ZIPAR
Zambia Institute for Policy Analysis & Research

Toward Stability and Growth

A Review of Pillar I & II of Zambia's Economic Stabilisation and Growth Programme 2017-2019

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Executive Summary

The economic crisis of 2015 destabilised Zambia's economic performance. The depreciation of the Kwacha and its pass-through effects led to inflation of as high as 22% and growth, at 2.9%, was far below the 5% target. The overall Budget deviation was 15% of Parliamentary appropriations in 2015, disrupting planned activities and attainment of set macroeconomic objectives. There were huge variations between what the consequent national Budgets committed to do and what they actually did. To fix this and nudge the country back towards high sustained economic growth, the Economic Stabilisation and Growth Programme (ESGP) was crafted in 2017. The five-pillar plan aimed to ensure prudent fiscal management by providing a system of accountability and a standard against which results could be measured, among other things.

The aim of this paper is to review the ESGP, particularly, its performance in 2018. The paper sets out to understand how well Zambia faired in implementing the ESGP as well as to highlight the broader fiscal trends recently. It ultimately seeks to make recommendations about how Zambia can revive its path to economic stability and growth. The paper focuses tightly on the first two pillars of the ESGP, i.e. (i) restoring budget credibility; and (ii) enhancing domestic resource mobilisation and refocusing public expenditure. The remaining three pillars are slated to be reviewed in the second half of 2019.

The first pillar of the ESGP aimed to restore Budget credibility through improved budget execution, containing the wage bill, phasing out costly subsidies and improving transparency and accountability. The second pillar sought to enhance domestic resource mobilisation by augmenting modernisation and automation of revenue; expanding the tax base to the informal sector; improving collections from property taxation; increasing road tolling; stemming illicit financial flows; and refocusing public expenditure.

Our analysis revealed that generally, during the ESGP period, the Government managed to contain the wage bill by setting a quantitative wage ceiling of 9% of GDP and restricting employment to frontline staff in health and education. By reforming the Farmer Input Support Programme (FISP) through the e-voucher system, programme costs were lowered thus reducing the burden on the Treasury. The Government also put in place measures to improve tax and non-tax administration resulting in improved VAT collections and higher than planned revenues from road tolls. Further, the Public Finance Management Act was enacted, markedly strengthening the legal environment for public financial management.

However, while the tenets espoused in the ESGP were sound by design, the EGSP did little to restore Budget credibility due to weak programme implementation. For instance, fiscal deficits remained persistently high as containment measures were generally not applied, savings from reduced FISP subsidies were not channelled to priority areas like social protection programmes. Moreover, high capital spending continued to dominate expenditure, and emerging problems of debt service payments and payment arrears went unaddressed. Further, planned reforms to enact other pieces of legislation for improving financial management systems as well as land titling seem to have stalled. Additionally, the planned IMF bailout never materialised. Added to this, illicit financial flows continued to bleed productive resources out of the economy.

What should be done?

A number of measures are proposed to ensure that the ESGP attains it goals. The salient ones are as follows:

Improve in-year monitoring of budget execution: The Ministry of Finance in collaboration with the Ministry of National Development Planning and other relevant government or quasi-government agencies, should strengthen budget monitoring and execution mechanisms aimed at identifying spending areas at most risk of weak or unsatisfactory budget execution. These early-detection mechanisms should be applied at all government levels.

Redouble efforts to rationalise expenditures: The Government should rationalise expenditures to take the pressure off the Treasury, focusing spending plans on increased support to priority social and growth areas. The Government should discontinue non-priority activities such as the creation of unappraised new districts, unappraised new road projects, new public institutions (ministries, commissions, agencies, etc). It should instead ensure that priority expenditures in social sectors such as health, education and social protection are sustained.

Devise a systematic and comprehensive framework for paying off arrears: The Government needs to devise and publish a medium-term arrears payment strategy that could be embedded in the Medium-Term Debt Management Strategy (MTDS); the MTDS is currently silent on the issue of arrears. This will also inform deficit financing policies and strategies.

Channel savings from dismantled and/or reorganised subsidies to social protection programmes: The Government should make refinements to the poorly targeted FISP and FRA, including instituting cost-saving strategies, and supplementing this with well-targeted (social protection or poverty alleviation) subsidy programmes that more effectively reach specific poor sub-groups of the population.

Implement further domestic resource mobilising strategies: on the domestic revenue mobilisation front, the Government should invest in automated mechanisms for road tolls that would enhance revenue collection efficiency. The toll takings should also be made non-deductible expenses for income tax. Illicit financial outflows require stricter legislation and enforcement in order to increase tax revenues as envisaged in the ESGP.

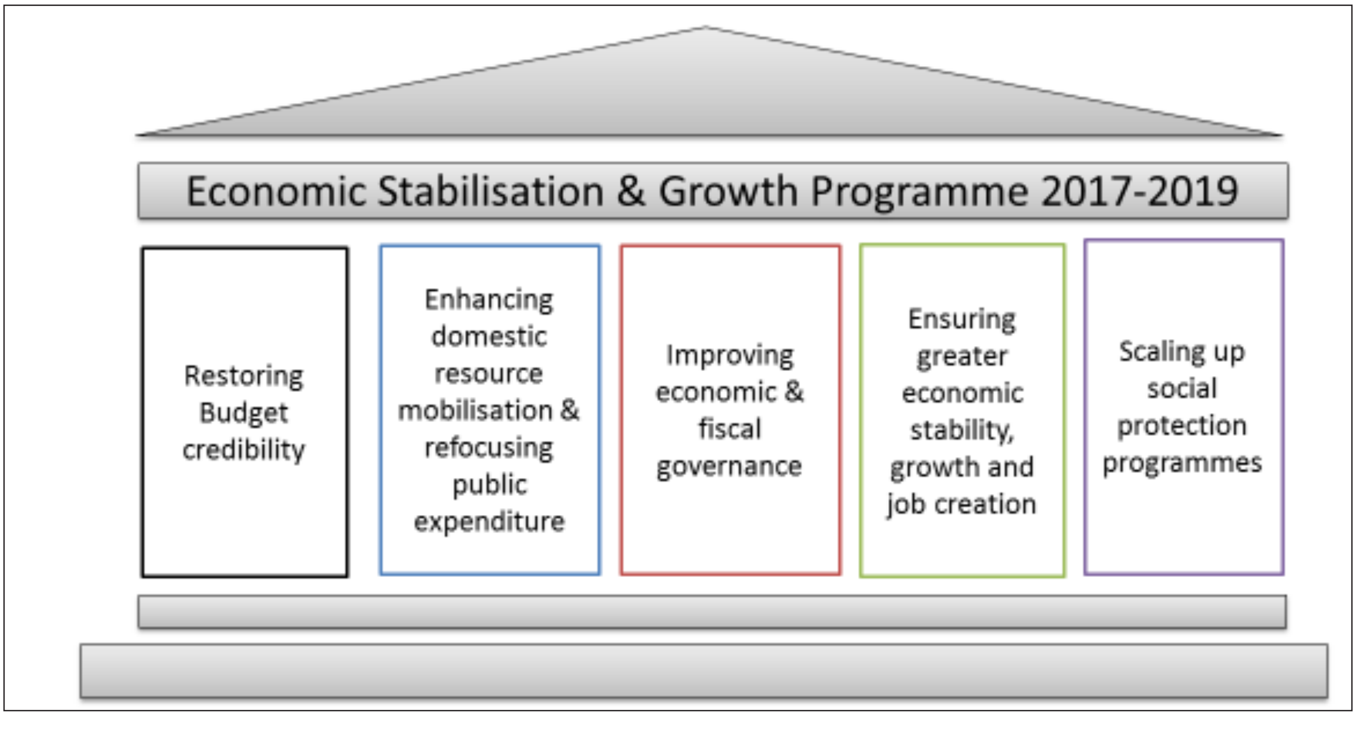
1 Introduction

Following Zambia's experience of a sizeable economic downturn in 2015, macroeconomic instabilities ensued. These included a 68% depreciation of the Kwacha from K6.20 per dollar in 2014 to K10.40 per dollar and strong pass-through effects of the depreciation to domestic prices, which led to inflation rates as high as 22%. Ultimately this and other exogenous shocks in 2015 and 2016 culminated into economic growth of 2.9%, which was far lower than the 5% target for 2015.

In response, the authorities launched the Economic Stabilisation and Growth Programme (ESGP) 2017-2019 in September 2017. The ESGP also known as Zambia Plus is a home-grown economic recovery programme that made room for Government efforts to be complemented by external partners [the plus in Zambia Plus]. It was envisioned as being instrumental in creating renewed consultative processes with Cooperating Partners. Notably it was envisaged as the main avenue for securing a bailout package from the International Monetary Fund (IMF). The ESGP was expected to be implemented over 2017-2019; although strictly speaking, the programme could only apply to 2018 and 2019 since it was launched towards the end of 2017.

The five-pillar Zambia Plus programme was premised on the idea of "Restoring Fiscal Fitness for Sustained Inclusive Growth and Development" and was meant to double as the Medium-Term Expenditure Framework (MTEF) for the period 2017-2019; but interestingly, it was published in the same month as a separate MTEF 2018-2020, which was considerably misaligned with the ESGP (ZIPAR, 2017a). The ESGP championed five key pillars, namely: (i) restoring Budget credibility; (ii) enhancing domestic resource mobilisation and refocusing of public spending on core public sector mandates; (iii) improving economic and fiscal governance; (iv) ensuring greater economic stability, growth and job creation; and (v) scaling-up social protection programmes (Figure 1.1).

Figure 1.1: The Five Pillars of the ESGP



Adapted from the ESGP

The aim of this paper is to understand how well Zambia fared in terms of implementing the ESGP, particularly (but not exclusively) through the 2018 National Budget. The ESGP theme "Accelerating Fiscal Fitness for

Sustained Inclusive Growth, Without Leaving Anyone Behind", set the tone for accelerating fiscal fitness and putting Zambia back on the path of robust sustained and inclusive growth. ZIPAR (2017a) postulated that the 2018 Budget would only be worth its salt if the Government could muster the will, persistence and discipline to navigate the policy, strategic and numerical commitments stipulated including those stated in the ESGP. Indeed, 2018 would be the year for testing the Government's sturdiness or stamina in fiscal and economic governance.

We therefore evaluate to what extent and in what ways the Government traversed the course of fiscal fitness in 2018 as was promised in the ESGP. We pay particular attention to any implementation gaps in the Government's attempts to traverse the fiscal fitness course. The key questions include: what were the "game changers" (or major milestones achieved) and "missed opportunities" in the implementation of the Programme? Specifically, where was the ESGP effective in terms of deliverables (outputs and outcomes) under the first two Zambia Plus pillars? Additionally, does the Government's performance in implementing the ESGP take Zambia on the path of fiscal sustainability?

To answer these questions, the ESGP evaluation involves systematic policy content review and programme analyses coupled with basic but policy-intuitive descriptive statistical analysis. Scope-wise, the review covers the first two pillars of the ESGP, i.e. (i) restoring budget credibility and (ii) enhancing domestic resource mobilisation and refocusing public expenditure. An analysis of the other three pillars of the ESGP is slated to be undertaken in the second half of 2019. Further, while the main year of analysis is 2018, reference is made to periods before the ESGP where necessary to emphasise certain observations and assertions.

Our main sources of data are the 2018 preliminary fiscal tables, the Economic and Treasury Brief (Ministry of Finance, 2019) and other Ministry of Finance outputs. We also use data from other government departments (e.g. Auditor General's reports) and from internationally reputable organisation like the IMF, World Bank, etc. The data are analysed and qualified within the context of social, economic and political economy happenings in Zambia during the reference period. We also take critical account of the policy, structural and legal reform strategies and measures envisioned in the ESGP.

The rest of the report is organised as follows: Section 2 reviews Pillar 1 of the ESGP which deals with restoring budget credibility. The ESGP states that "previous budget execution has been characterised by huge deviations between appropriations by Parliament and actual outturns. This has disrupted planned activities and attainment of set macroeconomic objectives. For instance, in 2015, budget deviations were as high as 15% of Parliamentary appropriations. Further, uncontrolled variations of the Budget have resulted in growing accumulation of arrears" (Ministry of Finance, 2017). An evaluation of whether this has been changed in 2018 is presented in this section.

Secondly, Zambia's unsatisfactory fiscal performance has not only been due to higher than planned expenditure, but also low and flat revenues, thereby leading to high fiscal deficits and increased debt burden. To counter the revenue gap, the Government devised a revenue mobilisation strategy mainly championed through five strategies discussed in Section 3 of this report. We analyse whether these strategies revamped domestic resource mobilisation in Zambia and also discuss whether refocusing of public expenditure was undertaken. Section 4 concludes and discusses some policy recommendations required to achieve the objectives of the ESGP.

2 Restoring Budget Credibility: the 2018 Budget and Zambia's fiscal trends

Every year, the Government devises and implements the national Budget which relates spending needs to available funds. The Budget is not merely an accounting document, but also a policy document which embeds the social and political choices at a given point in time. Establishing a legal means of authorising and controlling expenditures and revenues by directing specific sums of funds to specific uses, the Budget also provides a system of accountability and a standard against which results can be measured and assessed.

