. It is estimated that the prevalence rate stands at 16 percent among the 15-49 years age group. About 1 million Zambians are infected with HIV, of which over 200 000 are in need of anti-retroviral therapy (ART). About eight percent of boys and 17 percent of girls aged 15-24 are living with HIV and 40 percent of infants born to HIV infected parents are HIV infected. One of the areas of focus is to increase the number of people tested and number of people accessing Anti-retroviral drugs.

With regard to ***PEMFA***, we would like to advise the Bank to consider channeling the envisaged support to the programme through the Second Poverty Reduction Budget Support (PRBS II) as this will ensure that the resources reach the programme at the earliest time possible for implementation of the various activities under it.

Your Excellency, the Government of the Republic of Zambia believes that the measures listed in the PAF, of which the proposed ADF loan directly supports a critical subset, will contribute to achieve robust economic growth and poverty reduction within a sustainable macroeconomic framework. Further, the outlined policies, programmes and reforms in the Performance Assessment Framework will create a conducive environment for the effective and efficient utilization of ADF XI assistance and will support the FNDP's implementation.

Please accept, Your Excellency, the assurances of my highest considerations.



Ng'andu P. Magande, MP
MINISTER OF FINANCE AND NATIONAL PLANNING

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Programme Indicators for 2008 & 2009 (extracted from the PRBS II PAF)

A. ENABLING ENVIRONMENT			
Policy Objectives/ Indicators	Required Action Definition/Calculation	2008 Indicators	2009 Indicators (To be confirmed in 2008)
1. Private Sector Development	.		
(i) Number of days to register (licence) a business.	Objective is a reduction in the administrative barriers to starting the operation of a business. For the 2007 and 2008 assessments, a business is said to be started when it has received all of the following (i) Name Clearance (a) Business Registration (b) VAT Registration with ZRA (c) Registration of ID at ZRA (d) Opening a Bank Account (e) Registering with NAPSA The length of time taken is considered to be the sum of the average length of time to get all six of these, in the identified locations.	(i) (10 days in Lusaka and 4 regional offices. Comprehensive audit of licences completed.	(i) 10 days in Lusaka and all regional offices.
ii) Number of days to (a) import and (b) export products	(ii) In terms of required actions, the MTEF identifies the need to integrate the operations of all institutions involved in trade facilitation at two points of entry (Chirundu Border Post and Lusaka International Airport). This is expected to help border agencies exercise clear, transparent and holistic operations to facilitate quick trade and the passage of goods and persons transiting Zambian borders. At present the four elements measured to assess length of time are (a) Document Preparation (b) Inland Transport	(ii) No indicator	(ii) Reduced by half from 33 and 14 days in 2007 to 16 and 7 days in 2009.

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<p>(iii) Number of people additionally employed in MSMEs receiving support under the CEE fund.</p>	<p>(c) Customs Clearance (d) Ports and Terminal Handling The focus of the calculation will be on three points – Chirundu, Kasumbalesa and Nakonde</p> <p>(iii) The identified required actions to unlock the potential of this sector in order to promote value-addition and exports are to promote the growth of MSMEs through training in business management and technical skills; and strengthening the linkage between MSMEs and large manufacturing firms especially those supplying intermediate raw materials. Government will promote the development of the indigenous investment through the Citizens Economic Empowerment (CEE) initiative to ensure that local entrepreneurs are afforded easy access to factors of production especially finance and land.</p> <p>Employed means employed in the formal sector, whereby they pay income tax and / or NAPSA contributions.</p> <p>MSME = Micro Small and Medium Enterprises</p> <p>The reported number is the total number of new jobs created in companies who have accessed funds from the CEEF in the course of the year.</p>	<p>(iii) The Fund operational by January 2008 Number of people newly employed in companies receiving assistance under the CEEF.</p>	<p>(iii) Net number of people newly employed in companies receiving assistance under the CEE.</p>

