A REVIEW OF THE PERFORMANCE OF THE 2021 FIRST SEMESTER BUDGET

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October 2021

1. Introduction

Zambia's 2021 National Budget is being executed under the theme, "Stimulate Economic Recovery and Build Resilience to Safeguard Livelihoods and Protect the Vulnerable." During the budget planning process the COVID-19 pandemic took a heavy toll on economic activity that led the economy to contract by 3% in 2020. This is on the back of the economy having already being vulnerable to external shocks due to its structural weaknesses. Therefore, in line with aspirations to stimulate economic recovery, the 2021 National Budget set the growth target at 1.8%, underscoring a strong desire to crutch the economy to its recovery.

The Budget proposed a number of measures which included revenue and expenditure proposals aimed at: narrowing the fiscal deficit to 9.3% of gross domestic product (GDP) from a projected outturn of 11.7% of GDP in 2020; reducing the inflation rate towards the 6-8% medium target; and increasing Gross International Reserves to at least 2.5 months of import cover.

The following is a fact check on the mid-year budget performance. The brief offers insights into the expenditure and revenue performance of the National Budget against targets, the status and the growth trajectory of the Zambian economy. Further, the brief shows the credibility of the budget, the effects of the various policies that have been proposed by the Government, and identifies areas that still require interventions.

The rest of this brief is structured as follows: Section 2 presents the macroeconomic performance in the first half of the year; Section 3 presents the review of revenue performance in the first half of the 2021 Budget; Section 4 provides a review of the expenditure-side budget performance; Section 5 analyses the fiscal deficit and deficit financing in the first half of the year; and Section 6 concludes the analysis and provides some recommendations.

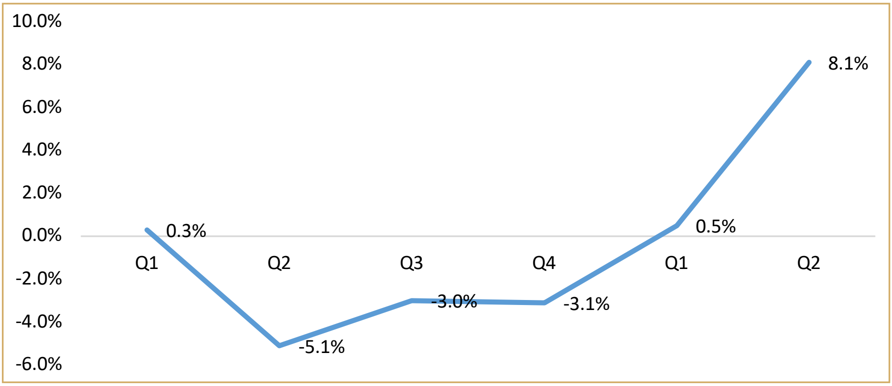
TEXT BOX 1: PUBLIC DEBT AND ECONOMIC GROWTH

Literature suggests that high public debt has a negative bearing on investment and growth via heightened long-term interest rates, inflation, and a general constraint on fiscal policies, which may lead to increased volatility and lower growth rates. For instance, a study was conducted using data for 44 countries, and it was found that across both advanced and emerging economies, high debt-to-GDP levels (90% and greater) are associated with notably less growth. Countries with debt-to-GDP ratios greater than 90% have median growth roughly 1.5% lower than that of the less-debt-burdened groups and mean growth almost 3% lower (Reinhart & Rogoff, 2010).

2. Macroeconomic Performance

The economy has been faltering over the past few years. This is due to the macroeconomic instabilities stemming from high public debt (See Text Box I). Exacerbated by the COVID-19 pandemic, the country recorded a negative GDP growth of 3% in 2020. In a turnaround, the economy in the second quarter of 2021, grew by 8.1%, which is a 13.2 percentage points increase from the -5.1% recorded in the same period of 2020 (**Figure 1**). The growth in the second quarter is on account of positive performance from industries such as: construction; information and communication and; education (ZamStats, 2021).

Figure 1: GDP Growth at Constant Prices, 2020 - 2021:Q2



Source: ZamStats

Inflation has continued on its upward trajectory. As at end June 2021, inflation was reported at 24.6%. The main driver has been food price increases leading to an overall increase in the cost of living in Zambia. Further, the import dependency and the resultant pass-through effects of the depreciation of the kwacha has contributed to the rise in inflation. The kwacha continued to lose value against major trading currencies, depreciating to K22.6/US$ in June 2021 compared to K17.98/US$ which was reported in June 2020.

