ZIPAR
Zambia Institute for Policy Analysis & Research

Debt Servicing and the Delivery of Social Services

Mid-Year Review of the 2018 Budget

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EXECUTIVE SUMMARY

A mid-year review of the January-June 2018 Budget estimates of revenue and expenditure reveals that:

- Overall, expenditures were above the projected spending while revenues were largely consistent with the approved Budget for 2018. In the period under review, Total Expenditure (including the clearance of arrears and debt maturities) was above its target and amounted to K39.6 billion (14.3% of 2018 projected GDP), against a target of K34.2 billion (12.4% of GDP). Total Revenue and Grants amounted to K25.1 billion (9.1% of GDP), which is close to the programmed target of K25.3 billion (9.1% of GDP). Soaring expenditures against targeted revenues led to a half-year fiscal deficit on cash basis of K12.8 billion (4.6% of GDP), against a target of K7.4 billion (2.7% of GDP). Only halfway through the year, the half-year deficit already represents three-quarters of the originally targeted annual fiscal deficit of 6.1% of GDP. The annual deficit outturn is therefore likely to be markedly higher than the annual target.
- Zambia has made some progress towards fiscal sustainability (i.e. domestic revenues fully covering operating expenditures) by reducing recurrent spending as a percentage of domestic revenues from 115% in the first half of 2017 to 102% in the first half of 2018 mainly by recurrent expenditure reductions in personal emoluments and the use of goods and services. However, these gains were wiped out by increased spending on debt servicing payments, thereby crowding out other critical spending including social benefits (which include spending on pensions and social cash transfers), empowerment programmes, inadequate funding of service provision, and most likely caused a gradual degradation of capital investments. This has a negative bearing on human development.
- One of the reasons for the rising cost of infrastructure has been the creation of new districts - the number of districts has risen from 72 in 2011 to about 115 by 2018. These have often relied on the treasury to finance their infrastructure needs. To ease the pressure on the Treasury, the Government needs to consider alternative financing options to fund infrastructural and developmental projects in these new districts.

Recommendations

a) **Government needs to prioritise expenditure on projects that stimulate growth and human development, such as schools and health facilities.** A number of infrastructure projects including schools and health centres have remained incomplete for years due, in part, to erratic funding brought about by the reprioritisation of expenditure to meet debt obligations. The recently announced austerity measures include the completion of projects above 80% completion rate. Refraining from the rigid application of the 80% completion threshold, the authorities should undertake rapid project appraisals, applying rationalisation criteria in the selection of high social- and economic-return (incomplete) projects on which to prioritise expenditure."

b) **The Government should consider alternative financing options to pay for infrastructure and other developmental projects.** Government currently pursues Public Private Partnership (PPP) as a financing and implementation mechanism for road construction. However, Government needs to address the capacity bottlenecks currently existing in the Government's PPP unit as the complex and long-term nature of most PPP projects requires special skills and understanding beyond the traditional contract management or administration.

c) **In line with the tenets of fiscal decentralisation, Government should consider issuing municipal**

bonds as alternative financing options for viable councils, to pay for infrastructure and other developmental projects at the local level. A municipal bond, which is a debt security issued by a municipality to finance capital expenditure, fetches the investor payments on a predetermined rate of interest over a stipulated period. As part of the preparations towards issuing municipal bonds, districts will need to be credit-rated from local and/or international rating agencies. The individual district ratings will be the same as bond ratings.

d) **In this period of fiscal consolidation, growth is essential. Government needs to rethink the philosophy of escalating user fees, fines and charges beyond the regular taxes at a time when the economy has slowed down**. To alleviate the liquidity crunch currently being faced by firms that are owed VAT refunds, the Government should establish a temporary reserve fund to pay VAT claims mostly for exporting firms while audits are on-going to alleviate the liquidity crunch currently being faced by firms. This will serve as a fiscal stimulus for the private sector that will help bring back the growth, and the corresponding tax revenue, that the country considerably needs ***now***. The Government should also consider reducing some tax rates to lower business costs and stimulate productivity and production, which will in turn help spur investment.

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Tables

1 Introduction

This policy brief reviews the performance of the first half (January to June) of the 2018 National Budget, drawing on data from fiscal tables produced by the Ministry of Finance. We employ a descriptive approach to analysing the data and summarising the results. We focus on fiscal revenue, fiscal expenditure, fiscal balances and the financing of the fiscal balances. We also provide preliminary comments about implications of the fiscal situation for spending quality and the quality of service delivery.

