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Report No.: 18058

IMPLEMENTATION COMPLETION REPORT

REPUBLIC OF ZAMBIA

ECONOMIC RECOVERY AND INVESTMENT PROMOTION CREDIT

(Cr 2764-ZA)

June 24, 1998

Private Sector Finance Group
Africa Region

CURRENCY EQUIVALENTS

Currency unit : Zambian Kwacha (K)
US$ 1 = 820 Kwacha (Exchange rate of April 1995)
US$ 1 = 1400 Kwacha (Exchange rate of December 1997)

WEIGHT AND MEASURES

Metric system

FISCAL YEAR OF BORROWER

January 1 - December 31

ABBREVIATIONS AND ACRONYMS

BOZ	-	Bank of Zambia
CBI	-	Cross Border Initiative
CEM	-	Country Economic Memorandum
CG	-	Consultative Group of Zambia
CIR	-	Country Implementation Review
CPPR	-	Country Portfolio Performance Review
CSPF	-	Civil Service Pension Fund
DBZ	-	Development Bank of Zambia
ERC	-	Economic Recovery Credit
ERIP	-	Economic Recovery and Investment Promotion
ESAC	-	Economic and Social Adjustment Credit
ESAF	-	Enhanced Structural Adjustment Facility
GDP	-	Gross Domestic Product
GOZ	-	Government of Zambia
IBRD	-	International Bank for Reconstruction and Development
IDA	-	International Development Association
IMF	-	International Monetary Fund
LASF	-	Local Authorities Superannuation Fund
LUSA	-	Lusaka Stock Exchange
MMMD	-	Ministry of Mineral and Mining Development
MMD	-	Movement for Multiparty Democracy
NEAP	-	National Environmental Action Plan
NEDC	-	National Economic and Development Committee
NSSRI	-	National Social Security reform Implementation
PER	-	Public Expenditure Review
PFP	-	Policy Framework Paper
PIRC	-	Privatization and Industrial Reform Credits
PTA	-	Preferential Trade Agreement
RAP	-	Rights accumulation Program
RPED	-	Regional Project for Enterprise Development
SCC	-	Systematic Client Consultation
SEC	-	Securities Exchange Commission
VAT	-	Value Added Tax
ZCCM	-	Zambia Consolidated Copper Mines
ZESCO	-	Zambia Electricity Supply Company
ZIMCO	-	Zambia Industrial and Mining Corporation
ZNPF	-	Zambia National Provident Fund
ZPA	-	Zambia Privatization Agency
ZSIC	-	Zambia State Insurance Company
ZRA	-	Zambia Revenue Authority

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ECONOMIC RECOVERY AND INVESTMENT PROMOTION CREDIT (Cr 2764-ZA)

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IMPLEMENTATION COMPLETION REPORT

PREFACE

This is the Implementation Completion Report (ICR) for the Economic Recovery and Investment Promotion (ERIP) adjustment operation for which a credit of SDR 90 million (US$140 million equivalent) was approved on July 11, 1995 and made effective on September 6, 1995. The credit was closed on December 31, 1997, compared with the original closing date of December 31, 1996. The first tranche, released upon effectiveness, was fully disbursed by August 1995; the second tranche was released on August 22, 1997 and the credit was fully disbursed. The project was not co-financed.

This report was prepared by Emile B. Sawaya and Lucy Fye, Private Sector Finance (AFTP1) of the Africa Region and David Greene (consultant). It was reviewed by Phyllis Pomerantz, Country Director (AFC02), and Ataman Aksoy, Manager (AFTM1), Macroeconomics 1.

Preparation of this ICR started during the Bank's final supervision and completion mission of February/March 1998. It was based on materials in the program file, including the Memorandum of the President (MOP), Development Credit Agreement (DCA), supervision reports, progress reviews and monitoring reports by the Borrower. The Borrower contributed to the preparation of the ICR by supplying the views reflected in the final mission's aide-memoire, preparing its own evaluation of the Program, and commenting on the draft ICR.

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ECONOMIC RECOVERY AND INVESTMENT PROMOTION CREDIT

(Cr 2764-ZA)

IMPLEMENTATION COMPLETION REPORT

EVALUATION SUMMARY

1. The objective of the Economic Recovery and Investment Promotion (ERIP) Credit was to support the Government's stabilization and economic reform effort. Specifically, ERIP supported continued implementation of sound macroeconomic policies designed to stabilize the economy; increasing the supply of long-term capital and improving its allocation; establishing a new national basic pension scheme; and strengthening the mining sector, by privatizing the parastatal mining company, and improving the sector's legal, fiscal and institutional frameworks. The objectives of the project were, to a large extent, achieved and its impact on economic performance has been positive. Substantial progress has been made toward macroeconomic stabilization, albeit not smoothly and not without fiscal relapses. Inflation has been reduced by improving fiscal performance, while protecting budgetary allocations for vital social services. A Value Added Tax (VAT) system has been successfully launched. Government's support for private investment has been reoriented: the government's financial institutions are no longer providing directly long term finance to private enterprises. A new apex institution is mobilizing concessionary funds for on-lending to private investors through commercial channels. The Development Bank of Zambia (DBZ) has suspended its lending activities and is concentrating on loan collections, but vigilance will be required to ensure that it does not resume lending, that its staffing and expenses are consistent with its reduced functions, and that all loan collections (net of expenses) are transferred to the Treasury. Legislation establishing a new national basic pension system has been enacted, but several critical issues remain to be resolved, including contribution rates, benefit levels and transitional arrangements for present members of Zambia National Provident Fund (ZNPF). Also measures have been taken to regulate private pension funds and insurance companies. Finally, the stage has been set for rapid, environmentally sound development of the mining sector by efforts to privatize Zambia Consolidated Copper Mines (ZCCM), and the establishment of a supportive legal and institutional framework for private investment in mining.

2. This has been accomplished despite a generally less than favorable external environment, including poor weather, a volatile world copper market and sharp declines in copper prices, and the hiatus in bilateral balance-of-payments support. Sustainability of the Government's economic reform program, and, indeed, future economic progress will depend critically, however on ensuring that sufficient and timely balance-of-payments support is available for the implementation of the macroeconomic program. This will require continued Government commitment to the economic reform process and the stabilization program. It requires, above all, the expeditious conclusion of the privatization of ZCCM, which is essential for ensuring the rapid rehabilitation of the mining sector and for providing a clear signal to investors of Zambia's

commitment to private enterprise. It also requires addressing the concerns of donors about governance issues, including economic governance issues.

3. The economy responded positively to the Government's program supported by the ERIP credit, as evidenced by lower inflation, increasing Gross Domestic Product (GDP) in 1996 and 1997, rising private investment, expanding nontraditional exports, and increased interest of international mining enterprises in exploring Zambia's mineral resources. The Government and other stakeholders have indicated that they consider the performance of the Bank in the design and supervision of the ERIP operation to have been satisfactory. On the whole, the performance of the Government in implementing the ERIP Program was satisfactory. Although the release of the Second Tranche was delayed about a year because it took longer than expected to prepare the legislation and institutional arrangements needed to regulate and supervise insurance companies and pension fund management companies, and to complete the restructuring of DBZ, these tasks were eventually completed satisfactorily. The first phase of privatizing ZCCM, whose objective was to prepare the ZCCM Privatization Plan and seek the requisite approvals proceeded smoothly, and in accordance with an ambitious timetable. The process also proceeded well until the bid opening and evaluation stage of the second phase, whose objective was to actually privatize the company. In March 1997, changes were made in negotiating leadership, strategy and tactics, as well as in the objectives of the sales process to place more emphasis upon the cash up-front component of the deal. This led to delays and many of the negotiations encountered problems. The delays and the problems facing the negotiators were most serious for the package that includes the Nchanga and Nkana mining divisions, ZCCM's largest and most profitable.

4. The lessons of the ERIP project are: (1) Timing of reform is critical. For example, an effort to push the privatization of ZCCM in 1991-92, would probably have been unsuccessful, as the Government was not yet committed to such a course. Moreover, once Government commitment is in place, the pace of reform must allow for building consensus among stakeholders. (2) Recovery of the economy after stabilization can take longer than expected, but should not be a reason for despair. The Zambian case illustrates that stabilization, coupled with vigorous structural adjustment will ultimately produce positive results. (3) Availability of technical assistance funds can facilitate acquisition of critical technical expertise, if task managers and government have flexibility in allocating these funds to problem areas as they arise. (4) Adjustment programs are easier to implement and supervise as well as more effective, if they have fewer, but more critical conditions, fewer tranches and shorter disbursement profiles. (5) Continuity of task management is beneficial, as is having the manager of the adjustment operation also responsible for related technical assistance projects.

REPUBLIC OF ZAMBIA

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PART I -- PROJECT IMPLEMENTATION ASSESSMENT

A. Statement/Evaluation of Objectives

1. The ERIP operation built on the achievements of the preceding operations, while also targeting areas where progress had not, so far, been adequate. The key elements of the ERIP Reform Program were: (1) execution of the macroeconomic program consistent with the objectives of stabilization, while strengthening the system of taxation by introducing the VAT, and protecting fiscal expenditures on critical social programs; (2) reorienting the role of Government in the financial sector in support of private investment by ending direct state lending for private investment, mobilizing term foreign exchange resources through a new apex institution, and ensuring the financial health of contractual saving institutions -- insurance companies and pension funds; (3) establishing a new national pension system; and (4) improving the legal, fiscal, environmental and institutional framework for the mining sector, strengthening the Ministry of Mines and Minerals Development (MMMD), and adopting a plan for the privatization of ZCCM.

