Program Information Document (PID)

Appraisal Stage | Date Prepared/Updated: 16-Dec-2023 | Report No: PIDA36986

BASIC INFORMATION

A. Basic Project Data

Country	Project ID	Project Name	Parent Project ID (if any)
Zambia	P181011	Zambia Second Macroeconomic Stability, Growth and Competitiveness DPF (P181011)	P174911
Region	Estimated Board Date	Practice Area (Lead)	Financing Instrument
EASTERN AND SOUTHERN AFRICA	21-Dec-2023	Macroeconomics, Trade and Investment	Development Policy Financing
Borrower(s)	Implementing Agency		
Republic of Zambia	Ministry of Finance and National Planning		

Proposed Development Objective(s)

The program development objectives are to help Zambia restore macroeconomic stability and debt sustainability and promote private-sector-led inclusive growth.

Financing (in US$, Millions)

SUMMARY

Total Financing	125.00

DETAILS

Total World Bank Group Financing	125.00
World Bank Lending	125.00

Decision

The review did authorize the team to appraise and negotiate

B. Introduction and Context

Country Context

1. **The proposed Development Policy Financing (DPF) is the second of two operations in a programmatic series aimed at helping Zambia restore macroeconomic stability and debt sustainability and promote private-sector-led inclusive growth.** The SDR 95.2 million (US$125 million equivalent) grant is part of the World Bank's multi-sectoral support to help Zambia emerge from the debt crisis and shift to a more sustainable and inclusive economic growth path. It also supports

Zambia in its efforts to obtain deep debt restructuring under the G-20 Common Framework for Debt Treatments beyond the Debt Service Suspension Initiative (from now on, "Common Framework").

2. **The Government of the Republic of Zambia (GRZ) is committed to fiscal and structural reforms to restore macroeconomic stability, reinvigorate growth, and reduce poverty.** During the 2010s, unsustainable macroeconomic policies, falling copper prices, and imprudent borrowing sharply increased external public and publicly guaranteed (PPG) debt. Deteriorating economic conditions during the global COVID-19 pandemic led the GRZ to default on its external bonds in November 2020. After the current administration's election in 2021, the GRZ launched an ambitious reform program. It improved the primary balance (commitment basis) by 6.6 percentage points in 2022, bringing it to a surplus and cutting inflation by half. The authorities have introduced measures to boost private investment and rebalanced the composition of government spending by canceling wasteful investment projects, withdrawing state intervention from the energy sector, transforming agricultural subsidies to invest in human development.

3. **Zambia has reached agreement with official creditors to restructure external debt and is negotiating terms with commercial creditors.** Official external creditors and Zambia finalized a memorandum of understanding (MOU) on the terms of debt restructuring in October 2023 and expect to sign it by the end of December 2023. Official creditors will reduce the net present value of outstanding debt by rescheduling all principal owed, providing a grace period on principal repayments during 2023–25, and charging a small interest rate. The authorities will subsequently resume debt service at a pace that depends on Zambia's debt-carrying capacity in 2026. The GRZ is negotiating with external bondholders for debt reduction on comparable terms. These agreements will downsize Zambia's debt stock and servicing to levels consistent with the DSA. Debt restructuring gives the GRZ fiscal space to reorient government spending and provides greater certainty to private investors.

4. **Although debt restructuring provides breathing space to restore macroeconomic stability, Zambia's structural challenges remain.** Lack of inclusive growth, weak macroeconomic performance, and successive negative shocks—including climate—increased poverty rates. The population below the poverty line is estimated to have risen from 54.4 percent in 2015 to 60 percent in 2022. Zambian households were severely hit by the COVID-19 pandemic, with welfare losses in urban areas and among those working in the informal sector. Rising food prices and reduced access to social services—including health—compounded job and income losses. Rural poverty remains stubbornly high, with almost 80 percent of the rural population living below the poverty line by 2022. Besides, Zambia is one of the most unequal countries in the world, with a Gini coefficient estimated at 0.56 in 2015.