3. Revenue Performance

In its 2021 National Budget, the Government proposed to collect domestic revenue of not less than 18% of GDP. This higher target was informed by policy measures which included innovative technological tax solutions, enforcement and stiffer penalties on tax evaders, improved use of tax administration data in analysis and segmentation, and use of local authorities as agents of tax collection in the informal sector. In the 2021 Budget analysis, ZIPAR argued that these measures will work to ensure that the revenue base is protected from actions that tend to shrink the Treasury's collections (ZIPAR, 2020).

During the first half of 2021, total revenue and grants overperformed compared to targets, and to collections in the first half of 2020, which were severely hit by the COVID-19 pandemic. Total revenue and grants amounted to K50.8 billion against a target of K34.7 billion representing an overperformance of 46% as shown in Table 1. Tax revenue collections over the same period were projected at K26.9 billion, while the actual collections stood at K33.7 billion. The tax revenue stream contributed more than 67% to total revenues. The over performance of tax revenues was on account of income tax collections that were 38.2% above target. The higher collections on income tax was driven by payment of tax arrears, upward amendments of provisional returns and advance payments by both mining and non-mining firms, and increased high payments compliance by Government institutions.

Non-tax revenue collections for the first half of the year were pegged at K3.3 billion, but actual collections were recorded at K3.8 billion, which was 14% above the approved figure. This was mainly driven by over-collection of mineral royalties which was on account of higher global copper prices. Copper prices are rallying due to the increased demand of the metal in the manufacture of electric cars, infrastructure development and scaling renewable energy (Weizhen , 2021). Further the depreciation of the kwacha has also contributed to the over performance of mineral royalties, because the mines remit the mineral royalty receipts in US dollars, which are subsequently converted to the kwacha.

Grants which are a key component of donor financing, were below target by 59%, against a revenue target of K496.6 million during the first half of 2021. This is similar to the underperformance in the first half of 2020, in which grants were below target by 65%. However, it should be noted that most donor support has merely moved to off budget expenditure programmes in health, education and social protection rather than direct budget support.

Table 1: Revenues and Grants Performance, H1:2020 and H1:2021

	H1:2020			H1:2021		
	Projected	**Outturn**	**Variance**	**Projected**	**Outturn**	**Variance**
Total Revenue and Grants	33,964.1	32,242.9	-5.1%	34,670.2	50,676.0	46%
- Total Revenue	32,410.1	31,513.3	-2.8%	33,6771	49,923.0	48%
o/w Tax Revenue	26,779.6	24,036.8	-10.2%	26,956.4	33,776.2	25%
o/w Non-Tax Revenue	5,630.5	7,476.4	32.8%	6,720.8	16,146.8	140%
- Grants	1,553.9	729.6	-53.0%	993.1	752.9	-24%

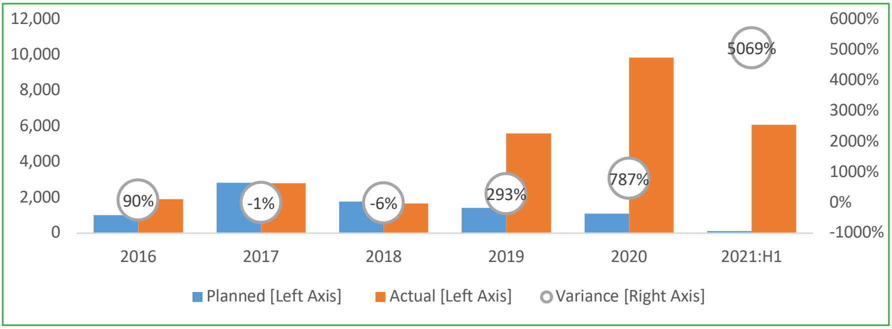
Source: MOF Fiscal Tables

4. Expenditure Performance

In the usual pattern that has characterised expenditure performance over the past years, Government has yet overspent in the first half of 2021, despite knowing very well the consequences of doing so. Total expenditure including amortisation (principal payments on public debt) was at K64.3 billion against a target of K57.7 billion, implying that the Government overspent by 11.4%. Further, total expenditure excluding amortisation was 32.2% over budget against a target of K47.8 billion. The higher than planned expenditure was on account of higher than planned disbursements on domestically financed expenditures which were above target by 40.1%.