B. Achievement of Objectives

2. **The Macroeconomic Program.** Zambia made significant progress towards economic stabilization during the period of implementation of the ERIP Program (July 1995 to December 1997). Along the way, there were problems of budgetary management, but these were adequately addressed, and fiscal performance improved from year to year. The Government's cash deficits have been relatively small (there was a surplus equivalent to 0.7% of GDP in 1995, and deficits of 2.5% in 1996 and 1.8% in 1997), domestic arrears were reduced, and there was virtually no net domestic financing of the budget during 1995-1997 taken as a whole.

3. The combination of relative fiscal balance and tight monetary policy led to a deceleration of inflation, although this task was at times complicated and slowed down by the fiscal relapses. As measured by the CPI (end of period), inflation declined from 48% in 1995 to 18% in 1997. Moderating inflation had a favorable impact on interest rates: commercial bank rates fell from 52% at end-1995 to 24% at end-1997, and the treasury bill rate fell from 42% at the end of 1995 to 13% at the end of 1997. Exchange rates remained fairly stable, with the market rate depreciating only 9% relative to the dollar in 1997, compared to a depreciation of almost 30% the previous year. There was, however, an acceleration in the rate of depreciation of the kwacha

in early 1998 because of the shortfall in ZCCM's foreign exchange earnings--due to declining production and low copper prices--and the continued hiatus in balance of payments support.

4. The IMF Board approved the midterm review of the first annual ESAF program under the three-year SAF/ESAF arrangement in February 1997, allowing the 1996 Paris Club Agreement to go into effect formally. Discussions with the IMF staff on the second-year ESAF were concluded in December 1997. Presentation of the second-year ESAF to the IMF Board was put on hold until after the May 1998 Consultative Group Meeting because of uncertainties in external financing. It has now been further delayed pending clarification of the potential fiscal impact of delays in privatizing the bulk of ZCCM.

5. As agreed under the ERIP Program, the Value Added Tax was implemented, on schedule, in July 1995. The Revenue Authority did an outstanding job introducing and gaining acceptance for the VAT. Collections on internal transactions (the VAT is also applied to imports) increased from K 108 billion in 1995 to K 184 billion in 1997. Total VAT collections in 1997, including the tax on imports, were about K 300 billion, providing almost a quarter of total tax revenues.

6. The Bank and the Government first agreed on minimum targets for social sector spending under the first ESAC, approved in 1994. Under ERIP the objective was to maintain the share of social sector spending. Actual budget outlays for the social sectors in 1995 were at or above the levels specified in the ERIP Letter of Development Policy. The share of total social sector spending in non-debt service budget releases was 35% (compared to the minimum target of 33%), and the share of non-personnel spending in these sectors was 25% (compared to the minimum target of 24%). Similar targets for social sector spending in 1996 under the ESAC II Program were fulfilled.

7. **Strengthening the Financial Sector** The Government is no longer playing the role of direct provider of term finance to private enterprises. The financially distressed Eximbank and Lima Bank have been closed and are being wound up. The ERIP Program also called for the Development Bank of Zambia (DBZ) to cease direct lending and to be restructured into an apex institution responsible for mobilizing and on-lending concessionary finance through commercial banks, and for its loan portfolio to be transferred to a separate collection agency. Transferring DBZ's portfolio to a collection agency proved to be legally problematic, and creating a new apex institution was not accepted by parliament. Instead, the objectives were accomplished by having DBZ's Board of Directors suspend lending operations and order the DBZ management to concentrate on the collection of non-performing loans. A new apex institution, Zambia Enterprise Finance Ltd., has been established under the Companies Act to mobilize concessionary external financing to be on-lent by commercial banks to the private sector. DBZ, however, has not been wound up and vigilance will be required to ensure that it does not resume lending operations, that its staffing and expenses are consistent with its reduced functions, and that all loan collections (net of expenses) are transferred to the Treasury.

8. Parliament has enacted legislation to establish clear, enforceable regulatory frameworks for insurance companies and pension funds. Under this legislation, which was drafted in consultation with the industry, all insurance companies and brokers and pension fund managers

will be licensed. A regulatory agency, the Registrar of Pensions and Insurance, has been established in the Ministry of Finance. A well-qualified Registrar and Deputy Registrar for Pension Funds have been appointed and other staff are being recruited, the process of consultation with the industry is underway and drafting of regulations will begin soon.

9. **Establishing a National Pension Scheme.** Legislation has been passed to establish a National Pension Scheme and to transform the existing Zambia National Provident Fund (ZNPF) into the agency responsible for operating it. The ILO is in the process of drafting proposals for transforming ZNPF into the administrative agency. In the meantime, several critical issues remain to be resolved, including contribution rates, benefit levels and transitional arrangements for present members of ZNPF.

10. **Privatizing ZCCM and Promoting Private Investment in Mining.** The privatization of ZCCM, per se, was not a part of the policy agenda of the MMD Government when it took office in late 1991. Rather, the new Government hoped that the efficiency and profitability of ZCCM could be improved and that investments in new mining projects could be carried out as joint ventures with private international companies. It was not until 1993-94, when ZCCM ran into severe difficulties maintaining its production levels and efforts to improve its efficiency had failed, that it was recognized that there was no alternative to privatization. In the January 1995 Budget Speech, the Minister of Finance announced that ZCCM would be privatized within two years.

11. A plan for the privatization of ZCCM was prepared by ZPA with the assistance of investment banking and legal advisors financed under the IDA ERIP Technical Assistance (ERIPTA) Credit. The plan, which called for dividing ZCCM's assets into packages for sale, was approved by the Boards of Directors of ZCCM and the Zambia Privatization Agency and by the Cabinet and issued in May 1996. This fulfilled the specific condition for the release of the Second Tranche of the ERIP Credit, and set the stage for beginning the implementation phase of the ZCCM Privatization Plan.

12. Although the ultimate objective of the ERIP program was the actual privatization of ZCCM, this was not made a condition of the ERIP Credit in order to keep the playing field level for ZCCM and the Government vis-à-vis potential buyers. The first phase of privatizing ZCCM, with the objective of preparing the ZCCM Privatization Plan and seeking the requisite approvals proceeded smoothly, and in accordance with what was at the time considered by most stakeholders to be an ambitious timetable. The process also proceeded well in the early stages of the second phase, when the objective was to actually privatize the company. Interested investors were pre-qualified and asked to submit bids. By the target date of February 28, 1997, bids were received for all the packages that were put out for competitive bidding. This was a very good response, and a good testimony to the attractiveness of the new mining policies in Zambia, and to the efforts of ZPA and the Advisors in marketing the ZCCM assets. At that time, ZPA and the advisors continued to aim to complete the process by the end of June 1997. Many of the stakeholders thought that was possible, and those that did not felt that slippages would be minor.

13. There was a change in the leadership of the ZCCM negotiating team in March 1997. As a consequence, there was a change in the negotiating strategy and tactics, as well as in the objectives of the sales process, which placed more emphasis upon the cash up-front component of the deal. Delays began to occur and many of the negotiations encountered problems. Agreements to sell the Power Division and the Luanshya-Baluba, Kansanshi, and Chibuluma mines were reached late in the third quarter of CY1997, several months later than planned. The delays and the problems facing the negotiators were most serious for the package that includes the Nchanga and Nkana mining divisions, ZCCM's largest and most profitable. As of the date of this Implementation Completion Report (ICR), there still is no agreement between Government/ZCCM and private sector buyers of these assets.

14. Government is continuing its efforts to privatize ZCCM and aims to complete the process in the third quarter of CY1998. This implies, in addition to a successful conclusion to the negotiations for the sale of the Nchanga and Nkana mining divisions, the successful conclusion to the sale of the Konkola mining division, including the Konkola Deep Mining Project, and the sale of the remaining assets of the Mufulira division. It also implies the sale of Ndola Lime Company, the last major subsidiary of ZCCM for which bids have been received and are now being evaluated.

15. With respect to the mining sector, several measures have been taken to improve the legal framework and the institutional support for mining investors. The Government adopted a new Mining Sector Policy Statement in December 1995, the objective of which was to "ensure a self-sustaining mineral-based industry, and encourage private investment in exploration and development. . . ." Also, a new Mining and Minerals Act was passed. It guarantees security of title, unrestricted access to foreign exchange, companies' right to market products, and freedom of commercial operation. It also provides for international arbitration of disputes. A new mining fiscal regime was also put in place by amending relevant sections of the Income Tax Act, the Customs and Excise Act and the Investment Act. The new fiscal regime concentrates taxation on profits, rather than output and is non discretionary, and internationally competitive.

16. Under the new mining environmental regulations, impact assessments will be required for all new projects, and mining areas will have to be rehabilitated after decommissioning. All licensees will be required to provide baseline studies, environmental engineering studies, an environmental management plan, and a plan for rehabilitation after decommissioning.

17. Progress has been made in strengthening the Ministry of Mines and Minerals Development (MMMD). The mining title system is working well and new geological data bases and maps are being prepared. MMMD has begun to implement recommendations of the studies on institutional improvements, including the establishment of regional mine offices to assist medium and small mining companies and gemstone miners.

C. Major Factors Affecting the Project

18. Zambia's ability to carry out the macroeconomic stabilization program that is central to the reform program has been made difficult by the limited room for maneuver that the country has because of its continued heavy reliance on copper exports, its high debt service burden and the key role played by international assistance and debt relief. Continued poor performance of ZCCM and the volatility of the international copper market has made budgetary and balance of payments management difficult. Copper still accounted for 56% of Zambia's exports in 1997 (copper and cobalt together accounted for 83%). The production of copper by ZCCM fell from 403,000 tons in 1993 to 307,000 tons in 1995, before stabilizing at an average of about 315,000 tons in 1996-97. The effects of production problems have been compounded by the volatility of the international copper market. The price of copper fell from 133 cents per pound in December 1995 to about 80 cents in December 1997 and Zambia's gross copper receipts declined from US$851 million in 1995 to US$613 million in 1997.