Ensuring the Budget is implemented as approved by Parliament is an important aspect of the Government's accountability to society and to elected officials. A credible budget is a first requirement of public financial management. Budget credibility is the ability of the Government to accurately and consistently meet their expenditure and revenue targets. Budget execution is also an assessment of the choices regarding the raising and spending of money vis-à-vis competing programmes and interests as well as the success with which Budget resources are usefully applied in Ministries, Provinces and Spending Authorities (MPSAs). Further, it is also a question of whether money has been raised and spent wisely and to good effect.

Restoring budget credibility requires fiscal discipline, strategic resource allocation and operational efficiency. Clearly, this is only feasible when revenues are predictable and the mechanisms for controlling expenditure well developed. The last few years have been characterised by huge variations between the approved Budget and the actual outturns, resulting in, among other things, a growing accumulation of arrears. The problem of Budget credibility was epitomised by persistently high fiscal deficits, averaging 6.8% of GDP during 2014-2016.

Recognising these short-comings, the Government, in the ESGP, committed itself to undertake a number of reforms aimed at supporting prudent fiscal management in light of growing economic constraints and pressing development needs. The measures included: improving budget execution; dismantling arrears; containing the wage bill; phasing out costly subsidies; revising the Public Finance Act; enacting the Planning and Budgeting Bill; and rolling out the Integrated Financial Management Information System (IFMIS) as well as the Treasury Single Account. These measures and how they performed are discussed in detail below.

2.1 Improving Budget Execution

To definitively assess whether there was improvement in budget execution in the ESGP period, we employ the budget execution rate, which is the percentage of the approved Budget for each function in a particular fiscal year that was actually absorbed and spent. Ideally, actual revenue and expenditure should match the approved Budget. But there could be variations. On one hand, the Government might overspend, implying an expenditure that is more than the authorised Budget or, conversely, it might under-spend. On the other hand, the Government might over-perform on revenue collection (i.e. collect more revenues than planned) or it might under-perform. A variation is considered favourable when the actual revenue is higher than the budget or when the actual expenditure is less than the budget.

However, it should be noted that over-performing on revenues could imply that targets were not appropriately set in the first place (suggesting inefficiency). Similarly, and worse, under-spending can be a signal of the inability to absorb resources and utilise them efficiently, or it could be a signal of funds being varied to other functions/programmes/budget lines.

What would be considered as significant over-performance or under-performance? Using the Public Expenditure and Financial Accountability (PEFA) framework, which is a universally-accepted standardised tool to assess a country's public financial management performance, the International Budget Partnership defines under-performance as budget execution of less than 97.5%; sound execution is defined as budget execution between 97.5% and 102.5% and over-performance is defined as budget execution greater than 102.5% (International Budget Partnership, 2018).

The PEFA framework provides four different dimensions of budget credibility. These are:

PI-1 Aggregate expenditure outturn compared to original approved budget;

PI-2 Composition of expenditure outturn compared to originally-approved budget;

PI-3 Aggregate revenue outturn compared to originally-approved budget;

PI-4 Stock and monitoring of expenditure payment arrears.

In our analysis, we employ the conventional PEFA framework as well as a variant of this framework, which uses deviations between planned and actual revenue and spending. In the alternative framework, the deviation (which is typically used interchangeably and loosely with the term 'variance') denotes an under-execution if the budget deviation is less than -2.5%, sound execution if between -2.5% and +2.5% and over-execution if any observation is above +2.5%.

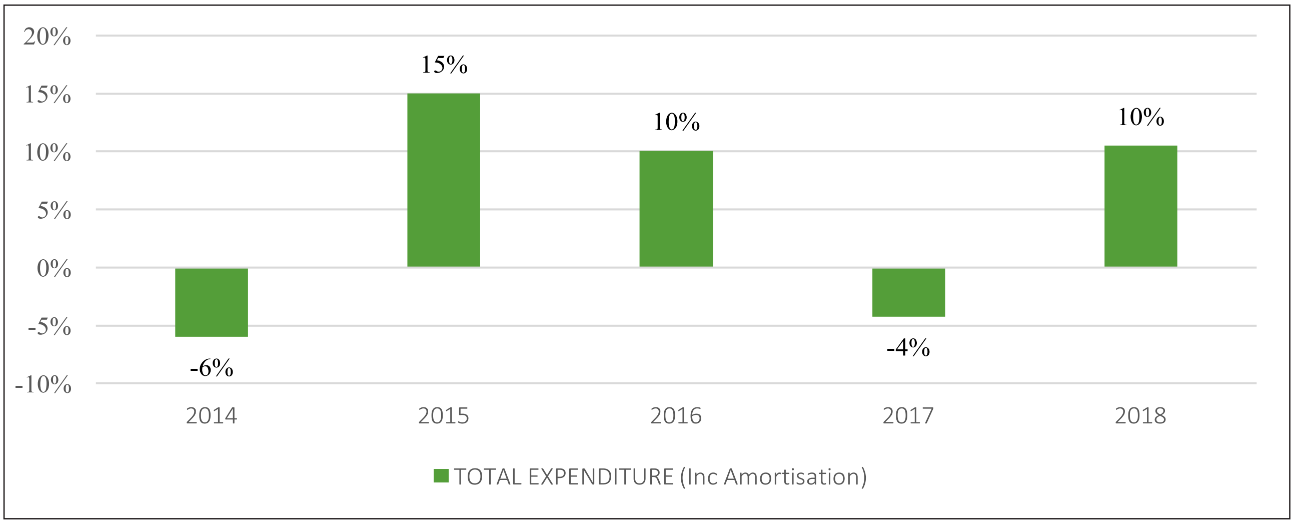
2.1.1 Aggregate expenditure outturn compared to originally approved budget

A few observations are noteworthy regarding the variances between planned and actual spending before and during the ESGP as shown in Figure 2.1. At the level of total budget expenditure, 2018 was characterised by an overall overspend of 10%. This was largely on account of higher than planned debt servicing costs and capital spending, which crowded out social and other critical spending. Even with a revenue over-performance of 4% (Section 2.1.3), this over-expenditure still significantly contributed to the high fiscal deficit during the year which was estimated at 7.6% of GDP (MoF, 2019).

The last five years were characterised by two years of underspending in 2014 (6%) and 2017 (4%), and three years of over-spending in 2015 (15%), 2016 (10%) and 2018 (10%). The year of the largest overspending (2015) was underpinned by an economic crisis to do with a collapse of global copper prices, severe electricity power shortages, and exchange rate volatilities coupled with rising inflation. Additionally, the overspend was aided by the issuance of an additinal US$1.25 billion Eurobond contributing to the 67% increase in debt service costs from US$185.3 million in 2014 to US$309.4 million in 2015 (MoF, 2016).

On the other hand, 2016 was a general election year, with the usual politically-prompted fiscal slippages. At the start of the ESGP period (2017), total expenditure variations declined to -4%. This could be partially attributed to the implementation of fiscal consolidation measures. However, these execution gains were reversed in 2018 as total expenditure was 10% above the approved expenditure (Figure 2.1).

Figure 2.1: Variance between planned and actual budget, 2014-2018



Constructed from Ministry of Finance Fiscal Tables (2014-2018)

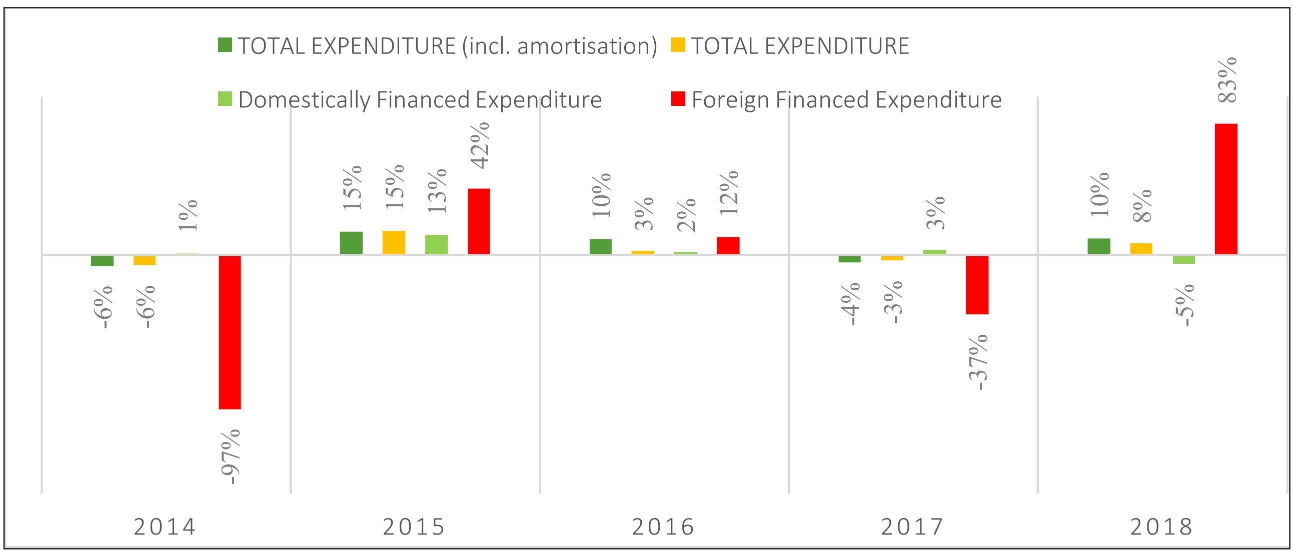
In 2018, total expenditure (including the clearance of arrears and debt maturities) was above its target and amounted to K74.6 billion (27.6% of 2018 projected GDP), against a target of K71.6 billion (26.5% of GDP). Total revenue and grants amounted to K53.2 billion (19.6% of GDP), which was above the programmed target of K51.5 billion (19% of GDP). This resulted into a fiscal deficit that was 25% above target. To finance this deficit, the Government borrowed both domestically and externally, with two-thirds of the fiscal deficit being externally financed. This borrowing will eventually add to the already high external interest payments and the stock of external debt. Increased spending on debt servicing payments (48% above target on external debt) crowded out other critical expenditure on pensions and social cash transfers which were underfunded by 56% and also resulted in no expenses on financial assets such as the Sinking Fund and empowerment programmes. This inadequate funding of service provision has had a negative bearing on human development in the ESGP period.

2.1.2 Composition of expenditure outturn compared to originally approved budget

In fiscal frameworks, total expenditure is typically measured or presented with or without amortisation (i.e. payments on principal debt). In the Ministry of Finance (MOF) Fiscal Tables, total expenditure without amortisation is either categorised by source of expenditure (domestic or foreign-financed) and or by operational classification (recurrent vs capital expenditure).

Regarding the source classification (Figure 2.2), a striking observation is that while both domestic-financed expenditure and foreign-financed expenditure experienced marked volatility during 2014-2018, foreign-financed expenditure was far more volatile. Thanks to huge project disbursements during 2018, foreign-financed expenditure was 83% above target. It swung from an underspend of 97% in 2014 to overspends of 42% in 2015 and 12% in 2016, and then to a plunge of 37% in 2017 before shooting up to an overspend of 83% in 2018. This suggests that the Government did not have much control over foreign-financed disbursements.

Figure 2.2: Variance between planned and actual domestically- and foreign-financed expenditure, 2014-2018



Constructed from Ministry of Finance Fiscal Tables (2014-2018)

From an operational classification perspective, total expenditure excluding amortisation is classified into recurrent and capital expenditure. Recurrent expenditure, which was above budget during 2014-2016, was within budget in 2017 and under budget in 2018 (Table 2.1). This was primarily due to reductions in spending in all recurrent expenditure other than interest payments on debt.

Interest payments on debt were 24% above budget in 2018 and averaged 24% above budget during 2014-2017. This was despite putting in place a Medium-Term Debt Management Strategy (MTDS) in 2017 to stem debt servicing costs during the ESGP period. Increments were perpetuated by increased borrowing to finance costly capital projects and under-utilisation of available concessional financing. Capital spending, which was largely foreign-financed, was above budget by 58% in 2018 and averaged 19% during 2014-2017. It was largely driven by spending on non-financial assets which include roads and water and sanitation.

Grants and other payments saw an underspend of 8% in 2018 from an underspend of 10% in 2017. This is coming from massive positive variances of 79% and 78% in 2015 and 2016, respectively. The overspends in 2015 and 2016 were due to pressures to finance the Farmer Input Support Programme (FISP) leading up to the elections, pressures which subsided with the streamlining of FISP in the electronic-voucher reforms in 2017 and 2018. Further, since late 2016, and in line with the ESGP aim of phasing out costly subsidies, the Government instituted some fiscal consolidation measures which included, among other things, the removal of fuel and electricity subsidies.

