ZIPAR
Zambia Institute for Policy Analysis & Research
Working towards the formulation of sound economic policies

TRANSFORMATION THROUGH INCLUSIVE GROWTH: ACHIEVING A BALANCED RECOVERY

Analysis of the 2022 National Budget
November 2021

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READER'S DIGEST

Zambia's 2022 National Budget was launched on 29th October 2021 as the inaugural budget of the newly elected United Party for National Development Government. The Budget comes in the wake of weakened economic performance and mounting socio-economic hardships underpinned by the adverse effects of the COVID 19 pandemic over 2020-2021 and prolonged domestic policy misalignments, particularly in fiscal and debt management policies.

Nonetheless, the 2022 Budget takes a markedly expansionary fiscal stance. At K173 billion, it is 45% larger than the 2021 Budget, in nominal terms. Our analysis of the key fiscal and macroeconomic priorities, debt management and international financing relations, the real sector policy issues and governance pronouncements of the 2022 budget are summarized below along with selected key recommendations for the consideration of the authorities:

- Towards good governance at the local level, the 2022 Budget seeks to take development closer to the people by, among other things, increasing the Constituency Development Fund (CDF) by 1,500% from K250 million in 2021 to K4.0 billion in 2022. An expenditure devolution of such magnitude should be implemented programmatically with comprehensive and cascaded development plans and local implementation strategies, clear monitoring and evaluation systems, and aggressive regulatory reforms, underpinned by a review the CDF Act No.11 of 2018.

- To restore central level good governance, the 2022 Budget proposed to amend a number of commendable key legal and institutional reforms to resolve widening fiscal deficits, rising debt and lingering macroeconomic instabilities. However missing from the reform menu are: the inclusion of fiscal rules in the Planning and Budgeting Act (2020); the establishment of greater transparency and accountability in domestic debt contraction through, for instance, publishing records of private placements of Bonds for public scrutiny; the establishment of a stolen public asset recovery programme; and the establishment of a comprehensive expenditure rationalization programme across the public sector.

- On the macroeconomic front, the real GDP growth rate target for 2022 is set at 3.5% while the inflation target is to reduce inflation to single digit in 2022. Given the expansionary 2022 Budget, which seeks to transform and reboot the economy, inflationary pressures are likely to increase, particularly if the fiscal expansion will not be matched by increased domestic food supply.

- The fiscal expansion is anticipated to be supported by the good fortune of equivalent of US$1.33 billion in Special Drawing Rights from the International Monetary Fund. However, using this injection to introduce additional recurrent expenditure items such as personal emoluments, raises serious sustainability concerns beyond 2022.

- The 2022 Budget also proposes measures for enhancing domestic resource mobilization, but our estimates indicate that the various tax measures will result in an estimated net reduction of 5.9% (revenue loss of K4.6 billion) in tax revenues; this raises concerns about the extent to which the generous tax concessions will enhance growth and compensate for the revenue loss.

- The Government aims to limit domestic borrowing in 2022, but will do well to mind the feasibility of this, given the likely inertias and high propensities for fiscal slippages in the fiscal system which were inherited from the recent past. Getting rid of the vices and purging the fiscal system of past institutional weaknesses will require a structured and comprehensive institutional reform programme.

- Regarding agriculture, in the 2022 budget, the allocation to FISP will remain high at ZMW5.4 billion, expeditious FISP reforms will be crucial.

- In tourism, commendable measures to diversify tourism packages across the country are anticipated in 2022, which are likely to increase the average length of stay of international tourists. But critically, Government must demonstrate political will to finally implement a single licensing system and a two-tier system to promote domestic tourism.

- With ambition to ramp up production of copper in the long-term to three million metric tonnes in 2032 from 837,996 tonnes in 2020, in 2022, the Government intends to harness opportunities for greater beneficiation and participation in global value chains; by establishing a stable and predictable mining tax regime. The Government will do well to establish legal and institutional mechanisms for this, which eliminate risks of policy reversals.

- The 2022 National Budget envisages supporting the growth of small and medium enterprises through decentralization, which is commendable. However, in local level administration of empowerment funds, the Government must foster the undertaking of vetting of borrowers, monitoring and recovery of loans by an independent specialised institution to avoid high defaults. It must also ensure mechanisms to improve the capacity of SMEs, youths and women-led businesses to prudently utilise the empowerment funds and improve their capacity to produce quality and competitive products and services.

- On energy, the implementation of the Renewable Energy Investment Plan is essential for fostering increased private sector involvement in renewable energy power generation for small and medium scale projects of up to 20 MW. The establishment of a legal and regulatory framework will be necessary in 2022 for governing the renewable energy sector.

- The 2022 Budget has pronounced plans for leveraging private sector financing for infrastructure development, harnessing Information and Communication Technology (ICT), supporting climate change adaptation (including through green bonds), etc. All these programmes will require the establishment or strengthening of related legal and institutional frameworks.

- In the social sector, it will be important to mind the quality gaps in the quest to deliver free education for all. Thus, the free education initiative must be supplemented with a robust medium-term strategy to revive Zambia's education system and improve the quality of the education delivered.

- Arming the health sector for the battle against COVID-19 will require, beyond the recruitment of 11,200 health workers, the development of a medium-term strategy to recruit even more health workers so as to address the deficit that will still remain after 11,200 hires.

Contents

1 INTRODUCTION

The Zambian National Budget for the year 2022 was announced by the Minister of Finance on 29th October 2021. This marked the first Budget of the newly elected United Party for National Development Government following the August 12, 2021 national election. As such, this represented the first formal statement of the new Government's economic policy.

The presentation of the National Budget comes against the background of deteriorating economic performance, compounded by the global COVID-19 pandemic over the preceding 2 years. The economic malaise was manifest in high inflation, falling output and unstable exchange rate. Additionally, there was widespread social malaise with rising levels of unemployment and a rise in poverty.

It is against this background that the new government had to make drastic economic decisions to attenuate the macroeconomic instability, mitigate social hardship and set the country on a new trajectory of economic transformation. The stagflationary situation required a careful analysis and choice of trade-offs.

It is within these limitations that Honourable Dr. Situmbeko Musokotwane, MP, Minister of Finance and National Planning, presented the 2022 National Budget. Our first reading of the Budget suggests to us that this was a bold and cautiously optimistic Budget dealing with the need to restore stability in the economy and promote economic growth in an inclusive manner.

What is striking, is that the Minister unveiled an expansionary Budget of K173 billion that is nearly 50% larger than the 2021 Budget estimated at K119.6 billion, under the theme: '**Growth, Jobs and Taking Development Closer to the People**.' However, if this will be an eon of balanced growth, the judicious implementation of the 2022 Budget is important for all meaningful Zambians. While the Budget contains many transformative ideas, it is important to zoom in on the areas where caution is imperative and what those specific details means for the people the Budget is meant to serve, and for the whole economy.

This paper therefore analyses the 2022 National Budget under the theme: '**Transformation through Inclusive Growth: Achieving a Balanced Recovery**'. The paper present insights into the key fiscal and macroeconomic priorities, debt management and international financing relations, the real sector policy options to stimulate the balanced and green recovery of the economy and taking development closer to the people. The paper also gives pointers for strengthening the governance environment for effective budget execution and for sidestepping the perils of the ambitious decentralisation programme.

2 FENCING THE GARDENS TO NURTURE GROWTH THROUGH GOOD GOVERNANCE

Good governance is a core attribute of the social and economic development process. Through right policies and appropriate institutions Government can influence a country's level of economic freedom, ensure security of property, support the enforcement of contracts and foster the rule of law, guarantee civil liberties and inclusivity in decision making, and attract investment inflows all which are critical to provide for greater economic performance. The critical elements of governance of interest in this Budget include decentralization as one of the biggest reform agenda expressed through the unprecedented allocation to the Constituency Development Fund (CDF). Also, of interest are some key reforms institutional and regulatory reforms of Central Government aimed at securing public finances and investments.

2.1 Decentralization: Government's biggest fiscal experiment

The astronomical increase in the allocation to the CDF in the 2022 Budget is perhaps the most significant public service reform of recent times. It is a striking departure from the past. The reform is a translation of the desire of the Government to promote "Growth, Jobs, and Taking Development Closer to the People.". But the push to bring development closer to the people through decentralization of Government functions is not new though it often lacked political will.

