Republic of Zambia

2011- 2013 MEDIUM TERM EXPENDITURE FRAMEWORK AND THE 2011 BUDGET

GREEN PAPER

Ministry of Finance and National Planning

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TABLE OF CONTENTS

FOREWORD

It gives me great privilege to present the 2011-2013 Green Paper, which constitutes the Government's first medium-term expenditure framework under the Sixth National Development Plan (SNDP). Whilst the SNDP is still in the draft stage, this MTEF provides a platform for concerned stakeholders to provide comments that could be factored in the 2011 Budget and the final draft of the SNDP.

Over the past five years, the economy has consolidated the macroeconomic stability gains achieved in earlier years, and has made significant strides in creating a vibrant and investor friendly growth and business environment. Growth has averaged above six percent per annum, and inflation has been brought down to single-digit levels.

Having achieved this economic stability, our focus over the medium term will be to embark on a bold and ambitious investment and diversification strategy. This will unlock even higher growth and remove bottlenecks that impede further private sector development across the remote areas of the country. At the same time, the Government will not relent in its efforts to increase spending in social sectors such as health and education. This investment strategy, therefore, will not only include the construction of roads, bridges, and energy projects, but also schools, health posts, and water and sanitation facilities.

It has been observed that the Government pays more for goods and services than it should be. One of the main messages in this Green Paper is the Government's aggressive intention of increasing the value of its money spent. As we embark on finalising the 2011 National Budget, therefore, I implore upon all Ministries, Provinces and Other Spending Agencies to measure every Kwacha against the guiding principle of "value for money", in both budget preparation and execution.

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1 MACROECONOMIC PERFORMANCE AND OUTLOOK

1.1 Introduction

The global recovery from the recent financial and economic crisis is now underway, with growth expected to be around 4 percent in 2010 and 2011, compared to a contraction of 0.6 in 2009. These projections, however, are fraught with risk as uncertainties of the extent of the recovery still persist. This uncertainty has been particularly reflected in the volatility of global financial markets, which have at best remained turbulent in recent months. The biggest concerns that seem to inhibit a restoration of confidence in global markets centre on the sustainability of the recent unprecedented fiscal expansion in advanced economies. The countries most affected by this lack of confidence from financial markets were Greece and other Euro area countries. Recent data has also revealed uncertainties over the extent of the recovery in emerging markets such as China and India, with recent consumer and industrial data faring below expectations.

Notwithstanding these developments, it is expected that the current recovery will gather momentum over the course of 2010 and a full recovery is expected in 2011. Global inflationary threats are expected to remain relatively weaker than in previous years, while the supply of credit is expected to ease alongside the global recovery, allowing for resumption in portfolio and investment flows to emerging markets.

While Zambia has largely benefited from the global recovery, prevailing uncertainties, however, have had a negative impact on the country's financial markets. In particular, substantial portfolio withdrawals led to exchange rate depreciation during the second quarter of 2010. This bears continued evidence to the sensitivity of Zambia's external sector to these global events. It also serves as a reminder that external shocks will continue to present a risk to the 2011-2013 MTEF.

1.2 Domestic Economic Developments in 2010

1.2.1 *Growth*

The economy is expected to continue along its growth trend, and is projected to grow by 6.6 percent in 2010. This is an upward revision from the projection of 5 percent contained in the previous MTEF (2010-2012) and 2010 Budget. The revision is on account of better than expected performance in several sectors of the economy during the first half of 2010. The agriculture sector recorded the largest maize harvest in history, of approximately 2.7 million tonnes compared with 1.8 million in the previous season. With this bumper harvest, growth in the agriculture sector is now projected at 7.7 percent, which is 5.7 percentage points higher than initial forecasts.

A recovery is also expected in the tourism sector following indications that spill over effects from the 2010 World Cup were better than expected. Further, observed increases in demand for international travel are also expected to contribute to growth in the sector. Preliminary data indicate that international passenger movements at the country's major airports increased by 17 percent during the first half of 2010, and stronger growth in arrivals at major tourist centres and national parks. In addition, the construction sector is also expected to contribute significantly to growth in 2010.

Copper output in the first half of 2010 increased by 10.2 percent to 363,682 metric tonnes compared to the first half of 2009, when a total of 330,125 metric tonnes was produced. This was attributed to the resumption of production at the Luanshya Copper Mines, as well as an increase in production at several other mining companies. With production expected to increase during the third quarter of 2010[1], total copper production is now projected at 740,000 metric tonnes, 8 percent higher than the 696,900metric tonnes produced in 2009. Production of nickel also commenced at Munali this year. Overall, the mining sector is forecast to grow by 5.9 percent in 2010.

The average price of copper on the international markets during the first half of 2010 was US$6,614 per metric tonne, representing an increase of 64 percent from the corresponding period of 2009 when the average price was US$4,034. This recovery in prices was a result of both a rebound in global demand, as well as supply constraints arising from the Chilean earthquake in early 2010. Copper prices, however, fell by 11.7 percent to US$6,515 per metric tonne at end-June 2010 from US$7,375 per metric tonne at end-December 2009. This was mainly due to the European debt and banking crisis, which affected the commodities market and dampened the demand for industrial metals. Since July, however, copper prices have recovered and traded at above US$7,000 per metric tonne, although there are risks that it could slip to the US$ 6,000 per metric tonne level due to renewed concerns about a weak global recovery.

1.2.2 *Inflation*

The annual inflation rate declined to 8.4 percent in July 2010 from the 14 percent recorded in July 2009, and was in line with the projected inflation path for the period. This outturn was mainly attributed to the slow-down in food inflation following improved supply of most food items, particularly cereals and vegetables. However, annual non-food inflation remained high, reflecting higher fuel prices coupled with the pass-through effects of the depreciation of the Kwacha against the US dollar and other major currencies. The overall inflation target for December 2010 remains unchanged at 8 percent; although it is expected that upward inflationary pressures may persist from the recent increase in electricity tariffs. This, however, should be mitigated by lower food prices as the result of the recent good harvest and expectations of a relatively stable exchange rate.

1.2.3 *Exchange Rate*

Weaker copper prices and the strengthening of the US dollar against the Euro during the first half of 2010 affected the exchange rate of the Kwacha against major currencies. This led to a 8.5 percent depreciation of the Kwacha against the US dollar from K4, 687.89 in December 2009 to K5,122.89 at end-June 2010. In August, however, the Kwacha recovered and appreciated to below K5,000 against the US dollar, as a result of an easing global risk environment and the resumption of portfolio inflows.

[1] Typically, mineral production seasonally rises during the second and third quarters on account of the dry season.

2 MACROECONOMIC FRAMEWORK (2011-2013)

2.1 Introduction

The macroeconomic framework for 2011-2013 will focus on maintaining macroeconomic stability, and building on the gains achieved during the last MTEF. It will also serve as the first MTEF under the Sixth National Development Plan (SNDP), in which the key macroeconomic objectives will be to:

- Expand and diversify the economy;
- Sustain single-digit inflation;
- Increase domestic revenue mobilisation;
- Reduce commercial lending rates;
- Maintain public debt sustainability; and
- Increase productive employment.

Economic growth during the MTEF (2011-2013) is projected to average 6.5 percent per annum on account of the continued strength and expansion of the Zambian economy, as well as a global economic recovery over this period. In 2011, growth is projected to slow down marginally to 6.4 percent, reflecting the return to trend levels in agriculture and tourism. Growth will be mainly driven by the construction sector, in part due to the commencement of large infrastructure projects in the energy and roads sectors. In addition, an increase in copper production and productivity gains at existing mines will also aid growth in the mining sector.

The transport and communications sector is also expected to continue expanding with the recent privatisation of Zamtel, the liberalisation of the international telecommunications gateway, and the imminent launch of 3G services in the country. The implementation of economic diversification, policy and structural reforms over the last MTEF period is also expected to unlock further growth over the period.

Inflation is projected to remain in single digits during this MTEF, in line with the projected normal crop harvest, as well as assumptions on the external economy. In a continued effort to reduce commercial lending rates and ensure that domestic borrowing does not potentially crowd-out credit to the private sector, the Government will continue to decelerate its accumulation of domestic debt during this MTEF. The overall fiscal deficit (including grants) is, however, expected to increase to an average of 3.5 percent of GDP during this MTEF, as Government continues with its ambitious infrastructure investment plans. This increase in the deficit will be financed primarily through sustainable external borrowing. Table 1 presents selected macroeconomic targets.

Table 1: Selected Macroeconomic indicators (2008-2013)

	2008	2009	2010*	2011*	2012*	2013*
Real GDP	5.7	6.4	6.6	6.4	6.6	6.7
CPI Inflation (end period)	16.6	9.9	8.0	7.0	6.0	5.9
CPI Inflation (annual average)	12.4	13.4	8.2	7.5	6.5	6.0
Overall Fiscal Balance (Including Grants, % of GDP)	-2.2	-2.7	-2.5	-3.4	-4.1	-3.0
Domestic Borrowing (% of GDP)	1.8	2.1	1.9	1.4	1.3	1.2
Gross International Reserves (months of import cover)	2.1	5.1	>4	>4	>4	>4
Change in GDP deflator	12.3	10.7	5.2	5.1	5.4	5.4
Commodity Price Assumptions						
Annual Average Copper Price (US$ per pound)	2.9	1.9	3.0	3.2	2.9	2.7
Annual Average Copper Price (US$ per metric tonne)	6,393	4,189	6,614	6,950	6,500	6,000
Oil Price (US$ per barrel)	97.5	61.8	77.14	80.0	82.75	84.0
Copper production (metric tonnes)	575,000	696,900	740,00	800,873	869,498	904,498

* Projection

2.2 Monetary Policy Outlook

Monetary policy will continue to focus on maintaining single digit inflation while ensuring adequate levels of liquidity for the growing economy. Inflation is expected to further decrease from the projected level of 8.2 percent in 2010, to reach 7 percent by end-2011, and remain at around 6 percent in the outer years of this forecast. As indicated earlier, these projections are premised on food prices and the exchange rate remaining stable.

Additionally, monetary policy tools are being reviewed with the aim of ensuring an optimally designed monetary framework that will support the Zambian economy going forward. The key outcomes of this review will be implemented over the course of this MTEF.