Relationship to CPF

5. **The proposed DPF supports the World Bank Group's Country Partnership Framework (CPF) for Zambia for FY19–23, discussed by the Board on February 14, 2019 (Report No. 128467), which was informed by the 2018 Systematic Country Diagnostic.** This proposed operation is a core part of the CPF, and the DPF contributes to critical areas of the CPF. Reforms in Pillar A contribute to achieving CPF Objective 3.1 (Fiscal and financial fitness increase). Reforms in Pillar B contribute to achieving CPF Objective 1.1 (Agro-food sector becomes less maize-centric, more productive, and better connected to domestic and external markets). Reforms in Pillar C contribute to achieving CPF Objective 1.3 (Access to and quality of resilient infrastructure services increases). Reforms in Pillar C contribute to achieving CPF Objective 3.1 and Objective 3.2 (Trade and infrastructure for economic integration increase). Both the CPF and the proposed operation support wider IDA goals.

6. **The proposed operation complements many other World Bank projects and analytics.** World Bank investment and policy-based financing and related technical assistance support the implementation of *Pillar A's* reforms to improve fiscal management. *Pillar B* of the DPF series supports changes to policies on agricultural subsidies while, through a PforR and IPF, the World Bank helps the GRZ reallocate public spending from subsidies to irrigation, extension, and other activities that promote adaptation to climate change and increase farm productivity. Reforms in *Pillar C* to ensure affordable access

to electricity complement World Bank financing provided through the Electricity Service Access Project (P162760), while policies aimed at restoring ZESCO's financial viability lay the groundwork for a proposed regional IPF and power sector reform PforR. Operations approved in FY24 are financing investments in infrastructure and institutional capacity that will help the policy reforms supported in *Pillar D* pay off with jobs and inclusive, private-sector-led growth.

C. Proposed Development Objective(s)

7. **The program development objective is to help Zambia restore macroeconomic stability and long-term debt sustainability and promote private-sector-led inclusive growth.**

Key Results

8. **On completion of the DPF series, the reform outcomes will lay the foundations for long-term fiscal and debt sustainability, and a more inclusive and resilient development path in a livable planet.** The operation is supported by four pillars and eight prior actions. The prior actions in the first pillar will help strengthen debt accountability and transparency and improve fiscal governance and credibility, supporting Zambia's efforts to restore long-term fiscal and debt sustainability. Pillar two's prior actions will increase farmers' productivity and access to agricultural markets by removing market distortions in input and output markets, encouraging farmers to diversify into more climate-resilient crops and move away from maize-centric subsistence production that puts pressure on biodiversity. The policy and institutional measures under pillar three are expected to expand electricity access to poor and vulnerable households, as well as support investments in non-hydro renewable energy and promote efficiency in fuel supply to help reduce the government's liabilities. Finally, prior actions under pillar four will enhance access to green finance and increase Zambia's competitiveness to attract, retain and expand FDI, boosting private sector development. Ultimately, these reforms aim to shift to a more inclusive and resilient economic growth path, creating more and better jobs, and reduce poverty and inequality in a livable planet.

D. Project Description

9. **The proposed Development Policy Financing (DPF) supports critical growth-enhancing and competitiveness reforms while seeking to reduce poverty on a more livable planet**. The SDR 95.2 million (US$125 million equivalent) grant is the second of two operations in a programmatic series aimed at helping Zambia restore macroeconomic stability and debt sustainability and promote private-sector-led inclusive growth. The Program Development Objectives (PDOs) will be achieved through reforms aimed at: i) restoring fiscal and long-term debt sustainability; ii) increasing farmer productivity and access to agricultural markets; iii) ensuring sustainable access to energy; and iv) enhancing access to finance and private sector development. These align with Zambia's Eighth National Development Plan (8NDP), as well as the World Bank Group's (WBG) FY19–23 Country Partnership Framework, the IDA20's Policy Commitments in Governance and Institutions and Jobs and Economic Transformation. Prudent stewardship of public finances that will reduce Zambia's public debt burden and free up public resources to invest in the Zambian people are central to this programmatic series. Reforms aimed at increasing farmers' productivity, expanding access to electricity and finance, and generating greater private sector dynamism will create more and better jobs that reduce poverty and inequality. A more predictable investment climate will increase external financing and boost Zambia's competitiveness. Additionally, the proposed operation supports measures that will help unlock private financing for green investments, increase the resilience of agriculture and electricity generation to climate shocks, and diversify Zambia's energy mix to non-hydro renewables.