We observe that while revenue collection was largely consistent with the approved budget for 2018, it was not enough to cover the higher than planned spending emanating from increased capital and debt servicing expenditure. Moreover, although progress has been made towards fiscal sustainability, the overruns have resulted in inadequate funding of key public services including social benefits and empowerment programmes.

The rest of this report is organised as follows: Section 2 presents the review of Zambia's 2018 half-year fiscal performance while Section 3 considers the implications of high capital spending and debt servicing costs. Section 4 presents the conclusion and recommendations.

2 Fiscal Performance

Overall, revenues were largely consistent with the approved Budget for 2018, though they could have been better, while expenditures soared above the projected spending. Mid-year performance indicates that Total Expenditure (including the clearance of arrears and debt maturities) was above its target of 14.3% of 2018 projected GDP by almost 2 percentage points, against a target 12.4% of GDP. Total Revenue and Grants, on the other hand, were spot on target at 9.1% of GDP. This resulted in a fiscal deficit on cash basis of 4.6% of GDP (K12.8 billion), against a target of 2.7% of GDP (K7.4 billion).

Sections 2.1 and 2.2, respectively consider, in more specific detail, the revenue and expenditure sides of Zambia's fiscal performance in the first half of 2018.

2.1 Revenue performance was lopsided

In the 2018 Budget, the Government introduced a number of proposals meant to widen the tax base and improve the efficiency and administration of revenues. As at June 2018, the Government had collected K25.1 billion or 49% of the planned K51.5 billion target for Revenue and Grants. While tax revenue collection was at 52% of the Approved Budget, non-tax revenues (45%) and Grants (9%) dragged the overall revenue collections downwards. Value Added Tax (VAT) was the best performing tax type, with 64% of the targeted collections for VAT (Table 2-1).

Table 2.1: Domestic Revenue Performance, Jan-Jun 2018, K' million

	Approved Budget 2018	Projection Jan-Jun	Outturn Jan-Jun	Year-to-date Outturn % of approved budget
Revenue & Grants	**51,525**	**25,286**	**25,070**	49%
Domestic Revenue	**49,087**	**24,066**	**24,858**	51%
Tax Revenue	**40,874**	**19,930**	**21,162**	52%
Income Tax	20,338	10,641	10,150	50%
o/w Mining	1,948	1,456	1,298	67%
Value Added Tax	12,369	5,548	7,951	64%
Customs & Excise Duties	8,047	3,679	2,990	37%
Non-tax revenue	**8,213**	**4,136**	**3,695**	45%
o/w RTSA	968	474	239	25%
o/w Road tolls	845	423	721	85%
o/w mineral royalties	3,528	1,768	1,819	52%
Grants	**2,438**	**1,219**	**213**	9%

Source: Ministry of Finance and ZIPAR's own calculations

2.1.1 VAT performance continues to outshine other taxes

Against a target of K5.5 billion, VAT revenue amounted to K7.9 billion in the first 6 months of 2018. The measures introduced in 2017 and 2018, including withholding the tax at source by appointed agents, seem to be paying off.

However, this outstanding performance may not be all due to the measures outlined. The Zambia Revenue Authority now makes pre-VAT audits for firms perceived to be risky before refunds can be effected. Previously, all firms could claim VAT before an audit was done. But now, some firms (especially exporting firms) can only claim VAT ***after*** being audited. Delays in auditing have resulted in a backlog of VAT refunds of up to about a year, thereby constraining liquidity to the private sector[1]. With such a backlog, the reported VAT performance may not be a pure reflection of VAT collections as it may include some VAT refunds.

2.1.2 Income tax underperformed

Against a target of K10.6 billion, income tax collections amounted to K10.1 billion. This was due to lower than projected collections for both mining and non-mining company income tax, pay as you earn, and withholding tax. Lower-than-projected performance of income taxes in the period is reminiscent of poor performance in 2017 and points to the sluggish economic growth experienced since 2015, and a multiplicity of tax rates and incentives.

Sluggish economic growth continues to prevail at present. GDP growth was recorded at 2.6% in Q1 2018, the lowest growth since Q4 2015, and a far-cry from the strong growth experienced before 2015. The low growth has resulted in declining taxable income. By not paying attention to, and sufficiently promoting private sector performance, the Government is now missing out on taxable income.