The 1,506% increase in the budgetary allocation to CDF from K250 million in 2021 to K4.0 billion in 2022 is a huge experiment, which must be implemented with caution. It will place onerous performance demands on councils' systems of administration most of which have weak public finance management capacities. The Auditor General's reports on accounts of councils for the 2015, 2016 and 2017 financial years show some glaring audit queries in some councils. The sudden and huge jump in the allocations to CDFs without first addressing the public finance management councils is setting the well-intended programme to disappoint.

Further, the other existing structure through which CDF is managed, the Ward Development Committees (WDCs) and the Constituency Development Fund Committees (CDFCs) have previously often been enmeshed in financial irregularities and thus, subject of public scrutiny in the way they have managed the CDF allocations in the past. It is still unclear whether the accountability challenges faced by the WDCs and CDFCs have been decisively addressed.

It is a matter of concern however, that research has show that the current CDF Guideilines are inadequate. Despite this, CDF has been increased before the revision to the CDF guidelines.. Several cases of wasteful expenditures under CDFs have been documented. Consequently, it is imperative that CDF guidelines are revised to clearly state what is permissible and what is not with the funds.

Further, while the composition of the WDCs includes civil servants operating from the local areas, their capacities to interpret local area integrated development plans (IDPs) in the formulation of ward development plans becomes an issue of concern. Moreover, capacities to appropriately procure and monitor the implementation of public projects for cost, timeliness and value for money may not exist in some areas. Although the Budget made pronouncements about strengthening national planning, internal controls and audit as major areas of focus, it is in these very areas of focus where the flow of benefits of decentralisation may get bottlenecked with the hastened expenditure devolution of such high magnitude in the short to medium term.

This paper cautions that expenditure devolution of such magnitude should be implemented programmatically with comprehensive and cascaded development plans and local implementation strategies, clear monitoring and evaluation systems, and aggressive regulatory reforms. For this reason, we advise to quickly review the CDF Act No.11 of 2018 promulgated to provide guidance on the management and administration of the Fund, to reflect the increase in the allocations and the mandate of the CDFs to guard against wasteful expenditures and tie the selection of development projects to be funded to National Development Plan priorities and respective IDPs. Further, the Government should put in place sterilisation measure to avoid cumulation of the Fund at the constituency to quickly detect irregularities. Government is thus advised to release the funds to constituencies in tranches and based on their performance on the previous tranches.

2.2 Reforming the Centre to enhance the governance framework

Institutions play a critical role in creating an environment necessary for prosperity. The 2022 National Budget attempts to set a tone for people centred development, albeit this process must be accompanied by required legal and institutional reforms. It promises to promote the functioning of the private sector. This call emphasizes the President's inaugural speech during the ceremonial opening of the first session of the Thirteenth National Assembly on regaining trust, reducing uncertainty, and creating an environment for revenue generation.[1]

The 2022 Budget tries to advance key legal and institutional reforms to solve widening fiscal deficits, rising debt, and macroeconomic instabilities. In this view, the government intends to revisit some key pieces of legislation such as the Loans and Guarantees (Authorisation) Act (LGAA), with the view to further implement a strengthened and sound Public Finance Management. This move is good, but we strongly encourage the government to deal with illegitimate domestic debt acquired due to procurement loopholes. For example, for the allocated funds to dismantle accumulated arrears, we implore the government to conduct a detailed forensic audit in order to pay deserving suppliers of government goods and services.

Likewise, the amendment of the Planning and Budgeting Act (2020) should be considered towards the inclusion therein of fiscal rules (i.e., legally binding quantitative restriction on fiscal targets such as debt contraction and the fiscal deficit). This will limit the amount of discretion in debt contraction. And while an IMF programme will be a critical an anchor to the planned debt restructuring engagement and debt management in general, arguably, fiscal rules will be a more reliable anchor. Towards greater transparency and accountability in domestic debt contraction, past and forthcoming future private issuances or placements of Bonds should be published by BOZ for public scrutiny by stakeholders.

In addition, the Budget intends to progressively reduce fiscal deficits to sustainable levels through, *inter alia*, expenditure rationalization measures. Other than the measure to migrate beneficiaries under the Farmer Input Support Programme to a cheaper Comprehensive Agriculture Support Programme, few expenditure rationalization measures are pronounced. Bearing in mind that the 2022 Budget takes an expansionary fiscal stance, with a 46% increase in the nominal total budget, risks of continued fiscal indiscipline, particularly given a public system that was embattled with bad habits of wasteful spending, misappropriation, and corruption over a prolonged period of 8-10 years are high. A comprehensive public expenditure rationalization reform programme or agenda across all Ministries, Provinces and Spending Agencies is recommended, starting in 2022.

Regarding the revision of the Loans and Guarantees (Authorization) Act, our wish is that this process will irrevocably grant parliament the final authority on debt contraction as opposed to situations where the National Assembly's oversight function is limited to approving debt ceilings and the Money Bills.[2] Further, the scope of public debt needs to be widened in the Act to include

1 President's speech to the National Assembly https://www.parliament.gov.zm/node/9472

2 In 2020, ZIPAR conducted a study on legal framework governing public debt management. See https://www.zipar.org.zm/download/legal-framework-public-debt-management/

debt acquired by State-Owned Enterprises (SOEs).[3] Also, this should be aligned with other pieces of legislation such as Public Finance Management Act, 2018 and the Constitution No.1 of 2016. To further strengthen key legal frameworks, especially around debt management, we are of the view that the government should have provisions on the preparation of a Medium-Term Debt Strategy (MTDS) explicitly stated in the primary legislation for debt contraction, and should be backed by the law. This is importance because it will help government on borrowing plans in the medium-term to avoid risks from both domestic and external markets.

Furthermore, the 2022 National Budget promises increased allocation to law enforcement agencies and investigative wings. This is a welcome development as it will help institutions such as the Anti-Corruption Commission, Drug Enforcement Commission (DEC) and Financial Intelligence Centre (FIC) to effectively carry out their mandates of protecting public funds and offices. But beyond these financial allocations, there is need to capacitate these institutions with adequate skills and technology to detect and handle complex financial-related crimes such as illicit financial flows. Also, these institutions will require the removal of undue political interference if they are to carry out their duties professionally and efficiently.

Prudence and jealous oversight of public resources is an important condition *sine qua non* for stability, progress and development.

More importantly, low-cost institutional reforms to bring back integrity, ethics, and professionalism at all levels in these entities will be crucial for the fight against corruption. In addition, President Hichilema's inaugural speech at the First Session of the Thirteenth National Assembly (10th September 2021)[4] promised to establish "specialized fast-track stolen assets recovery mechanisms and courts for corruption and economic crimes" and to "also enact legislation on ethics and integrity for improved transparency and accountability". The Budget Address should be equally loud and clear on the specific agenda on these issues in 2022. Moreover, it should provide a roadmap or at least broad policy measure for the establishment of a structure of stolen public asset recovery programme.

But to achieve great transparency and accountability, the publication of time-bound data and statistics, including on debt, GDP, enterprise productivity, production, trade, and socio-economic as well as demographic statistics should be produced towards this end. The budgetary commitment to undertake the Census is a commendable step in the right direction.

3 The Public Finance Act, 2018 Part 1 Sub article 2 defines "public debt" as financial, material and other resources including guarantees acquired or borrowed by a public body in the interest of the Republic. However, the subsidiary law, the LGAA, does not specify on how to address debt of SOEs.

4 https://www.parliament.gov.zm/node/9472

3 ZAMBIA'S MACROECONOMIC FUNDAMENTALS: THE RECOVERY PLAN

The 2022 National Budget moves public policy towards "Growth, Jobs and Taking Development Closer to the People." This section describes how Zambia should ensure that: the expansionary fiscal policy yields growth rather than stifling it. In this section, we provide insights on the macroeconomic objectives, debt management and fiscal policy pronouncements made in the 2022 National Budget.