10. **The proposed operation is also an integral element of a growing IDA portfolio that has helped Zambia respond to multiple crises since 2020.** The active portfolio has more than doubled to around US$2.9 billion since the onset of the global pandemic in 2020. To support Zambia's debt restructuring, the World Bank is providing increased net positive flows of highly concessional financing—on grant terms for new operations approved after July 1, 2023. IDA financing enabled

the government to protect pro-poor expenditures during this period of fiscal consolidation and buffer the poor and vulnerable from the pandemic and other shocks. The portfolio also finances investments that mutually reinforce the policy reforms supported by the proposed DPF in governance, agricultural transformation, energy sector governance, and the business-enabling environment.

11. **Furthermore, it is aligned with the goals of the Paris Agreement**. First, the economic reform program supported by the proposed DPF is consistent with Zambia's climate commitments, including those that Zambia made in its (2016) and revised (2021) Nationally Determined Contribution (NDC), the 2017 National Health Adaptation Plan, and the climate objectives articulated in the 8NDP. Second, no prior actions for the proposed DPF will likely cause a significant increase in GHG emissions to impede Zambia's planned low-carbon development path. Third, all prior actions for the proposed DPF program are aligned with the mitigation goals of the Paris Agreement. Finally, all prior actions align with the adaptation and resilience goals of the Paris Agreement

12. **The World Bank and IMF continue to work closely to coordinate policy dialogue, analysis, and technical assistance.** The joint work between the institutions includes supporting the authorities to comply with only concessional borrowing under the Sustainable Development Financing Policy and IMF Debt Limit Policy. The IMF approved a 38-month program under the Extended Credit Facility (ECF) in the amount of SDR 978.2 million (US$1.3 billion) on August 31, 2022, and completed the first program review. The Fund noted Zambia's strong performance, despite the challenging global environment and multiple domestic shocks, completing the first program review in July 2023.

E. Implementation

Institutional and Implementation Arrangements

13. **The Ministry of Finance and National Planning (MOFNP) will coordinate the monitoring and evaluation for this proposed operation.** The institutional and policy reforms supported by the programmatic DPF series fall under the purview of the Ministry of Agriculture, MCTI, Ministry of Energy, MOFNP, Ministry of Justice, Ministry of Tourism, BoZ, ERB, and the Public Procurement and Regulatory Agency. MOFNP has chaired the multi-sector coordinating committee established to oversee the preparation of the operation. This committee will remain in place during the program's implementation and will be responsible for monitoring results indicators and evaluation activities. MOFNP will provide information to the World Bank to monitor outcomes in the results framework. Most results indicators are based on routinely published information by the government. For those that are not, MOFNP will liaise with focal points in the other ministries involved to provide such information at a frequency and in a format satisfactory to the World Bank.

F. Poverty and Social Impacts, and Environmental, Forests, and Other Natural Resource Aspects

Poverty and Social Impacts

14. **DPF-supported reforms are expected to underpin sustainable poverty reduction and reduce inequality in the medium term.** Debt and fiscal sustainability measures minimize the risks of another macroeconomic crisis, which is amongst the most important causes of large increases in monetary poverty worldwide and long-term damages to the human capital of the poor. Enhanced public investment and increased participation of private investment through PPPs are expected to help close critical infrastructure gaps that disproportionally hurt the poor. Improved market performance and higher agricultural productivity are necessary to reduce poverty in rural areas. Zambia has the fifth-highest coverage gap in electricity in the world. Given the high correlation between poverty and connection gaps, expanding access through the grid and off-grid electrification is expected to directly benefit the poor and vulnerable, including women, closing

inequalities. By laying the foundations for instruments that finance climate-resilient investments, the green loan guidelines can reduce vulnerability and improve financial inclusion, particularly in underserved segments. Higher FDI can generate more employment opportunities, particularly in the formal sector.