2.3 Fiscal Policy Outlook

Government will adopt an expansionary fiscal policy stance during this MTEF, in order to accelerate investments in infrastructure and the social sectors. This expansionary stance, however, will be within sustainable and acceptable fiscal limits, so as to ensure that macroeconomic stability is not threatened. Over this MTEF period, the overall fiscal deficit (including grants) is expected to increase to an average of 3.5 percent of GDP, from 2.5 percent during the 2008-2010 MTEF. Further, in order to address the challenge of increasing revenues to the Treasury, a comprehensive reform of the current tax system will be undertaken so as to broaden the tax base and increase revenues.

2.4 External Outlook

Although a full global recovery is expected during this MTEF, there continues to remain uncertainty from turbulent financial markets, and a general lack of investor confidence. As a result, copper prices may moderate somewhat from present levels, particularly in view of uncertainties in the extent of the recovery in emerging markets such as India and China. These risks continue to underscore the country's overdependence on a single export commodity and its susceptibility to volatile commodity price movements. As a result, the build-up of gross international reserves is expected to slow down compared to the 2008-2010 MTEF. Reserves are expected to remain in the region of 4 months of imports.

Over the years, a flexible and fully convertible exchange rate has served Zambia well, as particularly evidenced by Zambia emerging relatively unscathed from the recent financial crisis. Accordingly, there will be no shift in the Government's policy of maintaining a fully flexible exchange rate regime.

Over the medium term, the current account is expected to remain in deficit, but within sustainable trend deficit levels. Imports are expected to grow in line with new public and private investments, particularly in the roads, energy and mining sectors. Exports are also expected to grow as a result of higher copper and mineral export volumes forecast over this MTEF period.

2.5 Investment Policy Outlook

The Government is committed to accelerating private sector investment so as to achieve increased and diversified growth. The Government will, therefore, continue to create a vibrant and enabling environment for both domestic and foreign investment. Measures will include providing requisite land and infrastructure, creating a business-friendly licensing environment; stimulating domestic entrepreneurship through empowerment funds and capital financing; and providing investment incentives.

Planning for the Lusaka South and East Multi-Facility Economic Zones was completed over the last MTEF, and the process of mobilising resources for their development is expected to commence soon. In addition, a new Zone was designated at Lumwana in 2010, where development is expected to commence over this MTEF. These Zones and industrial parks are aimed at creating linkages in the economy that will eventually expand Zambia's manufacturing base, and reduce dependency on imported inputs.

2.6 Aid Policy and Management Strategy

In line with Zambia's vision of becoming a prosperous middle-income country by 2030, it is expected that aid dependency should reduce over time. This requires that economic growth and diversification are accelerated and sustained while the domestic revenue base is expanded. This is also important in light of heightened unpredictability of Cooperating Partner resources over the recent past.

Over the medium term, development assistance will, however, play a role in light of the development challenges the country is facing. The Government, in collaboration with Cooperating Partners, are in the process of developing a new Joint Assistance Strategy for Zambia (JASZ) within the framework of the Paris declaration to succeed the one developed for the FNDP. This strategy will not only be used to manage and harmonize arrangements with Cooperating Partners, but also guide and monitor their overall performance. At the same time, the Government will continue to place strong emphasis on strengthening public financial management, to ensure that all resources, both domestic and external, are utilised in an accountable, efficient, and transparent manner.

Estimates of development assistance provided in the fiscal framework (Chapter 3) are based on indicative commitments by Cooperating Partners. It should be noted that grants from Cooperating Partners are subject to change, because at the time this MTEF was being prepared, some Cooperating Partners had not yet made firm commitments for the medium-term. With regard to new projects that will be undertaken during the SNDP period (as differentiated from continuing projects), the Government will work with Cooperating Partners to establish a system of candidate project selection that ensures strict alignment to national development priorities under the SNDP.

2.7 External Debt Policy and Management Strategy

External borrowing will increase significantly during this MTEF period in order to finance economic infrastructure that is urgently needed across the country. The Government expects to contract approximately US $2 billion to support the financing of various infrastructure projects during this MTEF period that are outlined in Tables 2 and 3. The contraction of this debt will increase Zambia's debt to GDP ratio from 9.1 to about 14.9 percent of GDP over this MTEF period, which is still well within sustainable limits.

2.8 Risk assessment of the Macroeconomic Framework and Estimates

The macroeconomic framework and policy environment outlined above was projected under a number of assumptions about both the domestic and external economic and political climate. These assumptions, however, come with a number of upside and downside risks, which could affect macroeconomic outcomes over the course of this MTEF.

2.8.1 *Global environment*

The global economic environment poses the most significant risk to macroeconomic estimates over this MTEF. In particular, there are continued concerns that the recovery may slow down or even reverse into a second round of recession. Should this happen, it is almost certain that global demand for copper will be negatively affected. This would lead to lower than projected Government revenues, and pose a threat to GDP growth. Global investor appetite for emerging market securities could also dry up under this scenario. This would lead to a depreciation of the exchange rate and an increase in volatility.

On the other hand, a stronger than expected recovery, particularly if this recovery comes towards the end of 2010 and early 2011, combined with global copper supply constraints, could see copper prices rise well beyond the US$ 7000 per metric tonne level. This would lead to a more favourable growth and external sector outcome for the Zambian economy, and would result in more buoyant Government revenues.

2.9 Climatic conditions

The agriculture sector has been a strong contributor to growth in 2009 and 2010. This sector continues to be pivotal to growth and poverty reduction in Zambia. In preparing these macroeconomic estimates, growth in agriculture has been premised on a continuation of favourable climatic patterns, and continued investments in storage facilities. Unforeseen shifts in the climatic pattern could threaten this outcome, and thereby negatively impact growth estimates for the medium term.

2.10 Domestic factors

The exponential growth of the wage bill over the last five years constitutes the largest risk to the continued ability of the Government to create the necessary fiscal space to engage in widespread poverty reduction efforts. The majority of civil service recruitment over this period, however, has been exclusively targeted at social sectors such as health, education, and police services. This recruitment effort has led to marked improvements in service delivery over the last five years. Wages are expected to consume an average of 44.5 percent of domestic revenues during this MTEF, compared with an average of 48.3 percent in the 2008-2010 MTEF period.

Despite this downward trend, the wage bill still consumes an excessively high share of domestic revenue. To tackle this, the Government has committed to engaging in medium-term pay reforms aimed at rightsizing Government operations and ensuring that Zambians can enjoy an efficient and productive civil service. Delays in engaging these reforms could further erode resources over the medium term.

The most significant challenge, however, will be in containing the annual wage awards to within inflationary levels. Wage awards have been consistently above inflation for the last five years, and have been the single largest contributor to the exponential growth in the wage bill.

The forthcoming general elections in 2011 will also pose a risk to the macroeconomic framework. As evidenced across emerging economies worldwide, investment activity reduces around an election period. In particular, this is more acutely observed with portfolio investments. To Zambia's advantage, however, will be the fact that it has always enjoyed peaceful elections in the past, and this will mitigate investor risk during this period of uncertainty.

This macroeconomic forecast is also premised on the timely completion of certain large-scale investments, such as key mining projects, as well as the completion of the Kariba North Bank Extension project. Delays in the completion of these investments would pose a downside risk to growth over this MTEF period.

2.11 Donor Assistance

Development assistance from Cooperating Partners has been particularly unpredictable over the last two years. Two main factors have contributed to this outcome. First, weaknesses in financial management in the health and roads sectors have led to direct suspensions of aid assistance to these sectors as well as to general budget support. Further, uncertain political climates in our partner countries have also heightened volatility and delays in disbursements. These factors combined have had a significantly negative effect on budget execution in 2009 and 2010. This uncertainty is expected to continue into this MTEF period, in view of recent changes of governments and forthcoming elections in partner countries. Budget support in particular, which is the Government's preferred aid modality, has come under threat as the debate around its effectiveness continues.

Major changes in policy from our Cooperating Partners could pose significant downside risks to these macroeconomic estimates, particularly in view of the role that development assistance has both on the budget, as well as on the external sector. On the other hand, increases in support will have a positive effect on both the fiscal and external accounts of the economy.

2.12 Economic Strategies

The key economic objective in the medium term will be to expand and diversify the economy, create higher employment and tackle the high poverty levels, especially in the rural areas. To realise this objective, the 2011-2013 MTEF will address the identified constraints inhibiting rapid and diversified growth and rural development. Poor and inadequate infrastructure and low human capital have widely been identified as some of the key factors that constrain economic growth and wealth creation.

This MTEF will, therefore, focus on expanding investments in infrastructure and human capital development. In terms of infrastructure, priority will be on energy, transportation (roads, rail, and border infrastructure), communication, water supply and sanitation. In line with the goal to enhance rural development, projects that improve service provision in rural areas, such as rural electrification, universal access to telecommunications, and the development of rural feeder roads, will be scaled up, while also enhancing agriculture development.

In line with commitments made in the 2009-2011 and 2010-2012 MTEFs, the Government will continue to prioritize resources towards economic diversification. Crop production, livestock development, tourism, and manufacturing will be the main focus areas during this MTEF. Resources in agriculture will be allocated towards the enhancement of extension services, livestock disease control and management, and farmer input support, among others.

In tourism, the Government will continue with its efforts to develop the Northern tourism circuit through the completion of infrastructure and the attraction of private sector investment in the Kasaba Bay area. Work will also continue on the wider development of the Greater Livingstone Area and Kafue National Park, with the aim of improving access infrastructure, wildlife management and anti-poaching efforts, as well as to increase the number of private investments in the national park.

Over the course of this MTEF, the energy sector will receive substantial focus of both the Government as well as the private sector. In particular, construction works will commence on flagship projects such as the 700-800MW Kafue Gorge Lower, and the 120MW Itzehi-tezhi. The Kariba North Bank Extension project, which commenced in 2009, is likely to be completed towards the end of this MTEF. With the completion of these projects and various other private sector initiatives such as the Kabompo Gorge, Kalungwishi, Lunsemfwa, Luapula River, and others, more than 1,000 megawatts of capacity will be added to the national grid. These efforts are expected to secure Zambia's future energy requirements, and serve as an important part of the Government's export diversification strategy.