3.1 Macroeconomic Fundamentals

Zambia's real GDP growth has slowed down markedly in recent years, recording a recession of 2.8% in 2020 at the height of the COVID -19 pandemic. In 2021, growth is projected to reach 3.3%. Despite this projected modest recovery, macroeconomic challenges are expected to persist. These include a high fiscal deficit and associated debt overhang with the US$750 million Eurobond falling due, high inflation, a deteriorating kwacha (despite the intermittent 2021 gains), and low gross international reserves. In view of the above, there is significant risk of failing to achieve the 3.5% targeted GDP growth for 2022. Therefore, realising economic transformation will be critical to achieving this target.

The 2022 Budget has maintained agriculture, tourism, mining and industry as sectors to spur growth and economic recovery and drive economic diversification and job creation in line with the country's long-term developmental plans. Moreover, the Government proposes to enhance its support to SMEs and cooperatives, and this is further expected to create jobs and promote growth. Growth of ICT, a key enabler of economic growth, will be a key prerequisite for economic recovery, productivity and income growth. The Government should endeavour to deliver on the proposed tax and non-tax policy measures to support these sectors, as they drive growth. Further, effective implementation of the decentralization agenda is expected to stimulate local demand for construction, wholesale and retail and other economic sectors. However, capacities will have to be quickly built in the local Government as the lack of capacity is likely to cause setbacks.

3.1.1 Towards Single Digit Inflation

The inflation target set for the 2022 Budget is to reduce inflation to single digit. This is commendable though considering that Zambia recorded a 10-year high inflation of 24.6% in June 2021, closing at 21.1% as at October 2021 this will be a challenging target to achieve. Overall inflation is expressed more strongly through food inflation arising from the supply side constraint of the food value chains. In this sense, the Budget highlights an improved commitment to the agricultural industry aimed at increasing agricultural production, and thus reduced commodity prices. Therefore, the diversification of the agricultural sector must be expedited, to ensure increased supply of various agricultural commodities beyond maize, if food inflation is to be reduced substantially.

Further, in September 2021, the Bank of Zambia projected inflation to reduce faster on account of the favourable outlook on the exchange rate and improved prospects for fiscal consolidation[5]. However, the expansionary 2022 Budget is likely to accelerate inflation, particularly if the increased expenditure is not matched by increased domestic food supply. Evidence shows that an expansionary fiscal policy has a short run inflationary pressure on the Zambian economy[6] risking failure to meet the single digit target unless the increased spending is indeed complemented by increased supply.

5 Bank of Zambia September 2021 MPC
6 Bulawayo, Chibwe and Seshamani (2018): The Impact of Budget Deficits on Inflation in Zambia.

3.1.2 Safeguarding Gross International Reserves

At end-August 2021, Gross International Reserves (GIR) received a major boost, with reserves increasing to US$2.9 billion, representing 5.5 months of import cover, following an injection of Special Drawing Rights (SDR) equivalent to US $1.33 billion from the IMF. The target for GIR in 2022 has been set at no less than 3 months import cover. To sustain this level of reserves, particularly following the planned drawdown on SDRs in 2022, economic transformation through a combination of improved domestic productive capacity and import substitution, promotion of export-led growth, and limited external borrowing (especially commercially) will be vital.

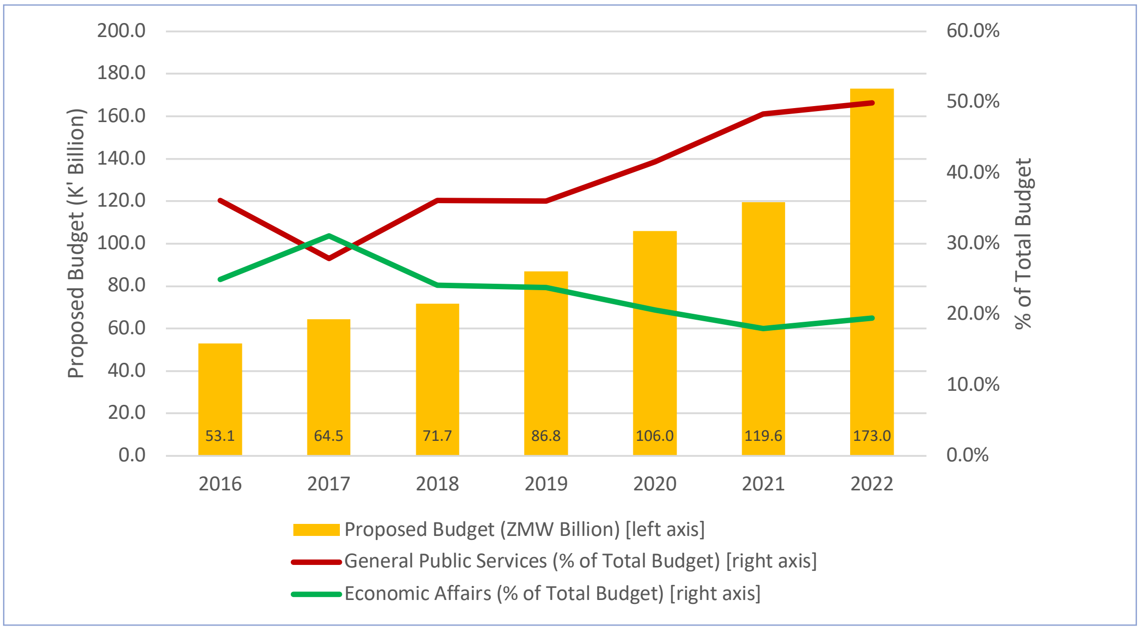
The persistent decline in GIR in the past has largely been on account of external debt service payments, compounded by the import demand, without corresponding increases in export earnings. With the current slowdown in imports and the anticipated relief in external debt service payments from debt restructuring, the 2022 GIR target is likely to be met. However, as trade continues to normalise from the COVID-19 pandemic, we expect to see a steady increase in imports going into 2022. This would exert pressure on the country's international reserve position, and in turn on the targeted months of import cover.

4 ZEROING IN ON THE NUMBERS: REVENUES AND EXPENDITUREs

4.1 Sustainability of Expansionary Fiscal Stance

In 2022, the budget amount is set to increase by 44.6% in nominal terms to K173 billion. This is the largest nominal increase of any budget in recent years, with the last three budget increases averaging under 20% (Figure 3.1). The biggest jumps in allocation by functional classification are in Economic Affairs (56.8%), General Public Services (49.4%), and Social Sector Spending[7] (33.6%).

Figure 4.1: Proposed budget and allocations, selected functions (% of total Budget)



Source: Author's construction based on various Budget Speeches, MoF (2016-2021)

7 This includes spending to health, education, social protection, and water supply and sanitation.

The increase in allocation in the 2022 Budget has been to the Constituency Development Fund (CDF), which has increased 16-fold from K0.25 billion to K4.0 billion. However, it is important to note that, within the Budget, this is merely a reallocation of funds from Central Government, and not an entirely new introduction of funds. This leap in the CDF allocation speaks strongly to the theme of this budget, which is to “take development closer to the people”. What is important to note is that the Government has no fiscal space; with debt servicing and personal emoluments together accounting for more than 110% of domestic revenue. This means that the rest of the Budget will be financed from borrowing.

In 2022, the Nation has the good fortune of having the equivalent of $1.33 billion in Special Drawing Rights (SDRs) to support the Budget. However, introducing recurrent expenditure items such as personal emoluments that will need to be covered beyond 2022 could be concerning. For example, the proposed recruitment of 41,200 public service workers (health and education) is expected to increase the wage bill by approximately K3.66 billion to a total of K30.5 billion in 2022[8]. This represents a wage bill of 6.6% of GDP or 31% of domestic revenue in 2022. That is, as a proportion of the SDR allocation, approximately 17% that will be used to finance the additional wage bill from the proposed recruitments.

The challenge to the Government is to increase the domestic revenue mobilisation by a higher proportion than the increase in recurrent expenditure in order to sustain the recurrent expenditure into the future. On recruitment of public service workers, a more prudent approach would be to do so incrementally over the medium-term, in tandem with growth in the economy and revenue raising capacity. Overall, the expansionary nature of this Budget will require innovative financing options into the future in order to maintain the momentum.