Environmental, Forests, and Other Natural Resource Aspects

15. **The proposed operation is aligned with the Paris Agreement on climate change, and several reforms under this operation are expected to have considerable positive impacts on the environment, forests, and other natural resources; the remaining reforms will likely have no significant positive or negative impact.** Financial sector reforms are expected to unlock Zambian firms' access to financing to invest in green projects and contribute to achieving Zambia's NDC, while agriculture reforms aim to increase farmers' ability to diversify into crops that are more resilient to drought and rising temperatures. The energy sector reforms will increase access to affordable, reliable, and sustainable energy sources, which will likely reduce vulnerable households' reliance on biomass energy. Reforms that integrate PPPs into MOFNP's public investment management systems will ensure that environmental risks are considered before proposed PPPs enter the public investment program. Reforms that reduce subsidies and direct state intervention and increase the efficiency of government spending will create fiscal space for the GRZ to invest in long-term climate resilience.

G. Risks and Mitigation

16. **Risks to achieving the program's objectives have moderated since the DPF1; the engagement still faces substantial risk.** The three main sources of risk described below are inter-connected and could impede the achievement of the proposed operation's results. First, political and governance risk is substantial. Resistance from vested interests or reform fatigue could slow the implementation of the GRZ's reform program or weaken its commitment to fiscal restraint. Additionally, changes to agricultural subsidies or policies governing fuel supply can generate a popular backlash. Increased transparency—of market mechanisms or in public procurement, debt, and financial management—narrows the scope for collusion, corruption, or rent-seeking. The nearing general election could slow the pace of reforms. The extensive consultations that the GRZ conducts tend to mitigate these risks. GRZ has built public awareness of cost efficiency by presenting analytical work to public gatherings and parliamentary committees. Reallocating efficiency gains for spending on social programs also mitigates risks. Second, macroeconomic risk is high. The official creditor's agreement in October 2023 to restructure debt and the GRZ's additional track record of fiscal constraint ease macroeconomic risks. However, shocks to Zambia's GDP, balance of payments, price volatility in global commodities and financial markets, or adverse weather conditions could weaken GRZ's fiscal stance or delay agriculture and energy sector reforms. BoZ's newly strengthened autonomy and mandate mitigate macroeconomic risks to the PDOs, as do the commitments by multilateral development banks to provide net financial flows in highly concessional terms to support Zambia's debt restructuring. Agreeing and signing debt reduction MOUs with commercial creditors would significantly reduce uncertainty about Zambia's macroeconomic outlook. Finally, some existing institutional arrangements are weak and represent a substantial risk. Low capacity in some government functions may challenge the achievement of reform objectives, such as an improved business-enabling environment or increased use of PPPs. The GRZ is taking steps to build capacity in these areas, including with support from World Bank financing operations and technical assistance.

CONTACT POINT

World Bank

Philip M. Schuler, Albert Pijuan Sala
Lead Economist

Borrower/Client/Recipient

Republic of Zambia
Felix Nkulukusa
Secretary to the Treasury
felix.nkulukusa@mof.gov.zm

Implementing Agencies

Ministry of Finance and National Planning
Felix Nkulukusa
Secretary to the Treasury
felix.nkulukusa@mof.gov.zm

FOR MORE INFORMATION CONTACT

The World Bank
1818 H Street, NW
Washington, D.C. 20433
Telephone: (202) 473-1000
Web: http://www.worldbank.org/projects

APPROVAL

Task Team Leader(s):	Philip M. Schuler, Albert Pijuan Sala

Approved By

Country Director:	Achim Fock	01-Nov-2023