The road network in the country is also expected to receive significant attention over the course of this MTEF. The Government's main focus will be on completing large projects of national importance that have remained incomplete for a number of years. These roads include the Kasama-Luwingu, Choma-Chitongo-Namwala, Mutanda-Chavuma, and Chipata-Lundazi roads. Efforts will also be stepped up to improve regional connectivity, such as through the completion of the Kazungula bridge (Botswana), Mongu-Kalabo-Sikongo road (Angola), the Great East road / Nacala Corridor (Malawi/Mozambique), as well as the Sesheke-Senanga-Mongu road (Namibia). Improvements will also be made to the Bottom road along the shores of Lake Kariba, with the aim of improving agriculture and tourism in the area.

Further, in the expansion of both road and energy infrastructure, the role of the private sector is expected to be vital in attaining the Government's objectives within the Public-Private Partnership (PPP) framework. Table 2 presents some selected projects by both Government and Private Public Partnership expected to be undertaken over the course of this MTEF:

Table 2: Selected Projects under Government and Public Private Partnership (US $ Millions)

Project	Estimated cost	Location	Type	Status
Government				
Power Generation Projects				
Kafue Gorge Lower (600-700Mw)[2]	1,500	Lusaka Province	BOOT	Financier for project has been identified
Lusiwasi Mini Hydro	61	Central Province	Yet to be decided	1997 feasibility studies being reviewed
Lunzua Mini Hydro	37	Northern Province	Yet to be decided	1998 feasibility studies being reviewed
Power Transmission Projects				
Itezhi Tezhi Transmission	146.5	Southern Province	TBA	Feasibility completed
Kariba North Bank Transmission	50	Southern Province	TBA	Feasibility completed
Electricity Access Expansion				
Distribution Intensification and Grid Extension Project (23 projects in rural areas)	33	Countrywide	TBA	Consultancy being sought
Road Projects				
Choma-Chitongo	29.5	Southern Province	Public	Project on-going
Kasama-Luwingu	35.5	Northern Province	Public	Project on-going
Kabompo-Zambezi-Chavuma	60	North Western	Public	Feasibility completed
Mongu-Kalabo	229	Western Province	Public	Project on-going
Lundazi-Chama-Muyombe-Isoka	151	Eastern Province	Public	Project on-going
Mongu-Senanga-Sesheke-Katima mulilo	155	Western Province	Public	Feasibility study completed
Road in the Nansanga Farm Block	6.44	Northern Province	Public	Project on-going
Chembe-Mansa	8	Luapula Province	Public	Project on-going
Mfuwe-Chipata	63	Eastern Province	Public	Project on-going
Landless corner-Mumbwa	68	Central Province	Public	Feasibility completed
Mansa-Luwingu	61	Luapula/Northen Province	Public	Project on-going
Other Infrastructure				
Lusaka urban development (water supply, sanitation & drainage)	198	Lusaka Province	TBA	Feasibility study on-going
Multi-Facility Economic Zones	120	Lusaka Province	TBA	Project on-going
Construction of Lusaka National Stadium	96	Lusaka Province	TBA	Discussions on-going

Project	Estimated cost	Location	Type	Status

[2]The Project is expected to be implemented as a PPP and GRZ might contribute about 15 % of the total project cost

Public Private Partnership				
Road Projects				
Chingola-Solwezi-Mwinilunga-Jimbe	600	Copperbelt/N.Western	BOT/Tolling	EOI
Kitwe Chingola		Copperbelt	BOT/Tolling	EOI Advertised
Chingola-Jimbe Border		Copperbelt/N.Western	BOT/Tolling	EOI Advertised
Lusaka-Livingstone		Lusaka/Southern Province	BOT/Tolling	EOI Advertised
Kafue –Chirundu		Lusaka/Southern Province	BOT/Tolling	EOI Advertised
Rail Project				
Chingola-Solwezi-Lumwana-Jimbe railway line;		C/Belt/Nwestern	TBA	Still under consideration
Kazungula-Livingstone railway spur		Southern Province	TBA	Still under consideration
Kafue Lions den;		Lusaka Province	TBA	Still under consideration
Njanji commuter		Lusaka Province	TBA	Still under consideration
Nseluka-Mpulungu railway spur;		Northern Province	TBA	Still under consideration
Solwezi via Kasempa-Kaoma-Mongu to Katima Mulilo		N/Western/Southern/Western	TBA	Still under consideration
TAZARA line to Chipata		Eastern/Northen Province	TBA	Still under consideration
Operation of train services between Chipata and Mchinji		Eastern Province	TBA	Still under consideration
Zambia Railways Concession		Countrywide	Concession	Concession entering 7th year of operation
Border Post Infrastructure				
Kasumbalesa		Copperbelt Province	BOT	Developer mobilized/on site
Kazungula		Southern Province	BOT	EOI Advertised
Nakonde		Northen Province	BOT	EOI Advertised
Mwami		Eastern Province	BOT	EOI Advertised
Jimbe		N/Western	BOT	EOI Advertised
Kipushi		N/Western	BOT	EOI Advertised
Energy				
Itezhi Tezhi (120Mw)	200	Southern Province	TBA	Financial closure being pursued
Development of Kabompo mini-hydro		Western Province	TBA	Still under consideration
Development of Kalungwishi mini-hydro		Northern Province	TBA	Still under consideration
Development of Mombututu mini-hydro		Luapula Province	TBA	Still under consideration
Upgrade of Indeni and TAZAMA		Copperbelt/Northern	TBA	Feasibility Study advertised

Project	Estimated cost	Location	Type	Status

Estate & Housing				
Government Offices Complex		Lusaka Province	Maintenance Contract	Implementation in progress
UNZA Hostels		Lusaka Province	BOT	Completed
UNZA Ultra modern business park		Lusaka Province	BOT	Feasibility and selection
Luburma Market		Lusaka Province	BOT	Implementation in progress
4 000 Housing Unit each in Livingstone, Lusaka and Ndola		Lusaka/Southern /C/Belt Province	BOOT	Advertised
Health				
Development of an ultra-modern centre of Excellency hospital in Lusaka		Lusaka Province	TBA	Still under consideration
Development of 3 diagnostic health facilities in Lusaka, Livingstone and on the Copperbelt.		Lusaka/Southern/Copperbelt	TBA	Still under consideration

Note: **EOI – Expression of Interest / BOT – Build Operate Transfer / BOOT – Build Own Operate Transfer / TBA – To be assessed**

2.13 Social Sector Strategies

The Government will continue to place a high priority on investments in the social sectors. In this regard, allocations will be scaled up in the key sectors of health, education and water and sanitation.

Over the years, primary education enrolments have expanded significantly and Zambia is firmly on track to meet the MDG goal of universal access to education. While there are now many more pupils in schools, there is need to ensure that the quality of education is not compromised. Focus, therefore, will be on improving learning standards and increasing resources to key inputs. Special attention will also be placed on skills development and increasing access to high school, tertiary, and technical/vocational education.

In the health sector, strategic efforts will focus on the improvement of service delivery, particularly in rural areas. This will be achieved by the continued recruitment and retention of key frontline medical personnel; infrastructure development and rehabilitation; provision of essential equipment; and improvements in the supply chain of drugs across the country. Furthermore, key reforms will be undertaken, including the finalisation of revisions to the National Health Policy of 1992 in order to harmonize the various policies and pieces of legislation. Additionally, the Government will embark on the development of a comprehensive National Health Service Act, in order to provide a legal framework for the operation of health services in the country.

In the area of water and sanitation, the Government's strategic focus will be to continue with the implementation of the National Rural and Urban Water Supply and Sanitation programmes. The Rural programme, in particular, will be scaled up to support the objective of accelerating rural development and the attainment of the Millennium Development Goal of increasing sustainable access to safe drinking water and sanitation.

2.14 Structural Reforms

2.14.1 *Public Financial Management*

The need to improve financial governance through a credible budget and procurement system is of paramount importance. To this end, the Government over the medium term will continue pursuing reforms to the public financial management (PFM) system through the development of a new PFM Reform Strategy for 2011 onwards. Key reforms, among others, will focus on:

- Improving the preparation and execution of the budget;
- Enactment of planning and budget legislation;
- Strengthening expenditure control, accounting, audit functions and reporting; and
- Improving cash management through a Single Treasury Account System.

Major activities expected to continue during this period include the rollout of the Integrated Financial Management and Information System (IFMIS) that has been piloted at the Ministry of Finance and National Planning. Once fully implemented, IFMIS will improve record keeping, budget preparation and execution, and the timely preparation of Government accounts. The Government will also introduce planning and budgeting legislation aimed at reinforcing the budget planning process, and budget execution by MPSAs. Additionally, the Government will speed up the decentralization of the procurement system to MPSAs so that the Zambia Public Procurement Authority plays its regulatory and capacity building role.

2.14.2 *Financial Sector Development*

The level of access to financial services in Zambia has remained low for a long time. The FinMark Trust study (2009) revealed that only 37.3 percent of Zambians have access to finance, leaving two thirds of the population without access to financial services. In order to address these challenges, the Government has extended the Financial Sector Development Programme (FSDP II) for an additional three years until December 2012.

The key objectives of FSDP II will be to enhance access to financial services, while stimulating competition and promoting improvements to market infrastructure. Key programme components will include legal and regulatory reforms; enhancing the payments system; enhancing market efficiency; and enhancing transparency and human resource development. Additionally, the programme will complement measures to increase access to rural finance that is being undertaken under the Rural Finance Programme. The aim of these efforts over the long run will bring depth, resilience and competition to the Zambian financial markets, and will result in increased lending, improved access to finance, and lower costs.

2.14.3 *Business and Investment Facilitation*

The business environment and climate has steadily increased over the past few years. In the World Bank's Doing Business Report 2010, the country is ranked 90 out of 183 countries, an improvement from 99 out of 178 countries in 2009. These improvements have been, in large part, through implementation of reforms under the Private Sector Development Reform Programme. Recognising the need to further improve the business and investment climate in the country, the Government will continue with measures to reduce the high cost of doing business that have been identified as a binding constraint to growth and private sector development in the country. In this regard, reforms to reduce the number of licenses will continue through legislative reforms. Additionally, efforts to shorten time for trading across borders, through integration of the operations of agencies at various border posts will also continue.