Table 2.1: Variance between planned and actual decomposed expenditure, 2014-2018

	2014	2015	2016	2017	2018	Average 2014 - 2018
RECURRENT EXPENDITURE	5%	14%	7%	-2%	-5%	4%
Personal Emoluments	2%	-3%	-8%	0%	-5%	-3%
Use of Goods and Services	-11%	-18%	-4%	-14%	-23%	-14%
Interest Payments	22%	52%	5%	17%	24%	24%
Grants and Other Payments	25%	79%	78%	-10%	-8%	33%
Social Benefits	-24%	-17%	-53%	-20%	-46%	-32%
Other Expenses	45%	81%	14%	3%	-50%	19%
CAPITAL EXPENDITURE	-38%	18%	86%	10%	58%	27%
Non-Financial Assets	-37%	21%	93%	9%	63%	30%
Financial Assets	-48%	-31%	22%	54%	-86%	-18%
LIABILITIES	15%	17%	98%	-6%	-67%	11%
FISCAL BALANCE	-2%	83%	60%	15%	20%	35%

Constructed from Ministry of Finance Fiscal Tables (2014-2018)

With the Government recognising that the implementation of the ESGP would likely have negative effects especially on the poor and vulnerable in society, the Government planned to ring-fence social spending in the medium term by increasing the number of beneficiaries for the Social Cash Transfer Scheme, Food Security Pack, women's development programmes, Public Welfare Assistance Scheme and the Home-Grown School Feeding Programme, among other programmes. However, this did not materialise as intended over the implementation period. The EGSP failed to safeguard social protection expenditure. There was an underspend of 46% of the approved Budget in 2018. This was far below the underspend in 2017 (20%) but better than the underspend in 2016 (53%). This deterioration was due, in part, to the crowding-out effect of rising interest payments on debt.

In contrast, constitutional obligations such as Personal Emoluments were protected from underspending and thus saw relatively lower variations: -5% in 2018, no variations in 2017 and the largest being -8% of the approved Budget in 2016.

Non-financial assets – where the GRZ roads programme falls – saw a 63% variance or overspend in 2018, suggesting that the emergency austerity measures of mid-2018 (Government of the Republic of Zambia, 2018) to curb infrastructure projects overspending (and other fiscal slippages) were either not implemented or did not work.

2.1.3 Aggregate (and composite) revenue outturn compared to originally approved budget

For revenues, improvements in execution targets were recorded in 2018 as revenues and grants were 4% above target. The improved performance in 2018 was largely attributed to higher than targeted revenues for Value Added Tax (VAT) and Mineral Royalties, with execution rates of 140% and 112%, respectively. The introduction of a number of VAT administrative initiatives in 2017, including the appointment of withholding agents and the introduction of audits before disbursement of refunds, increased the VAT execution rates from 80% in 2016 to 147% in 2017 and 140% in 2018. Additionally, a rebound in copper prices and the introduction of a price-based mineral royalty system in 2016 helped to improve the revenue from mineral royalties with collections being 16% above the target during 2016-2018.

Table 2.2: Trends in budget execution (revenue), 2014-2018

	2014	2015	2016	2017	2018	Average
Revenues & Grants	95%	97%	92%	95%	104%	97%
Domestic revenues	103%	100%	92%	99%	108%	100%
Tax revenue	106%	104%	92%	103%	108%	103%
Income tax	107%	109%	104%	92%	99%	102%
Value added tax	117%	127%	80%	147%	140%	122%
Customs & excise duties	86%	74%	83%	76%	82%	80%
Non-tax revenue	88%	86%	93%	81%	104%	90%
Total user fees & fines	0%	144%	30%	81%	92%	69%
Mineral royalty	81%	63%	106%	129%	112%	98%
Grants	11%	30%	96%	19%	26%	36%

Constructed from Ministry of Finance Fiscal Tables (2016-2018)

However, customs and excise duties, user fees and fines as well as grants underperformed significantly in 2018. The execution rate of 26% for grants implies that only a quarter of what was pledged by Cooperating Partners was received.

Further insights into the composite revenue outturns compared to the approved budget items can be gleaned from Table 2.2.

2.1.4 Stock and monitoring of expenditure payment arrears

Going into the ESGP period, the Government was carrying a heavy load of arrears that were admittedly, in part, a reflection of weak controls in terms of commitment to expenditures (Ministry of Finance, 2017). Domestic arrears increased significantly to K18.8 billion in 2016 from K2.8 billion in 2015 mainly on account of non-payments to road contractors, and piling electricity imports and fuel bills.

The chronic and persistent accumulation of arrears by the Government had severe economic consequences including the following[1]:

- *Reduced economic growth partly as a result of payment arrears:* In Zambia, most businesses are dependent on government contracts. Therefore, payment arrears led to reduced business activities as a result of payment delays. The delays imposed difficulties in businesses accessing credit from commercial banks, due to a liquidity problem in the economy resulting in a reduced pace of economic activity. Zambia's economic growth averaged 3.6% during 2016-2018, a far-cry from the average of 5.9% per annum in the five years before the 2015 economic crisis.

- *Increased cost of service provision*: government suppliers mitigated the risks and opportunity cost of delayed payments by the upward adjustment of prices of their supplies.

- *Reduced or interrupted public service delivery*: increased costs and diversion of resources to settle previous arrears forced the Government to reduce the amount of supplies purchased or volume of services delivered. Some public services/projects may have been halted where providers of essential services/materials suspended supplies.

- *Increased interest rates*: illiquid suppliers bridged the delay in payment by borrowing from banks and other financial institutions, and this led to a significant increase in the portion of non-performing loans (NPLs) at 10%, adding pressure to credit markets and driving up interest rates to as high as 24% with adverse consequences for monetary policy.

- *Impact on the banking system*: as banks provided credit to companies owed by the Government, they bore the brunt of the problem. The rise in NPLs left banks unable to extend credit to new customers. Credit growth to private sector contracted in real terms because of tightened credit conditions arising from the rise in NPLs. To offset the risks of non-recovery, banks passed the cost of arrears onto other

1 International Monetary Fund (IMF) (2014). Public Expenditure Review Study on the Prevention and Management of Payment Arrears.

private borrowers by adding a premium to their lending rates.

- Second-round fiscal costs: as government suppliers suffered from liquidity shortages there were knock-on effects from lower profits, which may have resulted into job losses. Suppliers reduced or withheld payments of taxes and social security payments to offset the delays in receiving amounts owed to them by Government.

In recognition of these challenges and to counter accumulation of arrears, and as part of the measures to ensure credibility of the Budget during the ESGP period, the Government made dismantling of arrears one of its major priorities in 2017.

The envisaged *accelerated dismantling of arrears* to suppliers of goods and services saw a strong positive outcome in the first year of the ESGP. The Government reduced domestic arrears to K12.7 billion by December 2017 from K18.8 billion in 2016. The commitment to dismantle arrears continued in 2018 albeit at a slower pace. Ministry of Finance (2019) reports that "In an effort to dismantle the arrears, a total of K4.5 billion was paid out in 2018 against the Budget target of K1.3 billion Budget".

Nevertheless, loopholes remained. The accumulation of arrears to K15.1 billion in 2018 from K12.7 billion in 2017, after K4.5 billion was paid out, suggests that the Government accumulated about K6.9 billion in new arrears. This shows that while the Government was committed to the dismantling of arrears, it did not deal with the root causes of their accumulation within the Ministries, Provinces and Spending Agencies (MPSAs). For instance, it did not institute effective implementation commitment control systems. Neither did it ensure the restriction of new capital projects nor major equipment procurements.

Further, the reduced expenditure on lines such as the Use of Goods and Services and Grants and Other Payments meant that Ministries and Grant-Aided Institutions were faced with challenges in meeting their financial obligations, thereby accumulating more arrears. This includes the K17.9 billion owed in VAT refunds.

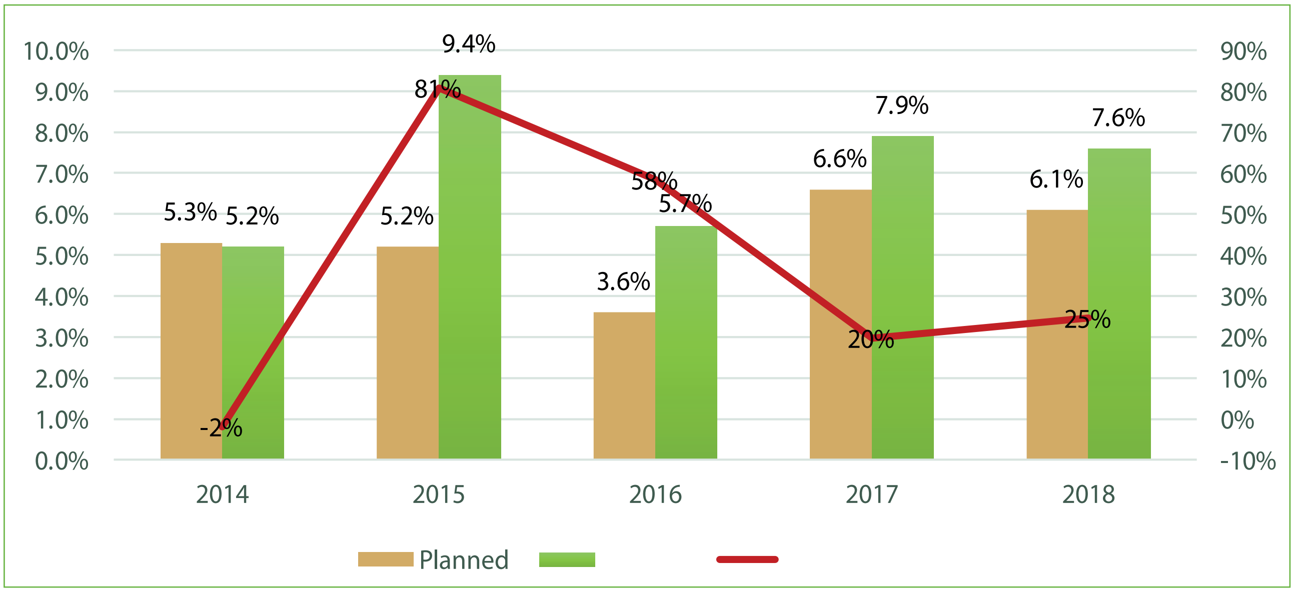
Thus, the performance on the dismantling of arrears was mixed. Undeniably, with the MTDS silent on the issue of dealing with domestic arrears, there was a missed opportunity within the ESGP period to gauge the exact stock of, not only arrears, but also the fiscal deficit on a commitment basis and subsequently the exact stock of public debt.

2.1.5 Fiscal deficit and its financing

Coming from a previous period of high fiscal deficits - as high as 9.4% of GDP in 2015 - the 2018 Budget sought to limit the fiscal deficit, on a cash basis, to 6.1% of GDP. However, the fiscal deficit remained elevated at 7.6% of GDP, although slightly lower than the 2017 deficit of 7.9% of GDP (Ministry of Finance 2019). This is shown in Figure 2.3.

The higher than expected deficit in 2018 was largely driven by increased interest payments on public debt on account of a depreciated Kwacha, and foreign-financed projects, especially those related to infrastructure development, exceeding the targeted amount. The fiscal deficit was financed through borrowing, both domestically - mainly through the issuing of treasury bills and bonds - and externally. The Government went overboard with domestic borrowing in 2016 and 2017 and anticipated that domestic borrowing would take up a bigger share of their borrowing strategy even in the ESGP. However, this was not to be with the share of domestic financing relegated to 43% in 2018 due to the undersubscription of treasury bills.

Figure 2.3: Planned and outturn fiscal deficit as a % of GDP



Constructed from Ministry of Finance Fiscal Tables (2016-2018)

Nonetheless, the higher domestic borrowing in 2016 and 2017 resulted in the crowding-out of private sector borrowing and commercial bank interest rates increased and continued to be persistently high in the period. A combined effect of this and the accumulation of domestic arrears meant that the estimated fiscal deficit on commitment basis stood way higher than the deficit on cash basis at roughly 12.8% of GDP in 2018, majorly on account of increased payment arrears. And when VAT refunds are added to the outstanding arrears, the fiscal deficit stood at 17.9% of GDP.

Further, amortisation on domestic debt, which was reduced to 41% under Budget in 2017 from 518% in 2016, shot up to ten times above Budget in 2018, due to shorter maturity periods especially on treasury bills which formed a greater part of the debt portfolio. On the other hand, external financing which was subdued in 2016 and 2017, recorded an overspend of 134% in 2018. Amortisation on external debt also followed a similar trend (Table 2.3).

Table 2.3 Variance between planned and actual financing, 2014-2018

	2014	2015	2016	2017	2018	Average
FINANCING	-2%	93%	61%	17%	25%	39%
Net Domestic Financing	27%	-23%	368%	293%	-35%	126%
Amortisation	21%	26%	518%	-41%	899%	285%
Net External Financing	-16%	179%	-29%	-46%	134%	44%
Amortisation	-34%	-12%	0%	-19%	14%	-10%

Constructed from Ministry of Finance Fiscal Tables (2014-2018)

On the whole, the fiscal deficit outturn was higher than the targets set in the years under review leading to greater financing needs. In particular, expenditure outturns were consistently outside the sound execution range of -2.5% to 2.5% prescribed by the PEFA framework. This was largely as a result of overspending on interest payments and capital expenditure. Revenue budget execution was generally consistent with targets thanks to a well performing VAT and mineral royalty tax. However, this improved performance was completely overshadowed by the poor performance on the expenditure side resulting in the persistently high fiscal deficits in the period. Thus, the ESGP failed to bring about effective budget execution.