19. The suspension of balance of payments support by bilateral donors in 1996 largely because of their concern about governance issues has further complicated the tasks of budgetary and balance of payments management. Balance of payments support from sources other than the World Bank, which totaled US$ 133 million in 1995, amounted to only US$ 9 million in 1997.

20. Past ICRs for adjustment operations in Zambia have noted that the technical and administrative capacity of the Zambian Government is quite limited. This seems to have been less of a problem in the case of the ERIP operation because: (1) the Government has gained experience and confidence through implementation of past programs; (2) ERIP implementation was supported by Bank-financed technical assistance in key areas; and (3) while the tasks to be accomplished were complex, there were fewer of them and they were more clearly focused.

D. Project Sustainability

21. The Government appears to be committed to continue making progress on the overall economic reform program and that enhances the prospects for sustainability. Privatization is a good example of how progress on implementation affects economic performance and impacts sustainability. The progress on the privatization of non-mining companies by ZPA, which was not included in the ERIP program, reflects the Government's commitment and has elicited a good response from investors and is starting to show good results in terms of investment and economic growth. During 1995-97, 152 companies were privatized, bringing the total number of units privatized to 224 out of ZPA's working portfolio of 330. Moreover, the Minister of Finance in the 1998 Budget Speech announced that ZPA would begin work on the privatization of the large parastatals, not yet part of its portfolio, including ZAMTEL, and other parastatals in the hydrocarbon, transport and commercial banking sectors. However, the slowdown in the privatization of ZCCM, which was a major focus of ERIP, poses serious risks to the economy's recovery and the program's sustainability.

22. Sustainability of the reform program will be enhanced if the government continues to take the necessary measures to ensure the continuation of the economic recovery. Improved economic conditions will, in turn, increase the political and social acceptability of the reform effort and reinforce the positive impact of the Government's commitment to stabilization and structural reform. Nonetheless, sustainability depends critically on the expeditious completion of the ZCCM privatization. ZCCM's financial situation is precarious. Further delay could affect its operations and its relations with its creditors. Completion of the sale would allow the payment of the company's domestic arrears and provide a boost to the economy. Inflows of foreign exchange resulting from the sales proceeds would provide some relief for Zambia's presently critical foreign exchange reserve position. New owners taking control rapidly would accelerate the process of improving efficiency and increasing output, which is in the company's and the country's interests as well. Finally, the completion of the ZCCM privatization would provide a strong positive signal to other potential investors in mining as well as other sectors.

23. There are other factors influencing the programs sustaintability. Unless sufficient balance-of-payments support is available for the implementation of the macroeconomic program over the next two years, the stabilization program could unravel. Ensuring that this does not happen will require addressing the concerns of bilateral donors on governance matters, including the Bank's concerns about economic governance issues. The Consultative Group meeting held in Paris in May 1998 clarified that donor support will be forthcoming if further progress is made on governance issues. Government has stated that it is fully committed to the strengthening of governance in Zambia and is preparing a medium term program to strengthen the capacity of institutions that promote and enhance good governance. Government is planning to request donor support for its governance program.

E. Bank Performance

24. Bank performance in preparing and supervising the project was satisfactory. The project was better focused and structured than its predecessor PIRCs (Credits 2405-ZA and 2523-ZA), had fewer tranches (two rather than three) and fewer, more specific and high priority conditions for tranche release. Nevertheless, the tasks of macroeconomic stabilization, privatizing ZCCM, liquidating government banks, establishing a regulatory framework for pension funds and insurance companies, and establishing a new social security system, were undoubtedly the maximum the Government could handle in the two years the ERIP was planned to cover. Some elements of prior adjustment operations were, therefore, not included in the ERIP. For example, because progress on the privatization of companies other than ZCCM, seemed assured, it was not necessary to make this part of the ERIP program. On the other hand, the complex issue of civil service reform, was not included in ERIP in order not to overload the agenda. In retrospect, the reform agenda under ERIP could have been even more focused, with fence areas and related conditionality.

25. IDA's Technical Assistance credits played a vital role in ZCCM's privatization and improving the legal and institutional framework for private sector mining. Funds from the earlier Mining Sector Technical Assistance Credit (Cr. 2269-ZA) supported the development of the new mining code and fiscal regime, and the parallel ERIPTA Credit (Cr. 2875-ZA), including its

US$2 million project preparation facility advance funded the hiring of the legal and financial advisors, whose role in the ZCCM privatization was indispensable. Use of the same staff to supervise the two TA credits and ERIP ensured close complementary of the operations.

26. Supervision of the project was good. Supervision missions were frequent, especially during the earlier stages of implementation. Bank staff provided timely and useful advice to the Government and their role was appreciated. Discussions with the Government and other stakeholders indicated that they also considered that the Bank had done a good job in preparing and supervising the project.

F. Borrower Performance

27. There were two problematic areas in project implementation. Release of the Second Tranche of the Credit was delayed by about a year because it took longer than originally expected to prepare the required legislation and to put in place the required institutional arrangements for the regulatory regime for insurance and pension fund management companies. Nevertheless, legislation was enacted and the agency responsible for supervision has gotten off to a fast start, to some extent making up for lost time.

28. Restructuring the DBZ was delayed because the requisite legislation was not approved by the Zambian Parliament. The Government, however, showed ingenuity and determination in achieving DBZ restructuring, and the intent of the agreement between the Government and IDA, namely, to discontinue DBZ's retail lending activities, to focus greater effort on the collection of DBZ's loan portfolio, and to establish an apex institution which would allow Zambia to mobilize concessional funds for on-lending through commercial banks, was achieved.

29. Once a decision was made to privatize ZCCM, the process proceeded as smoothly and as quickly as possible until the bid opening stage, but began to encounter difficulties and delays after that. Because of its popular image as Zambia's "crown jewel," the Government newly elected in late 1991 had to consider every reasonable alternative to privatization, in order to avoid accusations of giving the company away to foreign interests. However, once it was obvious that the company was not capable of self-reform, the decision to privatize it was inevitable and politically acceptable. Many tasks had to be undertaken. Experienced, high quality international investment and legal advisors had to be recruited (in part to give the sale political and business credibility) to prepare a privatization plan. Following the plan's approval, documentation to solicit bids had to be prepared, data centers to enable due diligence had to be established, the capacities of interested investors had to be reviewed to select those who qualified, requests for bids had to be issued, bids needed to be reviewed and evaluated and finally deals had to be negotiated and sales concluded.

30. Both the Bank and the Government may have underestimated the complexity and the time required to implement the ZCCM Privatization plan, particularly after the change in the leadership of the negotiating team and the adjustment of the objectives and strategy of the sales process (paras. 10-14). However, if the current plans to complete the privatization in the third quarter of CY1998 materialize, then this transaction would not be unduly slow by international

standards. This transaction was comparable in size and complexity to the privatization of British Coal, which took four years to complete. Moreover, complex issues relating to retrenchment of labor, handling of ZCCM's accumulated arrears, liability for past environmental damage, ownership of staff housing, and provision of social infrastructure and municipal services had to be resolved. The fact that the Government was not the sole shareholder meant that the rights of the other shareholders had to be considered and protected and that proved to be time consuming.

Table 1: Macroeconomic Indicators

	1991	1992	1993	1994	1995	1996	1997
Real GDP growth % Shares of GDP		-1.7	6.8	-8.6	-2.0	6.4	3.5
Consumption							
Government	14.8	16.2	17.9	14.8	14.6	12.6	12.3
Private	75.4	82.1	78.1	76.3	77.6	78.5	77.9
Investment					13.9	14.9	15.0
Gross fixed capital	11.4	11.4	14.6	13.0	13.6	14.5	14.7
Public	5.8	4.0	3.4	4.4	5.7	5.8	5.2
Private	5.5	7.4	11.3	8.6	7.9	9.7	9.6
External Debt (US$ million)	6898	6827	6260	6532	6347	7012	7033
Fiscal performance (% GDP)							
Revenues and grants	27.4	28.5	23.9	26.9	30.8	28.0	24.0
Expenditures and net lending	34.7	31.0	29.4	33.7	34.8	26.4	24.4
Overall balance (accrual)	-7.2	-2.5	-5.6	-6.8	-4.0	1.6	-0.4
Increase in consumer prices (annual average)	160.1	183.4	54.5	39.4	43.1	24.5	
T-Bill rate (annualized, end of period)				23.3	42.0	75.8	13.0
Commercial Bank rate (end of period)			36.2	47.7	52.0	37.9	24.0
Real exchange rate period average K/US$	691	715	905	687	670	668	
Exports (US$ Million)	1085	1120	994	1066	1186	993	1101
o/w metals	998	1020	870	910	984	754	806
Imports	-952	-1302	-1019	-1003	-1194	-1055	-1125
Debt service due	683	522	542	590	453	371	
Debt rescheduling/relief	551	359	227	37	310	159	
Copper export volume (000 MT)	375	409	403	360	307	341	310
Copper export price US$/lb.	1.09	1.08	0.96	0.8 1	1.19	0.85	0.98

G. Assessment of Outcome

31. Though not fully accomplished as yet, by end of 1997, it was apparent that progress on stabilization and the liberalization of the Zambian economy was beginning to have positive effects on economic performance. After declining by 2.3% in 1995, real GDP increased by 6.4% in 1996 and, despite a decline in agricultural output due to relatively poor weather, by 3.5% in 1997. Growth in 1997 was broad based, with all sectors other than agriculture and financial services expanding. Manufacturing value added grew by 6.9% compared to 2.6% the previous year. Mining value-added grew by 2.4%. However, GDP per capita in 1997 was still about 13% below its level in 1991. Gross domestic savings increased from 7.7% of GDP in 1995 to 9.1% in 1997 and gross fixed capital formation rose from 13.8% of GDP to 15% over the same period. The private sector accounted for almost all of the increase in investment.