1 The President of the Zambia Association of Manufacturers (ZAM) brought this to light at a Town Hall Consultative meeting on debt management in Lusaka in June 2018

2.1.3 Customs and excise duties not doing so well

Customs and excise duties underperformed – against a target of K3.7 billion for the first six months of 2018, only K3.0 billion was collected. Particularly, excise duties had a relatively poor performance – against a target of K2.1 billion, collections from excise duties were K1.4 billion. This translates to an under-collection of K667 million during the first half of the year.

Considering that imports have been on the rise in the first half of the year, this seems to suggest a challenge on the domestic side of excise duties. Some measures introduced in the 2017 and 2018 Budget (such as increasing excise duty on air time from 15% to 17.5%; the aligning of excise duty to 125% on methylated spirits) may either be having a dampening effect of reducing consumption and therefore the taxes, or have not been fully implemented.

2.1.4 Non-tax revenues and grants remain low, but on the rise

In the last two years, Government has introduced a number of non-tax revenue measures as well as revised upward fees and charges collected by various Government institutions that have not been revised in a long time. These include:

- Skills development levy computed at a rate of 0.5% of total emoluments paid by an employer;
- Various fees and charges to be applied to all motor vehicles transiting through Zambia;
- Landing rights charge of K3,150 per television channel which has less than 35% local content
- Increase of the TV levy to K5 from K3 per month and the changing of collection from electricity bills to a subscriber management licencing system.

Collections from non-tax revenues in the first half of 2018 were K3.7 billion or 45% of the targeted non-tax revenues of K8.2 billion for 2018. The K3.7 billion outturn of non-tax revenue was lower than the projected K4.1 billion for this period. This is due to lower than projected fees, fines and charges, including from the Road Transport and Safety Agency (RTSA). But mineral royalties and road tolls continued to out-perform expectations; so did the Tourism Levy. The declaration of the first ever dividends by TAZAMA Pipeline Limited, a state-owned enterprise, is likely to boost non-tax revenues further[2].

2.1.5 Foreign grants continue to be erratic, while an IMF programme remains elusive

Project grants, which are a key donor financing component, were only K213 million or 9% of the target revenue of K2.4 billion for 2018. The revenues from this component have been dwindling and erratic in the last few years. The average funding rate of this budget line has been 28%. From the foregoing, it is highly unlikely that the 2018 target will be met by the end of the year. Going forward, more realistic targets need to be set. With the IMF deal off the table for now, it is unlikely that inflows from cooperating partners will improve this year.

2.2 Expenditure soared

During January to June 2018, the Government's expenditure was K40 billion or 55% of the 2018 Budget of K71.7 billion[3]. This is higher than the projected expenditure of K34 billion. Interest payments have been the main drivers of this over-spending (owing to high debt accumulation) as well as capital expenditure (due to increased disbursements for foreign-financed capital projects). Out of the approved interest payments budget on debt, 67% has already been gobbled (Table 2-2),

2 On May 24, 2018, TAZAMA declared a dividend of K9 million to the Ministry of Finance following the recording of K50.4 million profit before tax in 2017. However, these numbers are not yet reflected in the May 2018 fiscal numbers.

3 These figures do not include the supplementary budget approved by Parliament in July 2018.

while capital spending has taken up 85% of the planned spending for this budget line. Interest payments and capital expenditure are clearly the major sources of spending overruns in 2018.

Table 2.2: Expenditure performance Jan-Jun 2018, K million

	Approved Budget 2018	Projection Jan-June 2018	Outturn Jan-June 2018	Outturn % of Total Budget
EXPENDITURE (incl. amortisation)	71,662	34,193	39,586	55%
EXPENDITURE	68,445	32,647	37,848	55%
EXPENSES	52,452	24,409	25,314	48%
Personal Emoluments	23,104	11,390	10,431	45%
Use of Goods and Services	7,420	3,076	2,849	38%
Interest Payments	10,923	5,113	7,332	67%
Domestic debt	6,764	3,116	4,336	64%
External debt	4,159	1,996	2,996	72%
Grants and Other Payments	7,993	3,624	3,896	49%
Social Benefits	1,782	891	597	34%
Social Cash Transfers	721	361	197	27%
Other Expenses	1,230	314	209	17%
ASSETS	14,663	7,494	12,391	85%
Non-Financial Assets	14,201	7,270	12,327	87%
o/w: Roads	3,517	1,941	1,690	48%
Water & Sanitation	479	312	216	45%
Financial Assets	462	225	64	14%
LIABILITIES	1,330	744	143	11%
FISCAL BALANCE: Surplus(+)/Deficit(-)	-16,919	-7,361	-12,778	76%
Primary Balance	-5,996	-2,248	-5,446	91%