Is Zambia on a path to fiscal fitness? We attempt to answer this question in Textbox I using the Fiscal Fitness Index, a multiple indicator-based approach developed by ZIPAR and modelled on the Human Development

Index's relative distance methodology[2].

Box 1: Is Zambia on the path to fiscal fitness?

The Fiscal Fitness Index quantitatively depicts the overall fiscal fitness using three dimensions (i) fiscal performance, (ii) budget credibility and (iii) sustainability of the economy. Like the HDI, we define very high performance as an index higher than 0.800, high performance as an index between 0.700 and 0.799, medium performance as an index between 0.550 and 0.699, and low performance as an index below 0.550. The values of the indices are standardised to lie between 0 and 100, with 0 depicting weak/very low performance and 100 strong/very high performance.

Zambia's overall fiscal fitness posted an index of 0.517 in 2018, which is not so different from 0.512 in 2017. However, the index remains low, i.e. below the 0.550 threshold for medium performance. While some gains have been scored in fiscal performance, particularly revenue collections, higher than planned spending has eroded budget credibility. Further, increased debt accumulation has reduced debt sustainability. The estimated sub-indices for the five-year period 2014-2018 are shown in the table.

Fiscal Fitness Index, 2014-2018

		2014	2015	2016	2017	2018	Performance* 2018
Overall Fiscal Fitness Index		**0.715**	**0.411**	**0.453**	**0.512**	**0.517**	**Low**
Fiscal Performance index		0.647	0.463	0.582	0.470	0.553	**Medium**
	Revenue	0.719	0.536	0.198	0.523	0.844	Very high
	Spending	0.331	0.900	0.544	0.352	0.226	Low
	Fiscal Balance	0.761	0.000	0.800	0.507	0.664	Medium
	Deficit Financing	0.779	0.416	0.784	0.499	0.480	Low
Budget Credibility index		0.792	0.374	0.376	0.664	0.614	**Medium**
	Revenue	0.558	1.000	0.000	0.573	0.828	Very high
	Spending	0.610	0.000	0.370	1.000	0.309	Low
	Fiscal Balance	1.000	0.000	0.558	0.786	0.704	High
	Financing	1.000	0.495	0.576	0.299	0.614	Medium
Fiscal & Debt Sustainability index		0.712	0.400	0.426	0.430	0.407	**Low**
	Fiscal	0.614	0.168	0.400	0.364	0.564	Medium
	Debt	0.810	0.632	0.452	0.496	0.249	Low

**Low performance: 0.000-0.549; medium performance: 0.550-0.699; high performance: 0.700-0.799; very high performance: 0.800-1.000*

The **Fiscal Performance Index** improved from low (0.470) in 2017 to medium (0.553) in 2018, thanks to significant gains in revenue performance, thereby reducing the fiscal deficit to 7.6% of GDP in 2018 from 7.8% of GDP in 2017. Deficit financing marginally deteriorated.

The **Budget Credibility Index** declined from 0.664 in 2017 to 0.614 in 2018. This was mainly as a result of a deterioration in spending. This entails a wider gap between the spending targets and the actual outturn. Against a budget of K71.7 billion in 2018, the Government instead spent 10.5% more, resulting into an overall spending outturn of K79.2 billion. The **Fiscal and Debt Sustainability Index** still remains low and has actually deteriorated from 0.430 in 2017 to 0.407 in 2018. This is on account of debt sustainability issues. While fiscal sustainability performance has increased from low to medium, on account of some reduction in the ratio of recurrent expenditure in general, and the wage bill in particular, to domestic revenues, debt sustainability remains low. This is consistent with the concerns that have been expressed recently about debt sustainability.

Clearly, while the country has made some improvements in achieving fiscal fitness, particularly in revenue collection, improvements need to be made with regard to expenditure performance and credibility, deficit financing and debt sustainability.

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2 This method takes both favourable and adverse parameters in the construction of the index. The index constructed for favourable indicators is called the *Improvement Index*; the index computed by taking adverse parameters is called the *Deprivation Index*. The value of both the indices will be standardized to lie between 0 and 100.

where, X refers to the actual value of the parameter for a given state; Max(X) and Min(X) are the maximum and minimum value of the particular parameter across the states in a specified (five-year) period. Similarly, Y can be interpreted like X with the condition X≠Y. The value of D and Y lies on a 0 to 100 scale where 0 depicts worst performance and 100 implies the best performance.

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Clearly, while the country has made some improvements in achieving fiscal fitness, particularly in revenue collection, improvements need to be made with regard to expenditure performance and credibility, deficit financing and debt sustainability.

2.2 Containing the Government Wage Bill

For a while, the Government's wage bill has been the single largest expenditure item on the annual Budget. To this effect, the ESGP acknowledged that this element of the Budget had over time eroded the fiscal space for funding other developmental programmes. Increases in both salaries and staffing levels were not matched by revenue generation, and were therefore, putting additional pressure on the Treasury (Ministry of Finance, 2017). Attempts to contain the growth of the wage bill resulted in employment restrictions by the Government vis-à-vis a wage and employment freeze which lasted from September 2014 to December 2015. From 2017, Government also confined new public sector recruitments primarily to frontline workers in the health and education sectors.

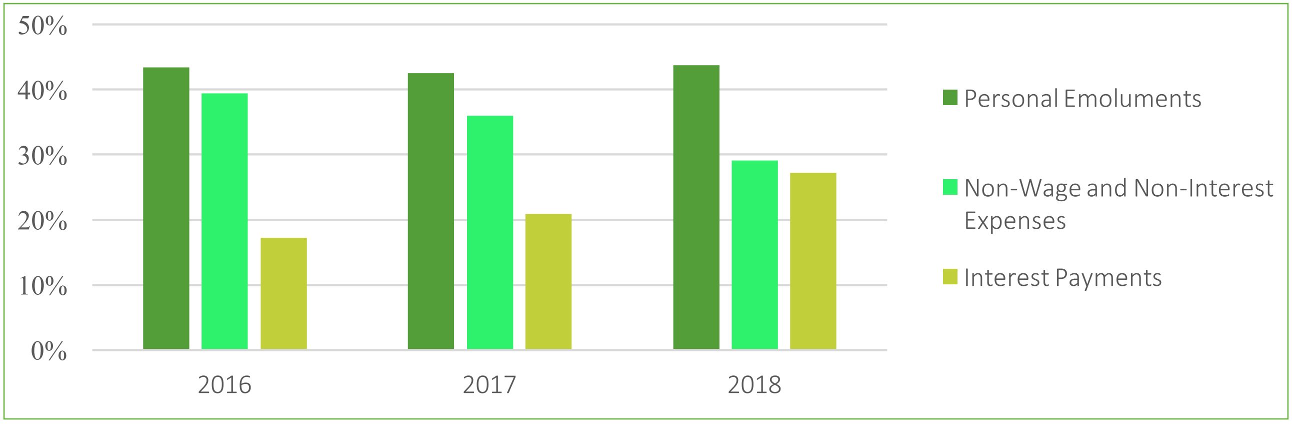
Under the ESGP, in an effort to contain the civil service wage bill and create fiscal space, two measures were proposed: i) a quantitative Central Government wage ceiling set at 9% of GDP, and ii) restricting employment to priority sectors and linking these to overall development objectives. In mid-2018, more measures were announced to "address fiscal and debt challenges for sustained macroeconomic stability and growth" (Government of the Republic of Zambia, 2018). These included i) reducing expenditures related to both local and foreign travel and workshops, ii) limiting the maximum size of delegations accompanying Chief Executive Officers of loss-making State-Owned Enterprises (SOEs) and statutory bodies, and iii) requiring all workers to take leave annually to reduce expenditures such as commutation of leave days.

In 2016, the year before the ESGP was launched, personal emoluments accounted for 32% of total expenditure (including amortisation), or 48% of domestic revenues. Once the wage and employment freeze were lifted in 2016, a total of 3,507 health workers and 3,892 teachers for both primary and secondary were recruited. And this was followed by further recruitments in 2017 of 8,157 health workers (against a target of 7,400) and 10,042 teachers. In the case of Zambia, the continued recruitment of frontline workers in health and education is needed to address the shortage of workers and improve the quality of health and education services by reducing patient-doctor and teacher-pupil ratios, for example.

Despite these recruitments, the share of personal emoluments as a percentage of total expenditure came down to 31% and 28% for 2017 and 2018, respectively. As a share of domestic revenue, personal emoluments also reduced from 47% in 2017 to 41% in 2018. However, against a targeted 2% reduction in personal emoluments in 2017, the outturn increased by 6%. And though there had been an anticipated increase of 15% in personal emoluments in 2018, the outturn only increased by 9%. Within this period, the Government managed not to breach the wage ceiling of 9% of GDP, maintaining the outturn of personal emoluments at 9% of GDP in 2016, followed by 8% of GDP in both 2017 and 2018 respectively.

Figure 2.4 shows that the outturn on personal emoluments as a percentage of recurrent expenditure remained fairly constant at around 42-44% of recurrent expenditure. However, rising interest payments as a share of recurrent expenditure, gobbled into the share of other non-wage expenditures such as social benefits and spending on goods and services. Therefore, while the wage bill as a share of recurrent expenditure was kept relatively constant in recent years, spending on other essential items suffered due to increases in the share of interest payments and were not being protected as much as personal emoluments.

Figure 2.4: Personal emoluments as a share of recurrent expenditure (%)



Constructed from Ministry of Finance Fiscal Tables (2014-2018)

In dealing with the sheer size of the Government wage bill, however, it may not be feasible to maintain a wage freeze for an extended period. As the cost of living continues to rise and real wages of civil servants are eroded over time, there will be increased pressure to adjust salaries and wages upwards. However, salary adjustments should be planned and consistent so that pressure is not allowed to build to a point where large increments need to be made at a go.

Moreover, addressing fundamental issues such as removing ghost workers from the payroll would give a lasting reprieve to the Treasury from the heavy burden of the wage bill. This is going by a Ministerial statement made by the Minister of Finance in February 2019 that ghost and absentee workers should be removed from the Government's payroll. Ghost workers refer to non-existent employees on the payroll; including ones who died but whose salaries continue to be paid out. To this effect, while such an effort would require considerable strengthening of public financial management systems, once the payroll has been cleaned up, Government should make concerted efforts to keep it clean and lean.

2.3 Reforming the Farmer Input Support Programme

The majority of farmers in Zambia's agricultural sector are either small-scale or subsistence operators. The agricultural sector deserves special attention because for many years it has been regarded as an escape route from poverty. The Government, in an effort to diversify the country's agriculture sector and improve agricultural productivity, came up with deliberate policies for small-scale and subsistence farmers. Notable among these productivity enhancement measures is the Farmer Input Support Programme (FISP), which is also hoped to help alleviate poverty.

The introduction of FISP in 2002 envisioned economic growth through agricultural diversification and the reduction of rural poverty through the empowerment of smallholder farmers. Initially, the focus of FISP was on increasing the production of maize through the provision of fertilizer and improved maize seed, thereby potentially increasing farmers' earnings. As an add-on, the ESGP sought to improve the efficiencies within FISP and also to increase coverage of beneficiaries.

Despite the constant increases in the FISP budgetary allocations since its implementation, FISP has been characterised by poor beneficiary targeting, where the poor were left out; delays in input distribution; poor monitoring of programme effects; and a lack of exit strategy to graduate some farmers from the system (IAPRI, 2018). As a result, FISP has yet to make a significant impact on the livelihoods of small-scale farmers, particularly those that are rural-based. To illustrate, rural poverty declined marginally from 77.9% in 2010 to 76.6% in 2015. In fact, in provinces such as Western, Northern and Luapula, where the most common livelihood is small-scale/subsistence farming, poverty levels actually increased during the assessment period (Central Statistical Office, 2016).

The Ministry of Agriculture in the 2015/2016 farming season sought to address most of the above stated challenges by piloting the Electronic Voucher (e-Voucher), also known as FISP e-Voucher or e-FISP, in 13 districts. In line with the ESGP, the e-Voucher was rolled out in the 2016/2017 farming season and it was envisaged to improve the targeting of farmers and facilitate agricultural diversification to include a wider range of inputs for crops in addition to maize. The e-Voucher was also extended to livestock farming, fisheries and forestry products. Further, the e-Voucher aimed to create a strong linkage between the formal private sector players in agricultural markets like agro-dealers and the smallholder farmers through the development of private sector input supply chains and creation of jobs.

The ESGP's aim to reduce or eliminate the high overheads associated with the traditional FISP framework was somewhat achieved. Table 2.4 shows that expenditure towards FISP reduced substantially between 2017 and 2018, reducing by K1.2 billion from K2.8 billion in 2017 to K1.6 billion in 2018. The reduction in expenditure by the Government on FISP was largely as a result of the clean-up exercise of removing ghost farmers and duplicated beneficiaries, stricter application of the eligibility criteria, and also passing on transportation and storage costs to the agro-dealers.