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B : PUBLIC FINANCIAL MANAGEMENT REFORMS			
2. Percentage of Expenditure variance between original budget and total expenditure (selected sectors)	<p>(i) Expenditure Variance is the summed absolute values from each budget head (administrative classification) as a percentage of the total originally budgeted GRZ expenditure.</p> <p>Original Budget is the originally approved budget by parliament (that is, it excludes the supplementary budget). At present, this is based on Government Expenditure only for <u>all</u> expenditure heads.</p> <p>Expenditure is the reported expenditure as presented by Office of the Accountant General.^{TN4}</p>	(i) 5%	To be determined

^{TN4} Steps for calculation for (a) Total:

- (i) For each budget head included calculate the deviation between actual expenditure and original budget
- (ii) Sum the absolute value of the deviations for all budget heads
- (iii) Calculate the sum as a % of total budgeted expenditure

The indicator shall measure the extent to which reallocations between budget heads have contributed to variance in expenditure composition.

Steps for calculation for (b) Selected Expenditures:

- (i) For each of the eight budget heads and one sub-head calculate the deviation between actual expenditure and original budget
- (ii) Sum the absolute value of the deviations for the selected budget heads
- (iii) Calculate the sum as a % of total budgeted expenditure for the selected heads

The Eight selected heads are (a) Ministry of Health; (b) Ministry of Education; (c) MEWD; (d) MACO; (e) MWS; (f) MLGH; (g) OAG; (h) MoFNP.

The one selected sub head is NRFA (under head 21, unit 02, Programme 9 in the Yellow Book)

This is a similar calculation as PEFA PI-2 designed to measure credibility of the budget.

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PEMFA - Programme logical framework

Narrative summary	Objectively verifiable indicators	Means of verification	Assumptions
Goal Improved delivery of pro-poor government services in line with priorities set out in the National Development Plan and Poverty Reduction Strategy	1. Trends in NDP 2. Core indicators for inputs, outcomes and impacts in priority sectors and in governance reforms	1. Periodic national sample surveys 2. Government's NDP Annual Review and joint WB/IMF staff assessment note	
Purpose To Improve efficiency, effectiveness and accountability in the management and use of public financial resources	1. Variance between MTEF, annual budget and expenditure reduced annually from FY 2006 onwards 2. Budgetary proposals and execution scrutinised by Parliament and civil society from FY 2008 onwards	1. Finance Minister's Budget Speech and Annual Report 2. Reports of JCE and PAC plus submissions to JCE and PAC by CSOs	1. NDP monitoring system enable timely presentation of performance data 2. Economic growth sustained at target levels 3. Donor funding remains at planned levels with a pro-poor focus 4. Macro economic shocks avoided or mitigated by donor partner support
Outputs 1. More effective financial management and commitment control	1. Each MPSA commitment will not be more than 80% of the approved budget in 2007 and annually thereafter.	1. Government Accounts, Expenditure Statements, and Financial Reports	1. Wider public sector reforms on pay and right-sizing help address human resource constraints in key sectors 2. Government able to attract and retain professionals in accountancy and IT 3. Interdependencies and linkages with other, complementary reform programmes are strong resulting in synergies 4. Reforms that have been implemented are maintained/sustained by GRZ
2. IFMIS fully implemented	1. By end of project: • Financial statements produced and submitted for external audit within 6 months of the end of the fiscal year. • Monthly Expenditure Returns (MER) online • Reconciliation of central Government bank accounts at least monthly and within 4 weeks of end of period. • In-year budget reports issued within 4 weeks of end of period	• Annual Financial Statements • Monthly spot checks • Bank reconciliation reports • In-year budget reports	
	• Reduced annual incidence of wastage and mis-procurement by MPSAs • Increased non-tax revenue collections by MPSAs	• Audit Report • Financial statements	