4.2 Enhancing Domestic Resource Mobilization

The share of domestic resources (revenue and financing) in GDP is projected to increase from 22.7% in 2021 to 26.5% in the 2022 budget. This is line with the country’s broad agenda of economic transformation and job creation while enforcing fiscal discipline. However, tax revenue as a share of total budget remained relatively flat at 45% in the 2022 Budget, compared to 44.5% in 2021. Further, tax revenue measures in 2022 will mostly be in terms of tax concessions. Our estimates indicate that the various tax measures announced in the 2022 Budget will result in an estimated net reduction of 5.9% (revenue loss of K4.6 billion) in tax revenues (Table 3.1). The main tax reforms that have implications for resource mobilization, fiscal consolidation and debt sustainability are discussed further below.

8 This is based on rough calculations using estimates of Central Government employee monthly wage per capita based on the 2020 Labour Force Survey and 2020 wage bill.

Table 4.1: Tax Revenue Implications of Proposed Measures

Proposed Tax Measure	Tax revenue loss/gain (est.) (K million)
Deductible mineral royalty in the mining sector	-3,200.0
Increase the exempt threshold for Pay-As-You-Earn	-600.0
Reduce the standard Corporate Income Tax rate	-599.0
Reform the Rental Income Tax regime	-169.1
Increase exemption value on selected petty consignment goods	-161.4
Zero-rated VAT on solar equipment	-54.0
Extend 15% Corporate Income Tax rate on hotel & lodge income	-23.2
Reduce customs duty to 0% on solar equipment	-20.2
Zero-rated VAT on selected agric. equipment & accessories	-19.0
Remove 10% export duty on maize	-18.1
Harmonize CD on bus & lorry tyres, & construction & agric. items	-16.0
Tax exemptions on interest earning on individual bank accounts	-9.2
Corporate Income Tax suspended on ceramic manufactures	-7.1
Extend the waiver of customs duty on various tourism vehicles	-2.9
Remove 5% customs duty on filler masterbatch	-2.7
Introduce 20% withholding tax on reinsurance	48.6
Upward revision of presumptive tax bands	107.2
Increase the taxable base for VAT	178.9
Total revenue change	-4,567.2
Total revenue change (% of total tax revenue)	**-5.9%**
Total tax revenue	77,900.0

Source: 2022 Budget Speech

4.2.1 Empowering the Lowest Earners through PAYE Reforms

The 2022 Budget proposes to increase Pay-as-You-Earn (PAYE) from K12.87 billion to K17.26 billion, representing a nominal increase of 34.13%. Further, the Budget proposes to raise the PAYE exempt threshold from K4,000 to 4,500, thereby injecting K600 million extra cash in the hands of the workers. Based on ZRA[9] (2020) estimates, this measure is expected to impact 72.86% of PAYE taxpayers, indicating that this measure will benefit the largest percentage of taxpayers. This relief is particularly crucial given the ongoing COVID-19 pandemic and the high inflation. However, this measure also entails some risk significant revenue losses.

The adjustment to the PAYE raises the need to implement aggressive measures to broaden the tax base. Nevertheless, it is envisaged that the K600 million cash injection would stimulate demand, thereby contributing to increased tax collections through consumption taxes. To reduce fiscal slippage risks, Government should consider exploring strategies to broaden the tax base and increase tax compliance across tax categories. Some of strategies to consider include enhancing the revenue collection capacity of local authorities, enhancing informal sector tax collections, leveraging on ICT to improve reporting and tax collections, among others.

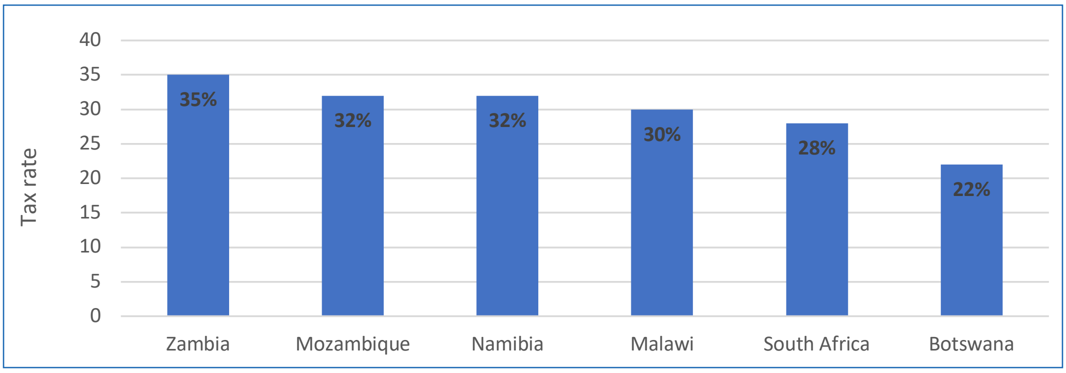
9 ZRA (2020). Tax Statistics in Zambia

While these adjustments to PAYE provide some relief to formal sector workers who bear most of the PAYE burden, it still falls below ZIPAR recommended threshold of K4,800[10], and average formal sector earnings of K 5,873. We therefore propose a comprehensive review of the tax band structure with a view to raising the PAYE tax bands and reducing the rates.

4.2.2 Revenue Implications of Corporate Income Tax Reforms

To promote investment and growth, the 2022 Budget has proposed to reduce the standard Corporate Income Tax rate to 30% from 35% but maintain the top marginal tax rate for telecommunication companies at 40%. This measure reduces total tax revenue by 0.8% (calculated from Table 3.1). Despite these projected revenue losses, the corporate tax revenue is projected to drastically increase from K9.11 billion in the 2021 Budget to K16.4 billion in the 2022 Budget. This represents a nominal increase of 79.9%. This raises the question of how such a sharp revenue increase would be achieved.

Figure 4.2: 2020 Corporate Tax Rates: Select SADC Countries



Source: Constructed from https://taxsummaries.pwc.com/

Despite the revenue loss, the measure is welcome, given that the Zambian corporate tax rate was higher than most countries in the SADC region (Figure 3.2). If the private sector is to meaningfully contribute to job creation and growth, the Government should consider reforming the corporate tax structure. Specifically, there is need to simplify and standardize the corporate tax rate further to lessen potential distortions and attract FDI.

4.2.3 Implications for Revenue and Deficit Targets

The Budget has placed more emphasis on company tax than PAYE, possibly banking on the anticipated higher revenue from the copper price boom. However, given the unstable mining tax regime and the volatile copper prices, this reliance on mining revenue could create deeper fiscal imbalances and widen the deficits. We suggest that the Government explores ways to diversify the tax base and tax structure.

The 2022 Budget has also proposed several measures that negatively impact domestic revenue mobilization. Our analysis (Table 3.1) indicates that the proposed tax measures will reduce tax revenues by K4.6 billion (5.9%). One of the proposed strategies for mitigating revenue losses stated in the Budget is the enhancement of the revenue collection capacity of the local authorities, which have assumed a significant role in the administration of the enhanced CDF. However, the lack of tax collection capacity in local authorities may negatively impact the revenue mobilization and the set fiscal targets. The Government should also enhance the revenue collection capacities of local authorities and promote

10 ZIPAR (2021). Proposals Towards the 2022 National Budget

partnerships between agencies involved in tax collection and ZRA. Additionally, there is a need to elaborate on solid strategies for improving informal sector taxation as this offers a viable option for broadening the tax base.

4.2.4 Hitting Higher Revenue Targets

Given the expansionary nature of the 2022 Budget, domestic resource mobilisation will remain key for the implementation of the Budget. In 2022, the Government aims to raise domestic revenue of not less than 21.0% of GDP. In past years, the Zambia Revenue Authority (ZRA) has consistently met its revenue collection targets, averaging collections of 18.8% in the six years to 2020. However, compared to the regional average of 25% for Eastern and Southern Africa, Zambia's average revenue target was fairly modest. Nevertheless, meeting the 2022 domestic revenue target will require ingenuity, given the numerous tax concessions that have been extended.

Following the modernisation and automation of revenue collection processes by ZRA, one key area to focus on in meeting the domestic revenue target will be to address the administrative inefficiencies that continue to plague revenue collection. The Government should enhance sensitisation programmes to ensure that the citizens are equipped to use the automated systems, which will be at low costs for both themselves and the Authority.