Table 2.4: Budgetary allocations to FISP and FRA in K'000, 2016-2018

Year	*Description*	*FISP*	*FRA*
2016	*Target*	*1,003,551*	*750,000*
	Prelim Outturn	*1,902,301*	*910,300*
	Variance (%)	*90%*	*21.4%*
2017	*Target*	*2,824,339*	*942,500*
	Prelim Outturn	*2,801,079*	*965,761*
	Variance (%)	*-0.8%*	*2.5%*
2018	*Target*	*1,785,000*	*1,051,200*
	Prelim Outturn	*1,674,872*	*381,600*
	Variance (%)	*-6.2%*	*-63.7%*

Source: Constructed from MOF Fiscal Table (2016-2019)

Additionally, the streamlining of FISP was expected to create some fiscal space for the Government so as to channel these saved resources to other targeted social protection programmes that could better reduce rural poverty. While these savings have not been materially realised during the period of the ESGP, the Government should commit to the full rollout of the e-FISP in the next season, after scaling it back to 60% of districts, and consider how participants to the programme can graduate and thereafter reduce the number of beneficiaries over time.

2.4 Reducing the Role of the Food Reserve Agency (FRA)

The FRA's main mission is to ensure national food security by maintaining a sustainable national strategic food reserve that stabilises crop prices for farmers and mealie meal prices for consumers. By providing a ready market for farmers, it helps to raise their incomes and reduce poverty. However, just like FISP, there is little evidence on FRA's influence in alleviating poverty. The FRA promotes continued reliance on maize and deters diversification into more productive crops, while operational inefficiencies discourage a lot of small holder farmers from selling their produce to the FRA owing to the frequent, long and uncertain delays between when the farmers deliver their crop and when they receive payment.

Under the ESGP framework, it was recommended that the budgetary allocation to FRA be only enough to maintain the required strategic food reserve at 500,000 metric tonnes of maize and maize-equivalent grain. This was expected to free up resources for other developmental programmes in the agriculture sector, particularly given that there was a continuous trend of buying more reserves than was prescribed. These excess reserves tended to increase the arrears accrued by Government, as well as payment delays for most farmers.

As a first step to achieving the reductions in spending, FRA's actual expenditure between 2017 and 2018 reduced by almost K600 million, representing a 61% reduction. In 2018, K381 million was spent against a budgeted amount of K1 billion. This saving was primarily as a result of the clean-up exercise of removing ghost farmers who were no longer on the Government's payroll.

Furthermore, FRA can play a smaller role in the maize market. By matching its prices to the prevailing market price, it could reduce the volume of purchase from farmers and channel these savings to other social protection schemes in the agricultural sector such as the Food Security Pack that reach specific poor sub-groups of the population. IAPRI (2019) recommends that as a way of ensuring food security at lower costs, Government should revise the strategic food reserve to 150,000 metric tonnes (3 months lead time) or 350,000 metric tonnes (5 months lead time) for 2018/19 season; and conduct periodic reviews of the strategic food reserve size to reflect changing population dynamics, market, availability and consumption patterns.

The ESGP aimed to reduce expenditure on subsidies to FISP and FRA through reducing the Government's involvement in both FISP and FRA. The Government was to channel savings from FISP and FRA to other needy areas as well as disengage from sourcing of inputs with the expectation to stimulate private sector participation in agriculture marketing . Our analysis shows that despite the reductions in budget allocations and savings made from the two subsidies during implementation, the allocation towards social sectors (excluding FISP) grew marginally by 2 percentage-points, from 30% of the total budget in 2016 to 32% in 2017 and remained static at 32% in 2018 implying that the other social needy areas did not benefit from the reductions. Regarding stimulating private sector participation in the agricultural sector, storage capacity increased to 947,000 MT of maize in 2018 from 500,000 MT before the ESGP period (IAPRI, 2019). Additionally, private sector investment in agriculture increased with the number of e-voucher agro-dealers increasing, thus in many ways private sector participation was enhanced as envisaged .

2.5 Refocusing Public Expenditure

As a way to rationalise expenditures, the ESGP recognised that "optimal use of public resources is crucial in the country's ability to stabilise the economy, and put it back on a sustained and inclusive growth path" [p.7]. Over the implementation period of the ESGP, the following public expenditure refocusing strategies and measures were emphasised:

- Accelerate the dismantling of arrears to suppliers of goods and services to unlock economic activity;
- Support priority and growth areas of economic activity, namely: agriculture, tourism, industrialisation and non-traditional mining outside copper;
- Sustain and enhance critical health and education services;
- Rationalise the creation of new districts and ensuring availability of funds before creation; and
- Mitigating the effects of the ESGP on the vulnerable.
- Create an efficient system of managing empowerment programmes through consolidation of multiple schemes and funds supported through the national budget

Box 2 highlights some of the opportunities that the EGSP missed in its design, having focused only on the five strategies and measures above.

Box 2: Design omissions in ESGP Public Expenditure Refocusing

The following aspects were not included as part of the design of the EGSP, but they would have been critical for ensuring a reliable and effective fiscal consolidation programme:

- Priority setting mechanisms: the ESGP should have included measures and provisions for ensuring that all major project expenditures (e.g., in infrastructure) were only undertaken and funding released based upon prior (approved) project appraisals, feasibilities studies, economic returns analyses, and environmental impact assessments. This would have been a strong and reliable expenditure prioritisation mechanism.
- Rationalisation of the creation of new public institutions: new institutions (ministries, commissions, public agencies, public universities, health facilities, etc.) increase pressure on the Treasury. A strategic rationalisation mechanism would have helped to reduce this pressure, for example, Ministry of Finance should be consulted to ascertain the financial position of the Treasury prior to establishing these institutions.

In terms of progress with the five areas during the reference period, the following is noteworthy:

2.5.1 Supporting priority and growth areas

Over the review period, support to priority and growth areas of the economy (agriculture, mining, tourism, and manufacturing) waned somewhat. For instance, as highlighted earlier in this report, allocations to FISP under agriculture declined for various fiscal consolidation and rationalisation reasons. Similarly, allocations and expenditures in other priority growth areas – tourism, industrialisation and non-traditional mining – were suppressed in the wake of the constrained fiscal environment during the ESGP. Ultimately, real GDP growth outcomes remained subdued such that the authorities reprogrammed their growth targets downwards significantly to match the “new normal” outcomes.

Growth in the period 2014-2018 averaged 3.7%, but was not entirely from the identified growth and priority sectors. Instead, construction, education, and wholesale and retail trade were the top growth-driving performers. These were followed by manufacturing, information and communication, mining and quarrying and financial and insurance activities (Table 2.5). This mismatch between the priority sectors and the actual growth drivers points to a weak link between sectoral policies and budget allocation.

Table 2.5: Percentage-point contribution to GDP growth rates, 2014-2018

Industry	2014	2015	2016	2017	2018	2014-2018
Agriculture, forestry and fishing	0.1%	-0.6%	0.3%	0.7%	-1.6%	-0.2%
Mining and quarrying	-0.3%	0.0%	0.7%	0.3%	0.7%	0.3%
Manufacturing	0.5%	0.4%	0.2%	0.4%	0.3%	0.4%
Electricity, gas, steam and air conditioning supply	0.0%	0.0%	-0.2%	0.3%	0.2%	0.1%
Water supply; sewerage, waste management and remediation activities	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Construction	0.9%	1.6%	1.0%	0.7%	0.2%	0.9%
Wholesale and retail trade; repair of motor vehicles and motorcycles	0.8%	0.3%	0.0%	0.2%	0.7%	0.4%
Transportation and storage	0.2%	0.0%	-0.1%	0.3%	0.0%	0.1%
Accommodation and food service activities	0.1%	0.0%	0.0%	0.1%	0.0%	0.0%
Information and communication	0.3%	0.1%	0.6%	-0.5%	1.3%	0.3%
Financial and insurance activities	0.5%	0.4%	-0.1%	-0.2%	0.8%	0.3%
Real estate activities	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%
Professional, scientific and technical activities	0.1%	0.0%	0.1%	0.1%	0.0%	0.1%
Administrative and support service activities	-0.1%	0.0%	0.0%	0.1%	0.1%	0.0%
Public administration and defence; compulsory social security	0.2%	0.1%	0.5%	0.1%	0.1%	0.2%
Education	0.8%	0.0%	0.4%	0.5%	0.4%	0.4%
Human health and social work activities	0.1%	0.0%	0.0%	0.2%	0.2%	0.1%
Arts, entertainment and recreation	0.1%	0.0%	0.0%	0.0%	0.0%	0.0%
Other service activities	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Total Gross Value Added for the economy	4.4%	2.6%	3.6%	3.3%	3.5%	3.5%
Taxes less subsidies	0.3%	0.3%	0.2%	0.2%	0.2%	0.2%
Total for the economy, at market prices	4.7%	2.9%	3.8%	3.5%	3.7%	3.7%

Constructed from CSO National Accounts Statistics

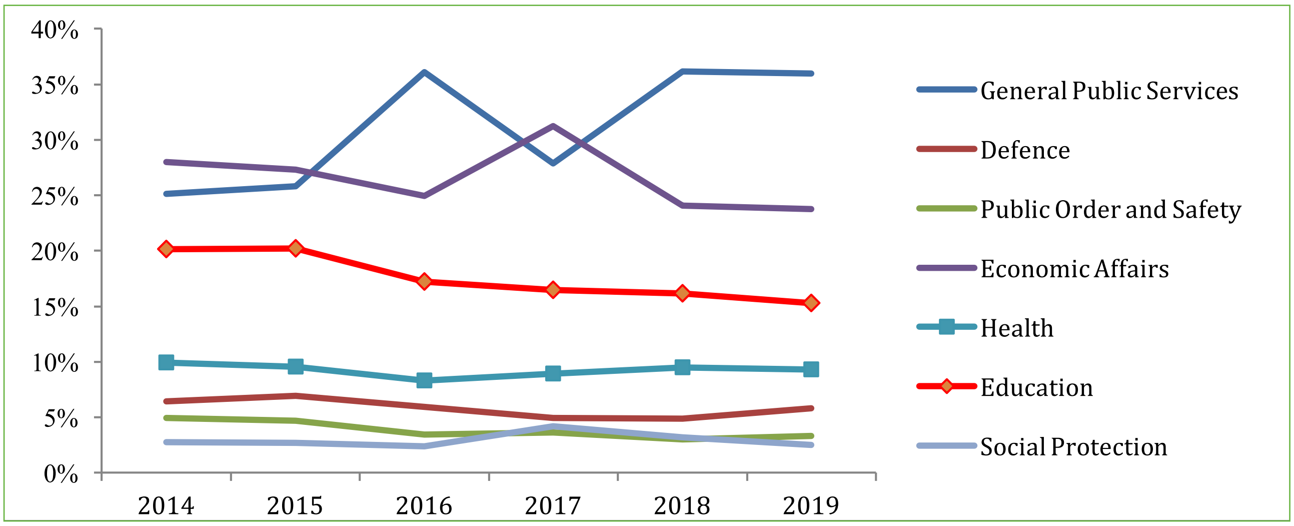
To boost growth, the identified priority sectors should be holistically leveraged on the current drivers of growth. Take agriculture for instance. A growth driving sector like construction could be used to build feeder roads to link produce to markets; to construct irrigation infrastructure to boost non-rain fed agriculture; as well as develop livestock breeding centres to boost the livestock numbers, particularly where export markets are readily available. Similarly, ICTs can be used as an efficient and cost-effective means to leverage commodity information in the agriculture sector. Further, access to finance and insurance can be enhanced by extending digital financial services to farmers. Using these and other innovations, agriculture, which is currently performing poorly, could realise its potential as a true driver of growth.

2.5.2 Sustaining and enhancing critical health and education services

Regarding health and education, Zambia managed to sustain a reasonable budgetary allocation to health during the review period, with an annual average allocation of 9.2% of the total national Budget in 2017-2019, compared to 9.3% during 2014-2016 (see, Figure 2.5). However, this fell short of the set Abuja Declaration target of allocating at least 15% of the annual budget to improve the health sector.

On the other hand, education commitments declined in the EGSP period, with shares falling from a period high of 20% of the total Budget in 2014 to a period low of 15.3% in 2019. While this was still within international commitments such as the Incheon Declaration of 2015 which sets a target of 15-20% of total government budgets on all levels of education, this reduction arguably put the objective of sustaining and enhancing education services in jeopardy during the ESGP period.

