POLICY MONITORING AND RESEARCH CENTRE

UNDERSTANDING ZAMBIA'S ECONOMIC RECOVERY PROGRAMME

Unlocking Zambia's Potential

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ABBREVIATIONS

AG	Auditor General
CSO's	Civil Society Organisations
DRM	Domestic Revenue Mobilization
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
IDA	Integrated Development Approach
ICT	Information and Communication Technologies
IFMIS	Integrated Financial Management Informations System
NGO's	Non Governmental Organisations
MTEF	Medium Term Expenditure Framework
MIS	Management of Information System
MPSA's	Ministries, Provinces and Spending Agencies
PFM	Public Financial Management
7NDP	Seventh National Development Plan

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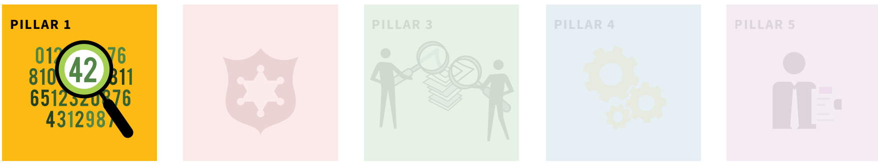
INTRODUCTIONS

On the 11th of November 2016, the Minister of Finance, Hon. Felix Mutati MP, delivered the 2017 Budget Address to parliament and the rest of the country. The theme of the 2017 National Budget is “Restoring Fiscal Fitness for Sustained Inclusive Growth and Development”. In order to restore economic stability, the Government has designed an Economic Recovery Programme dubbed ***“Zambia Plus”.*** This Programme is aimed at ensuring sustained and inclusive growth. Zambia’s economic recovery programme ‘Zambia Plus’ is a home grown plan designed with the objective of attaining inclusive and sustained growth by Zambians and complimented by cooperating partners. The Zambia plus programme is anchored on fives pillars of economic recovery namely;

I. Enhancing domestic resource mobilisation and refocusing of public spending on core public sector mandates;
II. Scaling-up Government’s social protection programmes to shield the most vulnerable in our society from negative effects of the programme;
III. Improving our economic and fiscal governance by raising the levels of accountability and transparency in the allocation and use of public finances;
IV. Restoring credibility of the budget by minimizing unplanned expenditures and halting the accumulation of arrears; and
V. Ensuring greater economic stability, growth and job creation through policy consistency to raise confidence for sustained private sector investment.

This analysis discusses each pillar, providing the status, and recommendations on what strategies that Government must utilize in order to restore economic stability.



PILLAR 1: Enhancing Domestic Revenue Mobilisation and Refocusing of Public Spending on Core Public Sector Mandates

In under developed regions, especially sub-Saharan Africa, domestic resource mobilization (DRM) has a significant international dimension. In most instances, resources lost to capital flight and transfer pricing exceed aid flows; remittances are becoming increasingly important; revenues from trade taxes are in decline; and aid accounts for a large (in many cases growing) share of the government budget. The dramatic reversal of trade and financial flows during economic crisis that saw a plunge in commodity prices has heightened the need to think about more stable and sustainable modes of development finance and Zambia is not an exception to this. DRM has been a relatively neglected factor in strategy development, especially in sub-Saharan Africa (Culpeper and Bhushan 2008, 2009, 2010).

Enhancing Institutional frameworks for domestic revenue mobilisation

Increasing the revenue GDP ratio to above 20% as purported in the 2015-2017 Medium Term Expenditure Framework (MTEF) has eluded Zambia for some time despite the strong economic growth registered during the last decade. Some tax handles like VAT, which were expected to grow in tandem with the GDP growth, remained weak (Ministry of Finance, 2016).

Improving domestic revenue mobilization remains critical for the Government's fiscal agenda. Efforts to broaden the tax base have encompassed a wide range of initiatives, focusing both on internal operational issues of the revenue collector and the external environment of revenue collection, particularly the interface with tax payers. Despite the various efforts, challenges remain for the revenue collecting institutions. These are mainly reflected as inadequacies in administrative efficiency, limited infrastructure and lack of procedures in mobilizing domestic resources.