32. The new mining policies had already had a positive impact. For example, the operations of the Bwana Mukubwa mine, which had ceased in 1984, were reactivated in 1997 under private ownership. There has been an upsurge in new private exploration since the passage of the new Mining Act. The number of prospecting licenses in force has risen from two to about twenty, and an estimated US$100 million has been spent on exploration over the past three years.

33. The shift towards a pro-export orientation in policy is helping to make the export sector a more dynamic and significant feature of Zambia's economy. The value of non-traditional products increased in 1997 by 26%, reaching a record level of over US$300 million. These exports now account for 28 % of the total and include an expanding range of agricultural, non-metal mining, agro-industrial and engineering products.

Table 2: Social Indicators

Nutritional status of the under five population		
	1991	**1996**
Stunted Growth	40%	42%
Underweight	22%	22%
Access to safe water	50%	50%
	1989-91	**1994-96**
Total fertility rate	6.5	6.1
Infant mortality rate	107	109
Child mortality rate	94	98
	1990-93	**1995-96**
Literacy rate	73%	78%
Gross Primary enrollment rate	97%	93%

34. The economic reform program, with the support of ERIP and its predecessor and successor adjustment operations seems to be having a positive effect on poverty. According to a Government study based on the Priority Survey in 1991 and the Living Conditions Monitoring

Surveys in 1993 and 1996, the incidence of poverty, which had increased from 69.7% of the total population in 1991 to 73.8% in 1993, declined to 69.2% in 1996. Extreme poverty (consumption insufficient to meet basic daily food intake) which rose from 58.2% in 1991 to 60.6% in 1993, declined to 53.2% in 1996. As evident in Table 2, the country's social indicators show some deterioration since 1991, but probably less than might have been expected given the decline in per capita income. This suggests that preserving government outlays for social services may have had a positive effect, but the situation is still precarious and any emerging positive trends may reverse if the reform program is not sustained.

I. Key Lessons Learned

35. Successful implementation of the ERIP program provides some useful lessons.

(1) Timing of reform is critical. For example, an effort to push the privatization of ZCCM in 1991-92, would probably have been unsuccessful, as the Government was not yet committed to such a course. Moreover, once Government commitment is in place, the pace of reform must allow for building consensus among stakeholders.

(2) Recovery of the economy after stabilization can take longer than expected, but should not be a reason for despair. The Zambian case illustrates that stabilization, coupled with vigorous structural adjustment will ultimately produce positive results, provided the efforts can be sustained.

(3) Availability of technical assistance funds can facilitate acquisition of critical technical expertise, if task managers and government have flexibility in allocating these funds to problem areas as they arise.

(4) Adjustment programs are easier to implement and supervise as well as more effective, if they have fewer, but more critical conditions, fewer tranches and shorter disbursement profiles.

(5) Continuity of task management is beneficial, as is having the manager of the adjustment operation also responsible for related technical assistance projects.

REPUBLIC OF ZAMBIA

ECONOMIC RECOVERY AND INVESTMENT PROMOTION CREDIT (Cr 2764-ZA)

IMPLEMENTATION COMPLETION REPORT

PART II -- STATISTICAL TABLES

Table 1 : Summary of Assessments

A. Achievement of Objectives	Substantial	Partial	Negligible	Not Applicable
Macroeconomics policies	√			
Sector policies	√			
Financial objectives		√		
Institutional development	√			
Physical objectives				√
Poverty reduction		√		
Gender concerns				√
Other social objectives		√		
Environmental objectives	√			
Public sector management		√		
Private sector development	√			

B. Project Sustainability	Likely	Unlikely	Uncertain
			√

C. Bank Performance	Highly Satisfactory	Satisfactory	Deficient
Identification		√	
Preparation assistance		√	
Appraisal		√	
Supervision	√		

D. Borrower Performance	Highly Satisfactory	Satisfactory	Deficient
Preparation		√	
Implementation		√	
Covenant compliance		√	
Operation		√	

E. Assessment of Outcome	Highly Satisfactory	Satisfactory	Unsatisfactory	Highly Unsatisfactory
		√		

Table 2 : Related Bank Loans/Credits

Loan/Credit Title	Purpose	Year of Approval	Status
Preceding Operations			
1. Second Economic Recovery Credit	Macroeconomic stabilization, agricultural sector liberalization, private sector expansion, and restructuring and reforming the civil service and the parastatal sector.	1991	Closed
2. Mining Sector Technical Assistance	To assist the Government of Zambia to implement an effective development strategy for the mining sector that would make the mining sector efficient and productive, in order to generate resources needed to support recovery and diversification of the Zambian economy. It would also promote new copper mines by private investors in the framework of joint ventures with ZCCM; and strengthen environmental protection in the mining sector.	1991	Closed
3. Privatization and Industrial Reform I	To modernize business framework, establish market-based exchange rate mechanism, and promote private sector through privatization and improvement in parastatal efficiency.	1992	Closed
4. Privatization and Industrial Reform II	To provide balance of payments support to the parastatal reform and privatization program.	1993	Closed

Loan/Credit Title	Purpose	Year of Approval	Status
5. Privatization and Industrial Reform TA	To strengthen capabilities in ministries and other responsible institutions for pararstatls reforms and privatization.	1992	Closed
Simultaneous Operation 6. Economic and Social Adjustment	To contribute to filling the identified external financing requirements for Zambia in 1994 and 1995 and to support reforms in areas of public sector management, developing a market for land, ending the budgetary drain of Zambia Airways, planning for value added tax, improving he duty drawback system, strengthening and decentralizing social services delivery systems and improving budget allocations to and within social sectors.	1994	Closed
Following Operations 7. ESAC II Second Economic and Social Adjustment Credit	Enhance prospects for sustainable and widely-shared economic growth in Zambia by supporting reforms that will make the private sector more competitive and the public sector more efficient and by providing vitally needed foreign exchange.	1996	Closed

Table 3 : Project Timetable

Steps in Program Cycle	Date Planned	Date actual
Identification	May 1994	May 1994
Preparation		August , 1994
Appraisal	January, 1995	February 14, 1995
Negotiations	April, 1995	April 1995
Letter of Sector Policy	May, 1995	May 21, 1995
Board presentation	May, 1995	July 11, 1995
Signing	July, 1995	July 18, 1995
Effectiveness	August, 1995	September 6, 1995
First Tranche Release	August, 1995	September 6, 1995
Second Tranche Release	October, 1996	August 22, 1997
Closing Date	December , 1996	December 31, 1997

Table 4 : Credit Disbursements

(US$ million)	1995	1996	1997
Appraisal estimate	70.0	70.0	
Revised Estimates[1]	70.0	82.1	70.0
Actual	36.2	45.5	61.2
Actual as % of revised estimate	51.7	55.4	87.4

Date of final disbursement : 26th August, 1997

[1] Includes US$ 12.1 million which was an IDA supplement loan: C-29101.

Tables 5 : Key Indicators for Project Implementation and Operation

Major Activities	Actions	Timetable	Status
1. Macroeconomic and Fiscal Policies			
• Maintain macro-economic policy framework consistent with objectives of economic reform program	Macro program consistent with fiscal and monetary targets agreed with IDA and IMF	Board condition and second tranche release	Done
• Improve revenue mobilization while reducing reliance on trade and indirect taxes and minimizing distortions to economic incentives	Implement VAT	Second tranche release	Done
• Continue redirection of public spending from low-priority areas to infrastructure and social services.	Total allocations for social sectors in 1995 budget at least 33% of total non-interest allocations	Second tranche release	Done
• Improve cash-budget management procedures to control spending and to avoid surprises causing recourse to deficit financing or undesirable changes in composition of spending	Improve controls over commitment by ministries and provinces	Structural benchmark in IMF program	Done
	Maintain cash-budget system	Reflected in LDP	Done
• Achieve a lower average tariff	Abolish uplift factor at time of introduction to VAT	Second tranche release	Done
	Reduce tariff levels further in 1996	Reflected in LDP	Done

Major Activities	Actions	Timetable	Status
2. Financial Sector Reform			
• Government to rely on private sector for decisions on capital formation and investment	Government to mobilize term resources from official and concessionary sources of funds	Reflected in LDP	Done
• Adopt new policy principles, framework and strategy for provision of term finance to private sector	Government decision to restructure DBZ as an apex institution that mobilize funds from concessionary sources and transfer DBZ loan portfolio to a separate collection entity		Done
	Government decision to privatize Lima Bank and Eximbank		Done
	Submit to Parliament draft DBZ legislation, complete the sale or liquidation of Eximbank and Lima Bank through ZPA	Condition for Second Tranche Release	Done
• Reforming policies and laws for insurance industry and pension-fund management companies	Decide on which ministry will be responsible for prudential regulation of pension-fund management companies		Done. Ministry of Finance designated.
	Submit to Parliament draft legislation to regulate and supervise insurance and pension-fund management companies and establish necessary regulatory and supervisory agency	Condition for Second Tranche Release	Done
3. Social Security Reform			
• reform social security/ pension fund system as follows:			
• Short term	Adopt action plan for social security strategy reform and implementation schedule		Done
	Decision to amend modified benefit formulae and early retirement provisions and repeal 22-years-of-service compulsory retirement law 1991.		Done