Figure 2.5: Budgetary allocations, by functional classification



Source: Constructed from Budget Speeches

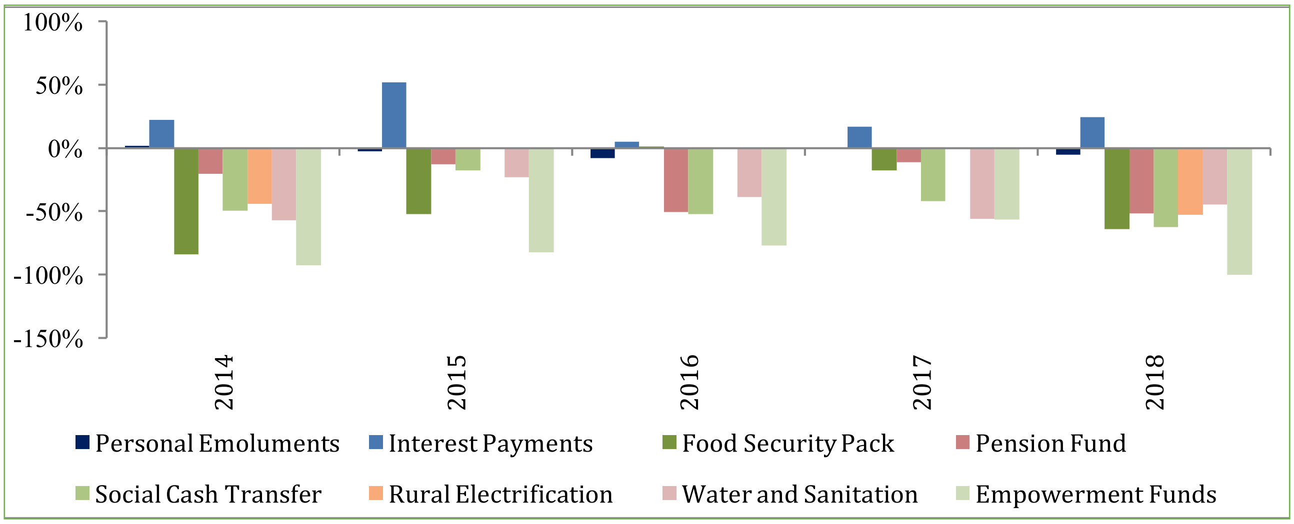
2.5.3 Rationalising the creation of new districts

Regarding slowing down the commissioning of new districts, during the six years between 2012-2017, the authorities increased the number of districts from 72 to 105, implying a total of 35 new districts during the period or 6 new districts per year. Because of the permanent new demands that these new districts placed on the Treasury vis-à-vis operational costs, during the reform period, the ESGP meant to rationalise and slow down the creation of new districts. However, by the end of 2018, a total of (at least) 115 districts were in existence in the country, meaning that an additional ten new districts were commissioned during the year. Seemingly, the EGSP made no difference in slowing down the establishment of new districts.

2.5.4 Mitigating the effects of the ESGP on the vulnerable

Finally, refocusing expenditure during the reform period was meant to mitigate the effects of the ESGP on the vulnerable. Among other things this would have meant ensuring the ‘ring-fencing’ of social protection expenditure. However, in practice the underfunding of social protection expenditures deepened markedly during the ESGP period, particularly in 2018 when actual spending on the Social Cash Transfer was 62% under-Budget with only 1 of the 6 payment cycles made to new beneficiaries. Additionally, there were concerns of misappropriation leading to a recall of funds by donors. Food Security Pack was 64% under-Budget, Empowerment Fund was not funded at all, and all the other social protection items shown in Figure 2.6 were also underfunded.

Figure 2.6: Variances between planned and actual expenditure, selected items



Source: Constructed from MOF Fiscal Table (2013-2018)

From the foregoing, the strategy for refocusing of public expenditure in the ESGP had limited success in fostering the avoidance of spending deviations from Parliamentary appropriations. Moreover, activities that could have been rationalised and/or delayed in order to take the pressure off the Treasury were largely implemented as business as usual. Ultimately, the refocusing tenets in the ESGP did little to restore Budget credibility.

2.6 Improving Accountability and Transparency

The ESGP specified transparency and accountability as being about curbing corruption, money laundering and drug trafficking as well as the management of public resources with diligence, prudence and accountability. It identified these as key tenets for good economic governance.

However, from a design perspective, the ESGP's definition of transparency and accountability was somewhat narrow. According to the National Assembly (2017), transparency is described as openness and accessibility of the public sector, achieved through a proactive, deliberate, unrestricted and truthful provision of financial information and records to the citizenry. On the other hand, accountability is the establishment of clear responsibilities, the appropriate delegation of authority, systems to hold people in authority to account for the results they achieve, proper stewardship of funds, and consequences for failure to do so. Thus, while the ESGP reflected a clear focus on promoting accountability, it did not possess any explicit practical mechanisms for transparency. It did not explicitly commit to a regular or periodic public provision of information on implementation and programme performance.

2.6.1 Some proposed legal reforms did not materialise

In terms of accountability mechanisms, the ESGP aimed, inter alia, to ensure that the fiscal authorities reviewed the Public Finance Act of 2004 to make the laws and underlying regulations more punitive to abusers, and to spearhead the enactment of a Planning and Budgeting Bill to improve adherence to planned expenditure. Against these targets, by the close of 2018, the Ministry of Finance had fostered the repeal of the Public Finance Act and enactment of the Public Finance Management Act (No. 1 of 2018), an important positive score under the ESGP. However, as of December 2018, the Ministry of Finance had not submitted the Planning and Budgeting Bill to Parliament. Thus, the country's Planning and Budgeting Policy (Ministry of Finance, 2014) continued to be implemented in the absence of a legal framework, thereby limiting the levels of responsiveness, transparency, accountability and results orientation that could be achieved.

In addition, two legal frameworks for fiscal prudence, transparency and accountability that were not included among the EGSP legal reform targets, but which required urgent review were the Public Procurement (Amendment) Act (No. 15 of 2011) and the Loans and Guarantees (Authorisation) Act (No.13 of 1994). These were identified in the 2017 and 2018 Budget Speeches as candidates for urgent review. By the end of 2018, neither of these had been tabled before Parliament for consideration.

Table 2.6: Legal Instruments for Improving Accountability and Transparency

Legislation	Desired Action	Status
Public Finance Management Act	Review to make laws and underlying regulations more punitive to abusers	Enacted
Planning and Budgeting Bill	Enactment to improve adherence to planned expenditure	Not submitted to Parliament
Public Procurement (Amendment) Act	Urgent review to enhance transparency and accountability	Not tabled in ESGP
Loans and Guarantees (Authorisation) Act	Urgent review to enhance transparency and accountability	Not tabled in ESGP

Therefore, regarding legal reforms towards fiscal prudence, accountability, transparency and responsiveness, the authorities only enacted the Public Finance Management Act out of a possible four pieces of legislation in Table 2.6. The Government authorities should expedite the preparation and submission to Parliament of the outstanding three pieces of legislation in order to complete the strengthening of the overall fiscal legal framework.

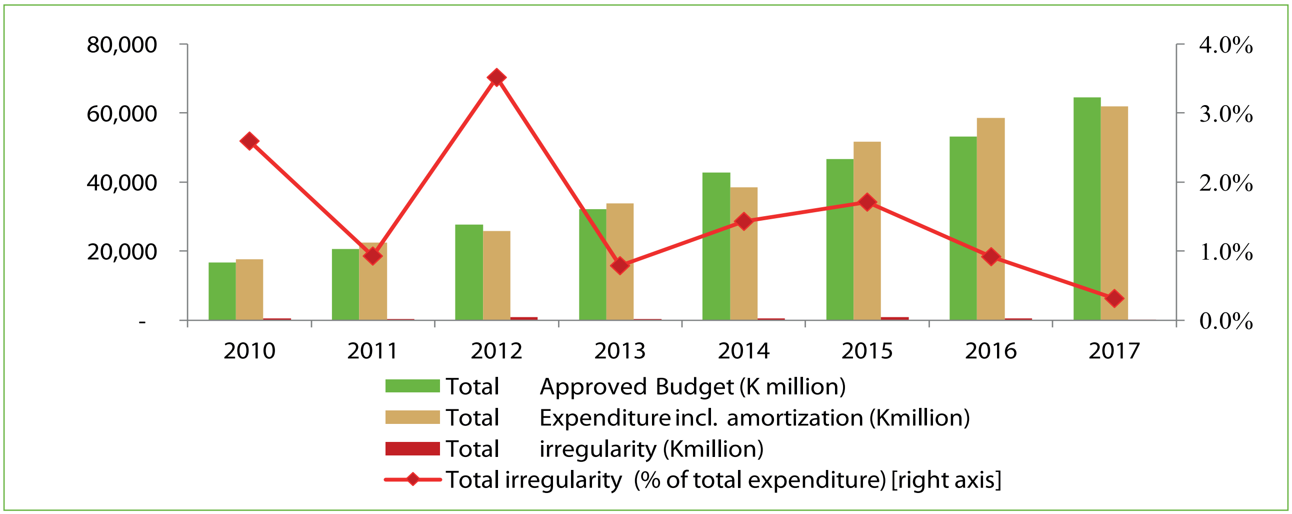
2.6.2 Fiscal rules not included for prudence and accountability

Since 2017, ZIPAR has also advocated for a strong legislative commitment to fiscal prudence and accountability through the establishment of explicit quantitative fiscal rules into the overall fiscal legal framework. Fiscal rules are long-lasting, legally-binding, quantitative constraints or restrictions on budgetary aggregates such as revenues, expenditures, public debt, budget balance and so on, which are kept in force for periods of over five years at a time and should become an integral part of the legal framework. In the Zambian context, fiscal rules would restrain both the Executive and the Legislature from amassing excessive powers and discretion to spend (Lienert & Fainboim, 2010; Schaechter, et al., 2012; Baunsgaard, T, et al., 2012).

2.6.3 Public financial irregularity subsided

The Zambia Plus did not pronounce explicit targets on curbing corruption, money laundering and drug trafficking during the ESGP period. As a proxy measure related to corruption, we used data from the Auditor General's Reports . The Auditor General's summary results on total public financial irregularity for 2010-2017 are presented in Figure 2.7. The results show that financial irregularity in the public sector (as a proportion of total budgetary expenditure), spiked to a high of 3.5% of expenditure in 2012. Irregularity subsided to 0.8% in 2013 but rose to 1.7% of total expenditure in 2015 and fell continuously thereafter.

Figure 2.7: Trends in public financial irregularity in Zambia



Source: Constructed from Auditor General's reports and MOF Annual Economic Reports

Even before the ESGP's launch and the aforementioned enactment of the Public Financial Management Act (2018), Zambia's public financial management systems were already undergoing self-correction and yielded positive outcomes in terms of reducing financial irregularity in the public sector. Once the 2018 Auditor General's report comes out, it will be interesting to check whether the downward trend was maintained or reversed in 2018.

Another aim of the ESGP, which also did not have explicit targets, was to ensure the sound management of public resources with diligence, prudence and accountability. In practice, this would mean sticking to appropriated or approved Budgets as observed in the sub section 2.1 on improving Budget execution.

2.6.4 Commitment controls were enhanced

In addition to the legislative reforms, the Government instituted a number of measures and reforms to improve commitment controls both on the revenue and expenditure sides in the ESGP period. These included the introduction of a number of VAT administration initiatives, as well as changes to the price-based mineral royalty regime of 2016 to enhance the benefits from the mines by increasing revenue collections. Additionally, a Public Private Partnership (PPP) was signed between Road Transport and Safety Agency (RTSA) and the private sector to enhance modern ways of revenue collection i.e. speed cameras as well as the scaling up of toll plazas throughout the country meant to improve non-tax revenue collections.

On the expenditure side, the introduction of the FISP e-voucher system and the removal of fuel and electricity subsidies (prior to the Plan) eased spending pressure on the Treasury. Other system measures put in place included the Treasury Single Account (TSA) which was meant to bring all Central Government institutions under the same financial operational system and improve liquidity management and budget credibility. In 2017, 31 Ministries, Provinces and other Spending Agencies (MPSAs) were put on the TSA bringing the total number to 44 out of 56 units and made Government some savings.

Another additional measure was the rollout of the Integrated Financial Management Information System (IFMIS) by end 2017, where no Ministry, Province or Spending Agency was to be allowed to spend outside the system; the aim was to curb the accumulation of arrears. With two MPSAs migrated to the IFMIS system in 2017, the total number was brought to 51 out of 56 heads. However, the continued accumulation of arrears cast doubt on the effectiveness of the IFMIS.

3 Enhancing Domestic Resource Mobilisation

In a bid to expand revenue collection and also improve the fiscal position, the Government sought to implement more efficient strategies and structural reforms for revenue mobilisation. Five strategies were outlined in the ESGP to enhance domestic resource mobilisation namely: (i) modernisation and automation of revenue collection; (ii) taxing the informal sector; (iii) enhancing the collection of revenue from property taxes; (iv) increasing revenue collection from road tolls; and (v) stemming illicit financial outflows. Since expenditure levels were unsustainable in the period with recurrent expenditures out-pacing domestic resource mobilisation, the Government included a strategy to refocus its public expenditure[5] . Government acknowledged that without a change in its expenditure patterns, the five mentioned revenue strategies would be jeopardised.

3.1 Augmenting modernisation and automation of revenue collection

Prior to the ESGP, total revenue and grants stood at K39.4 billion against the targeted figure of K42.6 billion in 2016. The low revenue collection was on account of underperformance of VAT, and other revenue streams. VAT collections stood at K7.9 billion which represented 20.2% of total revenues and grants in 2016, but missed the projected target of K9.9 billion. Other tax revenue streams underperformed by 17% while non-tax revenue streams underperformed by 7%.