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3. A policy-based budgetary process in place in order to facilitate timely, adequate and effective mobilisation, allocation and utilisation of resources and attainment of policy objectives.	3. Model-based macro and sector analytical reports and multi-year budgeting and planning frameworks prepared annually by end December 2009	3. Reports and frameworks	
4. A credible budgeting process established with a transparent and clear presentation of the budget document; budget implemented in a more efficient and predictable fashion.			
5. Debt, both domestic and external, managed to sustainable levels and effectively managed government investments	<ol style="list-style-type: none"> 1. Reduction of the external debt stock from \$6.3 billion to \$ 2.0 billion by 31.12.2009 2. Reduction of the domestic debt stock from \$ x Billion to \$ y Billion by 31.12.2009 3. The elimination of all new domestic arrears from 2006 and the reduction of domestic arrears to 20% of its identified level of 2003 by 31.12.2009 4. The gradual annual reduction of debt interest payments as percentage of actual Government expenditure. 	<ol style="list-style-type: none"> 1. GRZ's annual accounts and financial statements 2. IDM reports and GRZ annual accounts 3. IDM's repayments schedules 4. GRZ's annual accounts and financial statements 	
6. Strengthened internal controls throughout the public sector for improved public expenditure management and financial accountability.	<ol style="list-style-type: none"> 1. Detection of fraudulent activities increase annually from FY2006 2. Effectiveness of internal control systems indicated by increased detection of wasteful expenditure and revenue shortfalls enhanced by 2009. 	<ol style="list-style-type: none"> 1. Audit reports 2. Audit reports 	

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7. Enhanced coordination of external finance.	<ol style="list-style-type: none"> 1. Volume of external finance recorded in the ETC database in % of total volume in the year 2005 (with Targets, 2005: 75%; 2006: 90%; 2007: 110%; 2008: 130%). 2. Percent of external finance recorded in the ETC database which is in line with Government budget lines in the ABB (with targets : 2005: 50%; 2006: 60%; 2007: 75%; 2008: 85%). 3. Donor reporting in line with endorsed disbursement format is x% compliant by when? 	<ol style="list-style-type: none"> 1. ETC database 2. ETC reports 3. ETC reports 	
8. A consistent and harmonised legal framework put in place to support transparency and accountability in the public sector	Updated financial legal framework meeting criteria 1.2 of The IMF Code of Fiscal Transparency in place by end of 2009	<ol style="list-style-type: none"> 1. Updated PEFA assessment report 	
9. Strengthened external audit through expanded coverage and better HQ and training facilities	<ol style="list-style-type: none"> 1. Annual audit coverage expands from about 50% to at least 70% by end 2008 2. Piloting of VFM, environmental, IT and forensic audits (2 each) completed by 2008 3. Strategic Five Year Plan 2008-2013 includes routine conduct of wider scope audits 	<ol style="list-style-type: none"> 1. Auditor General's report to Parliament 2. Audit plans and reports 3. OAG's Strategic Plan 	

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10. Capacity of Parliament developed to play its oversight role in public resource management in order to promote the culture of democratic governance, transparency and accountability	<ol style="list-style-type: none"> 1. Reduction in the number, value, and age profile of PAC queries unanswered or unsatisfactorily answered from x to y % over PEMFA implementation using the AG's Report of FYR 2002 (pages 135-151) as the benchmark. 2. For FY2007 and annually thereafter the Medium Term Fiscal Framework, as set out in the Green Paper, debated by the Joint Committee on Estimates (JCE) by end of September 3. Report of JCE on MTEF produced for FY 2008² budget and each year thereafter by end of October 4. Report of JCE on Budget Submission (Yellow Book) for FY 2008 by end January 2008 and annually thereafter 	<ol style="list-style-type: none"> 1. Action-Taken Reports by the Executive arm of government (Treasury reports) 2. Committee reports 3. Reports of Committee on MTEF 4. JCE report 	
11. Accountancy profession strengthened with effective regulatory services provided in order to promote high professional and ethical standards in the accountancy profession	<ol style="list-style-type: none"> 1. Increased number of qualified ZICA members working in the Government accountancy and audit cadres and OAG from approximately 40 in 2004 to 120 in 2009. 2. An active Public Sector Committee producing 4 newsletters and 2 technical bulletins per annum by 4th year of PEMFA. 3. Half yearly meetings between ZICA and other key stakeholders (PAC, Estimates Committee and MoFNP). 	<ol style="list-style-type: none"> 1. Examination reports and membership records 2. Copy of newsletter and bulletin 3. Minutes of the meetings 	
12. A transparent, accountable and efficient public procurement system promoted and institutionalised in order to improve expenditure management	<ol style="list-style-type: none"> 1. Confidence of civil society and international community in the public procurement system achieved by 31 December 2008 	<ol style="list-style-type: none"> 1. Client surveys 	