Major Activities	Actions	Timetable	Status
3. Social Security Reform			
•reform social security/ pension fund system as follows:			
•Short term	Submit to Parliament draft legislation on benefit formulae, early retirement and 22-year-of-service compulsory retirement or timely implementation action plan to finance resulting liabilities	Condition for Second Tranche Release	Done
	Adopt action plan, satisfactory to IDA to cover unfunded liabilities of public pension funds		Done
•Medium term	Adopt action plan to reform administration and operations of ZNPF		Done
	Submit to CLC draft legislation to establish new basic social security pension scheme and independent social security institutions	Board Presentation	Done
	Submit to Parliament legislation for new basic social security pension scheme and independent social security institutions	Condition for Second Tranche Release	Done
4. Mining Sector Reform and Privatization of ZCCM			
Revive Zambian mining industry, particularly copper mining, by attracting new private investment, technology and management to improve the productivity of existing operation and open up new mining areas.	Adopt new mining sector policy to encourage private investment		Done
	Adopt new legal, fiscal and environmental frameworks		Done

Major Activities	Actions	Timetable	Status
Strengthen capacity of MMMD to oversee new legal, fiscal and environmental frameworks	Strengthen capacity of Ministry of Mines to oversee new legal, fiscal and environmental frameworks		Done
Privatize ZCCM	Adopt and begin implementing plans to privatize and restructure ZCCM Submit Action Plan for ZCCM privatization	Condition for Second Tranche Release	Done
Develop on urgent basis the Konkola Deep project	Adopt plans to develop Konkola Deep project Government to submit a report to IDA on strategies to develop Konkola Deep project	Board Presentation	Done

Performance Indicators

Macro Indicators

	1992	1993	1994	1995	1996	1997(est.)
GDP Growth (actual)	-1.7	6.8	-8.6	-4.3	6.4	3.5
GNP per capita (US$, Atlas method)	389	390	380	400	430	430
Total Investment/GDP	10.5	12.0	6.9	11.7	12.0	15.0
Total Domestic Savings/GDP	6.4	8.6	3.0	2.9	3.9	
Current Account Balance $m	-117	-88	-185	-314	-472	-390
Total Revenues and Grants/GDP(%)	28.5	23.9	26.9	30.8	28.0	24.0
Total Expenditure and net lending/GDP(%)	31.0	29.4	33.7	34.8	26.4	24.4
Budget Deficit(accrual)/GDP	-2.5	-5.6	-6.8	-4.0	1.6	-0.4
CPI growth Rate	197.4	189.0	53.4	34.6	48.0	18.0
Total External Debt $bn	7.00	6.26	6.53	6.35	7.01	7.03
Exchange rate (av) ZK:$	172.21	452.76	669.37	857.23	1,203.7	1,315
Privatization						
• Number of companies assets (cumulative)			52	210	271	330
• privatizations completed			15	102	165	224
• under preparations			37	108	106	106
• Privatization:Total Sales Value (US$m)			2.7	22.4	65.5	56.5

Financial Indicators

	1994 Dec.	1995 Dec.	1996 Dec.	1997 Dec.
1. Share of bank credit to private sector (ZKmillion)	116.4	205.0	293.3	285.9
Year to Year change (%)		76.2	43.1	-2.5
2. Mobilization of financial resources by the reformed DBZ				

Mining Sector

	1992	1993	1994	1995	1996	1997
2. Mining output physical - copper, cobalt and coal (metric tons)	844.5	736.3	541.1	462.4	445.3	324.8
3. Gross Metal receipts (US$m)	1,019	905.7	965.2	1,100.7	760.9	858.5

Table 6 : Status of Legal Covenants

Credit Agreement Section	Covenant Type	Present[2] Status	Description of Covenant	Comments
Section 2.03	13	C	Credit Closing date. The closing date shall be December 31, 1996, or such later date as the Association shall establish. The Association shall promptly notify the Borrower of such a later date.	Date was changed to December 31, 1997.
Section 3.01(c)	05	C	Without limitation upon the provision of paragraph (a) of this section, the Borrower shall exchange views with the with the Association on any proposed action to be taken after the disbursement of the Credit which would have effect of materially reversing the objectives of the Program or any action taken under the Program, including any specified in Schedule 3 to this agreement. (Second Tranche release conditions)	Complied with
Section 3.03 (a)	09	C	The Borrower shall maintain records and accounts for the proceeds of the credit.	Complied with
3.03 (b)	09	C	The Borrower shall move the accounts and records audited, and furnish a certified copy within 6 months of close of fiscal year.	Complied with
3.03 (c)	09	C	The Borrower shall maintain records and accounts for SOEs, have SOE records and accounts audited and submit a copy to IDA within 6 months of end of fiscal year.	Complied with
Schedule 1, para. 4	09	C	Second Tranche Threshold	Complied with
Schedule 3,1	09	NC	Submit to Parliament legislation to restructure DBZ, to establish regulation and supervision of insurance companies and pension funds, to restructure social security institutions and establish new basic social security system, and to put in place new mining policy.	Complied with
Schedule 3,2	12	C	Adopt mining-related environmental regulations.	Complied with
Schedule 3,3	12	CD	Take necessary actions to privatize or liquidate Eximbank and Lima Bank	Complied with

Credit	Covenant	Present[3]

[2] Present status : C = complied with
CD = complied with after delay
CP = complied with partially
NC = not complied with

Agreement Section	Type	Status	Description of Covenant	Comments
Schedule 3,4	12	NC	Implement action plan to restructure DBZ.	Alternative option was applied
Schedule 3,5	12	C	Establish two independent agencies to regulate and supervise insurance companies and pensions funds.	Complied with
Schedule 3,6	02	C	Adopt and implement VAT.	Complied with
Schedule 3,7	10	C	Adopt and furnish IDA a satisfactory plan to privatize ZCCM	Complied with
Schedule 3,8	04	C	Maintain in 1995: (a) social sector spending at 33% of total non-interest spending, and (b) share of non-personnel spending at more than 24% of social sector spending.	Complied with

[3] Present status : C = complied with
CD = complied with after delay
CP = complied with partially
NC = not complied with

Table 7 : Bank Resources : Staff Inputs
(Staff - Weeks)

Stage of Project Cycle	Planned	Actual
Through appraisal (Preparation, Pre-appraisal)	n.a	110.0
Appraisal ➡ Board (Negotiation)	n.a	36.9
Board ➡ Effectiveness	n.a	n.a
Supervision	51.0	44.3
Completion	13.6	9.5
Total	203.2	200.7

Table 8 : Bank Resources : Staff Missions

Stage of Project Cycle	Month / Year	Number of Persons	Days in Field	Specialized Staff Skills Represented	Performance Rating: Implementation Status	Performance Rating: Development Impact	Types of Problems
Through appraisal	April-August 1994	13	38	Principal Private Sector Development Specialist, Principal Economist, Senior Economist, Principal Mineral Economist, Senior Financial Sector Specialist, Principal Financial Sector Specialist, Financial Sector Specialist, Economist			
Appraisal èBoard	February/ March 1995	8	21	Principal Private Sector Development Specialist, Principal Economist, Senior Economist, Economist, Principal Mineral Economist, Senior Financial Sector Specialist, Principal Financial Sector Specialist, Lawyer			
Board èEffectiveness	July/ September 1995						
Supervision							
I	October/ November 1995	4	17	Principal Private Sector Development Specialist, Principal Economist, Senior Economist, Principal Mineral Economist	S	S	Review of progress made, especially of ZCCM privatization
II	June/July 1996	4	17	Principal Private Sector Development Specialist, Principal Economist, Senior Economist, Principal Mineral Economist	S	S	Delays in preparation of legislation, restructuring of DBZ and establishment of regulatory agencies for insurance and pension funds

Stage of Project Cycle	Month / Year	Number of Persons	Days in Field	Specialized Staff Skills Represented	Performance Rating: Implementation Status	Performance Rating: Development Impact	Types of Problems
III	September 1996	4	17	Principal Private Sector Development Specialist, Principal Economist, Lawyer, Principal Mineral Economist	S	S	Delays on preparation of legislation, restructuring of DBZ and establishment of regulatory agencies for insurance and pension funds
IV	January 1997	5	14	Principal Private Sector Development Specialist, Lawyer, Advisor on Mining, Senior Mining Specialist, and Consultant	S	S	Review of progress made in ZCCM privatization
V	April 1997	3	14	Principal Private Sector Development Specialist, Lawyer, Advisor on Mining, Senior Mining Specialist, and Consultant	S	S	Review of progress made on ZCCM privatization, and financial sector
VI	August 1997	9	1	Principal Private Sector Development Specialist	S	S	
Completion ICR Mission	February 1998	2	14	Principal Private Sector Development Specialist, Consultant	S	S	Review of progress made on privatization of ZCCM

APPENDICES

ZAMBIA: ECONOMIC RECOVERY AND INVESTMENT PROMOTION (ERIP) CREDIT

IMPLEMENTATION COMPLETION MISSION

AIDE MEMOIRE

I. Introduction

1. A World Bank mission consisting of Messrs. Emile B. Sawaya, (Principal Private Sector Development Specialist and Task Team Leader- AFTP1), John E. Strongman (Mining Advisor - IENIM) and David G. Greene (Consultant) visited Lusaka from February 23 to March 3, 1998 to begin the preparation of the Implementation Completion Report (ICR) for the ERIP (Credit No. 2764-ZA). Specifically, the mission reviewed with the Government and other stakeholders: (1) the performance of the Government and that of the other agencies involved in the implementation of the ERIP Reform Program; (2) the performance of the Bank in assisting implementation of the Program; (3) the lessons to be drawn from the implementation of the ERIP Reform Program; (4) plans for the future operation of the institutions covered by the Program, if applicable; and (5) the Government's contribution to the ICR. In order to do this, the mission held discussions with key agencies in the public sector, private enterprises and interested members of the donor community. The mission's conclusions and recommendations, presented below, will be confirmed by the Bank after the mission's return to headquarters. The mission wishes to thank the Government for its cooperation and for the generous provision of time and effort.