The ESGP planned to continue efforts to modernise revenue mobilisation in order to strengthen tax compliance. It was anticipated that major revenue collection processes would be automated by end 2017. It was also believed that automated and modernised revenue collection measures would pave way for easier administration efficiency by reducing errors, improving processing times and lowering administration costs. Furthermore, rent-seeking behaviour would be minimised because of little or no interaction between revenue officers and tax payers. Several functions including electronic submissions of tax documents at ZRA, e-payment of tax obligations and direct deposits of user fees and non-tax charges to the Treasury would be simplified.

Some of the modernisation and automation strategies adopted included enhancement of information technology solutions to improve VAT collection particularly, the appointment of withholding agents and electronic fiscal devices for VAT registered suppliers. VAT collections improved on average by 44% in 2017 and 2018. Furthermore, the implementation of a tax amnesty in 2017 also served to increase other tax collections.

The Government also intended to strengthen existing non-tax collection mechanisms through modern techniques such as use of point-of-sale facilities, dedicated counter services by commercial banks, teller implants[6] and electronic banking to enhance non-tax revenue. However, non-tax revenues underperformed in 2017 by 19% due to the delay in the implementation of these measures to scale up the efficient collection methods with regard to user fees and fines. The underperformance in user fees and fines continued in 2018.

3.2 Expanding taxation to the informal sector

Any part of economic activity that is not registered and monitored by any form of Government regulation is considered to be part of the informal sector. Also known as the shadow economy, this part of economic activity has been receiving economic attention and occupies an important domain in revenue generation among developing economies. It is envisaged that taxing the informal sector has the potential to raise Government revenue, as the informal sector comprises a large and growing share of GDP.

The ESGP aimed to: (i) work with local authorities to develop practical mechanisms of bringing the informal sector into the tax net; and (ii) enhance measures to encourage the use of electronic payments in order to limit cash transactions and enhance availability of information on transactions that take place in the economy which is essential for tax purposes.

5 The refocusing of public expenditures has been discussed in Section 2 of the report.
6 Teller implant is a service where a Bank provides a teller who works at your premises to process deposits.

ZRA has over the years introduced simplified taxes which were meant to target the informal sector. These include presumptive tax, base tax and turnover tax. The collaboration with local authorities has seen to the base and presumptive taxes now being collected from markets and bus stations, but still only 1% of revenues are collected from the informal sector. The challenge to formalise the informal sector has been compounded by a huge cash economy with limited audit trail for tax purposes. The ESGP lacked clear mechanisms for harnessing informal sector tax collections, but the introduction of digital financial services offers an opportunity for the authorities to audit transactions and limit the cash economy.

3.3 Improving collections from property taxes

The need to introduce property taxation has been receiving a lot attention by many revenue authorities in African countries due to its many advantages. Zambia has an established property taxation regime with rental income charged and taxes levied on the sale of property. In addition, the Ministry of Lands, Environment and Natural Resources (MOLENR) is mandated to charge ground rents on tilted land while land rates are levied on properties within the jurisdiction of the local councils.

Since 1964, only 200,000 land titles had been issued nationwide by the year 2016. To take advantage of the revenue opportunities from titled land, the ESGP envisaged that by 2017, Government would have commissioned a land titling programme starting in Lusaka and extending to the rest of the country in the medium-term. Announcements were made in 2018 by the Government that the issuance of 300,000 land titles would commence, but by the end of the year this registration had not yet started.

Concomitantly, in the last five years, only 10% of potential ground rent revenue was collected from registered land parcels. This has been inhibited by a number of factors including lack of publicity on who should pay the tax. Therefore, the registration of 300,000 new land parcels in a year (given the automated title printing processes) would still not bring in the expected gains, given the inefficiencies at MOLENR and if the citizenry still did not pay the tax. The strategy, therefore, requires more efficient land management and information systems as well as enforcement vigour at the MOLENR, while increased land titling should be pursued in a more realistic time frame.

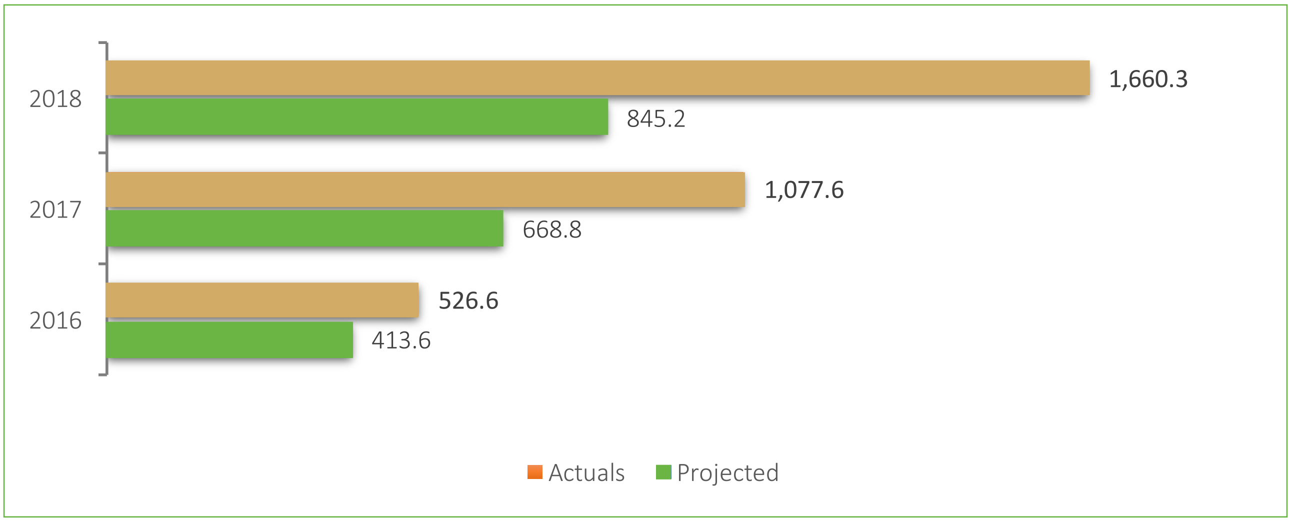
3.4 Increasing road tolling

Road tolling is considered globally as an effective means of boosting domestic mobilisation of resources to finance the maintenance of road infrastructure. In Zambia, the road tolling initiative is meant to augment the revenue base and ensure sustainable financing of roads. The ESGP aimed to accelerate the construction of toll sites across the country under the National Road Tolling Programme.

The Toll Act No.14 of 2011 was established to provide for the establishment and operation of road tolls while Statutory Instrument (SI) No. 73 of 2013, enacted on 7th August 2013, authorised operationalisation through charging and collection of tolls at toll gates and sites in Zambia. The sites include border posts, designated inland places and weighbridges. The SI listed 26 toll roads and 37 toll sites across Zambia. It also specified tolls for foreign-registered vehicles transiting through Zambia.

The performance of the road tolling programme has been above expectation. Figure 3.1 shows the total road toll collection for the period of 2016 to 2018, with actual revenues collected exceeding projected revenues.

Figure 3.1: Road toll collections, 2016-2018



Source: Ministry of Finance

In 2017, road tolls raked in K1.1 billion, at 61.1% above the target of K668.8 million, making it one of the best performing non-tax types. This was at a time when fuel levy (K778.8 million; 32.7% below target) and vehicle licence fees raised by RTSA (K416.6 million; 48.6% below target) underperformed. In 2018, the road tolls further showed a significant increase in collections which stood at K1.6 billion against an estimated target of K845 million.

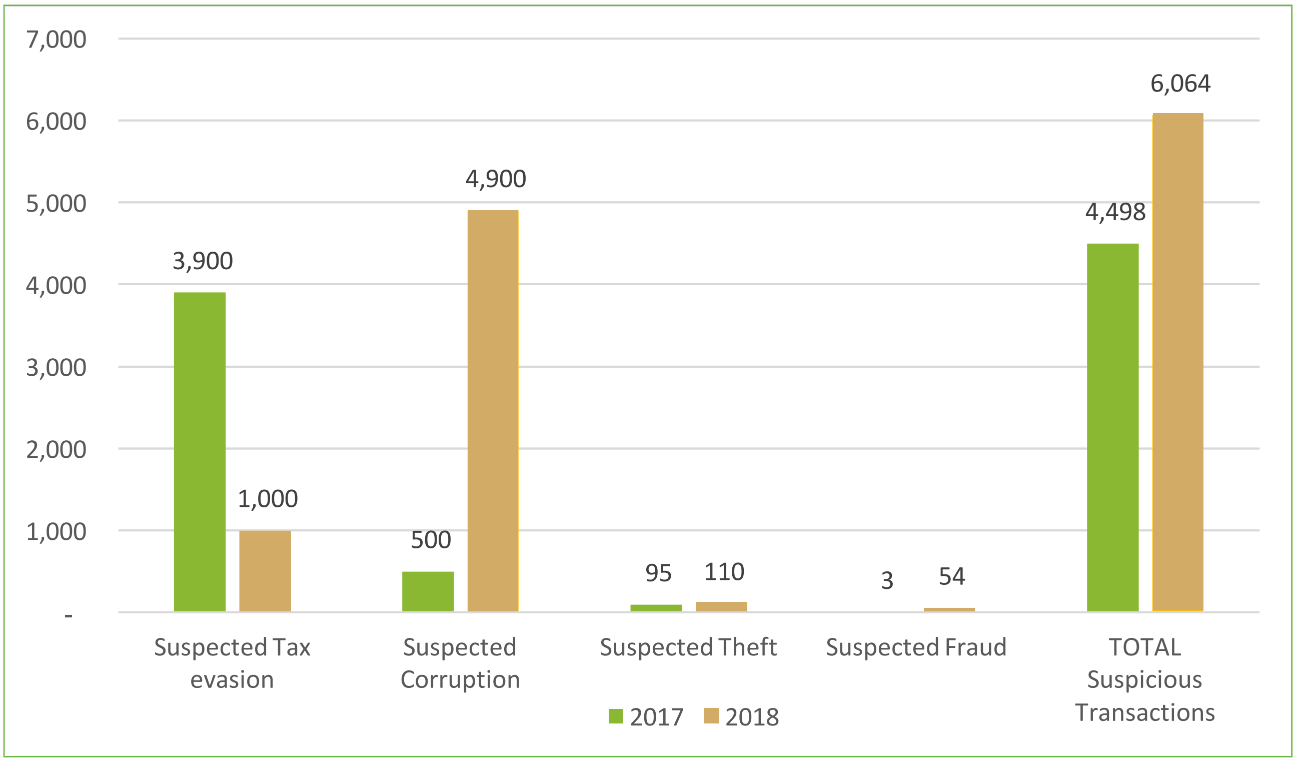
The over-performance of tolling fees was mainly attributed to the upward revision of the toll tariffs effected in 2016 and the increase in the number of inland toll points during the period. As at December 2017, there were 9 operational toll stations, 4 weighbridges and 8 port of entry collection points. The number of inland toll stations increased to 15 by end-December 2018, while the number of weighbridges and port of entry collection points remained unchanged. This revenue strategy is worth pursuing.

3.5 Stemming illicit financial flows

Illicit financial flows (IFFs) refer to illegal, unrecorded or wrongly recorded transfers of capital from an economy. Tax evasion stood out as a major global contributor (65%) to IFFs (United Nations Economic Commission for Africa, 2014), thereby undermining countries' fiscal spaces by denying governments and their financial sectors opportunities to enhance the mobilisation of public revenues.

IFFs continue to be a serious and growing concern for Zambia. Over the years, IFFs have potentially escalated in both magnitude and complexity, with significant implications for the country's fiscus. For instance, in 2017, the Trends Report of the Financial Intelligence Centre (FIC) flagged suspicious financial transactions covering tax evasion, fraud, corruption and money laundering. In combination, these amounted to K4.5 billion, with suspected tax evasion accounting for the largest amount of K3.9 billion (86%). The suspected illicit flows increased to K6.1 billion in 2018, largely as a result of a perceived increase in the value of suspicious transactions related to alleged corruption (K4.9 billion), while suspicious tax evasion reduced to K1 billion (Figure 3.2).

Figure 3.2: Estimated losses due to Illicit Financial Flows, 2017 and 2018, ZMW Million



Source: Adapted from Financial Intelligence Centre Trends Reports

The increase in IFFs as reported by FIC can partly be attributed to weak preventive and corrective (law enforcement) mechanisms and measures directed at curbing illicit financial activity, as well as the capacity limitations of ZRA in detecting certain types of tax evasion that are undertaken through sophisticated means. Some of the tax evasion cases analysed by FIC included false accounting, use of personal accounts for business, while some companies would externalise funds to their parent companies abroad and then receive the funds in form of loans to reduce their tax liability as interest on loans is a deductible expense.

To deal with the increasing trend in IFFs, the ESGP emphasised the need for the Government to collaborate with Cooperating Partners and other stakeholders that would work towards the development of appropriate laws and regulations to stem IFFs. In 2017, Zambia operationalised a currency transactions report threshold following the issuance of the Financial Intelligence Centre (Prescribed Thresholds) Regulation Statutory Instrument No. 52 of 2016. The statutory instrument requires reporting entities to report all transactions equal to or above US$10,000 in order to improve the ability to detect and prevent illicit sources and uses of cash. In 2018, the FIC was admitted to the Egmont Group of Financial Intelligence Units and can now exchange information with over 160 jurisdictions. This is likely to improve the effectiveness of the FIC in the execution of its mandate .