Spending on the Farmer Input Support Programme (FISP) was set at K117.6 million while the actual releases amounted to K6.1 billion during the first half, representing an outrageous 5069% overspend. This shows that FISP accounted for 10% of total expenditure in the first half of the year. The higher than planned releases under the FISP in the first half of 2021 is similar to the performance in 2020 as shown in **Figure 2**. While the budgeted amount towards FISP has declined since 2017, the actual trend of the releases show the opposite. With more money going towards FISP spending, the Government will crowd out other central government operations such as spending on the social sectors which are highly underfunded. Furthermore, the increase in FISP spending has not really been effective to address stubbornly high rural poverty rates, and evidence shows that the programme is both regressive and ineffective.

Figure 2: FISP Spending, 2016 - 2021:H1



Source: MOF Fiscal Tables

Social sector spending was below budget in the first half of year. The Government had projected to spend K1.7 billion but only spent K1.5 billion. However, this shows an improvement compared to the releases in the first half of 2020. For instance, Social Cash Transfer (SCT) spending was projected at K1.3 billion but only K995 million was released during the first half of the year. Considering that 54.4% of the population are living in poverty and with such low disbursements, the Government risks not achieving its target of reducing poverty by 20% as espoused in the Seventh National Development Plan (7NDP) 2017 – 2021. Further the low and untimely disbursements risk the country not attaining its social protection related Sustainable Development Goals (SDGs).

Transactions in financial assets and liabilities stood at K6.1 billion against an approved target of K1.5 billion, representing an over expenditure of 308.0%. The over expenditure was as a result of higher disbursements on dismantling of arrears for suppliers of goods and services, fuel suppliers and disbursements on empowerment funds. The dismantling of arrears is commendable. This is because the accumulation of arrears weakens the private sector cash flows and has led to stress on the banking sector, with negative ramifications for growth. Further, the accumulation of arrears fades the trust of the public in Government and the efficacy of fiscal policy. The fiscal multiplier also declines when domestic spending is mostly financed through arrears and it can turn negative when the private sector faces high liquidity constraints, and in cases where there are long delays in clearing arrears (IMF, 2020).

Table 2: Expenditure Performance, H1:2020 and H1:2021

	H1: 2020			H1: 2021		
	Projected	Approved	Variance	Projected	Approved	Variance
Total Expenditure (Incl Amortisation)	50,301.5	46,802.5	-7.0%	57,686.1	64,290.3	11.4%
Total Expenditure (Excl. Amortisation)	44,314.4	41,633.7	-6.0%	47,800.2	63,094.9	32.0%
Personal Emoluments (PEs)	12,345.8	12,487.3	1.1%	14,350.2	14,767.3	2.9%
Use of Goods and Services	2,963.5	3,690.9	24.5%	4,010.9	8,106.8	102.1%
Interest Payments	10,162.1	9,124.8	-10.2%	14,352.8	11,514.1	-19.8%
Domestic Debt	6,143.7	6,134.5	-0.2%	9,368.4	10,121.5	8.0%
External Debt	4,018.4	2,990.4	-25.6%	4,984.4	1,392.6	-72.1%
Farmer Input Support Programme	45.0	115.2	156.1%	117.6	6,077.6	5069.5%
Social Benefits	430.5	602.0	39.9%	1,728.3	1,502.8	-13.0%
Social Cash Transfer	347.9	52.0	-85.1	1,308.3	995.9	-23.9%
Transactions In Non-Financial Assets	14,941.5	9,980.1	-33.2%	7,839.6	9,829.7	25.4%
Transactions In Financial Assets & Liabilities	450.0	1,427.7	217.3%	1,484.4	6,056.3	308.0%

Source: MOF Fiscal Tables

During the first half of the year, Government projected to spend K14.4 billion on interest payments for both domestic and external debt, but only spent K11.5 billion. Interest payments on domestic debt were projected at K9.4 billion but Government released K10.1 billion. This was on account of increased securities issued through private placements to finance the FISP and imports of petroleum products (BOZ , 2021).

Interest payments on external debt in the first half of 2021 were projected at K4.9 billion but only K1.4 billion was paid, representing an underspend of 72.1%. The huge variance on external interest payments was on account of the continued debt service suspension that the Government received under the G20 Common Framework (MOF, 2021). According to the World Bank Estimates, Zambia has avoided about US$540.2 million or 2.3% of GDP from the debt standstill (World Bank , 2021). However, the debt standstill has led the Government to accumulate external debt arrears amounting to US$1.5 billion as at end-June 2021of which US$1.0 billion were principal arrears (included in the debt stock), US$470.3 million were interest arrears and US$6.8 million other debt-related charges (MOF, 2021).