II. Summary Evaluation

2. The key elements of the ERIP Reform Program were: (1) execution of the macroeconomic program consistent with the objectives of stabilization, while strengthening the system of taxation by introducing the VAT, and protecting fiscal expenditures on critical social programs; (2) reorienting the role of Government in the financial sector in support of private investment by ending state direct lending for private investment, mobilizing term foreign exchange resources and ensuring the financial health of contractual saving institutions -- insurance companies and pension funds; (3) establishing a new national pension system; and, (4) improving the legal, fiscal and environmental framework for the mining sector, strengthening the Ministry of Mines and Minerals Development, and adopting a plan for the privatization of ZCCM.

3. The mission concludes that the objectives of the project were achieved and the impact on economic performance has been positive. Substantial progress has been made toward macroeconomic stabilization: inflation has been reduced by improving fiscal performance, while protecting Government's support to vital social services; Government's support to private

investment is reoriented and concessionary funds are being mobilized; a national basic pension system is being established; and the stage has been set for rapid, environmentally sound development of the mining sector by privatizing ZCCM, and establishing a supportive legal and institutional framework. This has been accomplished despite a generally less than favorable external environment, which, among others things, was affected by drought, volatile world copper market and sharp declines in copper prices, and the cessation of bilateral balance-of-payments support.

4. The economy has responded positively, as evidenced by lower inflation, increased GDP, rising private investment and expanding nontraditional exports. On the whole, the performance of the Government in implementing the ERIP Program was satisfactory. Although the release of the Second Tranche was delayed about a year because it took longer than expected to prepare legislation and to put in place the institutional arrangements to regulate and supervise insurance companies and pension fund management companies, and to complete the restructuring of DBZ, these tasks were eventually completed satisfactorily. The Government and other stakeholders have indicated that they consider performance of the Bank in the design and supervision of the ERIP operation to have been satisfactory.

5. Despite the progress that has been made, sustainability of the Government's economic reform program, and, indeed, future economic progress will depend critically on ensuring that sufficient concessionary balance-of-payments support is available for the implementation of the macroeconomic program. This will require: (a) addressing concerns of bilateral donors about "governance" issues; and (b) continued Government commitment to the reform process and stabilization. It requires, in addition, the expeditious conclusion of the privatization of ZCCM. This is critical to ensure rapid rehabilitation of the mining sector and to provide a clear signal to investors of Zambia's commitment to private enterprise. A determined effort is therefore required to complete negotiations for the sale of the last remaining package, ACo.

III. Implementation of the ERIP Reform Program

A. The Macroeconomic Program

6. The Government is committed to ensuring that macroeconomic policy and performance are consistent with the objectives of ERIP. The review by IDA staff has concluded that the progress being made in the implementation of the ERIP Program is satisfactory and that the macroeconomic policy objectives of the Program are being met.

7. Zambia has made significant progress toward economic stabilization during the period of implementation of the ERIP Program (July 1995 to December 1997). Problems of budgetary management, which had persisted, as evidenced by chronic difficulties in meeting fiscal targets in the first quarter of each year, are now being addressed. Each year the Treasury has managed to tighten fiscal controls and improve revenue performance to meet its targets. Fiscal performance has improved from year to year. The Government's cash deficits were relatively

small (a surplus equivalent to 0.7% of GDP in 1995, and deficits of 2.5% in 1996 and 1.8% in 1997). In addition, domestic arrears have been reduced and relatively little domestic financing has been required. In fact, there was virtually no net domestic financing of the budget for 1995-1997, taken as a whole.

8. The combination of relative fiscal balance and tight monetary policy has led to a deceleration of inflation. As measured by the CPI (end of period), inflation declined from 48% in 1995 to 18% in 1997. Moderating inflation has also had a favorable impact on interest rates: the official bank rate fell from 52% at end-1995 to 24% at end-1997, and the treasury bill rate fell from 42% at the end of 1995 to 13% percent at the end of 1997. Exchange rates remained fairly stable, with the market rate depreciating only 9% relative to the dollar in 1997, compared to a depreciation of almost 30% the previous year.

9. The IMF Board approved the midterm review of the first annual ESAF program under the three-year SAF/ESAF arrangement in February 1997, allowing the 1996 Paris Club Agreement to formally go into effect. Negotiations for the second-year ESAF have been concluded and its presentation to the IMF Board is awaiting evidence that the external financing gap is covered.

10. As agreed under the ERIP Program, the Value Added Tax was implemented, on schedule, in July 1995. The Revenue Authority has done an outstanding job introducing and gaining acceptance for the VAT. The VAT has been very successful, as evidenced by the fact that domestic VAT collections (VAT is also applied to imports) increased from K 108 billion in 1995 to K 184 billion in 1997 Total VAT collections in 1997, including the tax on imports, were about K 300 billion, providing almost a quarter of total tax revenues. Collections of the VAT were estimated by the Revenue Authority to be 75% greater than those that the taxes it replaced would have yielded. The introduction of the VAT also improved the tariff system as it resulted in the elimination of the 5% import surcharge, or "uplift factor."

11. The Government has also met its obligation under the ERIP to protect expenditures on vital social services. Spending in the social sectors in 1995 has been at or above the levels specified in the Letter of Development Policy. The share of total social sector spending in non-debt service budget releases was 35% (compared to the minimum target of 33%), and the share of non-personnel spending in these sectors was 25% (compared to the minimum target of 24%). Similar targets for social sector spending in 1996 were agreed under the ESAC II Program and fulfilled.

B. Strengthening the Financial Sector

12. As agreed under the ERIP Program, the Government has virtually eliminated its role of direct term financier of private sector development. Under the project, it was agreed that Eximbank and Lima Bank would either be privatized or liquidated. As the financial status of these two institutions made their sale impossible, they were closed and are being wound up. The ERIP Program also provided for the Development Bank of Zambia to get out of the business of direct lending. It called for DBZ to be restructured into an apex institution responsible for mobilizing and on-lending concessionary finance to commercial banks, and for DBZ's loan portfolio to be transferred to a separate collection agency. Transferring DBZ's portfolio to a collection agency was legally problematic, necessitating the restriction of the DBZ to a collection function, and creating a new apex institution, which proved to be unacceptable to parliament. The objectives were therefore accomplished by having DBZ's board order its management to suspend lending operations and concentrate on the collection of its non-performing loans. A new apex institution, Zambia Enterprise Finance Ltd., has been established under the Companies Act to mobilize concessionary external financing to be on-lent by commercial banks to the private sector. The Managing Director of DBZ indicated that the institution was engaging in a limited amount of short term lending. This is inconsistent with the Board's decision, continues to place the full burden of servicing DBZ's borrowings on the Treasury, and is contrary to the objectives of ERIP. The Government should ensure that the staff and expenses of DBZ are reduced to a level consistent with its more limited functions and that any surplus it generates from collections be returned to the Treasury immediately.

13. Strengthening the contractual savings institutions--pension funds and insurance companies--was another important element of the ERIP Program. New Acts have been enacted by Parliament to establish clear, enforceable regulatory frameworks for insurance companies and pension funds. Until the passage of the new acts, the regulation of insurance companies and pension funds was limited and inspection infrequent--not consistent with the needs of a liberalizing economy. The new legislation was drafted in consultation with the industry. Under the legislation, all insurance companies and brokers will have to be licensed, as will all pension fund managers. A single regulatory agency, the Pensions and Insurance Authority, has been established in the Ministry of Finance. The decision to establish a single agency, rather than separate agencies for pensions and insurance seems sensible, in view of the fact that six of the country's eight insurance companies are also in the pension business. The Registrar is very well qualified, as is the recently appointed Deputy Registrar for pension funds. A process of consultation with industry executives is underway and drafting of regulations will begin soon.

C. Establishing a National Pension Scheme

14. Legislation has been passed to establish a National Pension Scheme and to transform the existing Zambia National Provident Fund (ZNPF) into the agency responsible for operating the new scheme. The ILO is in the process of drafting proposals for transforming ZNPF into the administrative agency. In the meantime, several critical issues remain to be resolved: contribution rates and benefit levels and transitional arrangements for present members of ZNPF. In deciding on contribution and benefit levels under the new scheme, it should be remembered

that the intention of the program is to provide minimum protective benefits at the lowest rates possible, thus leaving headroom for employer-based pension plans.

D. Restructuring Mining and Promoting Private Sector Mining Investment

15. The ERIP Program supported the formulation of a legal, regulatory and institutional framework for the mining industry to promote growth of the sector and to encourage private sector development of mineral resources. Consistent with these objectives, the Government adopted a new Mining Sector Policy Statement in December 1995. The objective of which is to "ensure self-sustaining mineral-based industry and encourage private investment in exploration and development. . . ." This would be achieved by putting in place a privatization plan for ZCCM and promoting private sector investment.

16. A new Mining and Minerals Act was passed, which guarantees security of title, unrestricted access to foreign exchange, companies' right to market products, and freedom of commercial operation. It also provides for international arbitration of disputes.