2.14.4 *Other Key Reforms*

Other structural reforms over this MTEF will be focused on institutional, legal, and policy reform in key infrastructure and growth sectors such as telecommunications, energy, and transportation. Following the reforms undertaken in the telecommunications industry over the last MTEF period, the Government will continue to focus on enhancing competition in the industry so as to further reduce costs, which continue to remain above regional averages.

In the energy sector, a review of the petroleum sub-sector will be undertaken to determine the optimal measures required to achieve efficiency and cost effectiveness in the petroleum supply chain. Under the electricity sub-sector, reforms will continue to emphasise on tariff reform to ensure full cost recovery, in order to attract and sustain private investment. Efforts will also continue to improve the ageing transmission and distribution networks. Further, the Government is in the process of establishing a grid code to ensure fair and efficient sharing of distribution networks, especially as private investment in electricity generation expands. In addition to efforts to accelerate rural electrification, the Government will study the possibility of enhancing affordability of electricity to rural households, while still remaining committed to full cost recovery.

In light of the importance of rail transportation in national development and given the sharp deterioration in the performance of the sector over the last decade, a review of the existing concessions will be completed with the aim to raise investment in the sector. With regard to the road sub-sector, focus will be to implement reforms with a view to improving management capacities, including monitoring and supervision, so as to achieve value for money and effectiveness in project execution.

Long processing delays at our country's borders continue to present one of the biggest impediments to the enhancement of national competitiveness. Already facing a relative disadvantage of being landlocked, the movement of goods and services across borders must be undertaken in the most efficient manner to reduce both time and cost.

In this regard, the Government has embarked on the rehabilitation and upgrading of all border posts, which has commenced with the Kasumbalesa Border facility (D.R. Congo). Once completed, this "one-stop" border complex will significantly enhance the flow of goods and services, and reduce clearance times. Work on the remaining border posts will continue over the course of this MTEF. In addition, work is also underway by the Zambia Revenue Authority to centralise the processing of customs data, and is engaging in bilateral steps with neighbouring customs administrations to speed up and simplify the clearance process.

Tourism development in Zambia cannot thrive on investment alone. It requires both a sound regulatory environment, as well as a competitive enabling environment. In this regard, the Government is in the process of submitting legislation to more efficiently regulate the tourism and hospitality sector.

The labour market in Zambia has been characterised by rigidities, particularly with regard to the costs associated with job separation, which are the highest in the region[3].This has consistently discouraged employers from creating more jobs, and has contributed to mismatches between wages and the prevailing living conditions in the economy. In response to these challenges, the Employment Act (Cap 268), Minimum Wages Act (Cap 269) and the Industrial Relations Act (Cap 270) will all be reviewed with the aim of encouraging more formal sector employment and improvements in the quality of the workforce. Further, the Government will take a deliberate policy to encourage job creation through use of local labour based suppliers in undertaking some government programmes such as local school desk production.

[3] Doing Business Index 2010

3 FISCAL STRATEGY AND FORECAST

3.1 Fiscal Trends 2007-2009

Fiscal policy in the period under review was anchored on prudence and placed emphasis on safeguarding macroeconomic stability and leaving room for growth of private sector investment. In this regard, budget deficits averaged 1.7 percent of GDP and domestic borrowing averaged only 1.3 percent of GDP. In addition, fiscal policy focussed on creating fiscal space through the expansion of domestic revenues and reduction of lower priority expenditures. This was aimed at facilitating an increase in spending on infrastructure so as to encourage diversification of the economy. As such, expenses (current expenditure) declined from 19.6 percent of GDP in 2007 to 18.2 percent in 2009 while assets (capital expenditure) rose from 3 percent of GDP in 2007 to 4.0 percent of GDP by 2009.

Table 4: Revenues and Expenditures (Kwacha Millions), 2007-2009

	2007 Budget	2007 Actual	2008 Budget	2008 Actual	2009 Budget	2009 Actual	2010 Budget
GDP	**46,195**	**46,195**	**55,079**	**55,079**	**65,754**	**65,754**	**76,191**
Revenues and Grants	**10,306**	**10,626**	**12,802**	**12,304**	**13,652**	**13,105**	**14,534**
Domestic Revenues	**8,125**	**8,522**	**10,523**	**10,235**	**10,883**	**10,315**	**12,107**
Tax	7,807	8,184	9,828	9,668	10,429	9,661	11,385
Non Tax	318	338	695	567	454	654	722
Grants	2,180	**2,104**	2,279	**2,069**	**2,769**	**2,790**	**2,427**
Total Expenditure	**11,547**	**10,735**	**14,342**	**13,540**	**15,216**	**14,841**	**16,422**
Expenses	**8,380**	**9,046**	**10,423**	**10,538**	**11,565**	**11,945**	**13,112**
o/w Wages	3,535	3,531	4,256	4,465	5,100	5,274	6,025
Assets	**2,827**	**1,367**	**3,250**	**2,409**	**3,299**	**2,618**	**3,041**
Domestically Financed	1,350	1,083	1,560	1,271	1,827	1,842	1,888
Liabilities	**339**	**322**	**669**	**593**	**352**	**278**	**269**
Overall Balance	**-1,241**	**-109**	**-1,539**	**-1,236**	**-1,564**	**-1,736**	**-1,888**
Financing	**1,241**	**109**	**1,539**	**1,236**	**1,564**	**1,736**	**1,888**
External	743	145	619	257	1,069	243	401
Domestic	498	-36	921	979	495	1,493	1,487

Table 5: Revenues and Expenditures (Percent of GDP), 2007-2009

	2007 Budget	2007 Actual	2008 Budget	2008 Actual	2009 Budget	2009 Actual	2010 Budget
Revenues and Grants	**22.31**	**23.00**	**23.24**	**22.34**	**20.76**	**19.93**	**19.08**
Domestic Revenues	**17.59**	**18.45**	**19.11**	**18.58**	**16.55**	**15.69**	**15.89**
Tax	**16.90**	**17.72**	**17.84**	**17.55**	**15.86**	**14.69**	**14.94**
Non Tax	**0.69**	**0.73**	**1.26**	**1.03**	**0.69**	**0.99**	**0.95**
Grants	**4.72**	**4.55**	**4.14**	**3.76**	**4.21**	**4.24**	**3.19**
Total Expenditure	**25.00**	**23.24**	**26.04**	**24.58**	**23.14**	**22.57**	**21.55**
Expenses	**18.14**	**19.58**	**18.92**	**19.13**	**17.59**	**18.17**	**17.21**
o/w Wages	7.65	7.64	7.73	8.11	7.76	8.02	7.91
Assets	**6.12**	**2.96**	**5.90**	**4.37**	**5.02**	**3.98**	**3.99**
Domestically Financed	2.92	2.34	2.83	2.31	2.78	2.80	2.48
Liabilities	**0.73**	**0.70**	**1.21**	**1.08**	**0.54**	**0.42**	**0.35**
Overall Balance	**-2.69**	**-0.24**	**-2.80**	**-2.24**	**-2.38**	**-2.64**	**-2.48**
Financing	**2.69**	**0.24**	**2.80**	**2.24**	**2.38**	**2.64**	**2.48**
External	**1.61**	**0.31**	**1.12**	**0.47**	**1.63**	**0.37**	**0.53**
Domestic	**1.08**	**-0.08**	**1.67**	**1.78**	**0.75**	**2.27**	**1.95**

3.1.1 *Revenue and Grants Trends*

Revenue and grants in the period under review declined from 23 percent in 2007 to 19.9 percent of GDP in 2009. This was mainly attributed to the adverse impact of the global financial crisis on tax collections and grant receipts especially in 2008 and 2009.

Consequently, domestic revenues declined from 18.5 percent of GDP in 2007 to 15.7 percent in 2009.[4] This was mainly on account of the taxes that fell sharply from 17.7 percent of GDP in 2007 to 14.7 percent in 2009 and was attributed to lower than projected collections under customs duty, excise duty and import VAT. Non-tax revenues averaged 0.9 percent of GDP over the medium term.

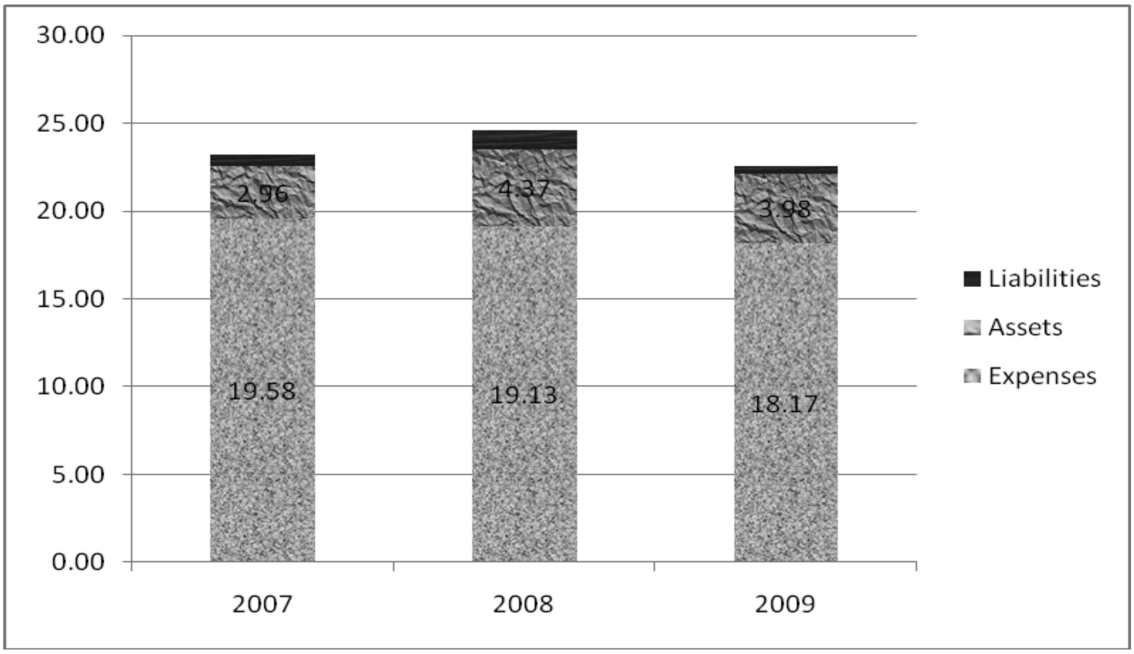
Grants receipts from Cooperating Partners declined from 4.6 percent of GDP in 2007 to 4.2 percent in 2009.