Source: Ministry of Finance and ZIPAR's own calculations

2.2.1 Progress towards fiscal sustainability

Zambia has made some progress towards fiscal sustainability (typified by domestic revenues fully covering operating expenditures). Recurrent spending as a percentage of domestic revenues, which amounted to 115% in the first half of 2017, has since reduced to 102% of domestic revenues during the first half of 2018. This positive development was largely due to a reduction in personal emoluments, which accounted for 42% of domestic revenues, from 53% of domestic revenues for the first half of 2017. Additionally grants and other payments (including subsidies) also reduced as a percentage of domestic revenues during the first half of 2018 (Table 2-3).

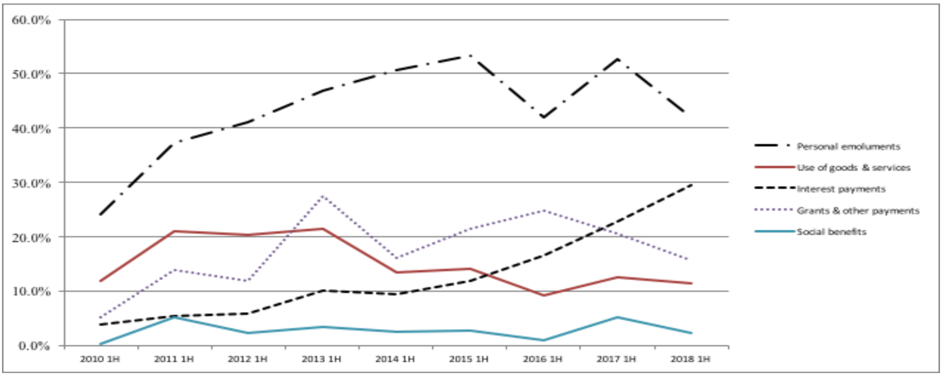
Table 2.3: Recurrent spending as a percentage of domestic revenues, 1H 2010 – 1H 2018

	Personal emoluments	Use of goods & services	Interest payments	Grants & other payments	Social benefits	Other expenses	Total recurrent spending
2010 1H	24.2%	11.9%	3.9%	5.3%	0.4%	3.4%	49.1%
2011 1H	37.3%	21.1%	5.5%	13.9%	5.2%	2.2%	85.2%
2012 1H	41.2%	20.4%	6.0%	11.9%	2.4%	9.1%	91.0%
2013 1H	46.9%	21.5%	10.2%	27.6%	3.4%	0.6%	110.1%
2014 1H	50.7%	13.6%	9.5%	16.1%	2.7%	0.7%	93.1%
2015 1H	53.4%	14.2%	12.0%	21.6%	2.8%	3.2%	107.1%
2016 1H	42.0%	9.4%	16.6%	24.9%	1.1%	1.1%	95.1%
2017 1H	52.6%	12.6%	22.7%	20.6%	5.4%	1.5%	115.5%
2018 1H	42.0%	11.5%	29.5%	15.7%	2.4%	0.8%	101.8%

2.2.2 … But crowding out other critical spending

However, gains made from the reduction in wages and salaries and subsidies as a percentage of domestic revenues were wiped out by an increase in spending on interest payments, which accounted for 29% of domestic revenues in the first half of 2018, up from 23% in the first half of 2017. Social benefits, which increased significantly in the first half of 2017 to 5.4% of domestic revenues, have declined to 2.4% of domestic revenues as shown in Figure 2-1. While the national budget for the SCT programme in 2018 allocated K721.2 million with an additional K200 million from Cooperating Partners (CPs) contributing, the current caseload of 574,000 beneficiary households costs approximately K822 million per annum. Government is thus expected to disburse bi-monthly payments of K137 million to cover the costs of the cash transfers to beneficiaries as well as programme-related administrative costs. At mid-year, only K197 million or 27% of the budget was disbursed. This is only sufficient to pay one bi-monthly payment cycle for the first two months of the year (i.e. January and February). Being a priority in the implementation of the Economic Stabilisation Programme, this situation is not only attributable to the increased cost of servicing debt, but to untimely requests for disbursements by the responsible ministry from the Ministry of Finance.