Thus, ultimately even though tax revenues on the whole were above target by 4.3% in 2015, with the contribution from mining increasing by 127.3%, other tax types including PAYE, Customs and Excise Duties were far below target. Non tax revenue struggled mainly on account of mineral royalty proceeds which were below target by -13.5% and FISP recoveries which were below target by 66.7% (Ministry of Finance, 2016). The record of non-performance or under-performance of the various tax types listed above is now well documented elsewhere. Based on the evidence, we propose the following institutional reform measures for improving tax performance:

- Supporting ZRA to reform and restrict the PAYE practice that allows returns to be made without payments, particularly given that Section 71 of the Income tax Act stipulates that payment shall be deemed to be made when the emolument is received.
- Supporting the reform and rationalization of the generous customs duty exemptions, which currently significantly lower the performance of this trade tax.
- Improving the minerals diversification strategy (away from a skewed focus on copper to balanced focus on other minerals through exploration for and research and development (R&D) in oil, natural gas, semi-precious minerals, and precious minerals (gold, diamonds, etc.), with robust production monitoring mechanisms, including as supported by like-minded cooperating partners.
- Supporting the elimination of cash from the payment cycle and the establishing a holistic improvement in revenue collections through social transformation that moves society towards widely using emerging information and communication technologies (ICTs) to make electronic (mobile phone, computer, etc.) payments for goods and services (in line with the President's Opening Address of the First Session of the Twelfth National Assembly in October 2016).

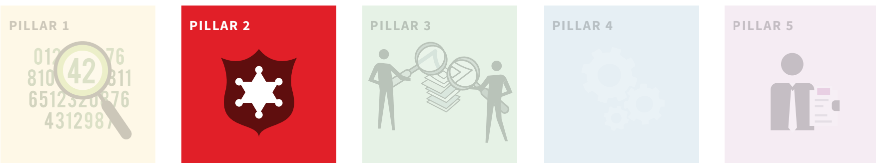
- Ensuring the establishment of robust consultation and dialogue mechanisms and arrangements, which are weaved into the processes of tax policy formulation, revenue forecasting, and general economic policy making.

Refocusing of public spending by reducing non-priority infrastructure spending

Infrastructure is critical for the provision of affordable, efficient, reliable and high quality services like energy, transportation, finance, telecommunication, health, education and skills development services, water and sanitation, and many others. It helps with reducing the costs of production and of doing business.

Infrastructure development requires careful long-term planning and budgeting; it requires extensive project appraisals that take full account of the availability of long term financing. The government should not make capital project decisions based on short-term considerations unless these are of an emergency nature. For example, going forward the unplanned road infrastructure spending of 2015 (Figure 2) should not be allowed to happen again. As such, the reduction in the year-to-date (January to August 2016) spending on roads by 60% is commendable; it resulting in a reduced share of roads spending from 13% in the approved 2016 budget to 5% in the total year-to-date expenses. *The precedence of reducing spending on roads, especially the unplanned road spending should be maintained and possibly enhanced.*

The government should consider all infrastructure projects only on the basis of full project appraisals, prioritizing high economic return project in energy and other services; and should carefully match the projects with adequate term financing from affordable (preferably developmental and concessional) sources. The government should devise a National Infrastructure Delivery Plan 2017-2021 that will be part of the Seventh National Development Plan. This will bring together all of the government's plans and resource estimates (by source) for economic infrastructure development over the next five years



PILLAR 2: Scaling-up the Government's social protection programmes to shield the most vulnerable in our society from the negative effects of the programme;

It is encouraging to note that Government has recognised that the removal of subsidies can harm the poor and vulnerable in society, as they are least able to adjust. The second pillar of the economic recovery plan is an effort to ensure the poor are protected and empowered. This pillar seeks to increase budgetary allocation to social protection. The scope of social protection in Zambia includes destitute households, house holds headed by children and children without adult care, street children, the aged, incapacitated and households that are not able to meet their own needs due to various severe states.