4.3 Financing the Deficit

The 2022 Budget projects the fiscal deficit to be K72.3 billion, representing is 6.7% of GDP. The Government has proposed to finance the deficit from external sources amounting to K49.7 billion (of mostly concessional borrowing) and domestic sources at K24.5 billion. Government is also aiming to limit domestic borrowing, and this would be a commendable break from the past, as shown in Table 1. For instance, in 2020 domestic financing was 878% above the approved figure of K3.5 billion. The trend continued into the first half of 2021 with domestic financing above by 72.8% above the approved figure of K6.3 billion.

However, the feasibility of limiting domestic borrowing should be carefully gauged, given the inertia from the past in the fiscal system. This would require a more structured and comprehensive institutional reform programme that would include purging the fiscal system of past institutional weaknesses that have contributed to slippages on domestic borrowing.

Table 1.2: Domestic Financing 2019 - 2021:H1, K 'millions

		2019	2020	2021
Net Domestic Financing	**Approved**	3,502.6	3,115.6	6,327.4
	Outturn	8,859.9	31,018.4	10,780.8
	Variance	153.0%	895.6%	70.4%
Domestic Financing	**Approved**	4,164.2	3,456.9	6,327.5
	Outturn	11,875.9	33,809.4	10,931.2
	Variance	0.0%	0.0%	0.0%
Amortisation	**Approved**	-661.7	-341.3	-
	Outturn	-3,016.3	-2,791.1	-150.3
	Variance	3.6%	7.2%	-

Source: MOF Fiscal Tables

5 IN CONTINUED PURSUIT OF AN IMF PROGRAMME

The 2022 Budget Speech reiterated the critical role of the IMF Programme to Zambia's economic reform programme. Indeed, the success of this Budget appears to hinge on certain key assumptions holding: i) securing an IMF programme; ii) debt restructuring under the Common Framework; iii) sustained copper price boom; iv) limited interruption to productivity due to the COVID-19 pandemic, and v) favourable agricultural yields, among others.

In the case of the IMF programme, there have been certain sticking points in the past that have hampered the finalisation of a deal. The 2022 Budget Speech speaks to addressing some of these aspects, but falls short of elaborating on others. Removal of subsidies is one of the sticky points not addressed clearly. Expenditure on things like fuel subsidies and arrears, and electricity subsidies will have to be dealt with in order to eliminate the distortionary effects that they introduce. That is, in terms of price distortions that make these commodities cheaper than they would otherwise be, this becomes a disincentive for private sector to invest in these areas. And given the drive for private sector led growth, this is an important consideration for the Government. More rudimentary, however, is the burden that subsidies place on the treasury, particularly considering Government's need to create additional fiscal space.

6 POISED FOR SUSTAINED INCLUSIVE GROWTH OR MUCH ADO ABOUT NOTHING?

Economic transformation and job creation is the central theme of the new Government's national development agenda. The concept of development – which implies an improvement in incomes and livelihoods and a subsequent reduction in poverty – historically, has been characterised by a restructuring of economic activities and employment from low productivity activities to higher productivity activities within and from agriculture, to manufacturing and then services.

That said, Zambia's economic transformation and employment creation is taking a different path, starkly in contrast to the manufacturing-led path taken by East Asia and the West.[11] In addition to manufacturing, other industries such as horticulture (a subsector of agriculture), tourism, transport, wholesale and retail trade, finance and business services including information and communications technology, have been found to be highly productive and to be rapidly expanding employment.[12] These industries, which by and large are aligned with the industries identified in the budget, are driving transformation and job creation in Zambia.

Nonetheless, their full potential remains constrained by structural impediments and more contemporary challenges brought on by climate change, pandemics and technological advances. This section analyses the extent to which the proposed 2022 budgetary measures for the real sector addresses the well-known sector-specific and cross-cutting constraints, and supports higher and more sustainable growth and employment opportunities particularly for Zambia's burgeoning youthful population.

6.1 Ploughing for Growth and Resilience in the Agro Sector

Budgetary allocations to agriculture have continued to be dominated by the Farmer Input Support Programme (FISP) and Strategic Food Reserves with a combined 1.4% share of GDP in the 2022 Budget. In past years, these two programmes have essentially concentrated on the promotion of maize entailing clinging on to a "maize-centric" sector at the expense of diversification. This is against a backdrop of evidence indicating a tenuous impact of the Programme on rural poverty reduction and a myriad of implementation challenges as highlighted by the Minister of Finance

11 Rajaram, Chiwele, & Phiri (2021), *forthcoming*; Newfarmer, Page and Tarp (2018)
12 Ibid.

and National Planning. However, the Government has clearly stated that FISP will be transformed through the implementation of a new comprehensive agriculture support Programme.

In the 2022 budget, the allocation to FISP remains high at ZMW5.4 billion. Our call on the Government is to expeditiously reform the FISP to a more efficient system. One option is to establish a comprehensive rural development Programme to encourage comprehensive structural transformation which also supports agriculture, livestock and fisheries. Additionally, a clear graduation cycle for the direct beneficiaries should be embedded in the Programme.

In the livestock sub-sector, it is commendable that the government intends to remove surtax on bovine semen in order to help improve cattle breeds and train farmers in grazing management and livestock disease prevention and control. However, these measures should correspondingly be implemented with capacity building in the technical staff who will provide services, as some of these measures require specialisation.

As a country, Zambia is still a net importer of fish despite having abundant water resources. Riding on the back of the Budget statement to increase fish production under aquaculture by more than 15,000 metric tonnes, the Government should roll out the aquaculture skills training programme to stimulate growth in the fish subsector. The zero-rating of VAT on a number of selected agricultural equipment and accessories is commendable although the Government should closely monitor the implementation of this measure to ascertain its benefits.

Though the 2022 Budget speech did not mention R&D in the agriculture sector, R&D plays a significant role in the development of good agriculture practices and technologies that farmers require to enhance their productivity and crop diversification. Therefore, funding for R&D needs to be increased. What the Budget mentions is an intent to increase variety release fees charged by the Seed Control and Certification Institute (SCCI). This measure will hurt breeders, and inevitably hinder the release of improved crop varieties. In view of this, a phased approach in the increment of the fees recommended.

6.2 Becalming the Headwinds in the Tourism Sector

The tourism sector has recently been hit by the COVID-19 pandemic on account of the collapse in demand for tourism services. While the sector posted positive growth of 4.8% in quarter 1 of 2021, it slowed down in quarter 2 to 3.4%[13]. Thus, the extension of current relief measures to December 2022 is commendable. We also endorse the proposed reduction in VISA fees by 50% across all categories as this will align our regime to regional competitors. Further, we commend the measures to diversify tourism packages across the country as this has potential to increase the average length of stay of international tourists which declined from 6 days in 2013 to 4.7 days in 2018. Beyond these measures, the Government must demonstrate political will to finally implement a single licensing system which has eluded the sector despite appearing in successive budget speeches. The Government must also implement a two-tier system to promote domestic tourism which is a viable alternative to international tourism in the wake of the pandemic.

6.3 Mining: Calming the Storm

The 2022 National Budget has made two important pronouncements relating to mining with potential to restore calm to the industry. First, the commitment to establish a fair, stable and predictable tax policy which presumably, will include the mining fiscal regime, is important to note. Inconsistent fiscal policy has been a major thorn in the mining industry. As discussed in past ZIPAR budget analyses, since 2001, the mining fiscal tax regime has on average, undergone one

13 Accommodation and food services activities have been used to proxy tourism

tax change every 18 months.[14] Such frequent changes including reversals, signals uncertainty and instability to investors which in turn discourages new and reinvestments in the sector. This limits the sector's growth potential and accrual of increased foreign exchange earnings, economic growth and employment associated with an expansion in output. Businesses thrive on certainty, thus having a sense of the level and type of taxes to be paid is critical for forecasting cash-flows and profits, and minimising investment risk. Stability and predictability evoke investor confidence thereby encouraging investments and thus rents to accrue.

