ZIPAR
Zambia Institute for Policy Analysis & Research

WHAT WE SAID ON THE 2019 NATIONAL BUDGET

Excerpts from the ZIPAR 2019 Budget Analysis

September 2019

Introduction

After the 2019 Budget Speech was read on 28th September 2018, on 4th October 2018, ZIPAR published an analysis of the 2019 Budget. We dubbed the analysis “Taking the Road Less Travelled: In Pursuit of Fiscal Consolidation.” This year, as the country gears up to hear the 2020 Budget Speech, we thought it might be informative to reproduce verbatim some of what we said about the 2019 Budget nearly a year ago. This is towards keeping sight of the recurring issues in successive budgets, which may require more concerted efforts to resolve.

Here is what we said last year.

On Growth:

… The Budget Speech projects the GDP to grow at around 4% in 2019 … As we have set out, the 4% target is not without risk – the debt burden, exchange rate volatility and subdued growth rates in agriculture caused by climate change – which could all persist in 2019.

ZIPAR’s view is that the economy is slowing down and the debt burden is likely to slow it down even further. Zambia will continue to record positive economic growth but will most likely be at a decreasing rate and growth will definitely not be at the levels set out in the Vision 2030, posing a challenge to Government’s quest for poverty reduction and improved livelihoods.

On Inflation:

Additionally, if the El-nino forecasts materialise, lower harvest will inevitably put upward pressure on food prices. With inflation breaching 8% in August 2018 (though falling to 7.9% in September), inflation is already pushing the upper bound of the target. These factors suggest a credible risk to breaching the inflation target in 2018 and possibly in 2019. Thus, the monetary authorities will have to play a balancing act between keeping inflation low by raising the policy rate and being supportive to the already subdued growth by keeping the policy rate unchanged.

On Spending:

… [The] continued expansionary spending stance adopted in the 2019 Budget is unsustainable during these times of austerity. The Government should adopt pro-growth strategies by identifying priority sectors that are likely to bring quick returns in the medium-term to pay off the debt and help jump-start the much-needed economic growth. For example, the K443 million earmarked for the construction of the FTJ University in Luapula Province can be invested in aquaculture, an activity the province has comparative advantage in.

On Sales Tax:

… Since the sales tax is a single stage tax levied at the point of sale of the final product, it is vulnerable to evasion unlike the VAT which is collected at several points and hence secures revenue. For instance, under a VAT system, if the final seller is not taxed, say due to evasion, only the tax on the value-added at the final stage is lost. On the other hand, under the sales tax all the tax is lost if the final seller is not taxed. The vulnerability to evasion is said to heighten if the rate of sales tax is pegged at higher rates than 10%. The sales tax does not have the self-enforcing feature of the credit-involved? mechanism under the VAT (the notion that the purchasers will help enforce the VAT due to their interest in obtaining a proper invoice from their suppliers in order to claim VAT paid on their inputs) and therefore will require extra enforcement. Further, in practice under the Sales Tax, it is difficult to ensure that the tax burden does not fall on production inputs as in the case of VAT. Therefore, this may lead to cascading, which is simply a 'tax on tax' that may result in distorting production decisions. Therefore, the design of the sales tax will require to take into consideration these issues, to ensure that it comes out more superior than the VAT it will replace in contributing to revenue.

On Non-deductibility of Mineral Royalty from Company Income Tax:

… Besides the changes in the structure and rates of the MRT, for both cobalt and copper, the MRT will now be a non-deductible levy for income tax purposes. While this in principle implies increased revenue for the Government from the sector, it also translates into loss of income for the mining companies. Depending on the significance of these losses, the mining companies could defer their capital investments decision; which would impact production in the long term. Low growth of the industry would in turn imply reduction in revenue collected from the sector. In the short term, however, the mining companies might respond to these changes in a negative way as was the case during the 2015 fiscal year.

On Rising Debt & Debt Servicing Costs:

… Debt payments will be a dominant area of spending in 2019. External and domestic debt payments will together increase by K9.3 billion in 2019, representing an increase of 66%. As a percentage of GDP, debt payments are projected to increase by as much as 3 percentage points from 4.7% in 2018 to 7.9%. Interest payments alone will take-up 4.7% of GDP, almost one percentage point higher than in 2018. The depreciation of the Kwacha against the US Dollar will further increase the cost of debt servicing. The debt servicing burden is best illustrated in per capita terms (Figure 4.2): on average, each Zambian will contribute K1,394 towards debt payments in 2019. More importantly, critical spending on social spending, for example, will be at the tail end.