3.1.2 *Expenditure Trends*

With declining revenue and grants, total expenditures in the review period also declined as a share of GDP from 23.2 percent in 2007 to 22.6 percent in 2009. In line with the Government's policy to reduce lower priority expenditures and bolster resources for infrastructure development, spending on assets (capital expenditure) increased by 1 percentage point while expenses (current expenditure) decreased by 1.4 percentage points.

[4] Preliminary budget GDP numbers were K45,283 billion for 2007, K50,716 billion for 2008 and K63,257.5 billion for 2009.

Figure 1: Expenses, Assets and Liabilities as a Percentage of GDP, 2007-2009



Expenses declined from 19.6 percent of GDP in 2007 to 18.2 percent by 2009. The reductions were mainly in the areas of foreign travel, workshop and seminar and other related costs. Even though expenses were seen to be declining over the period, expenditures such as salaries and wages remained relatively high as they accounted for 39 percent in 2007, 42.4 percent in 2008 and 44.2 percent in 2009. The increasing trend in the wage bill was mainly accounted for by a higher than budgeted wage and salary award in all the three years.

In line with the Government's policy to direct more resources to infrastructure development, spending on assets for the period under review rose from 3 percent of GDP in 2007 to 4 percent of GDP in 2009. The resources were largely directed towards education and skills development, roads and health, accounting for 80 percent over the period. Liabilities in the same period reduced as a share of GDP, from 0.7 percent in 2007 to 0.4 percent in 2009. This was in line with the Government's objective of dismantling all arrears.

3.1.3 *Overall Balance Trends*

Although both revenues and expenditures rose in the period under review, expenditures increased at a higher rate. As a result, the overall deficit increased from 0.2 percent of GDP in 2007 to 2.6 percent in 2009. This was higher than the target for the period by 10.1 percent.

3.1.4 *Outturn for First Half of 2010*

In its 2010 National budget, the Government's aim was to continue to pursue prudent fiscal management, while simultaneously providing for an environment for high economic growth. While this has been largely achieved, challenges have come to the fore. The first half of 2010 has been characterised by revenue shortfalls on some taxes. By end-June 2010, revenues were below target by 5.9 percent leading to a compression of releases to most expenditure categories. In addition, smooth budget execution was compounded by the higher than budgeted wage award to civil servants and led to a diversion of resources from expenditures on priority areas.

In the second half of 2010, the Government aims to enhance efforts in revenue collection and will borrow externally so as to protect the 2010 fiscal and growth objectives, particularly infrastructure development. As a result, external financing is expected to be 0.6 percent of GDP by the end of the year. The overall fiscal balance (including grants) is now projected to be 2.6 percent of GDP for the year.

3.2 Fiscal Policy for the 2011-2013 MTEF

Prudent fiscal policy will remain critical during the 2011-2013 MTEF period in order to augment economic gains made in the last five years and support overall economic growth. In this regard, the focus will be to create fiscal space through the expansion of domestic revenues, the reduction of lower priority expenditures and the allocation of more resources to infrastructure and human development. To increase the scope of infrastructure development, the Government will vigorously explore private sector financing under the public private partnership arrangement.

3.3 Fiscal Measures for 2011-2013 MTEF

3.3.1 *Revenue Mobilisation*

Domestic revenues as a share of GDP have been declining over successive MTEF periods. In order to arrest this trend, the Government will step up its efforts to increase domestic revenues. The Government has already commenced a review of tax policy and administration with the aim of reviewing tax incentives, particularly with regard to exemptions under VAT, customs and excise duties. In addition, the Government will continue with its modernisation programme at the Zambia Revenue Authority in order to improve tax administration and compliance. Over the course of this MTEF, comprehensive tax reforms will be undertaken with the objective of increasing revenues from 15.9 percent of GDP in 2010 to around 18 percent.

3.3.2 *Expenditure Measures*

The Government will place emphasis on the efficiency of resource use and realign expenditures in order to create room for development and investment spending by:

i. Avoiding spreading development resources too thinly across numerous programmes and projects;

ii. Freeing up additional resources through aggressive cost-cutting measures such as reductions in administrative expenditures;

iii. Focusing on productivity and "value for money" at every stage of the expenditure process including policy, budgeting, procurement and execution;

iv. Developing a benchmarking mechanism and price database to ensure that Government procurements are at competitive prices to ensure "value for money"; and

v. Reversing unsustainable trends in the public wage bill.

3.3.3 *Medium Term Forecast*

Total domestic revenues and grants are projected to marginally increase from 19.6 percent of GDP projected in 2010 to 20.7 percent by 2013. Domestic revenues are projected to increase from 16.3 percent of GDP projected in 2010 to 18.6 percent by 2013. Tax revenues, as a share of GDP, are projected to rise steadily from 15.4 percent of GDP projected in 2010 to 18 percent in 2013. The increase in tax revenues is expected to come from direct and value added taxes. This is premised on both a buoyant economy as well as improvements in tax administration and policy. Non-tax revenues are projected to remain constant at about 0.6 percent of GDP during the medium term.

Grants from Cooperating Partners, on the other hand, are projected to decline from 3.3 percent of GDP in 2010 to 2.1 percent by 2013. These estimates are conservative, however, as firm commitments have not yet been received from a number of Cooperating Partners.

Total expenditures are expected to increase slightly from 22.1 percent in 2010 to 23.7 percent in 2013. Expenses (current expenditures) are expected to decline from 17.7 percent of GDP in 2010 to 16.2 percent by 2013. Spending on assets (capital expenditures) on the other hand is projected to increase from 4.1 percent of GDP in 2010 to 7.3 percent by 2013.

Table 6: Summary of 2011-2013 MTEF

	2011		2012		2013	
	K' billions	% GDP	K' billions	% GDP	K' billions	% GDP
Gross Domestic Product	**87,756**	**100**	**100,145**	**100**	**109,853**	**100**
Total Revenue and Grants	**17,892.17**	**20.39**	**20,799.77**	**20.77**	**22,694.36**	**20.66**
Domestic Revenue	**15,868.43**	**18.08**	**18,529.19**	**18.50**	**20,440.73**	**18.61**
Tax Revenue	15,370.13	17.51	17,947.95	17.92	19,816.15	18.04
Non-tax Revenue	498.29	0.57	581.24	0.58	624.58	0.57
Grants	**2,023.74**	**2.31**	**2,270.59**	**2.27**	**2,253.63**	**2.05**
Total Expenditure	**20,842.99**	**23.75**	**24,920.04**	**24.88**	**26,020.21**	**23.69**
Expenses	16,020.94	18.26	17,328.36	17.30	17,824.61	16.23
Assets	4,627.10	5.27	7,413.16	7.40	8,019.27	7.30
o/w Non Financial Assets	4,520.41	5.15	7,284.47	7.27	7,888.68	7.18
Liabilities	194.95	0.22	178.51	0.18	176.33	0.16
Fiscal Balance Surplus (+)/ Deficit (-)	**(2,950.82)**	**(3.36)**	**(4,120.26)**	**(4.11)**	**(3,325.85)**	**(3.03)**
Financing	**2,950.82**	**3.36**	**4,120.26**	**4.11**	**3,325.85**	**3.03**
Net Domestic Financing	1,228.58	1.40	1,301.89	1.30	1,318.24	1.20
Net External Financing	1,722.23	1.96	2,818.37	2.81	2,007.62	1.83

Further, the Government projects to spend an average of 0.2 percent of GDP towards the liquidation of liabilities (arrears) over this MTEF period. This will ensure that the private sector is not deprived of its much-needed working capital.

In order to fully finance this fiscal plan and support the ambitious infrastructure expansion programme in the road and energy sectors, the Government projects to incur an overall deficit of 3.5 percent, on average, over the MTEF period. In an effort to protect the flow of credit to the private sector, net domestic financing is projected to decline from 1.4 percent of GDP in 2011 to 1.2 percent by 2013. Net external financing is also projected to decline from 2 percent of GDP in 2011 to 1.8 percent by 2013.

4 REVENUE MOBILISATION

4.1 Overview

Tax revenues as a share of GDP have been declining since 2000. This decline has been associated with a significant change in the tax structure, characterized by a steep and disproportionate increase in the share of personal income taxes to domestic revenues. On the other hand, the contributions of VAT, excise and customs duties have declined significantly.

Between 2007 and 2010, Zambia's tax to GDP ratio has declined by 3 percentage points, from 17.7 percent in 2007 to 15.9 percent by 2010. The table below shows the performance of different revenue types during the period 2007 to 2010.

Table 7: Revenue Performance 2007- 2010 (as share of GDP)

	2007 Actual	2008 Actual	2009 Actual	2010 Proj.
Domestic Revenues & Grants	**23.00**	**22.34**	**19.93**	**20.31**
Domestic Revenues	18.45	18.58	15.69	16.84
Tax Revenues	**17.72**	**17.55**	**14.69**	**15.86**
Income Tax	**8.30**	**8.53**	**7.71**	**8.24**
Company Tax	2.65	2.58	2.09	2.16
Personal Income Tax	5.50	5.41	5.27	5.56
Mineral Royalty	0.15	0.53	0.36	0.52
VAT	**4.83**	**4.00**	**3.76**	**3.96**
Domestic VAT	0.06	-0.78	0.47	0.67
Import VAT	4.77	4.78	3.30	3.29
Customs and Excise	**4.59**	**5.03**	**3.21**	**3.66**
Customs	2.61	2.54	1.56	1.72
Excise	1.98	2.49	1.66	1.94
Non-Tax Revenues	**0.73**	**1.03**	**0.99**	**0.97**
Grants	4.55	3.76	4.24	3.48

Possible factors for the decline in tax revenue receipts may include:

a. Tariff reductions under the Common Market for Eastern and Southern Africa (COMESA) and the Southern African Development Community (SADC);
b. Granting of tax concessions aimed at attracting investments;
c. Frequent suspensions of excise and customs duty on petroleum products in order to cushion the price of fuel; and
d. An increase in exempt or zero rated products under the various tax laws.