With ambition to ramp up copper production to three million metric tonnes in 2032 from 837,996 tonnes in 2020; and to harness opportunities for greater beneficiation and participation in global value chains arising from the green copper demand; a stable and predictable mining regime becomes even more imperative. In arriving at this fair, predictable and stable mining fiscal regime, the Government should ensure that it is founded on empirical research; bench-marked against industry-best practice; embeds a self-adjustment mechanism that allows for flexibility against prices changes; and is based on a wide and thorough stakeholder consultative process to avoid reversals. The Government needs to get it right once and for all!

Second, the reinstatement of mineral royalty as a deductible expense for income tax purposes is equally noteworthy. When mineral royalty deductibility was first disallowed in 2019, this measure was met with high condemnation as it went against best-industry practice more so that mineral royalty is collected irrespective of whether or not the mining firm makes profit. Mineral royalty payments are typically treated as deductible costs. By design, they are intended to compensate countries for the deletion of exhaustible mineral resources.[15] But at the same time, their simplicity entails that they are a more reliable form of revenue for governments that ensures that the country derives some form of benefit even when mining firms genuinely or otherwise, do not declare profits. Despite the mistrust between the Government and mining firms and concerns of mines not paying their fair share, the move to restore mineral royalty as a deductible expense is the right move and should be maintained. Concurrently, the Government should build capacity of the tax authority and support institutions, to audit mining operations and output and to detect and measure aggressive tax avoidance, transfer pricing, base erosion and profit shifting that erode revenues.

Although dependence on mining exposes the country to the risks of commodity price shocks, dependence on a few minerals within mining exacerbates this vulnerability. In this regard, the policy direction to promote diversification within the mining sector through the promotion of other minerals such as gold, manganese and gemstones, should help the country hedge against this risk.

6.4 Tax Cuts, Special Economic Zones, Incentives and *much more*…

Industry, has arguably received some of the most generous but welcome concessions aimed at stimulating investment and cushioning the adverse impact of the pandemic. The first notable measure is the reintroduction of tax incentives in special economic zones. These include zero percent tax on dividends declared on exports for a period of 10 years starting from year one of commencing operations; and zero percent tax on profits made on exports for a period of 10 years starting from year one of commencing operations for firms in multi-facility economic zones (MFEZs) or industrial park. Looking back to when MFEZs were designed, a zero percent tax on dividends and profits were provided for a period of 5 years starting from the first year of declaring dividends and commencing operations respectively, and were applicable to all activities in the zones, provided they met the investment threshold.

14 ZIPAR (2020). 2021 National Budget Analysis: Quest for Growth and Resilience in the Face of Mounting Economic Headwinds.
15 Manley (2013). A Guide to Mining Taxation in Zambia. ZIPAR

These incentives were rationalised in 2018 thus eliminating the tax holiday on corporate tax and dividends. Our 2020 paper on special economic zones found that the rationalisation had a negative impact on investments in the zones. They made the zones less differentiated and thus less appealing, inducing the complete withdrawal of some and reduction of other pledged investments.[16] The reintroduction of incentives is thus commendable more so that they are fit for purpose and targeted at promoting exports. Since businesses do not immediately realise profits when they start operating, the extension of the time period is also warranted. But other key considerations must also be taken into account if the potential of the zones to foster economic transformation and employment creation is to be fully realised.

We recommend to reform the SEZ programme comprehensively by according it an explicit SEZ policy and strategy to guide the location of the zones, provide for robust monitoring and evaluation mechanisms, provision of quality infrastructure and business support services including one-stop shops which are currently missing in the zones as well as linkages with local suppliers.[17] There is a host of other incentives that should be provided to promote youth employment, investments in research and development, training as well hi-tech products so as to draw on foreign capital, skills and technology required to diversify production, increase the sophistication of Zambia's exports, deepen the country's integration in regional and global value chains, and leverage the fourth industrial revolution for industrial growth. Above all, the incentives should be performance-based.

Government has further reduced the investment threshold for Zambian firms in the SEZs to qualify for incentives from US100,000 to US$50,000. But given the seismic investments that are needed to develop SEZs into world class preferential investment zones, Government should not be looking to reduce the entry threshold but rather, to deliberately provide for the participation of small and medium firms in the supply chains of the zones. The SEZs should be targeted at attracting multinational corporations and large domestic firms that beyond contributing to capital accumulation, also bring skills and technology transfers. Government should therefore: i) encourage joint ventures between foreign investors and SMEs; ii) integrate SMEs in the zones' supply chains to deepen linkages with the rest of the domestic economy; and iii) provide fiscal investments in the industrial yards designed for MSMEs.

Coming to contemporary challenges, the advent of the COVID-19 pandemic has had unprecedented adverse impacts on firms' output, employment, productivity as well survivability. To attenuate the impact on firms and economies, governments world over, had to step in with fiscal, monetary and other measures to support businesses.[18] Zambia in particular, liquidated some domestic arrears, cut policy interest rate, waived tax penalties, suspended duty on key imports, provided a stimulus package of K10 billion amongst other measures.[19] What the Government didn't do however, was to provide tax cuts. With the threat of the pandemic unabated, it is gratifying to see continued policy support more aligned with firms' expressed needs, aimed at cushioning the impact of the pandemic on firms in the 2022 National Budget. The reduction in the standard corporate income tax rate from 35 percent to 30 percent, is the utmost form of fiscal support expressly desired by manufacturing firms.[20] With the goal to achieve economic recovery and growth, the reduced tax rate will release more financial resources thereby improving firms' liquidity, ability to meet operational costs and reinvest back in the business and thus expand output.

16 Phiri and Shimukunku (2020). Special Economic zones in Southern Africa: White Elephants or Latent Drivers of Growth and Employment? The case of Zambia and South Africa. UNU-WIDER

17 See ibid for a more detailed discussion.

18 IMF, October 2020. World Economic Outlook: A long and Difficult Ascent. IMF

19 Phiri and Shimukunku (2021). Who is winning and Who is Losing? Economic Impact of COVID-19 on Manufacturing Firms in Zambia. ZIPAR, *Forthcoming*

20 Ibid

6.5 A Point of Departure? Engendering SME Growth through Decentralisation

A striking point of departure of the 2022 National Budget from budgets past is how it envisages supporting the growth of small and medium enterprises through decentralisation. First, we acknowledge that the establishment of a dedicated Ministry of Small and Medium Enterprise Development prior to the budget reading, signalled the importance the new Government has placed on realising the potential of SMEs to drive growth and employment creation. But beyond this, the most transformative measure with significant potential to promote broad-based development if well implemented and complemented with capacity building and technical assistance programmes, is the 1,509% increase in the Constituency Development Fund (CDF) and the expanded scope of utilisation.

The CDF which translates into K25.7 million apiece, has been earmarked for community-based projects such as the construction of primary school classrooms, teacher's houses, rural clinics, staff houses, local courts, community boreholes; etc., that are expected to be contracted to local SMEs from the respective constituencies. Empowerment funds for SMEs (K330 million) and for youths and women (K803 million) will also be distributed through the constituencies to ensure better targeting and more equitable distribution. The procurement of school desks has also been reserved for local manufacture and supply. Collectively, these measures present business and employment growth opportunities for SMEs and youths.

Now, while the Government has demonstrated foresight and already allocated K792 million for the up-skilling of youths to prepare them to take up such contracts, capacity development of not just youths, women and SMEs but local authorities as well, cannot be overemphasised. This is a necessary condition for decentralisation to be a successful tool for promoting inclusive development. This entails building capacity of local authorities to manage, monitor and evaluate CDF resources and projects; and to administer or manage empowerment funds. Regarding the latter, the local authorities' role should support the identification of prospective recipients that are from their communities to ensure better targeting. Whereas the funds' administration, including vetting of borrowers, monitoring and recovery should then be undertaken by an independent specialised institution to reduce the risk of ex-ante, adverse selection; and ex post, moral hazard.

For SMEs, youths and women-led businesses, in addition to providing financing which remains a major constraint to their growth, support should be holistic and complemented by adequate technical assistance support programmes in financial management skills, business know-how, innovation i.e. investments in R&D and technology, market access information, sustainable business practises especially in agriculture. This is requisite for improving the capacity of SMEs, youths and women-led businesses to prudently utilise the empowerment funds and improve their capacity to produce quality and competitive products and services that can lead to their growth and the creation of employment.