… The debt servicing costs are likely to displace other critical spending such as education, health care and social benefits. Indeed, all these expenditures are projected to reduce in 2019. Though Government intends to prioritise the dismantling of arrears and curtail its accumulation, the reduced funding to noninterest expenditures is likely to have the opposite effect. Spending cuts and delays in the processing of payments due to late release of funds is likely to lead to further accumulation of arrears.

On the Medium-Term Debt Management Strategy (MTDS):

… The fact that the levels of debt and its accompanying debt service costs continue to rise rapidly brings into question whether the MTDS is an effective Strategy for debt management. It shows that, on its own, the MTDS is not enough to stem the rising debt challenge. It needs to be supported by commensurate actions to deliver its objectives and extra effort to reverse the high risk of debt distress. These measures include limiting spending overruns, improving domestic resource mobilisation (by removing hurdles to growth mostly faced by the private sector), exercising restraint on commercial debt and obtaining only concessional and semi-concessional borrowing as outlined in the debt strategy. Cardinal to this is that debt should be utilised on high-return capital projects.

On Austerity Measures:

… We give some cursory remarks on some of the measures:

• Indefinitely postpone the contraction of all pipeline debt until the debt is brought back to moderate risk of debt distress: this is likely to address the reported disagreement with the IMF with regard to accessing a credit facility.

• Cancel some of the current contracted loans that are yet to be disbursed to reduce the debt service outlays: while this brings some relief in the short term, it is likely to be costly in the long term as Government is likely to be sued for breach of contract, and the earmarked projects will stall.

• Undertake refinancing on selected bilateral loans, both local and external to extend the maturity profile and attain lower costs on debt: this will offer the much-needed short term relief. But bilateral loans are only a small part of the debt portfolio and account for less than 5% of the total external debt.

• Cease the issuance of letters of credit and guarantees to state-owned enterprises that are technically insolvent until their balance sheet challenges are resolved: state-owned enterprises are the main source of contingent liabilities which are presently estimated at US$1.2 billion. High levels of contingent liabilities can lead to an increase in the risk premium on public debt

• Government to only sustain loans whose projects are at least 80% completion: the allocation of K442.7 million for the construction of the FTJ University, a green-field project in Luapula Province, and the

Copperbelt International Airport, at 13% completion, goes against this measure.

On State-Owned Enterprises:

… Institutional reforms in the 2019 Budget relate to improvement of the efficiency of State-Owned Enterprises (SOEs). However, a commitment regarding this was also made in the 2017 and 2018 Budgets. Various reports have shown that most of Zambia's SOEs are loss making. The 2019 Budget shows that only 17 out of 45 (38%) SOEs were profitable and out of the 17, only eight declared dividends. While this shows some progress in turning around the SOEs, this remains minimal. The continued sustaining of loss making SOEs continues to put pressure on the already financially constrained fiscus. The 2017 Budget announced that the IDC would undertake a situational analysis of SOEs to decide on which ones to recapitalise and which to hive off based on viability. Since then, there has been no update of this analysis. However, the 2019 Budget proposes to restructure ZESCO Limited, ZAMTEL Limited, Zambia Daily Mail and Times of Zambia. The Budget also states that efforts will be made to identify equity partners for INDENI Petroleum Refinery Limited and ZSIC General Limited, while plans to list ZSIC Life Limited and the Zambia Forestry and Forest Industries Corporation (ZAFFICO) on the Lusaka Securities Exchange have also been announced. While all these efforts are commendable, the pace at which the restructuring of the SOEs is taking place is slow given the number of loss making SOEs. Therefore, we urge the Government to act on loss making SOEs to reduce the drain on the treasury.

On Legislative Reforms for Fiscal Consolidation

… All these efforts to identify the key legislative reforms necessary for fiscal consolidation are commendable but we realise that a number of these reforms have been pending from one budget to another for the past few years. Therefore, we urge the Government to conclude the committed revisions and enactments proposed in the Budget in 2019. Of importance to note is that the Budget is silent on the Loans and Guarantees (Authorisation) Act CAP 366 of the Laws of Zambia which has been pending from the 2017 Budget. The pending revision to this Act is aimed at strengthening Parliamentary oversight over the entire debt contraction process. The delayed revision to the Loans and Guarantees Act has limited Parliament's role on debt to simply approving the debt ceiling and not providing oversight on the entire debt contraction process. This has limited the control on debt accumulation and led to significant increase in the debt stock.

Conclusion

As we await the 2020 Budget presentation, our expectations still revolve around the key issues highlighted above from the 2019 Budget. The 2020 Budget needs to bring back growth and rein in expenditure and further borrowing, including through passing long overdue legislation.