Figure 2.1: Trends in recurrent spending, % of domestic revenues, 2010-1H 201



Source: Ministry of Finance and ZIPAR's own calculations

2.2.3 Threats to fiscal sustainability

Capital spending continues to increase at a worryingly high pace

Government's efforts to close the country's infrastructure gap have led to large capital outlays and 2018 is no exception. At K12.4 billion, capital expenditure (capex) was K4.9 billion higher than the projected K7.5 billion. This was due to disbursements on existing foreign-financed capital projects which were made in the first quarter of 2018. Thus, by June 2018, 85% of planned capital expenditure for 2018 was already expensed, surpassing the K10.4 billion spending on personal emoluments which is traditionally the largest budget line. Since capital spending comes from borrowed money, it increases the debt servicing costs.

Ideally, increased spending on infrastructure, coupled with reduced recurrent spending as a percentage of domestic revenues should be beneficial for economic growth and help improve service delivery. However, the implementation of the infrastructure projects has been marred by several challenges. Saasa and Musonda (2018) outline some typical challenges with road infrastructure projects in Zambia[4]. These include the following:

i) The high road construction costs have generally posed additional challenges to the country's stressed fiscal regime, thereby constraining both the quantity and quality of road infrastructure.

ii) The current preference for road construction seems to reflect political preferences for their increased political "visibility" as opposed to a reflection of prudent application and management of resources.

iii) Late releases of funds further contributed to under-performance in both road construction and maintenance

iv) Cost escalation and schedule delays in road construction projects in Zambia have remained prevalent. Delayed payments; protracted financial processes; contract modification; materials procurement delays; poor supervision; and poor on-site coordination are among the many causes of schedule delays in road construction projects, which have almost always resulted in cost escalation.

All these challenges, if not addressed, have the adverse effect of slowing down the expected benefits of these capital investments.

Debt servicing costs still on the rise

The planned debt servicing for 2018 is estimated at K14.1 billion. During January-June 2018, Government spent two thirds of the planned Budget to service its debt – that amounts to K9.1 billion. External debt servicing, at 63% of the approved budget, was nearly just as high as domestic debt servicing at 65%. Interest payments on external debt reached 72% of the planned spending in 2018, while interest payments on domestic debt were 64% of the approved budget on domestic debt servicing. Although amortisation (the paying off of debt through regular payments) on external debt was consistent with the target (51%), amortisation on domestic debt was higher than the approved budget and is likely to be a major source of spending overruns in the second half of the year.

4 Saasa, O. & Musonda, C. (2018). Pro-growth Road Infrastructure Development in Zambia: Challenges, Opportunities and Policy Options: Premier Consult, May 2018

Table 2.4: Debt Servicing, Jan-May 2018

	Approved Budget	Projection Jan-Jun 2018	Outturn Jan-Jun 2018	% of approved Budget
Total Debt Servicing	14,141	6,659	9,070	64%
Domestic debt servicing	6,972	3,266	4,551	65%
Interest payments on domestic debt	6,764	3,116	4,336	64%
Domestic amortisation	208	150	215	103%
External debt servicing	7,169	3,393	4,518	63%
Interest payments on external debt	4,159	1,996	2,996	72%
External amortisation	3,009	1,396	1,522	51%

Source: Ministry of Finance and ZIPAR's own calculations

Reversing gains made from e-FISP

Another likely source of fiscal pressures will be the Farmer Input Support Programme. Despite relatively good rainfall during the 2017/2018 agricultural season, maize output reduced by 33%, from 3.6 million tonnes in 2017 to 2.4 million tonnes in 2018. In fact, real GDP growth rate for Q1:2018 dropped to 2.6% compared to 3.2% in the same period last year (2017), mainly because of poor growth performance in agriculture, forestry and fishing. Growth in this sector fell from 17.6% in Q1 2017 to -17.3% in Q1 2 018.

The reduction in output was partly because of the chaotic implementation of the e-voucher system for the Farmer Input Support Programme (FISP). The e-voucher programme was meant to, among other things, reduce fiscal pressures on the Treasury as there are hardly any procurement, transportation, storage, and handling costs involved on the part of Government since most costs are borne by agro-dealers. It also promotes private sector participation and diversification from crops to livestock.