To encourage the formalisation of micro and small businesses particularly, burdensome business registration and licensing procedures that increase the cost of formalisation should be addressed expediently through the implementation of single licensing systems. Above this, labour law regulations and social security requirements should also be differentiated for micro and small enterprises to encourage their formalisation.

6.6 Enabling Transformational Real Sector Growth

The 2022 Budget intends to promote utilisation of Renewable Energy Sources (RES) such as solar PV, wind and geothermal. This is commendable considering that the uptake by private sector participation has been considerably slow. Solar and diesel account for 3% and 2.7% of installed generation capacity, respectively. The implementation of the Renewable Energy Investment Plan is therefore, essential for fostering increased private sector involvement in renewable energy power generation for small and medium scale projects of up to 20 MW. For this to yield results in the immediate to short term, the establishment of a legal and regulatory framework is necessary for governing the renewable energy sector.

It is noteworthy that Government's focus on the energy sector is 'development and management of energy resources in a sustainable manner'. The energy sector remains key to enabling productivity and growth in the real sector. Zambia's energy mix is largely concentrated in hydro-power generation, which accounts for 80.8%, followed by coal and heavy fuel oil at 10% and 3.5%, respectively. This exposes the electricity sector to adverse climate shocks which has knock-on effects on other economic sectors. It is therefore, commendable that the Government is set to implement cost reflective tariffs to promote private power investment in the energy sector. This will result in reliable power supply and also allow for importation of electricity from the region. However, we advise the Government to effect the tariff increments in a phased approach to avoid a disruptive fallout.

For the petroleum sub-sector, this calls for clear and transparent roles by players in the value chain. Presently, the Government remains the main actor in the fuel sector. There is need to have Government exclusively provide oversight and halt its role in the procurement and marketing of petroleum products. Instead, due consideration should be towards establishing a National Petroleum Procurement body that will allocate supply quotas to Oil Marketing Companies through competitive open bidding. This will bring about transparency and competitiveness that will result in fair pricing and collection of the much-needed tax revenue by Government.

6.7 Leveraging Private Sector Financing for Infrastructure Development

Transport and logistics infrastructure are critical to driving economic transformation and trade. The Government has recognised this in the 2022 budget albeit with a proposed shift in expenditure on road infrastructure as a share of the total budget from 5.2% in 2021 to 2.8% in 2022. This is because recent public investments in transport have focused on roads at the expense of other modes, characterised by a bias towards urban roads to the impairment of critical rural and trunk roads. The Government is now faced with a daunting task maintenance the expanded road infrastructure. To support this activity, the Government should pursue reforms relating to the legal framework for the management of revenue from the road tolling programme. The road toll collections have generally been over performing, yet proceeds are not ring-fenced for road maintenance. We recommend that the legislation regarding road tolling should be changed to empower the implementing agency to assign the revenues collected for construction and maintenance of the road infrastructure.

The 2022 Budget also accentuates maintenance of rail infrastructure and this is laudable as it could shift some bulk cargo from road to rail and offer roads the much-needed load relief. The pronouncement on the use of Public Private Partnerships (PPPs) to finance railway and other transport infrastructure is creditable given Government's limited fiscal space. The Government has also committed to repeal and replace the PPP Act No. 14 of 2009 but it must also address administrative bottlenecks in the implementation of PPPs such as enhancing the technical capacities of staff. The Government can outsource PPP expert services to reboot the PPP initiative by capacitating local expertise. The Government must also undertake a review of the performance of the PPP model following enactment of the PPP Act in 2009.

6.8 Building Blocks for the Adoption of Climate Change Adaptation

Climate Change Adaptation has been chosen as the sole carrier of the budgetary allocation for Environmental Protection. This indicates that all activities in 2022, from conservation to management of protected areas and wildlife, will have to be focused on adopting practices that promote adaptation to climate change. The proposed allocation of K971.9 million is a mere

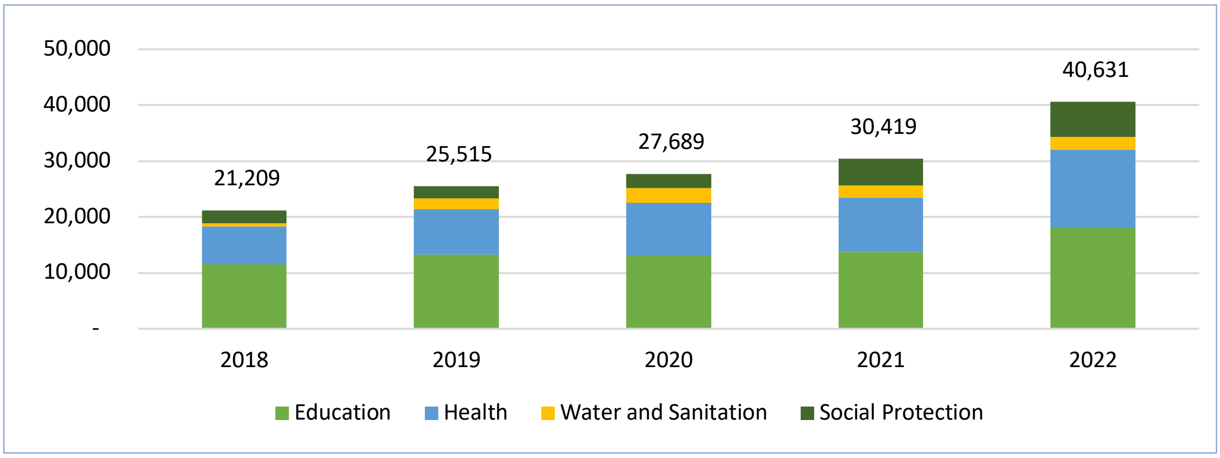
1.7% increase on that of 2021, but given the now singular focus, there will be a need for support in the form of policy and possible legislation. The proposed review on the fee structure for environmental impact assessments is aimed at both strengthening Zambia's management of the process and making it easier for investors to set up development projects. Caution should be taken though to ensure that there is no negligence in addressing possible impacts of projects on the environment.

The promotion of innovative financing for climate change interventions seems to be at the core of the push, with green bonds, carbon trading, and a proposed legislation for a National Climate Change Fund set to be drivers for it. Given that green bonds are financial instruments designed to finance projects with climate and/or environment benefits, the expectation is that part of the budgetary allocation to Environmental Protection will be used establish the market. It is still unclear whether these two initiatives will be the foundation on which the National Climate Change Fund will be built but there is also a need to expedite the development of the Zambia's National Adaptation Plan, in an inclusive multi-sectoral manner, as it is the document that will guide the national approach to climate change adaptation.

7 MINDING THE GAPS IN INCREASED SOCIAL SECTOR SPENDING

Government spending on the social sector is crucial to ensure that the Zambian population has access to basic services such as health care, education, water, sanitation and hygiene (WASH) and social safety nets. The new government has embarked on a revolutionary social spending plan that includes the provision of free education and mass recruitment of teachers and health workers. As a result of these measures, the social sector budget is projected to increase from K30.4 billion in 2021 to K40.6 billion in 2022, an increase of 34% (Figure 1).

Figure 3: Budget allocation to the Social Sectors, 2018-2022 (Kwacha million)



Source: Authors' own construction from the Ministry of Finance Budget Speeches

7.1 Minding the gaps in the quest to deliver quality free education for all

The Government through the 2022 Budget has delivered on a major election promise of providing free education. Other key pronouncements made included plans to recruit 30,000 teachers as well as build 120 secondary schools. The intention to move towards free education is commendable as access to secondary school education is extremely poor as only 2 out of 10 eligible children are enrolled.[21] Further, evidence shows that the number of households with

21 Educational Statistical Bulletins, Ministry of General Education, 2019

children out of school increased by three percentage points between 2014 and 2018.[22]

In order to achieve these commitments, a total of K18 billion was allocated towards education represents a 31% increase compared to the 2021 allocation of K13.8 billion. The 2022 Budget makes further commitments to increase grants to schools which are a critical component needed to recover the lost income for schools in the form of fees.