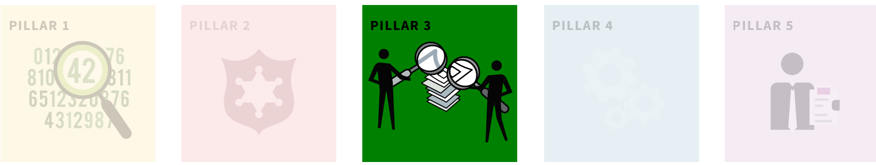
In an effort to actualize the second pillar of Zambia's Economic Recovery Programme, Government increased funding to social protection to about 2.7 billion Kwacha in the 2017 National Budget from about 1.3 billion Kwacha in the 2016 National Budget. This represents an 87% increment. Specifically, this increase takes into account the rise in the number of beneficiaries on the Social Cash Transfer Programme. The number of beneficiaries will increase from 242,000 to over 500,000 and monthly benefits (cash) will rise by 28%. This increase is also targeted at scaling up the Home Grown School Feeding Programme to enhance the learning abilities of school going children, increase their attendance and combat malnutrition.

There are various challenges and hurdles that must be overcome to ensure government successfully up scales and effectively implements social protection programs in light of austerity measures.

1. The completion of effective and efficient Management of Information Systems (MIS) and monitoring and evaluation systems. The transition to e-payments will facilitate for effective monitoring and reduce the administrative costs incurred in the implementation of various social protection programmes.

2. Assessment of various poverty reduction programmes implemented by all Government ministries in partnership with Civil Society Organisations (CSO's), Non Governmental Organizations (NGO's), research institutions and Developing Partners. The assessments will provide for reallocation of funds to high impact poverty reduction programs and provide for reforms in other programs.

Government must ensure the effective and efficient implementation of the special financing mechanisms for funds allocated to social protection programs to prevent delayed payments.



PILLAR 3: Improving our economic and fiscal governance by raising the levels of accountability and transparency in the allocation and use of public finances;

It is encouraging to note that the Seventh National Development Plan (7thNDP) is using an Integrated Development Approach (IDA) for national planning. Further, the National Planning and Budgeting Policy needs to be fully implemented if we are to realize a coordinated and integrated national development planning and budgeting system that is responsive, transparent, accountable and results oriented. It is also important to note that in order to promote accountability and transparency, major steps in the decentralization agenda should be undertaken so that some powers and privileges are transferred to the periphery. Decentralization is a pathway to the notion of equal distribution of wealth as this would allow the citizenry to be part of the development process even at a more advanced level.

In promoting transparency, we need to understand that decentralization has two principal components: participation and accountability. Participation is chiefly concerned with increasing the role of citizens in choosing their local leaders (providing inputs into local governance). Accountability constitutes the other side of the process; it is the degree to which local governments have to explain or justify what is being done and what has not been done.

On another aspect, In promoting economic and fiscal transparency, we cannot overemphasize some challenges that have been identified in the Auditor Generals report relating to inadequate funding, shortfall in human resources needs and weak internal controls. The Public Finance Act No. 15 of 2004 provides for the formation of Audit Committees in all Ministries, Provinces and Spending Agencies (MPSAs). However, the Auditor Generals report (2015) reports that; although formed in the MPSAs, most of the Audit Committees have not been operational and therefore have not provided the required oversight on enhancing Corporate Governance in the MPSAs.

Having observed the Auditor General (AG) report in the past years, we notice that " Unvounchered expenditure" has continued to be the highest query. In the 2015 AG report, Unvouchered expenditure amounted to K349,306,160. As a country, we cannot continue to observe reoccurring queries every year, to this effect; focus should be on internal controls within the MPSAs.

In order to establish trust, it is important that the government provides accurate and complete information on assets and liabilities as well as revenues and expenses in a timely manner. Providing complete information on all transactions will demonstrate accountability. For citizens to fully hold Government accountable, there must be constant flow of information from the Government relating to finances to development delivery.

Issues that need to be addressed: Auditor Generals Report: Promoting transparency and accountability

1. Access to information: the Auditor General's report needs to be made more available. Accessibility of the report still remains minimal.