But Government seems to have been unprepared to scale up the programme due to delayed funding and staff-induced inefficiencies. Other challenges included poor phone network coverage in most rural areas, unavailability of banks in some districts, limited liquidity and low capacity of some agro-dealers to stock inputs[5]. As a result, Government has decided to take back some farmers to the conventional FISP. This, according to the Minister of Agriculture, is to "enable Government resolve the problems associated with the e-voucher system". But conventional FISP is very expensive for Government, as the costs passed on to the private sector will now have to be covered by Government. Therefore, the gains made in reducing spending on the programme will creep back into the Budget in the second half of 2018. Government will essentially pay a premium for its own inefficiencies.

5 Auckland N. Kuteya , Chinyama Lukama and Vincent C. Malata (2018). Review of e-FISP Performance During 2017/2018 Agricultural Season: IAPRI, May 2018

2.3 Deficit and Deficit Financing

2.3.1 Fiscal Deficit higher than projected

With the continued rise of expenditure and one-sided revenues (i.e. taxes doing better than non-taxes and grants), budget performance during January-June 2018 showed a continued deterioration in Zambia's fiscal position. Based on the approved Budget, the originally projected fiscal deficit for 2018 was 6.1% of GDP. However, even before half the year was completed (i.e., as at June 2018), the fiscal deficit - the difference between the government's expenditures and its revenues and grants - at 4.6% of 2018 projected GDP, represents three quarters of the 2018 full-year projected deficit. Growth in expenditure primarily due to higher than planned capital spending and interest payments on debt, was higher than growth in revenue as shown in Table 2-5 leading to a higher than projected fiscal deficit.

Table 2.5: Overview of fiscal performance, Jan-Jun 2018

	Revenue	Expenditure	Fiscal Balance	Primary Balance
Fiscal Balance		(K million)		
Approved Budget 2018	51,525	68,445	-16,919	-5,996
Projected Jan-Jun	25,286	32,647	-7,361	**-2,248**
Prel. Outturn Jan-Jun	25,070	37,848	-12,778	**-5,446**
		Percent of GDP		
Approved Budget 2018	18.6%	24.7%	-6.1%	-2.2%
Projected Jan-Jun	9.1%	11.8%	-2.7%	-0.8%
Prel. Outturn Jan-Jun	9.1%	13.7%	-4.6%	-2.0%
2018 Projected GDP (K'million)	276,796			

Source: Ministry of Finance & ZIPAR's own calculations

The primary deficit lets us know how much borrowing has to be done by the Government in order to meet expenses in addition to the interest payments. It is estimated by deducting interest payments from the overall fiscal deficit. The primary deficit was targeted at 2.2% of projected 2018 GDP. Between January and June 2018, the primary deficit was projected at 0.8% of GDP. However, at 2.0% of GDP, it is very close to the 2018 whole year target. This means that Government has to borrow more and therefore incur more costs to meet non-interest payments.

2.3.2 Deficit Financing

To finance the fiscal deficit, Government planned to borrow 65% from domestic markets and 35% from external sources, consistent with the 2017-2019 Medium Term Debt Management Strategy (MTDS). However, as at June 2018, the share of net domestic financing was 38%.

Table 2.6: Deficit financing performance, Jan-Jun 2018

	Approved Budget 2018	Projection Jan-Jun 2018	Outturn Jan-Jun 2018	Outturn % of Total Budget
Deficit Financing	**16,919**	**7,361**	**13,213**	100%
Net Domestic Financing	**10,945**	**4,593**	**4,961**	38%
Domestic Financing	11,153	4,593	4,961	38%
O/w Govt Securities	10,230	3,914	4,390	33%
Amortisation	-208	-150	-215	-2%
Net External Financing	**5,974**	**2,918**	**8,467**	64%
Programme	1,425	1,000	0	0%
Project	7,559	3,314	9,989	76%
Amortisation	-3,009	-1,396	-1,522	-12%
% share of domestic financing	65%	62%	38%	