² Formal report by Estimates Committee only from FY2008 because dependent on new Budget Act being enacted during 2007

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13. PEMFA programme implementation efficiently and effectively coordinated and provided with technical support	1. PEMFA programme successfully implemented according to plan. 2. Level of achievement of stipulated outputs 3. Timely mitigation of risks	1,2 & 3 Progress reports, minutes of meetings, evaluation report, assessment/mid-term review report	
Activities See Outputs in individual component logical frameworks	Inputs		1. Timely release of funds by donors achieved 2. Management by donors focuses on strategic issues at Output and Purpose levels 3. Appreciation of the kwacha does not significantly reduce available funding 4. 'Ownership' and commitment at all levels of Government, including politicians, is achieved and maintained 5. Resistance to change is minimised assisted by effective communication

Narrative summary	Objectively verifiable indicators	Means of verification	Assumptions
			6. Sufficient number of staff, with necessary technical, subject knowledge and programme management skills, are deployed 7. Sufficient incentives, both personal and organisational, result in enhanced performance with PEMFA implementation 8. Required legislation enacted on time 9. Adequate component leadership providing vision, drive and prompt decision making

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INTERNATIONAL MONETARY FUND

EXTERNAL
RELATIONS
DEPARTMENT

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

**International Monetary Fund
Washington, D.C. 20431 USA**

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

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

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

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

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

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

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

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

"The program envisages a cautious policy on foreign borrowing, emphasizing concessional loans and close monitoring of external borrowing by public enterprises. To preserve the

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recent gains in external debt sustainability, the authorities will give priority to developing and implementing a comprehensive debt management strategy.

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

The PRGF is the IMF's concessional facility for low-income countries. PRGF loans carry an annual interest rate of 0.5 percent and are repayable over 10 years with a 5½-year grace period on principal payments.

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Zambia: Selected Economic Indicators

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

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

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

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

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

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Prerequisites Conditions for PRBS II

Prerequisites	Focus
General prerequisites	<p>Political stability: Zambia has enjoyed political stability since independence and has had two Presidents ousted through elections. There is peace and rule of law.</p> <p>Economic Stability</p> <ul style="list-style-type: none">• There is macroeconomic stability in Zambia:• growth averaged over 6% for the last three years;• Inflation is at single digit about 9% .• budget deficit was at -0.2% in 2007;• current account balance (including grants) was -2.5% in 2007• total external debt was 9.5% in 2007
Technical Prerequisites	<p>Existence of well designed PRSP</p> <ul style="list-style-type: none">• Vision 2030, FNDP prepared in a broad consultative process being implemented• MTEF, Green Paper for 2008-2010, provides rolling budgetary estimates• Poverty Reduction Budget Support (PRBS) framework anchored on a MOU, PEMFA, and the annual performance assessment reviews• Eleven donors for PEMFA and 9 for PRBS and they coordinate among themselves through their Chairpersons• PEFA review undertaken in June 2008 by external consultants working with locals and results show improved PFM system;• PRBS Group use country system for the budget support programme