In addition, challenges in tax administration resulted in lower than anticipated tax collections, while the impact of the global economic crisis adversely affected trade volumes resulting in lower trade tax collections.

4.2 Reforming the Zambian Tax System

Over the last two decades, Zambia has made significant strides in putting in place a modern tax system. Nevertheless, several challenges remain:

a. The tax incentive regime is based more on rate reductions than on deferments or increased capital allowances, which has also created an incentive for abuse;

b. The VAT base has been narrowed over time due to an increase in exemptions and zero-rated goods and services as well as compliance and administrative challenges;

c. The performance of customs and excise duties has been adversely affected by frequent suspensions and exemptions;

d. Differences in the company income tax rate structure across sectors have created distortions in the tax system; and

e. Tax incentives under the ZDA Act and the Triangle of Hope Initiative (TOHI) have further eroded the tax base.

These challenges arise from two opposing policy considerations. First, the Government has prioritized local and foreign direct investment as a key component of its growth acceleration strategy. This has resulted in the provision of various incentives in order for Zambia to remain a regionally competitive investment destination. On the other hand, the country faces an immediate need for resources in order to implement its ambitious development agenda.

In an effort to better balance these considerations, the Government has already initiated a comprehensive tax review and will implement necessary reforms over the medium term. The objective of these reforms will be to expand the tax base and increase revenue productivity while at the same time ensuring equity and simplicity of the system. Specifically, these reforms will aim at developing a tax system that will among other things:

a. be based on the principle of equity so that those with the same ability to pay should be taxed equitably (and this should apply to both companies and individuals);

b. address the distortions in the application of the VAT, broaden the tax base and remove the administrative challenges in enforcing the VAT Act;

c. promote economic growth and job creation in an open economy, in line with the Government's development agenda; and

d. facilitate compliance by taxpayers and make tax administration effective.

4.3 Revenue Forecast

Taking into account tax effort, improved economic activities and reforms in both tax policy and administration envisaged to be undertaken in the medium term, the following table presents a projection of Government's total resources over this MTEF:

Table 8: Projected Resources for the 2011 - 2013 MTEF

	2010		2011		2012		2013	
	Projected	% of GDP	Projected	% of GDP	Projected	% of GDP	Projected	% of GDP
Domestic Revenues and Grants	**15,065.11**	**20.31**	**17,892.17**	**20.39**	**20,799.78**	**20.77**	**22,694.36**	**20.66**
Domestic Revenues	**12,486.11**	**16.84**	**15,868.43**	**18.08**	**18,529.19**	**18.50**	**20,440.73**	**18.61**
Tax revenue	**11,764.33**	**15.86**	**15,370.13**	**17.51**	**17,947.95**	**17.92**	**19,816.15**	**18.04**
Income taxes	6,109.15	8.24	8,083.57	9.21	9,430.69	9.42	10,364.64	9.44
o/w Mining	543.10	0.73	1,198.90	1.37	1,100.02	1.10	1,318.24	1.20
Excise Duties	1,437.86	1.94	1,696.35	1.93	2,017.16	2.01	2,305.40	2.10
Value-Added Tax	2,939.66	3.96	3,902.56	4.45	4,533.37	4.53	4,972.84	4.53
Domestic VAT	500.28	0.67	718.28	0.82	922.58	0.92	1,012.01	0.92
Import VAT	2,439.37	3.29	3,184.28	3.63	3,610.79	3.61	3,960.82	3.61
Customs duty	1,277.67	1.72	1,687.65	1.92	1,966.72	1.96	2,173.28	1.98
Non-tax revenue	**721.78**	**0.97**	**498.29**	**0.57**	**581.24**	**0.58**	**624.58**	**0.57**
Grants	**2,579.00**	**3.48**	**2,023.74**	**2.31**	**2,270.59**	**2.27**	**2,253.63**	**2.05**
Budget Support	1,088.00	1.47	575.36	0.66	562.14	0.56	562.14	0.51
Project	1,491.00	2.01	1,448.38	1.65	1,708.45	1.71	1,691.49	1.54

Total tax revenue as a percentage of GDP is projected to increase from 15.9 percent in 2010 to 18 percent in 2013. The biggest share of this increase is expected to come from the mining sector, where mining taxes are projected to increase by 71.4 percent, from 0.7 percent of GDP in 2010 to 1.2 percent of GDP in 2013. The growth in mining revenues is premised on a projected increase in production and the continuance of favourable copper prices over the medium term.

Further, the Government expects VAT collections to increase by 69.2 percent by 2013 compared to 2010 levels, and remain fairly constant at around 4.5 percent of GDP over this MTEF. This increase is premised on administrative reforms to enhance tax compliance that are currently being implemented by the Zambia Revenue Authority.

Excise duties are projected to increase from 1.9 percent of GDP in 2010 to 2.1 percent in 2013, while Customs duty is forecast to increase from 1.7 percent of GDP in 2010 to 2 percent in 2013. These increases are mainly on account of improved economic activity over the medium term.

5 EXPENDITURE POLICY AND STRATEGY

5.1 Overview of Strategy

The Government will continue to pursue an expansionary but prudent fiscal stance, and channel resources to programmes that contribute significantly to addressing the challenges of realising broad based growth, employment creation and human development, in line with the SNDP. In this regard, the Government proposes to:

a) increase social sector spending in real terms each year; and

b) increase spending on infrastructure development programmes that generate high economic and social returns.

5.2 Recent Trends in Spending

The Government's expenditure policy in the period 2007-2009 focused on increasing spending on strategic programmes. This involved reducing lower priority expenditures, liquidation of domestic arrears and directing resources towards infrastructure and social sector. In the period 2007-2009, Government spending averaged 23.5 percent of GDP, translating to K39,116 billion in the period under review. Of this amount, 80.6 percent was channelled to expenses (current expenditures), 16.3 percent was directed to assets (capital expenditures) whilst the remainder was channelled to liabilities (see Table 9).

Table 9: Summary of Expenditures (2007-2009)

	2007	2008	2009	Average
	% of GDP	% of GDP	% of GDP	% of GDP
Expenditures	23.24	24.58	22.57	23.46
Current expenditures	19.58	19.13	18.17	18.96
Wages and salaries	7.64	8.11	8.02	7.92
Goods and services	5.28	5.10	4.87	5.08
Interest payments	1.68	1.72	1.57	1.66
Other	4.98	4.20	3.71	4.30
Capital expenditure	2.96	4.37	3.98	3.77
Domestically financed	2.34	2.31	2.80	2.48
Domestic arrears payments	0.70	1.08	0.42	0.73

On personal emoluments, Government spent K3,531 billion or 7.6 percent of GDP in 2007, K4,465 billion or 8.1 percent of GDP in 2008 and K5,274 billion or 8.0 percent of GDP in 2009. On average this translated to 45.6 percent of domestic revenues over the period. Whilst it has been Government's intention to reduce the personal emolument to GDP ratio to create fiscal room, the higher than anticipated wage awards in the period under review have led to the ratio averaging 8 percent.

With regard to expenditure on goods and services, Government spent 5.3 percent of GDP in 2007, 5.1 percent in 2008 and 4.9 percent in 2009. Some of the notable expenditures in the period under review included compensation and awards, presidential by –election and national constitutional conference.

Interest payments in the period under review amounted to K776 billion in 2007, K950 billion in 2008 and K1,033 billion in 2009. As a share of GDP, this averaged 1.7 percent during the period.

Other notable current expenditures include the Fertiliser Support Programme and the Strategic Food Reserve, which accounted for K409.2 billion in 2007, K515 billion in 2008 and K773.6 billion in 2009.

With regard to capital investment programmes, the Government spending marginally increased from 3 percent of GDP in 2007 to 4 percent in 2009. This was in line with previous MTEFs that emphasised the need for the spending to be increasing in this area. In nominal terms, the Government released K6,394 billion for capital investment programmes in the period.

5.2.1 *2010 First Half Budget Performance*

During the first half of 2010, the underperformance in revenues had a negative impact on expenditures. Preliminary data indicate that releases were K6,782.1 billion, below the programmed level of K8,484.9 billion by 20.1 percent. Most categories of expenditures were lower than projected, and a number of planned programmes and activities were postponed to the second half of the year. By end-June, expenses, assets and liabilities underperformed by 14.9 percent, 43.7 percent and 15.6 percent, respectively.

In addition, the Treasury faced challenges of unplanned expenditures particularly arising from the 15 percent wage award, which was higher than budgeted. The impact of this on the budget execution was such that some categories of expenditure had to be reduced to accommodate the new wage bill.

5.3 Expenditure Strategy for 2011 – 2013

The Government's expenditure strategy for the period will be based on reprioritisation of programmes and effective utilisation of the scarce resources. This will include continuing to reduce non-priority expenditures and controlling the spiralling wage bill over the medium term by limiting recruitment to the social sectors and the Zambia Police.

Total expenditures over the MTEF period will amount to K71,783.2 billion. Of this, K20,843 billion will be spent in 2011, K24,920 billion in 2012 and K26,020.2 billion in 2013. As a share of GDP, this will amount to 23.8 percent in 2011, 24.9 percent in 2012, and 23.7 percent in 2013. Expenses (current expenditures) will account for 76.9 percent in 2011, 69.5 percent in 2012 and 68.5 percent in 2013. Assets (capital expenditures) are projected to account for 22.2 percent in 2011, 29.7 percent in 2012 and 30.8 percent in 2013.

5.3.1 *Personal Emoluments*

Personal emoluments in the medium term, as a share of GDP, will increase from 2010 levels of 8.1 percent to 8.4 percent in 2011 and then decline to 8.1 percent in 2012 and further to 8 percent in 2013. On average, personal emoluments for education, health and Zambia police will account for 57.6 percent of the total wage bill. In order to curb the rising wage bill, the Government will restrict recruitment to a few sectors. In this regard, the Government proposes to recruit 15,000 teachers, 5,100 medical personnel and 1,000 police officers in the medium term (see Table 12).