17. A new mining fiscal regime, including relevant amendments to the Income Tax Act, the Customs and Excise Act and the Investment Act have been approved by Parliament. The new fiscal regime concentrates on the taxation of profits, rather than output, and is also non discretionary, and internationally competitive.

18. Under the new environmental regulations, impact assessments will be required for all new projects, and existing mining areas will have to be rehabilitated. All licensees will be required to have baseline studies, environmental engineering studies, an environmental management plan, and a plan for rehabilitation after decommissioning

19. Progress has been made in strengthening the Ministry of Mineral and Mining Development (MMMD). The new Mining Environmental Regulations will ensure that new investments are socially and environmentally sustainable. The mining title system is working well and new geological data bases and maps are being prepared. MMMD has begun to implement recommendations of the studies, including establishment of regional mine offices to assist medium and small companies, including gemstone miners.

20. The new policies have already had a positive impact. For example, the operations of the Bwana Mkubwa mine, which ceased operations in 1984, were reactivated in 1997 under private ownership. There has been an upsurge in private exploration since the passage of the new Mining Act. The number of prospecting licenses in force has risen from two to about twenty, and an estimated US$100 million has been spent on exploration in the last three years. Almost half the country is now covered by international mining companies carrying out exploration and prospecting work. New owners/investors are bringing strong financial, managerial and technical capacity to the sector.

21. A plan for the privatization of ZCCM was prepared by ZPA with the assistance of investment banking and legal advisors (N. M. Rothschild and Clifford Chance, respectively).

The plan, which calls for the sale of ZCCM's assets in packages, was approved by the Boards of Directors of ZCCM and ZPA and by the Cabinet and issued in May 1996. This was a major objective of the ERIP operation and fulfilled a condition for the release of the Second Tranche of the Credit. Approval of this plan marked the beginning of the implementation phase of the privatization of ZCCM. But the ultimate objective of the operation was the actual privatization of the company. The completion of the ZCCM privatization, originally targeted for June 30, 1997 is now expected in March 1998.

22. ZPA/ZCCM entered into direct negotiations with a consortium of Anglo American and Falconbridge of Canada for the Konkola Deep project and with Avmin, Ltd., a South African mining company for Konkola North. Negotiations on the latter have been completed and negotiations on Konkola Deep are ongoing, with the conclusion likely in the second quarter of 1998. In September 1996, ZPA issued an international invitation to bid on nine packages. In response 42 prospective investors carried out their due diligence. Bids were submitted by 27 investors and opened in February 1997. Since then, five asset packages were privatized and handed over to their new owners: including awarding the concession for Konkola North, and the sale of Kansanshi Mine (Cyprus Amax), Luanshya/Baluba Mines (Binani Group, a metals trading company), Chibuluma Mine (a consortium led by Metorex, a medium South African mining company), and the Power Division.

23. The major uncompleted transaction is the sale of Package A, together with the G and L packages--now consisting of Nkana and Nchanga Divisions (accounting for 55% of ZCCM's output), the Chambishi Cobalt/Acid Plant, the Chingola Refractory Ore Dumps, and some subsidiaries. This is the subject of negotiations with the Kafue Consortium, consisting of Avmin Ltd. of South Africa, Phelps Dodge of the US, Noranda Exploration of Canada, and UK Commonwealth Development Corporation. These negotiations have proven to be complex and lengthy, but the sale is now expected to be completed by the end of March 1998.

24. Despite a delay of approximately three quarters of a year resulting from a change in the leadership of the Government's negotiating team and in its strategy, the time required up until now for the implementation of the ZCCM privatization has not been excessive. All parties underestimated the complexity of the ZCCM privatization. ZCCM privatization is comparable in size and complexity to that of British Coal, the privatization of which took four years. ZCCM's sale will involve outlays of approximately a US$1 billion, including cash payments, assumption of some of ZCCM's outstanding term debt, and contractual commitments for investments over the next five years. Since the Government is not the sole shareholder of ZCCM (Anglo American owns 27.3%, and other Zambian and international private investors the balance), its listing on the Lusaka, London and New York Stock exchanges, requires that the rights of the other shareholders be protected, thus requiring additional time in preparation and notification. Moreover, there are complex issues relating to retrenchment of labor, handling of ZCCM's accumulated arrears, liability for past environmental damage, ownership of staff and worker housing, and provision of social infrastructure and municipal services that are requiring time to be adequately resolved.

25. It is in Zambia's strong interest that the privatization process be concluded rapidly, and the sale of the A, G and L packages to the Kafue consortium be finalized. ZCCM's financial situation is precarious. Further delay could affect its operations and its relations with its creditors. The company's performance has deteriorated to the point where it threatens to undermine both Zambia's economic recovery and the privatization of the company. Completion of the sale would allow the payment of the Company's domestic arrears and provide a boost to the economy. Inflows of foreign exchange resulting from up front payments would provide some relief for Zambia's presently critical foreign exchange reserve position. Allowing new owners to take control rapidly will accelerate the process of improving efficiency and increasing output, which is in the companies' interest as well. Finally, the completion of negotiations will provide a strong positive signal to other potential investors in mining as well as other sectors.

E. Impact of the ERIP Program

26. The stabilization and liberalization of the Zambia economy is beginning to show positive results. After declining by 2.3% in 1995, real GDP increased by 6.4% in 1996 and, despite a decline in agricultural output due to relatively poor weather, by 3.5% in 1997. Growth was broad based, with all sectors other than agriculture and financial services expanding. Manufacturing value-added grew by 7.4% compared to 5.5% the previous year. Mining value-added grew by 2.4%. Gross domestic savings have increased from 7.7% of GDP in 1995 to 9.5% in 1997 and gross fixed capital formation has risen from 13.8% of GDP to 14.7% over the same period. The private sector accounted for almost all of the increase in investment.

27. The shift towards a pro-export orientation in policy is helping to make Zambia's export sector a more dynamic and significant feature of Zambia's economy. The value of non-traditional products increased in 1997 by an impressive 26%, reaching a record level of over US$300 million. These exports now account for 28 % of the total and include an expanding range of agricultural, non-metal mining, agro-industrial and engineering products.

28. The economic reform program, with the support of ERIP and its predecessor and successor adjustment operations seems, at last, to be having a positive effect on poverty. According to a Government study based on the Priority Survey in 1991 and the Living Conditions Monitoring Surveys in 1993 and 1996, the incidence of poverty, which had increased from 69.7% of the total population in 1991 to 73.8% in 1993, declined to 69.2% in 1996. Extreme poverty (consumption insufficient to meet basic daily food intake) which rose from 58.2% in 1991 to 60.6% in 1993, declined to 53.2% in 1996.

F. Government Contribution to the ICR

29. As agreed with the Ministry of Finance, the Government's contribution to the ICR will be forwarded to the Bank by March 20, 1998.

For the Government:	For the Association
/S/	/S/
Professor Benjamin Mweene Secretary to the Treasury Ministry of Finance	Emile B. Sawaya Principal PSD Specialist Task Manager, ERIP World Bank

March 3, 1998
Lusaka, Zambia

STATUS OF ZAMBIA'S ECONOMIC REFORM PROGRAMME

COMPLETION REPORT FOR THE ECONOMIC RECOVERY AND INVESTMENT PROMOTION PROJECT (ERIP)

1 By the end of 1997 Government had completed the Economic Recovery and Export Promotion (ERIP) Project. This project - for which IDA provided the equivalent of US $140 million in two tranches - had been intended to facilitate the implementation of Zambia's Economic Reform Programme (ERP) in the 1995-1997 period. The ERP was designed to address poverty in Zambia through promoting private sector-led and export-oriented economic growth and by improving the delivery of vitally-needed social services. The IDA funds were used to strengthen the foreign exchange reserve position of the Bank of Zambia and helped with the smooth financing of imports, the payment of external debt service obligations and, more generally, with the implementation of the Government's programmes for economic and social development.

2. Government believes that the objectives of the ERIP project were achieved, despite a sharp decline in copper production and prices and the near-cessation of bilateral balance-of payments support. More could have been achieved - including in poverty reduction - if during the 1995-1997 period copper production had not stagnated at 300,000 tonnes annually. Nonetheless, some evidence has become available which indicates that the ERIP project has begun to have a positive effect on poverty.

3. The record of achievement can best be summarised as follows.

- macro-economic stability is being achieved: inflation dropped to 18.6 percent in 1997, down from 46 percent in 1995; interest rates fell by more than one-half since mid-1995 and are currently at about 20 percent, and in 1997 the Kwacha stabilised under free exchange market conditions; for the second year running, Government realised a domestic fiscal surplus of over 1 percent of GDP in 1997 which compares with a deficit of 0.3 percent of GDP in 1995;

- the growth momentum of the economy has been restored: after a decline of 2.3 percent in 1995, Zambia went on a positive growth path which reached 6.4 percent in 1996, indicating that the private sector has been responding positively to the Government's adjustment policies, in 1997, a growth rate of 3.5 percent was realised, despite excessive rainfall in the beginning of 1997;

- Government policies to stimulate and build partnerships with the private sector have made the private sector the engine of economic growth in Zambia, private investment now accounts for some 10 percent of GDP, up from 5.5 percent in 1991 and from 7-9 percent in 1995;

- significant benefits of privatisation are being realised in the wake of robust progress

with the privatisation programme; by end-February 1998, 212 parastatal companies had been privatised out of ZPA's working portfolio of 326 companies; these privatisations are having a favourable impact on production, employment, incomes and export earnings.