Strengthening institutional oversight of public limited companies including mines, through the securities markets, and improving transparency and accountability could increase revenues by 1-3% of GDP (Banda-Muleya & Nalishebo, 2018). Similarly, institutional strengthening of law enforcement wings and insulating them from the possibility of undue influence – for example, through strong technical assistance from law enforcement agencies from other jurisdictions that have an established track-record and reputation in fighting corruption, fraud, money laundering, tax evasion and so on – could also save the country billions of kwachas in illicit transaction losses and thus help to prop up the fiscus.

4 Conclusions and Recommendations

The assessment undertaken sought to understand how well Zambia fared in implementing the ESGP, particularly in terms of the 2018 National Budget. We evaluated the extent and nature of the Government's navigation of the path to fiscal fitness that is articulated in the ESGP. Among the key questions, we asked: what were the major milestones achieved and opportunities missed in implementing Zambia Plus? Did the Government's performance in implementing the ESGP leave Zambia on the path of fiscal sustainability?

Our assessment of the choices that the Government made regarding the raising of public resources and the spending of money under conditions of competing programmatic demands and interests, shows mixed outcomes in the success with which Budget resources were applied, particularly to strategies espoused in the ESGP. While funds were raised largely as targeted both in 2017 and 2018, the biggest issue remained that the funds were not spent wisely or optimally in line with the Budget and ESGP.

A number of improvements were observed at the start of the ESGP period (2017) as total expenditure declined. Noteworthy were the reduction in domestic arrears and a commitment towards funding social protection. In 2018, however, notable reversals were observed. For instance, total expenditure overshot the Budget target significantly, driven by high capital expenditure (infrastructure) and interest payments. This led to a higher than planned fiscal deficit on a cash basis and an even higher deficit on a commitment basis. Majorly this was on account of increased payment arrears. And adding VAT refunds to the outstanding arrears, the fiscal deficit stood at 17.9% of GDP on a commitment basis.

4.1 Summary takeaways

Overall, therefore, the Government's performance in implementing the ESGP was weak, reflecting insufficient progress in programme implementation. The weak implementation was seen in terms of below average performance on most elements, poor follow-through in sticking to the programme, lack of clear programmatic targets, and many contrary outcomes relative to what was planned. Granted, a few positive outcomes were observed, but these were marginal compared to the missed implementation opportunities.

A number of observations in relation to the EGSP's Pillar I on restoring budget credibility are worth recounting in summary.

Budget execution was epitomised by persistently larger than planned fiscal deficits on a cash basis, averaging about 7% of GDP per annum in the ESGP period. Generally speaking, the collection of revenues was above target; not so for expenditure. This was mostly due to higher than planned spending on debt servicing, agriculture subsidies and other transfers. Execution of the locally-funded component of the development budget performed better than the foreign-funded component as foreign-financed expenditure was often unpredictable as Cooperating Partners switched funding preferences; this resulted in high volatility in execution rates. Execution of recurrent expenditure was more favourable than the execution of capital expenditure. On the whole, the ESGP failed to bring about effective budget execution.

Annual budgets are, in practice, purely annual budgets with weak links to sectoral policies and plans as well as medium term spending frameworks. With evidence of disquieting disparities between the annual Budgets and the MTEF (ZIPAR 2017a), it is clear that the capacity to translate policy priorities into the budget, and then to ensure conformity of actual expenditures with the budget, depends in large part on the strength and autonomy of public institutions to keep within the Budget. To a large extent this has been difficult to implement in Zambia, further eroding already weak Budget credibility. The macroeconomic projections and targets seem to be taken as simple forecasts of trends in macroeconomic variables and yet they should be viewed as stringent (and in Zambia's case rigid) anchors of public policy. The annual budgets therefore, must be framed within a sound, rigid and binding medium-term macroeconomic framework to ensure they adhere to continuity in the medium term and strengthen the multi-year perspective of planning and budgeting.

Zambia faced a growing payment arrears problem, despite the good intention to dismantle the arrears. The accumulation of arrears intermittently reduced in 2017, but escalated in 2018 despite an interim pay-out of K4.5 billion during the year. The Government therefore accumulated considerably higher new arrears in 2018. Thus, while the Government tried to dismantle arrears, it did not deal with the root causes of their accumulation. Additionally, the habit of constantly viewing the fiscal deficit on a cash basis instead of on a commitment basis does not take into account payment arrears and floating debt that the Government accrued. This made the debt problem seemingly smaller. Therefore, the dismantling of arrears was not resolved as stated in the ESGP, a status quo that will remain until a comprehensive strategy to deal with the root causes and full cost is put in place.

Personal emoluments were contained within the expenditure and domestic revenue targets in the ESGP. Even though the Government's wage bill was the single largest expenditure item for some time, eroding fiscal space for funding other developmental programmes, in 2017 and 2018, the Government managed not to breach the set wage ceiling of 9% of GDP.

FISP and FRA subsidies were reduced. The streamlining of FISP to scale back expenditure happened as a result of the clean-up exercise of the ghost farmers and duplicated beneficiaries as well as the stricter application of the eligibility criteria during the ESGP. The reduction in expenditure in FISP was expected to create some fiscal space for the Government to channel these resources to other needy areas such as social protection, that could better reduce rural poverty. However, the funds were not channelled to social protection activities. On a positive note, FISP managed to create more private sector participation in agriculture through increased maize storage quantities and more agro-dealers investing and participating in the programme. On the other hand, the greater-than-targeted strategic reserve stock of 500,000MT maintained by FRA imposed a drain on the Government's financial resources and increased payment arrears to be paid through FRA.

Overall, the implementation of the ESGP's transparency and accountability tenets had considerable challenges. While the ESGP reflected a

Box 3: Key components of an arrears clearance strategy

The strategy for clearing arrears should have the following components:

a) Stocktaking: Accurate arrears data are needed to illustrate the scale of the problem, and for designing the clearance strategy to the nature of the arrears. Further, a definitive survey limits the risk of undisclosed arrears emerging later in the process. An incomplete assessment may result in creditors pursuing recognition of their claims through the courts, with the potential for delaying the clearance process and increasing the cost.

b) Verification: After taking stock of arrears, an audit should validate the accuracy and credibility of the claims. The validation process is intended to verify the documentation and transactions supporting the claims, and ensure that costs are legitimate and have not been inflated, fraudulently claimed or previously settled. The validation process could also help verify whether the transaction was conducted within or outside the normal procurement chain.

c) Classification: To allow for appropriate categorisation, a variety of data should be captured for each claim. These include the payment due date, enabling analysis of how long payments have been overdue; the total amount due, including amounts paid to date; the agency responsible for incurring the payment arrear; the contractor, institution or employee who is owed money and the currency in which the obligation is denominated. Each claim should be classified as to whether it relates to personal emoluments, goods and services, debt servicing, transfers, construction works etc. Further, an assessment of the consequences of further payment delays, e.g. incomplete project or legal action, need to be undertaken.

d) Prioritisation: A set of criteria for prioritising the liquidation of arrears should be determined. The prioritisation should be based on transparent criteria, which might include: socioeconomic impact - arrears of payments to vulnerable sectors having priority; vintage - older obligations should get preference; cost - arrears that accrue penalties and interest should be settled early; risk - arrears that threaten legal action, disruption of services or supplies should be prioritised; and currency - foreign denominated debt should be cleared where the exchange rate may deteriorate.

e) Liquidation: Agreeing upon a liquidation policy is a key element of an arrears strategy. The liquidation policy will consider whether legitimate claims would be honoured in full or in part; determine the form of financing and timeframe for settlement; and the responsibility for administering payments.

Source: International Monetary Fund (IMF) (2014). Public Expenditure Review Study on the Prevention and Management of Payment Arrears clear focus on promoting accountability, it did not possess any explicit practical mechanisms for transparency. It did not commit to a regular or periodic public provision of information on implementation and programmatic performance. Moreover, several aspects where progress was limited were within the control of the fiscal authorities; an example of this is the incomplete review of the legal fiscal framework. Another is the stalled implementation of austerity measures that would have otherwise curbed infrastructure spending. Further, the delayed rollout of the Integrated Financial Management Information System to prohibit spending outside the system and curb arrears in the early part of 2018 may have compromised efficiency, transparency and accountability. The intended impact of the roll out of the Treasury Single Account – to reduce borrowing costs – remains to be seen as borrowing costs continue to escalate.

In relation to Pillar II on enhancing domestic resource mobilisation and refocusing public expenditure, the following points are noteworthy:

Mixed outcomes on the domestic resource mobilisation measures espoused in the ESGP. While the modernisation and automation of revenue collection methods led to increases in the revenue base, the strategy to tax the informal sector seems not to have been viable because of the high administration costs involved in administering the tax. Property taxes appeared to be the more lucrative option for domestic resource mobilisation, but there was need to strengthen collection mechanisms in order to realise the necessary revenue. The performance of road tolling initiatives on the other hand, showed positive strides in fostering collections. Lastly, illicit financial flows continued to bleed productive resources out of the economy, and limiting them through stricter legislation and enforcement could potentially increase tax revenues.

Refocusing of public expenditure in the ESGP recorded limited success in stemming spending deviations relative to Parliamentary appropriations. The activities that could have been rationalised and/ or delayed in order to take the pressure off the Treasury were largely implemented as business as usual with little or no support to priority and growth areas. New districts were still created but at the cost of social sector expenditure in health, education, social protection and others. Ultimately, the refocusing tenets in the ESGP did little to restore Budget credibility.

4.2 What should be done?

The Government needs to improve in-year monitoring of budget execution. The budget execution process normally operates at two levels – at the line ministry/agency level and at the Ministry of Finance. The Ministry of Finance, in partnership with the Ministry of National Development should improve in-year monitoring and evaluation, by strengthening oversight on budget execution with all public sector institutions reporting to the Ministry of Finance on a quarterly basis. Not only will transparency be improved but early warning signs of budget deviations will be detected based on these reports. These systems and mechanisms will help identify those programmes and spending areas at highest risk of poor budget execution and implement financial management controls at the ministry/agency level and strengthen budget monitoring and execution for the Government as a whole. It is appreciated that there is already an internal monitoring mechanism which culminates into budget variations and/or supplementary budgets. However, an analysis of budget estimates, supplementary budgets and the actual audited expenditure shows that supplementary budgets are, in most cases, unjustified.

The Government should devise a systematic and comprehensive framework for paying off arrears. To address the problem of arrears, the Government needs to devise and publish a medium-term arrears payment strategy that could be embedded in the MTDS, which is currently silent on the issue of dismantling arrears. The proposed new arrears framework should incorporate the tenets outlined in Text Box 3. This will also inform the formulation of more reliable deficit financing policies and strategies.

Further limit the wage bill growth. Aside from the measures mentioned in the ESGP and mid-2018, additional measures to limit the wage bill growth include: extending the limitations on the maximum size of delegations that travel overseas, as well as the length of stay abroad beyond those SOEs and statutory bodies that are making losses; strengthening public financial management systems in order to effectively remove ghost workers from the payroll, as indicated by the Minister of Finance; and finding the political will to uphold policies that seek to suspend the creation of new public institutions whose payrolls are constitutionally protected, thus increasing the pressure on the Treasury.

The need for recruitment of frontline staff in key developmental areas cannot be done away with completely. However, Government should uphold policies that seek to suspend the creation of new public institutions that produce a permanent public sector staffing requirement, especially public institutions that are not of a frontline nature (education and health facilities) but of an administrative nature; for example, the creation of new districts, commissions, and ministries. All these tend to increase the pressure on the Treasury. And once created, the salaries of the employees in these institutions are constitutionally protected and must be honoured.

Replace the poorly targeted, FISP and FRA with well-targeted (social protection or poverty alleviation) subsidy programmes. Government should significantly scale back funding for FRA and FISP, which do not benefit the majority poor sub-populations as much as casual observers might claim. These should be increasingly replaced with social protection programmes, which are better targeted and more effective in reaching specific poor sub-groups of the population. Refocusing support away from FISP and FRA toward other social protection such as upscaling the Social Cash Transfer and the School Feeding Programme will have far greater long-term impacts in reducing poverty. To ensure growth in the agricultural sector, the Government needs to channel more of its agricultural budget on research and development, irrigation development, soil improvement and livestock farming.

The authorities should continue pursuing the domestic resource mobilisation strategy. Alongside the already stipulated strategies, the Government should also pursue mechanisms that ensure that the citizens are equipped to use the automated and modernised systems. To further improve informal sector taxation, indirect taxation of the informal sector through consumption taxes, as well as import and export duties would be a more effective channel to collect the much-required resources. The Government also needs to seal off all the leakages that have arisen through inefficient collection methods of property taxation. To boost road toll collections, automated collection systems should be initiated to improve service speed, thereby eliminating traffic jams and delays at the tolls. Additionally, road tolls paid by companies should be made non-deductible for income tax. And finally, to curb illicit financial flows, it is necessary to strengthen not only institutional oversight, but also strengthening of law enforcement wings and insulating them from undue influence – potentially with strong technical assistance from agencies from other jurisdictions that cannot be easily influenced themselves.

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