Table 12: Recruitment Drive (2011-2013)

Recruitment Drive	**2011**	**2012**	**2013**	**Total**
Medical Personnel	1,700	1,700	1,700	**5,100**
Teachers	5,000	5,000	5,000	**15,000**
Police Officers		500	500	**1,000**
Total	**6,700**	**7,200**	**7,200**	**21,100**

5.3.2 *Use of Goods and Services*

Over the past three years, the Government has been implementing an ambitious infrastructure development plan, particularly in the social sectors. This will entail the need to augment operational resources to ensure optimal utilization of this newly created infrastructure. Allocation for the use of goods and services are therefore projected to increase to K4,507.3 billion in 2011, K5,387.4 billion in 2012 and K5,108.6 billion in 2013.

5.3.3 *Interest Payments*

Interest payments on domestic debt are projected at an average of 1.2 percent of GDP while external debt service is projected at 0.7 percent over the medium term.

5.3.4 *Grants and Other Payments*

The Government projects to spend K1,754.6 billion in 2011, K1,932.7 billion in 2012 and K2,047.9 billion in 2013 on grants and other payments. Within these provisions, K276.7 billion in 2011, K323.1 billion in 2012 and K356.7 billion in 2013 has been set aside for the Zambia Revenue Authority operations and modernisation. In order to mitigate the increasing cost of farming inputs and ensure food security for the country, the Government has also made provisions of K485 billion in 2011, K521.4 billion in 2012 and K555.8 billion in 2013 for the Farmer Input Support Programme.

5.3.5 *Social Benefits*

Social benefits are projected to increase from K212.8 billion in 2010 to K453.7 billion in 2011. For 2012 and 2013, the allocations will be K414.6 billion and K413.3 billion, respectively. This is on account of three factors, namely, the increase in the grant to the

Public Service Pension Fund (PSPF), a provision set aside for the actuarial deficit (financing gap) for the PSPF and the mid-term gratuity to Constitutional post holders.

5.3.6 *Other Expenses*

Expenditure on financial restructuring has been projected at K422.4 billion in 2011, K63.3 billion in 2012 and K47.6 billion in 2013. This is for purposes of recapitalising and restructuring of public corporations. As for the unforeseen expenditure items of an urgent nature, a contingency of K150 billion has been set aside and spread evenly over the MTEF period. Further, K350 billion has been allocated to the Food Reserve Agency over the medium term to facilitate purchase of grains including maize from subsistence farmers in outlying areas.

5.3.7 *Assets*

The Government is cognisant of the role of capital investment in accelerating economic growth. Expenditure on assets, therefore, is projected to increase from 4.1 percent of GDP in 2010 to 7.3 percent by 2013. In this regard, allocations to assets are projected at K4,627.1 billion in 2011, K7,413.2 billion in 2012 and K8,019.3 billion in 2013.

5.3.8 *Non-Financial Assets*

Expenditure on the acquisition of non-financial assets has been projected at K4,520.4 billion in 2011, K7,284.5 billion in 2012 and K7,888.7 billion in 2013. This has more than doubled the resources available for capital investments over the medium term, compared to 2010 levels. These funds will go towards infrastructure development programmes identified in the SNDP.

Notable domestically financed expenditures under this category include the Rural Electrification Programme whose budgetary allocation will be increased from 2010 levels by 173.4 percent to K150 billion in 2011. This will be scaled up to K230 billion per year in 2012 and 2013. Government contributions to the road fund are projected to increase from K1,380.7 billion in 2011 to K2,706.8 billion in 2013, representing an increase of 96.1 percent in the medium term.

5.3.9 *Financial Assets*

In order to spur business entrepreneurship, the Government proposes to increase the allocation to empowerment funds from K40 billion in 2010 to K80 billion in 2011 and K100 billion each in 2012 and 2013. Of this amount, over 75 percent will go towards the Citizens Economic Empowerment Fund whilst the balance will be shared between the Youth and Women Empowerment Funds.

5.4 Medium Term Spending Reform Priorities

The Government will place emphasis on the efficiency of resource use and realign expenditures in order to create room for development spending by implementing the following measures:

5.4.1 *"Value for Money"*

In light of financial constraints, how the Government spends public funds is far more important than how much is spent. Developing a benchmarking mechanism and price database is, therefore, imperative in order to ensure that Government procurements are at competitive prices and reflect "value for money". In this regard, the Government will ensure that comparative studies are undertaken to determine unit prices for the procurement of various goods and services, particularly for huge infrastructure projects such as roads. Further, the monitoring and evaluation system will be strengthened to ensure that funds released to various projects and programmes are properly used in the most effective manner. Strict rules will be developed to ensure that the required standards and specifications of projects undertaken are met. The Government will also step up its efforts to improve the transparency in the implementation of public projects through the involvement of communities in the monitoring effort.

5.4.2 *Other Cost Saving Measures*

Freeing up additional resources through aggressive cost-cutting measures such as reductions in administrative expenditures, improved productivity of "unavoidable" expenditures and more stringent financial management will be implemented. In this regard, the Government proposes the following measures:

i. Personal to holder vehicles will be restricted to Ministers and positions above Permanent Secretaries;

ii. The Government will abolish the use of 4x4s and other luxury vehicles and will replace them with smaller vehicles in an effort to reduce overhead costs of running and maintenance, with the exception of strategic departments and units of Government that specifically require the use of such vehicles; and

iii. There will be no payment of allowances for all workshops held by Government institutions.

5.4.3 *Public Service Pay Policy*

In view of the challenges associated with high public service wage bill, the Government has developed a Public Service Pay Policy (PSPP), which will systematically address the issue of remuneration of public servants. The policy will provide a comprehensive, objective and consistent framework for determining appropriateness; rationalising disparities; and harmonising structures of pay in the public service. Additionally, the

Government will establish a Public Service Remuneration Board (PSRB) in 2011, which will be responsible for steering the implementation process of the PSPP.

5.4.4 *Decentralisation*

Cabinet approved the Decentralisation Implementation Plan (DIP) in December 2009. The thirteen MPSAs that have functions to be devolved to councils under the DIP will be required to finalise their sector devolution plans in 2011. This will allow the devolution of functions to be started from January 2012. In this context, the MPSA ceilings set out in this MTEF for 2012 and 2013 will be modified in the 2012-2014 MTEF to reflect the phasing of sector devolution from 2012.

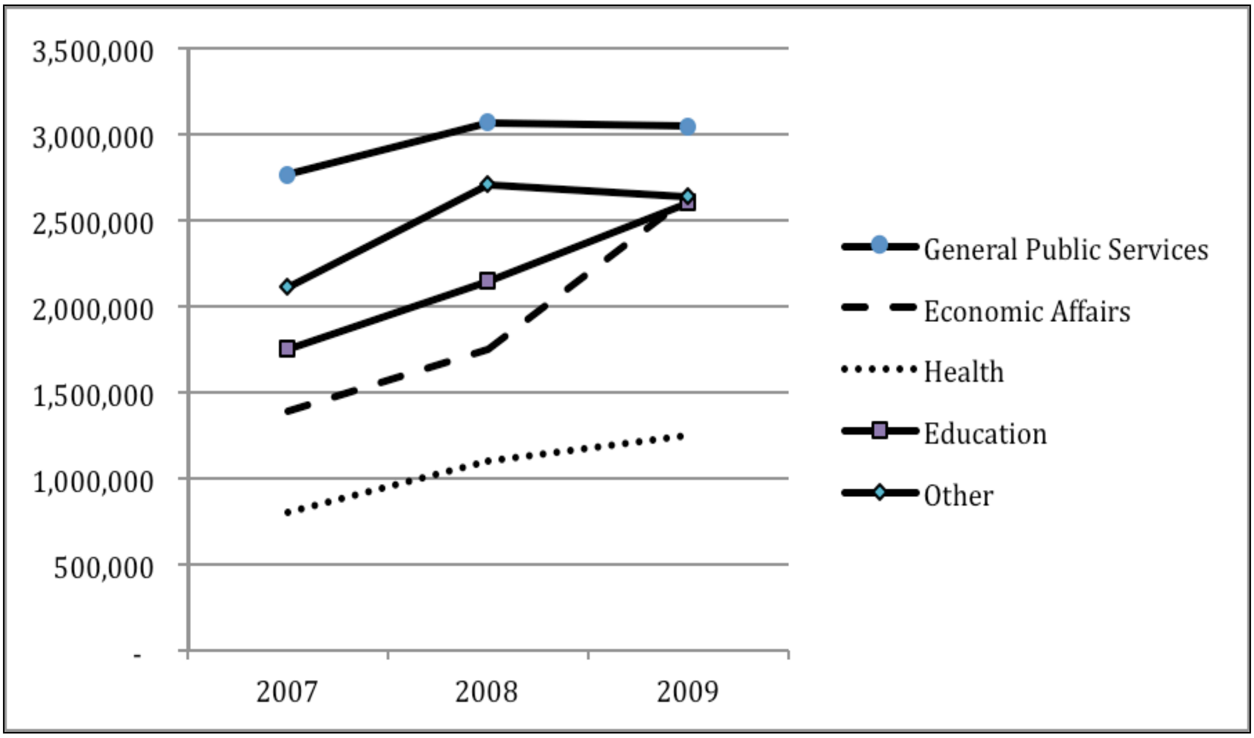
6 ALLOCATIONS BY FUNCTIONAL CLASSIFICATION

Government spending by functional classification in the medium term will continue to be guided by the country's national development plan, which reflects the Government's policies as well as overall economic priorities and strategies. In this regard, reference has been made to the Vision 2030 as well as the consultative process being undertaken in the formulation of the SNDP.

6.1 Spending Trends (2007-2009)

During the 2007 – 2009 MTEF period, the General Public Services function received the highest share of total expenditures, accounting for 27.9 percent, followed by Education at 20.5 percent and Economic Affairs at 18.2 percent. The other functions accounted for the balance of 33.4 percent including Health, which had a share of 9.9 percent of total expenditure(See Figure 2).