- after several years of preparation, the privatisation of ZCCM is close to completion, which, in combination with new investment in Konkola North and Konkola Deep, will inject fresh capital, new technology and private management into the copper and cobalt sector,

- Zambia's foreign trade and exchange systems have been liberalised; these reforms have helped to attract foreign private investment into agriculture, mining, tourism and industry,

- exports of non-traditional products have continued to increase at double-digit growth rates, from US $ 202 million in 1995 to US $329 million in 1997. These exports now account for 28 percent of Zambia's exports as compared to 17 percent in 1995-1

- to facilitate progress with poverty reduction, the share of social sector expenditures in the Budget was raised from 33.6 percent in 1995 to 34-6 percent in 19971

- a turn-around has begun in the provision of health services, reflecting the implementation of Health Sector Programme, nine out of ten babies are now born to mothers who receive ante-natal care from a doctor, a nurse or midwife, and child vaccination coverage has become much more widespread in Zambia: nearly four out of five children aged 12 to 2') months have received BCG, measles and three doses of each DPT and polio vaccinations.' as a result, infant mortality has stabilised- and,

- while the severity and incidence of poverty in Zambia remains high, national poverty in Zambia is on the decline., having risen from 70 percent of the population in 1991 to 74 percent in 199'), the incidence poverty has since declined to 69 percent in 1996. and in the 1993-1996 period extreme poverty fell from 61 to 53 percent-

4. However, Government is not satisfied with these achievements. Much more could have been accomplished if during the 1995-1996 period Zambia had not been required to devote a staggering 10 percent of its Gross Domestic Product to the service of its external debt (this percentage dropped to 5 percent in 1997 reflecting welcome action by Paris Club creditors and the IMF) and if external assistance had not declined by 30 percent in the 1995-1997 period from US $544 million in 1995 to US $388 million in 1997.

TABLE:EXTERNAL ASSISTANCE, DEBT SERVICE AND PRIVATE ('CAPITAL,

	1995 Actual	1996 Actual	1997 Estimate
A. EXTERNAL ASSISTANCE	544	510	388
BOP Support	283	141	120
Project Financing and Commodity Assistance	261	369	268
B. DEBT SERVICE	-377	-319	-212
Exports fob	1,186	993	1,101
Debt Service as % of Exports	32	32	19
GDP	3,467	3,307	3,923
Debt Service as % of GDP	11	10	5

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5. If Zambia's heavy debt burden would have been lighter and if more external assistance had been available,

- more progress could have been made with reducing poverty in Zambia. While Government increased the relative share of social sector expenditures in the Budget, social sector expenditures declined in real terms. This contriibuted to a drop in school attendance rates in the 1995-1997 period. This deterioration could have been avoided had more resources been available;

- Zambia's economic growth rate could have been 2 to 3 percentage points higher, With the resumption of economic growth in the 1995-1997 period which Government succeeded in initiating, per capita income growth could have been positive over the past three years. As it was, per capita income came down by 1 to 2 percent during the period, and,

- more progress could have been made with the rehabilitation of infrastructure which is holding back economic growth and social progress.

6. Clearly, Zambia's debt burden remains very heavy indeed. Unless it is reduced further, it still will remain a strong brake on economic growth and poverty reduction, precisely at a time when Zambia is poised for take-off in both areas. Government's policy remains focused on sound macroeconomic management, but its strategic agenda for the medium-term is anchored on a marked acceleration of economic growth and a decisive reduction in poverty.

7. Most of the decline in external assistance in the 1995-1997 period is accounted for by a reduction in bilateral balance-of-payments' support which fell from US $133 million in 1995 to

US $9 million in 1997 and which almost neutralised the benefits that was obtained from debt relief granted to Zambia in the 1996-1997 period. The reduction in BOP support began in 1996 when bilateral donors introduced governance considerations into their decision-making processes concerning the provision of BOP support. Since that time, the external financing programme underlying the Economic Recovery Programme has lacked the critical elements of assured and predictable availability. This seriously affected development cooperation between Zambia and the donor coalition and weakened economic recovery and social development. The lesson for the future is that more predictable and dependable levels of external assistance are needed to assist adjusting countries in implementing their reform programmes. This may require a review of the Special Programme for Africa which no longer assures that the successful implementation of economic programmes of adjusting countries will not be held back by the lack of external assistance resources.

8. As regards the decline in copper production from 500,000 tonnes in 1994 to an average of 300,000 tonnes in the three-year period thereafter, this led Government to stress the revitalisation of the mining sector so that it could once again become one of the most important determinants of economic performance in Zambia by generating increased income, foreign exchange and employment. In cognisance of this, Government decided to privatise Zambia Consolidated Copper Mines as the most viable alternative to arresting the Ion. run and steady decline in the production of metals and shrinking metal base. This privatisation process is now close to completion.

9. In conclusion, with the help of the ERIP project, the foundations for higher growth were strengthened in the 1995-1997 period, by the liberalisation of markets, by tax, tariff and financial sector reform, and by privatising state enterprises, Those reforms are now being taken further Government has already begun to Implement a three-year programme of economic recovery for the years 1998 to 2000, For this period, Government has now confidently adopted as its macroeconomic objectives the achievement of economic ,-growth on the order of 5-6 percent a year, a reduction in inflation to single-digit levels, and a further strengthening of Zambia's export sector. To achieve these objectives, Government is continuing its stabilisation efforts through tight financial policies. These are being complemented by structural reforms, specifically public service reform, further trade liberalisation and export promotion, further
privatisation and the provision of growth-enabling as well as social infrastructure. Government has already reached agreement with the World Bank and the IMF on its economic programme for the 1998-20()0 period. As part of the recovery programme 1998200(), Government is stepping up Zambia's efforts to increase savings(,s, making Government leaner and more effective and improving the efficiency of investment. Government is also stepping up investment in growth-supporting infrastructure and in education and health,

10. The successful implementation of the ERIP pr 'project has not only benefited from IDA's financial resources. Government also derived significant benefits from the high-quality economic policy and technical advice received from IDA staff.

Lusaka, 16th April, 1998

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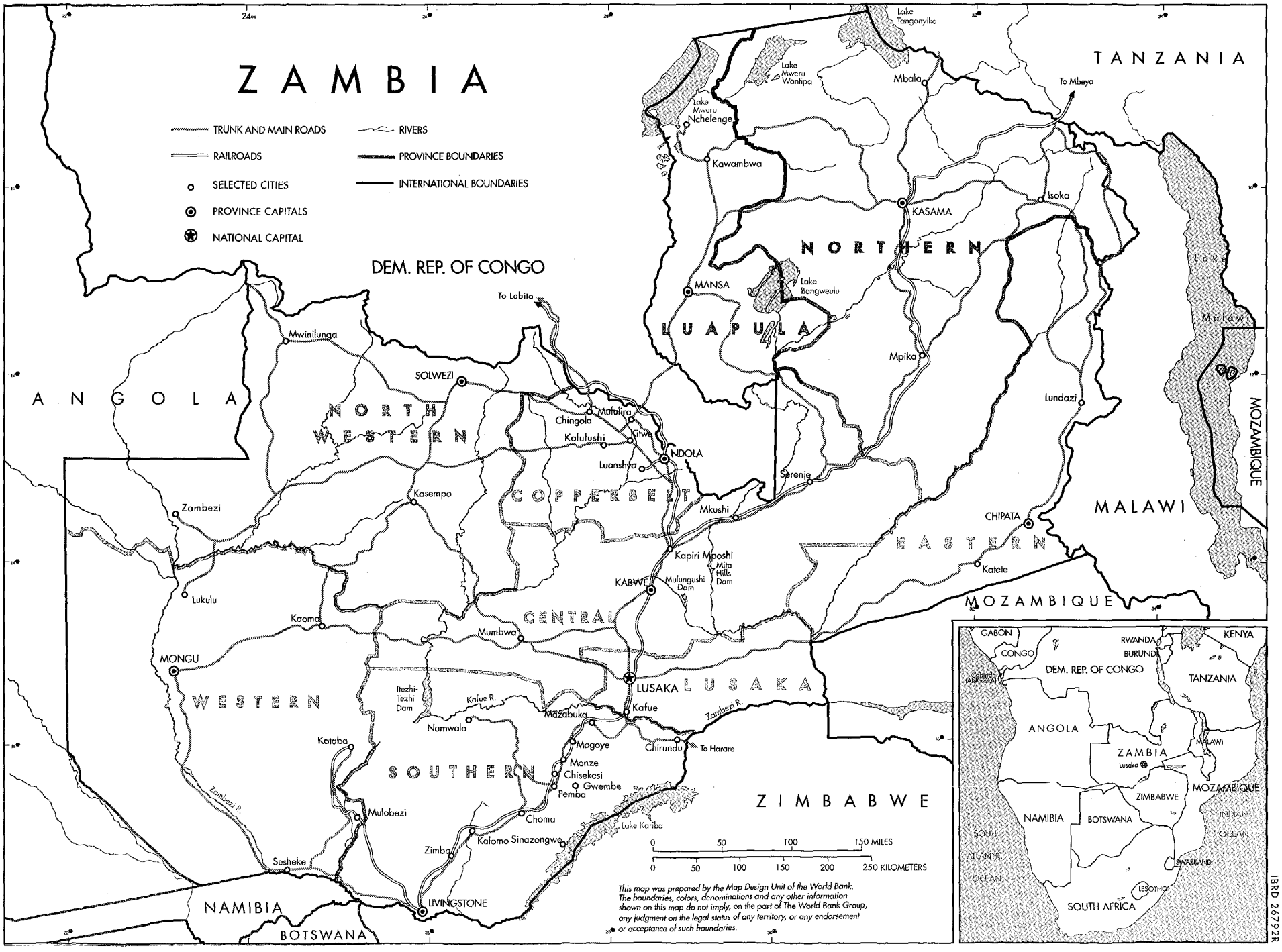

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