2. Inadequate skills and resources: there are some inadequacies in audit tools and logistics as well as a lack of technical knowledge in certain areas in the Auditor General auditing process. In some instances, there have been delays and challenges in the implementation of the Integrated Financial Management Information System (IFMIS).

3. Poor Internal Audits: provided for in The *"Public Finance Act 2004"* internal auditing procedures in Zambia have remained inadequate and this has been observed by the AG's office.

4. Lack of Sanctions And Follow- Up: Zambia experiences a fragile enforcement of sanctions and disciplinary action against contraventions, resulting in a continuation of infringement actions as no effective deterrent is in place. In some instances, there is also a lack of supervision, checking and monitoring by controlling officers to ensure compliance with regulations surrounding processes and procedures in the first place. There is also a lack of

follow up to ensure these actions and recommendations are implemented and necessary sanctions or recoveries of monies carried out.

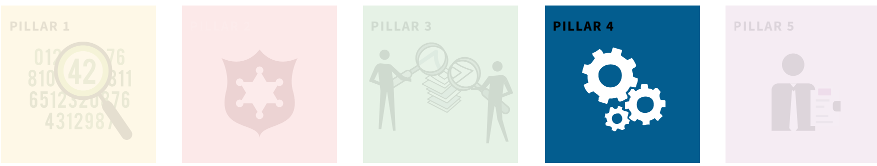
RECOMMENDATIONS

1. **IMPROVED ACCESS AND AWARENESS:** Public documents such as the National Budget and Auditor Generals report should be freely available to the public, with access provided online and in hard copies. This will improve society's awareness of financial matters and public expenditure, and promote greater transparency and accountability for public officers.

2. **GAP ANALYSIS OF FUNDING, SKILLS AND RESOURCES:** An assessment needs to be undertaken on the current funding needs and shortages, the staff levels and skills availability. Assessment should include a review of electronic systems in place, including IFMIS, to determine its success, resources to implement the system and future needs to improve implementation.

3. **REVIEW OF INTERNAL AND EXTERNAL AUDIT LINKAGES**: A review of the role of internal and external auditors needs to be undertaken, to determine key areas for improving linkages between the two, potential training needs, and measures to increase awareness on the role and importance of these audits within departments and ministries. The review also needs to consider internal and external audit processes, and key constraints affecting these.

4. **IDENTIFICATION OF ACTION IMPLEMENTATION MECHANISMS:** A review of processes to access the implementation of recommendations and action items following the PAC hearings need to be undertaken. Members of the Auditor General Office, the PAC and Parliament need to collaborate to identify appropriate mechanisms to monitor and review actions. Discussions need to identify roles and responsibilities, reporting mechanisms and sanctions for officers failing to implement recommendations.



PILLAR 4

The fourth pillar of the economic recovery programme that aims at restoring the credibility of the budget entails better planning, and adherence to expenditure plans and improvement of the quality of Government's spending. The government is planning to enforce measures that will enable the **budget support economic recovery** in the country by spending with available resources and spending on projects that will foster growth in the country. In its current status the country has several fiscal challenges that have led to debt accumulation and slow growth.

The continued accumulation of arrears and unplanned expenditure has led to the following:

The accumulation of government expenditure arrears is one of the most common problems in Public Financial Management (PFM) and it is a persistent problem among African countries. These arrears are financial obligations that have been incurred by any level of the public sector for which payments have not been made by the due date such as payment of social security benefits and payments of road construction which are the most common type of arrears in Zambia. These arrears distort the planned implementation of the budget and negatively impact on the government's finances and ability to deliver essential public services. In addition, incomplete information on arrears presents a risk that the real size of the government's deficit is concealed and the level of its liabilities understated.

On the other hand In the 2017 budget speech the Minister of Finance disclosed that the unplanned expenditure in the country has led to a cash deficit of around 3% of GDP especially from unplanned expenditure in fuel and electricity subsidies and the various road and infrastructure development projects of which most of them were not planned for and were financed by borrowed money.

In order for the government to achieve pillar number IV the following measures have been put in place in the 2017 budget.