Figure 2: Functional Allocation by year 2007 – 2009 (K' billions)[5]



6.1.1 *General Public Services*

Government expenditure on General Public Services amounted to K2,766.6 billion in 2007, K3,067.9 billion in 2008 and K3,043.7 billion in 2009, representing 27.9 percent of total expenditure over the period. The marked nominal increase between 2007 and

[5] The category "Other" comprises of the following functions: Defense, Public Order and Safety, Environmental Protection, Social Protection, Housing and Community Amenities, Recreation Culture and Religion

2008 was mainly attributed to the 2008 Presidential elections. In 2009, releases remained relatively constant at the 2008 levels.

As a proportion of total expenditure, resources released to this function significantly dropped from 31.4 percent recorded in 2007, to 28.5 percent in 2008 and further to 25.0 percent in 2009. This was in line with the Government's policy to reallocate resources to strategic areas identified in the Fifth National Development Plan.

6.1.2 *Education*

The Education function received a total of K1,752.0 billion in 2007, K2,146.1 billion in 2008 and K2,603.8 billion in 2009. This represented 19.9 percent of total expenditure in both 2007 and 2008 and 21.4 percent in 2009. The increase in expenditure facilitated, among others, the recruitment of 15,000 teachers. In addition, implementation of the education infrastructure development plan was scaled up. This targeted the construction of basic and high schools as well as the expansion of enrolment capacities for both TEVET training institutes and the three public universities.

6.1.3 *Economic Affairs*

Resources released to the Economic Affairs function during the period increased from 15.7 percent of total expenditure in 2007 to 21.7 percent in 2009. In total, releases to this function amounted to K5,772.1 billion. Most of these resources went to the agriculture and transport sectors. In agriculture, the aim was to enhance crop production through the Fertiliser Support Programme (now Farmer Input Support Programme), and livestock development. Resources were also directed towards the Food Reserve Agency, with the aim of improving market access to farmers in remote areas and creating an incentive for future production.

With regard to the transport sector, interventions focused on road development and rehabilitation across the country. This was to support the national growth and diversification strategy.

6.1.4 *Health*

Releases to the health function increased by 56.4 percent from K801.3 billion in 2007 to K1,098.9 billion in 2009. As a share of total expenditure, releases to the health function increased from 9.1 percent in 2007 to 10.3 percent in 2009. Key interventions included the construction of health infrastructure, provision of essential drugs and the recruitment of frontline medical personnel.

6.1.5 *Others*

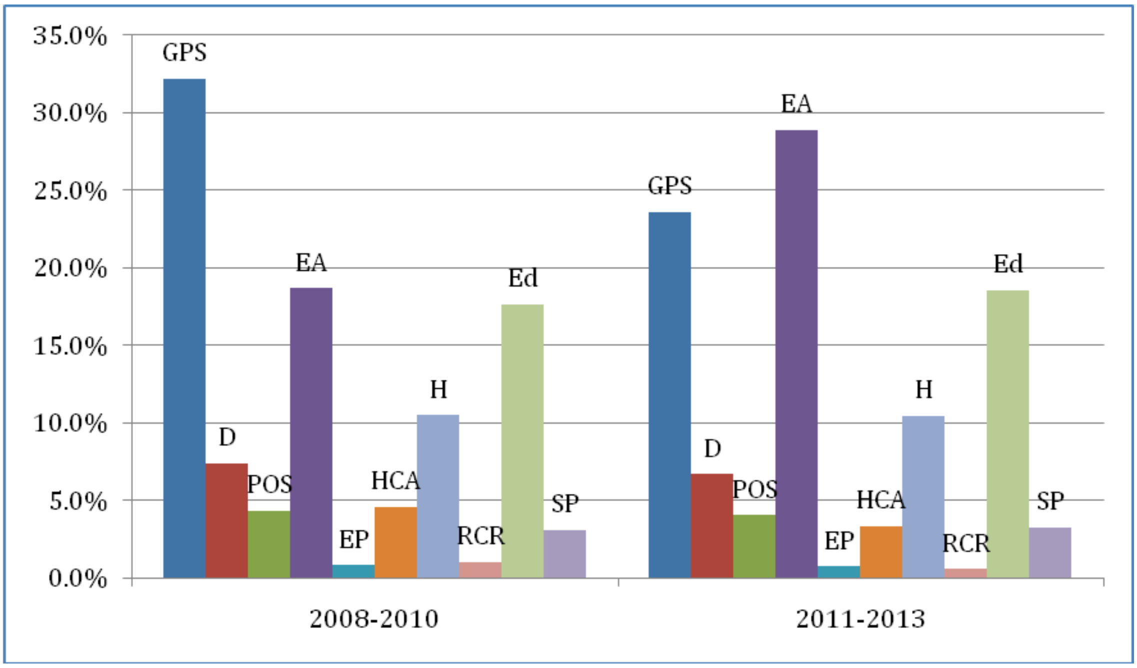
Releases to other functions increased from K2,115.8 in 2007 to K2,636.8 in 2009, representing an increase of 24.6 percent. Notable expenditures included the construction of police houses, rehabilitation and construction of local courts, and the implementation of the social cash transfer scheme.

6.2 Functional Resource Allocation Priorities for the 2011 – 2013 MTEF

The allocations over the 2011-2013 MTEF are anchored on the Government's commitment to accelerate socio-economic development for its citizens through broad based growth, job creation and poverty reduction. In order to continue promoting the diversification of the economy away from mining and stimulate growth in sectors such as agriculture and tourism, the focus over the medium term will be to scale up interventions in the areas of infrastructure and human development.

To attain these national development objectives, the Government will, over this MTEF, undertake necessary functional realignments to ensure optimal allocation of resources. In this regard, it is projected that the Economic Affairs function will take up the highest proportion of resources at 28.9 percent, followed by General Public Services, which is projected to fall significantly to 23.6 percent from 32.2 percent over the 2008–2010 MTEF. Allocations to the education and health functions are also projected to account for a significant proportion of total resources at 29 percent. Figure 3 presents a comparison of allocations by function.

Figure 3: A Comparison of Functional Allocations 2008-2010 and 2011- 2013 MTEFS[6]



[6] D – Defense | EA- Economic Affairs | Ed – Education | EP – Environmental Protection | GPS – General Public Services | POS – Public Order and Safety | H – Health | HCA – Housing and Community Amenities | RCR – Recreation, Culture and Religion | SP – Social Protection

The projected allocations over the 2011-2013 MTEF are premised on continued support from Cooperating Partners as rendered over the previous MTEF. Other assumptions include an increase in foreign borrowing in order to accelerate infrastructure development; and political commitment to implementation of the country's national development objectives.

6.2.1 *General Public Services*

The budgetary allocation to the General Public Services function is projected to significantly fall from 32.2 percent of total expenditure allocated over the 2008–2010 MTEF to 23.6 percent over the 2011–2013 MTEF. This decline has partly been made possible by the accelerated reduction of arrears undertaken over the 2008-2010 MTEF as well as the completion of major programmes such as the constitutional review process. In addition, the reduction is expected to come from the scaling down on central Government expenditure of lower priority.

6.2.2 *Economic Affairs*

The share of the Economic Affairs function is projected to significantly increase from 18.7 percent of total resources allocated over the 2008 -2010 MTEF to 28.9 percent. This increase will be directed towards investments in the transport, energy, tourism and agriculture sectors. Increased investments in roads and rural electrification are not only aimed at increasing market access, but also enhancing the opening up of new areas for investment, particularly in the tourism and manufacturing sectors.

Further, the Government will scale up resources for tourism promotion and marketing, as well as infrastructure development in the Greater Livingstone Area, Kafue National Park and the Northern circuit. In the agriculture sector, efforts will be directed toward increasing productivity and production of crops, livestock and fisheries.

6.2.3 *Education*

Over the medium term, the allocation to the Education function is projected to reach 18.5 percent of total expenditure, an increase of 0.9 percentage points from the 2008-2010 MTEF. In nominal terms, this represents a significant increase in resources by 66.9 percent. In addition to continued support for basic education, these resources will finance programmes that will increase access to and quality of high school and tertiary education. This will include the construction and expansion of schools, colleges and universities; procurement of teaching and learning materials; and curriculum improvement. In addition, 15,000 teachers will be recruited over the medium term.

6.2.4 *Health*

The Government will, over the medium term, continue to direct more domestic resources to the health function especially in the wake of reduced sector support by a number of Cooperating Partners. During the 2011-2013 MTEF, the allocation to the sector will increase by 58.4 percent compared to the 2008-2010 MTEF. This scaling up of resources to the sector becomes imperative following the fall in contributions by Cooperating Partners and will help in maintaining the allocation to the 2008-2010 MTEF level at 10.5 percent of total expenditure. However, more resources are expected to flow to the sector in the long term in line with sector strategies as highlighted in the SNDP

The allocation over this period will continue to address challenges of high disease burden, inadequate medical staff and equipment, and erratic supply of essential drugs. In view of shortfalls in Cooperating Partner assistance, the Government will scale up the allocation of domestic resources to tackle these challenges, and improve the quality of and access to health care, particularly in rural areas. In addition, the Government will recruit 5,100 frontline medical personnel over this MTEF.

6.2.5 *Housing and Community Amenities*

The allocation to the Housing and Community Amenities function has been projected at 3.3 percent of total expenditure. The resources under this function will be mainly directed toward water and sanitation programmes, which will account for 68.1 percent total allocation compared to 50.4 percent during the 2008-2010 MTEF.

6.2.6 *Public Order and Safety*

Resources allocated under the Public Order and Safety function will continue to be directed at maintaining law and order, and facilitating a conducive environment for investment and growth. The Government, therefore, projects to maintain the allocation at 4 percent of total expenditure over the medium term.

6.2.7 *Other functions*

The total allocation to remaining functions over this MTEF will account for a reduced proportion of total expenditure at 11.2 percent compared to 12.2 percent allocated in the 2008–2010 MTEF. This realignment of resources has been made in order to facilitate the implementation of the Government's strategic priority programmes during the SNDP.

7 ANNEXES

1. 2011 - 2013 Fiscal Framework

2. MPSA Resource Ceilings:
    i. Aggregate Ceilings
    ii. Personal Emoluments Ceilings.
    iii. Non - Personal Emoluments Ceilings

3. Budget Allocation by Function