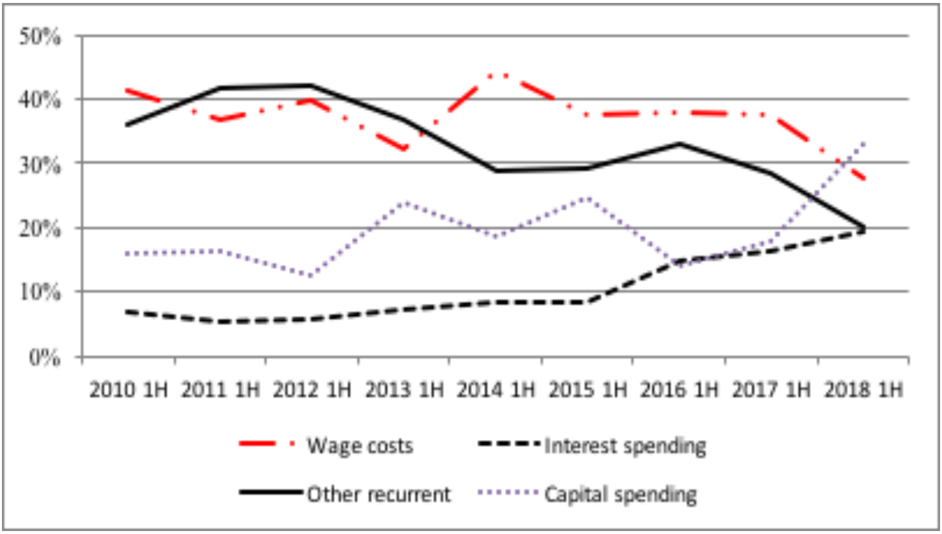
Source: Ministry of Finance and ZIPAR's own calculations

3 Implications of high capital spending and debt servicing costs

There has been a significant bias toward capital expenditures over the last few years. This bias has been reinforced by preferences of cooperating partners for project support rather than direct budget support. Due to limited domestic resources, Government has had recourse to increased borrowing to finance these infrastructure projects. It is ironic that the very objective underlying borrowing (to pay for infrastructure development and promote economic development) has been adversely affected by servicing liabilities, which are taking up an increasingly sizeable part of the limited resources. As a result, the share of capital spending and interest payments on debt has been on the increase.

With wage costs also taking up a significant share of the spending, one of the results of this capital bias is the reduction of funds available for operations and maintenance, leading to inadequate funding of service provision and the gradual degradation of capital investments and the quality of public services. This is shown by the rapidly declining 'other recurrent spending' in Figure 3.1 which has almost halved from a share of about 36% of total spending in the first half of 2010 to 20% in the first half of 2018.

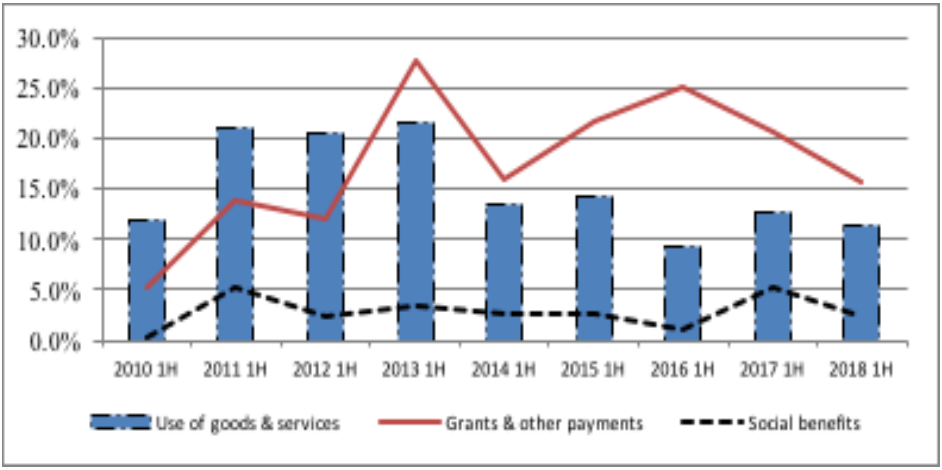
Figure 31: Trends in performance of non-wage non-interest spending as % of domestic revenues, 1H 2010-1H 2018



Source: Ministry of Finance and ZIPAR's own calculations

The non-wage non-interest recurrent spending is decomposed into use of goods and services, grants and other payments and social benefits. It shows that the use of goods and services has been on the decline, halving from 21% of domestic revenues in the first half of 2013 to 11% of domestic revenues in the first half of 2018. This gives a clue to the problem of the accumulation of domestic arrears as many goods and services purchased by Government may no longer be paid for.