1. Dismantling arrears to suppliers and contractors and immediately prevent the accumulation of new arrears through effective implementation of commitment control systems. To realise this the government has already started paying contractors money owed to them. As of December 2016, K190 million was released to pay contractors of which K 65 million was paid to the contractors working on the Kitwe- Chingola road.
2. Restrict new capital projects and major equipment procurements until all on-going projects are completed and slow down on capital infrastructure projects which are debt financed through costly borrowing.
3. Restore budget credibility and enhance transparency and accountability in accordance with the provisions of the Constitution relating to supplementary and excess expenditure. This can be realised if there is enforcement in the use of the revised legislation on the management of funds to ensure that those in charge of prosecution of those under audit query enforce appropriate disciplinary action.

RECOMMENDATIONS

1. Accumulation of arrears as seen poses a challenge to development, it is in this view that there is need for a comprehensive, transparent and credible strategy for controlling and preventing future arrears. This can be done by establishing mechanisms that do not allow Ministries, provinces and spending agencies (MPSAs) to incur arrears and expect the government to release money to clear the arrears instead they should spend within their current resources. The country should analyse the trends in arrears over the years, the sectors and agencies that are prone to incurring arrears, and the main causes of arrears

accumulation so that the information feeds into the development of a counter strategy to prevent arrears.

2. There is need for timely release of allocated funds as indicated in the budget by government to reduce the accumulation of arrears

PILLAR 5: Ensuring greater economic stability, growth and job creation through policy consistency to raise confidence for sustained private sector investment

The 5th Pillar of the economic program focuses on ensuring greater economic stability through policy consistency so as to improve private sector participation. Chiefly, the private sector must be segmented into local and foreign private investors and policies must be tailored to ensure that the local private sector become as competitive as their foreign counterparts. Tax incentives are one area that have been used to attract FDI, however, this has been done at the expense of the local private sector that have been made less competitive. Despite numerous government programs to support private sector development, a significant majority of local investors are still classified as Small Medium Enterprises (SMEs). According to the 1996 Baseline Survey on micro and small enterprises in Zambia, the sector consists of approximately 97% of all enterprises in the country (Parker, 1996), there has been little change to date.

Hence, in a bid to enhance economic growth, Government must refocus policy to ensure that the local private player become more competitive, this should be done by restructuring tax incentives to cater for the needs of local investors. A functional local private sector has the ability to provide employment, improve the terms of trade through import substitution, which would also lead to strengthening of the local currency and restoring the trade balance. Further, a strengthened local private sector will lead to reduced financial leakages that are as a result of over participation of foreign private investors in key economic activities that come at a huge cost to the nation.

Policy consistency is another key component of achieving the economic stability. The mining sector which is the largest contributor to foreign export earnings has been particularly challenging to this regard. The sector is vulnerable to changes on the international market and the Government in a bid to respond to these changes that affect output and revenue, has revised the tax regime three times in the last three years (2014 – removal of corporate income tax on profits; 2015 – re-introduction of corporate income tax; 2016: - flat mineral royalty rates). While it is important for the Government to be responsive, such moves in the long run make a sector unpredictable.

According to the World Bank's Foreign Direct Investment Survey (2013), a stable social and political environment is ranked 2nd in the determinants of FDI while national taxes are ranked 11th. This reiterates the need for policy consistency as well as a predictable economic framework as these enable investors to safeguard their investments. Further, it also provides insight on the importance of tax regimes. The survey indicates that taxes may not necessarily be of high priority in determining FDI. Thus investment policy should focus on ensuring a stable investment environment as opposed to the proliferation of tax incentives that undermine the efforts of local investors and erode the tax base.

In the 2017 Budget, Government has committed to supporting the creation of at least 100,000 decent jobs. Job creation improves the productive capacity of the economy and improves social welfare. The Government must let the private sector lead the process of job creation, policy must focus on creating an enabling environment for the private sector to thrive. Strategies should include reducing domestic borrowing, as this tends to crowd out private investment. However, we note that Government through the budget has indicated that it will maintain domestic borrowing to no more than 2% of GDP. Lastly , there is need to further reduce the cost of doing business by simplifying statutory requirements and providing the private sector with the appropriate incentives and conditions to enable them to meet Governments job creation targets.

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