After missing the coupon payments on a Eurobond in 2020 which made Zambia the first African country in the Covid-19 era to default on its Eurobond debt, the Government has continued to default on some of its external obligations. The Government skipped a US$56.1 million coupon payment on 30 January 2021 on the 2027 Eurobond, and a US$20 million on its 2022 Eurobond in March 2021. With this succession of defaults, the Governments risks putting the country into dire stress through the manifestation of the following (Nalishebo & Halwampa, 2015):

- ***Creditor Lawsuits*:** Over the years, sovereign debt was assumed to be above the law and non-enforceable, which meant that the defaulting country was protected by the principle of sovereign immunity. But creditor lawsuits have now become a common feature of sovereign debt markets (Schumacher , et al., 2018). For instance, the Argentina Government was taken to court by hedge funds who litigated for full repayment of its debt following the default of US$82 billion in 2001. The Republic of Congo was forced to pay on its default for 20 years in August 2017, when a creditor convinced a New York court to freeze a bond coupon payment to other bondholders. From the above, it is evident that if the authorities continue in this trajectory of defaults, it is highly likely that creditor lawsuits will be the order of the day in subsequent years and will affect future borrowing.
- ***Exclusion from Capital markets*:** A default triggers a downgrade on the credit ratings of a nation, as witnessed by recent reclassification of Zambia's Eurobonds to default by Fitch and Standard & Poor's (S&P). Therefore, the prospects for offshore borrowing from international markets will be limited, as investors will now perceive the country to be at high risk of defaulting.
- ***Effects on the Domestic Financial Sector:*** A default on public debt triggers a series of reactions in the domestic financial sector, such as a reduction in Foreign Direct Investment (FDI) inflows. Investor uncertainty over the country's defaults will further weaken the kwacha, which may induce a second round of effects including higher import prices, added pressure on inflation, lowered domestic value of remittances and more expensive external debt service.

5. Deficit and Deficit Financing

The fiscal deficit on a cash basis was projected to be 9.3% of GDP for the fiscal year 2021. During the first half, total revenue and grants amounted to K50.6 billion and expenditures excluding amortisation stood at K63.1 billion. This translated into a fiscal deficit of K12.5 billion representing 3.4% of GDP. However, the lower than planned fiscal deficit, is as a result of expenditure cuts arising from the debt standstill. In the irregular circumstances of the debt standstill, the Government could arithmetically meet its fiscal deficit target.

In order to finance the deficit, the Government relied more on the domestic market as shown in Table 51. According to the Bank of Zambia (BOZ), the increase in demand for domestic securities is reflected by the high yield rates and improved investor sentiments following the credit rating upgrade by Fitch in April 2021. This then attracted non-resident investors who accounted for about 70% of total Government securities (BOZ , 2021). As a result, domestic, domestic borrowing was at K10.8 billion against a projected figure of K6.3 billion.

In terms of financing the deficit from external sources, net external financing was below target by 96.2% against a budgeted figure of K6.8 billion. Amortisation on external debt was under budget by 89.4% partly due to the debt service suspension/standstill on all creditors except the multilaterals and few creditors disbursing towards priority projects in social and economic sectors.

Table 3: Financing the Deficit, Q1 2020 and 2021

	H1: 2020			H1: 2021		
	Approved	Outturn	Variance	Approved	Outturn	Variance
FINANCING	9,910.5	10,894.2	9.9%	13,129.9	14,117.2	7.5%
- Net domestic financing	2,781.2	7,086.6	154.8%	6,327.4	10,780.8	70.4%
Domestic financing	2,796.9	8,950.9	220%	6,327.5	10,931.2	72.8%
Amortisation	(15,860)	(1,864.3)	11654.9%	-	(150.3)	∞
- Net external financing	7,129.4	3,807.6	-46.6%	6,802.6	3,336.4	-51.0%
Programme	-	-	--	10,857.7	-	-100.0%
Project	13,100.7	7,112.1	45.7%%	5,830.8	4,381.4	-24.9%
Amortisation	(5,971.2)	(3,304.5)	-44.7%	(9,885.9)	(1,044.9)	-89.4%

Source: MOF Fiscal Tables

6. Conclusion and Recommendations

For over a decade, Zambia's growth prospects have been faltering, and the economy in 2020 went into a recession as a result of the COVID-19 pandemic, despite the economy being already vulnerable due to its structural weaknesses. Alongside this is the massive accumulation of external debt, which has pushed the economy into debt distress especially in the COVID-19 pandemic era. Consequently, this has impacted on the Government's ability to respond to the devastating effects of the pandemic on the economy and livelihoods.