While the move to provide free education is commendable, the structure in income for schools poses a risk to their operations. The loss in income from tuition fees and PTA contributions implies that the schools will now wholly depend on the Government for non-wage expenditure. If the current trend of poor budget execution and late disbursements continues, school operations risk being crippled if grant commitments are not fully met and disbursements are not made in a timely manner.

The free education initiative must be supplemented with a robust medium-term strategy to revive Zambia's education system and improve the quality of the education delivered. In the medium-term, we recommend that the Government develop a medium-term strategy to build school infrastructure that is equipped to provide quality education. Further, Government must ensure that commitments to provide grants to schools are fully met.

A key pronouncement of the 2022 Budget was the proposed recruitment of 30,000. The planned recruitments will increase from 107,000 to 137,000 representing a 21% increase and will positively impact the pupil-teacher ratio. To enhance the efforts towards achieving Zambia's industrialization agenda through a highly skilled labour force, recruitments must be targeted towards priority subjects such as the STEMS.

7.2 Arming the health sector for the battle against COVID-19

Zambia's health sector has come under strain in the last two years as the COVID-19 pandemic has exposed inefficiencies in the health system such as limited bed capacity, inadequate staffing levels and shortages of essential drugs and medical equipment. As the country continues its battle against the pandemic, the Government has allocated K13.9 billion towards the health sector, a 44% increase in nominal term. The increase indicates efforts to boost a strained health sector. The increase in the health budget is mainly on account of plans to recruit 11,200 health workers and efforts to procure COVID-19 vaccines.

A total of K3.3 billion is allocated towards Drugs and Medical Supplies in 2022. This allocation represents a 135.7% increase compared to 2021. The K3.3 billion includes K700 million allocated for the acquisition of vaccines. The increased allocation is indicative of strong Government will to tackle the pandemic. However, vaccinations rates remain low despite the availability of vaccines. As of 30th October 2021, only 14% of the eligible population had been fully vaccinated.[23]

The recruitment of 11,200 health workers is critical in providing relief to an understaffed health sector whose staff deficit is estimated at over 20,000. However, the planned recruitment will only half this deficit. As committed to in the Budget, the Government must develop a medium-term strategy to recruit health workers so as to address the current deficit.

7.3 Social Protection: Still Winning but Execution Remains a Factor

Zambia's Social Protection Systems has in the recent past faced tremendous pressure due to dampened growth and the effects of COVID-19 pandemic. The pandemic worsened poverty levels, however, evidence showed that implementation of an Emergency Cash Transfer combined

22 National Multidimensional Poverty Index, April 2020
23 ZNPHI Daily Updates, October 2021

with the Social Cash Transfer programme reduced the impact on poverty by 1%age point (UNU-Wider, 2021). These findings augment the importance of the social protection system

As a result of this impact, Social Protection has yet again received a boost in the 2022 Budget with allocations increasing to K6.3 billion from K4.8 billion in 2021, an upward adjustment of 56.8%. The Social Cash Transfer (SCT) programme which is a key component of social protection received an increased allocation of K3.1 billion in 2022 representing an increase of 33% from compared to 2021. The number of beneficiaries of the SCT for 2022 is expected to increase from 880,539 in 2021 to 1 million while transfer amount will also be raised from K150 to K200.

The changes to the SCT programme are commendable, however, past experience has shown that allocations have not matched outturns due to the shrinking fiscal space. Thus, Government is urged to ring-fence social sector expenditure which includes SCT to ensure that funding commitments are realized.

Allocations towards Pensions leaped by 100% from K1 billion in 2021 to K2.1 billion in 2022. The increase in allocations is mainly targeted at completely dismantling pension arrears which stood at K2.7 billion in the fourth quarter of 2020.[24] The move to dismantle pension arrears is commendable and must be actualized by improving budget outturn.

7.4 WASH – Consolidating the Gains Beyond COVID-19

Water, Sanitation and Hygiene (WASH) is important for preventing contagious diseases, such as cholera outbreaks and the recent COVID-19 pandemic. Arising from the COVID-19 pandemic, the past three years have had increased demand for WASH, particularly handwashing at household level. Similarly, handwashing practices improved in schools, health facilities and other public settings.

The increased demand for WASH facilities has however not been matched by significant increase in the national budget. In 2022, the WASH budget has turned around, registering a 9% nominal increase from K2.2 billion in 2021 to K2.3 billion in 2022, after being on a downward trend from 2019 to 2021.

Although the WASH budget increased in nominal terms, there has been a reduction in terms of its share to the national budget. The share of the WASH budget to the National Budget has reduced from 1.9% in 2021 to 1.4% in 2022. This implies the WASH budget is getting a smaller share of the cake, even when the National Budget increase is significant.

Additional investments in the WASH sector are required to achieve universal coverage by 2030. According to the COVID-19 Recovery Needs Assessment (2021), achieving Zambia's universal WASH coverage goals by 2030 requires an estimated US$ 584 million annually[25]. At present, the estimated 2022 Budget is expected to cover approximately 24% of the sector investment needs from 2021-30, leaving a financing gap of approximately $444 million per year. This financing gap notwithstanding, the increase in the CDF allocation from K1.6m to K25.7m may also support new water infrastructure particularly in rural areas where access is limited.

24 2020 Annual Economic Report, Ministry of Finance
25 UNDP, UNICEF et' al. 2021. COVID-19 Recovery Needs Assessment

7.5 Sustainably Financing Social Spending

To ensure sustained and continued protection of the poor and vulnerable, particularly given the adverse effects of the COVID-19 pandemic, the government has demonstrated that it can increase investment in the social sectors despite experiencing a combination of continued deterioration of economic conditions, low domestic revenues and weak economic buffers.

However, with debt servicing costs projected to increase by 129% in 2022, and coupled with an increase in the total wage bill, the non-wage component of the social sector budget will increasingly be financed from foreign grants and borrowing. In the absence of debt restructuring and increased growth, coupled with the fact that the US$3 billion Eurobond debt is due in the next five years, financing of social spending will increasingly be a challenge.

Given that the non-wage component of the Budget is largely discretionary expenditure, social sectors with the largest non-wage components are more vulnerable to financing constraints. Water and sanitation and social protection are the sectors most unlikely to be funded given their large discretionary expenditure component.

To sustainably finance social spending, the government would have to devise innovative ways of financing social spending. Measures include bringing back growth through the identified growth sectors in the budget. Additionally, Government must ring-fence revenues from mining exports, the sector is also a quick win and must be supported by facilitating a predictable and favourable environment in order to spur growth.

8 CONCLUSION

The 2022 Budget was delivered at the time of a political transition and when the economy is faced with unsustainable circumstances of a huge debt overhung, diminished growth induced by both external and internal factors and stagflation. Against the odds, the Government delivered an expansionary budget of K173 billion, which is 44.6% larger than the 2021 Budget in nominal terms and with non-discretionary spending representing more than 110% of the domestic revenue. That being the case, the Government did not have much choice but to finance everything else using borrowed money. The 2022 Budget is therefore, a very bold statement providing the general economic direction of Government for the next 5 years. But restraint should be exercised not to spend more than the Budget provisions.

The transformational focus on export-oriented growth, jobs creation in both the public and the private sector and taking taking development closer to the people through fiscal devolution using a ramped-up CDF in a tight fiscal space, is very resolute but commendable. We urge Government to take measured steps in implementing the devolution and to accompany the devolution with sterilisation measures.

The success of this Budget appears to hinge on certain key assumptions holding: i) securing an IMF programme; ii) debt restructuring under the Common Framework; iii) sustained copper price boom; iv) limited interruption to productivity due to the COVID-19 pandemic, and v) favourable agricultural yields, among others. Slippage in any of these key assumptions would occasion fateful outcomes to the economy. However, the successful implementation of this Budget would mark the start of a monumental turnaround to the Zambian economy and improve the lives of its people to whom it is intended to take development.

On the balance, we recognise the fact that the Government has not had sufficient time to engage the most crucial stakeholders in the preparation of this Budget. If any of the assumptions that this Budget is built on do not hold, especially after major consultations with the IMF and other lenders, we strongly advise the Government to take the option of revising the Budget midway and represent it to Parliament at a later date to avoid adverse outcomes.

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