Figure 3.2: Decomposition of non-wage non-interest spending, 2010-1H 2018



Source: Ministry of Finance and ZIPAR's own calculations

One of the pillars of the Economic Stabilisation and Growth Programme instituted in 2017 is "Scaling-up Government's social protection programmes to shield the most vulnerable in our society from negative effects of the programme". As part of this programme, Government increased spending to Social Benefits from 1% of domestic revenues in 2016 to 4% of domestic revenues in 2017. This is in a quest to leave no one behind as post-2015 fiscal consolidation measures kicked in. However, this has been scaled down to 2% of domestic revenues in 2018. As a result, scaling up the number of beneficiaries for the Social Cash Transfer Scheme from 590,000 in 2017 to 700,000 in 2018, for example, is likely to suffer a set back as just over a quarter of the planned budget (27%) was disbursed for this programme during the first half of 2018. Further, the planned doubling of beneficiaries of the Food Security Pack from 40,000 to 80,000 to support vulnerable but viable farmers and allocations to empowerment funds are likely to suffer setbacks as no funding has been allocated to these programmes as at June 2017.

4 Conclusions and recommendations

Budget overruns were worryingly high in the first half of 2018. Huge capital disbursements and interest payments are the major sources of the budget overruns experienced during January-June 2018. With subdued economic growth (GDP was recorded at 2.6% in Q1 2018, the lowest since 2015), the country cannot muster enough resources from domestic revenues to fund the budget, hence the recourse to borrowing. But the borrowing is increasing debt servicing costs and limiting the country's capacity to respond to future shocks and pay for other critical spending such as social benefits and empowerment programmes.

Government has instituted fiscal consolidation measures to address these challenges. This has resulted in some improvement in fiscal sustainability, as there has been a reduction in recurrent spending in relation to domestic revenues. This is due to a number of factors including the restricting of recruitments to mostly frontline staff in the health and educations sectors. That the Government can reduce personal emoluments in times of fiscal constraint means that it was wasteful during the non-austerity times. This reduction in recurrent expenditures, and the increased in capital expenditures, can, in the long run, be beneficial for economic growth and help improve service delivery. However, the implementation of the infrastructure projects has been marred by several challenges. These challenges will delay the intended benefits of improved infrastructure including delayed economic growth and continued strain on the limited Treasury coffers.

We therefore recommend the following financing options and ways to stimulate economic growth, and in turn free up Government resources that can be used to improve public service delivery and social welfare:

a) **Government needs to prioritise expenditure on projects that stimulate growth and human development, such as schools and health facilities.** A number of infrastructure projects including schools and health centres have remained incomplete for years due, in part, to erratic funding brought about by the reprioritisation of expenditure to meet debt obligations. The recently announced austerity measures include the completion of projects above 80% completion rate. Refraining from the rigid application of the 80% completion threshold, the authorities should undertake rapid project appraisals, applying rationalisation criteria in the selection of high social- and economic-return (incomplete) projects on which to prioritise expenditure."

b) **The Government should consider alternative financing options to pay for infrastructure and**

other developmental projects. Government currently pursues Public Private Partnership (PPP) as a financing and implementation mechanism for road construction. However, as observed by Saasa and Musonda (2018), there is need to address the capacity bottlenecks currently existing in the Government's PPP unit as the complex and long-term nature of most PPP projects requires special skills and understanding beyond the traditional contract management or administration.

c) **In line with the tenets of fiscal decentralisation, Government should consider issuing municipal bonds as alternative financing options for viable councils, to pay for infrastructure and other developmental projects at the local level.** A municipal bond is a debt security issued by a municipality to finance capital expenditure. It fetches the investor payments on a predetermined rate of interest over a stipulated period. As part of the preparations towards issuing municipal bonds, districts will need to be credit-rated from local and/or international rating agencies. The individual district ratings will be the same as bond ratings.

d) **To alleviate the liquidity crunch currently being faced by firms that are owed VAT refunds, the Government should establish a temporary reserve fund to pay VAT claims mostly for exporting firms while audits are on-going to alleviate the liquidity crunch currently being faced by firms.** This will serve as a fiscal stimulus for the private sector that will help bring back the growth, and the corresponding tax revenue, that the country considerably needs at the moment.

e) **The Government should also consider reducing some tax rates to lower business costs and stimulate productivity and production. This will in turn help spur investment. and lower the incentive of tax avoidance through tax planning.** In this period of fiscal consolidation, growth is essential. Government needs to rethink the philosophy of escalating user fees, fines and charges beyond the regular taxes at a time when the economy has slowed down.

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