The medium-term outlook for the economy is therefore gloomy and will require Zambia to re-orient its strategy. For a long time now, the country has been pursuing an expansionary fiscal policy path that has been characterised by widening and perpetual fiscal deficits. In order to cover the deficit, Government has resorted to massive external borrowing that has not yielded the required economic growth, nor has it resulted in a sustainable and resilient economy.

In order to gauge the performance of the 2021 Budget, we undertook the above analysis and the following are the main takeaways:

(i) **Revenue and grants were above budget:** Total collections of Revenues and Grants for the first half of 2021 amounted to K50.6 billion and were 46 percent above the approved budget target of K34.7 billion. Tax Revenue accounted for K33.8 billion, Non-Tax K16.1 billion and K753 million was from grants. Based on the analysis, the Government is on its way to achieving its revenue target for 2021. Of the 18% of GDP projected to be collected, 13.4%[1] was collected by the end of the first half of the year.

(ii) **Expenditure was higher than planned:** Expenditures for the first half of 2021 were projected at K57.7 billion but amounted to K64.3 billion. The higher than planned expenditure was as a result of higher expenditures on other liabilities and capital projects in 2021.

(iii) **The Government is on course in achieving the fiscal deficit target**: The fiscal deficit for the first half year was recorded at 3.4% of GDP. This is was on account of many issues including the debt service suspension that the Government has received. Therefore, if the Government continues in this trajectory, it will be on course to achieve the target of 9.3% of GDP.

In view of the above, we provide the following recommendations.

1 Using a GDP Figure of K366.8 billion.

(i) **Utilise savings from the DSSI in productive sectors:** As stated above, the World Bank estimates that Zambia has saved around US$540.2 million from the debt service stand still which is equivalent to K8.6 billion[2]. Therefore, the Government should use the money in key productive sectors that will be able to boost the economy and create more fiscal space. In addition, if the savings are used more efficiently, the Government can use the money to redeem the US$750 million Eurobond that is maturing in September 2022.

(ii) **Rationalise and contain spending towards FISP:** FISP has been one of the key drivers of budget overruns. In 2020, spending on FISP was 787% above the projected amount of K1.1 billion, and the first half of 2021 shows a continued trend. The rise in the expenditure has notably been due to the high costs of importing the farming inputs stemming from the depreciation of the kwacha and also administrative inefficiencies. In this regard, we propose that all farmers under the Direct Input Supply (DIS) system should be fully migrated to the e-voucher system, as this will improve institutional arrangements and targeting. Though this is a purely administrative measure, we also recommend that it is backed by legislation. The e-voucher will work out to be cost efficient for the Government, because all logistical costs are met by the agro-dealer, whereas the DIS has logistical costs that have to be borne by the Government. This is a short and medium term measure.

In the long term Government should focus on comprehensive reforms to the program of supporting farmers which will promote efficiency and commercialisation of agricultural activities. Government should therefore consider strengthening market based systems for farmers to access inputs, capacity building training and marketing their commodities.

(iii) **The Government should continue dismantling domestic arrears:** The Ministry of Finance needs to devise an arrears clearance strategy with a phased approach of how the arrears will be dealt with in the short to medium term. The Government should first make a comprehensive assessment of the scale of the problem by taking stock, after which the stock of arrears will need to be verified, and categorized according to type (goods and services, debt servicing, transfers, etc.); the payment due date to determine how long payments have been overdue, and consequences

2 Using the daily exchange rate of 15.8/US$ as at 31.8.12

of further payment delays. The Government should then set a criteria for the liquidation of arrears and a policy that will consider whether legitimate claims would be honored in full or in part, the form of financing and timeframe for settlement and the responsibility for administering the payments. Further, the Government should consider a mutually agreeable arrangement between themselves and the private sector players who are owed refunds. For example, arrears can be offset against existing or future tax liabilities.

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