Republic of Zambia

2013-2015

MEDIUM TERM EXPENDITURE FRAMEWORK

AND

THE 2013 BUDGET

GREEN PAPER

Ministry of Finance

September, 2012

FOREWORD

The 2013-2015 *Green Paper* provides a platform for the Government to consult with all stakeholders on the intended course of action with regard to Zambia's development agenda in the next three years. This is the first Medium Term Expenditure Framework (MTEF) that has been wholly prepared by the current Government. As such, the identification of programmes and the criteria for allocating resources, in each of the three annual budgets, will be predominantly guided by the aspirations of the Patriotic Front (PF) Manifesto and centred on the attainment of the Sixth National Development Plan's (SNDP) strategic focus.

While acknowledging that significant economic outcomes have been recorded over the last decade with strong economic growth and lower inflation, poverty levels particularly in the rural areas have remained unacceptably high. The Government's immediate responsibility, therefore, hinges on ensuring that the economic inroads that our country continues to attain, must translate into reduced poverty levels and improved standards of living for all Zambians.

The Government's focus in the medium term will be centred on the development of social infrastructure and gainful human capacities. This will be done through the stepping up of both human effort and financial resources in areas that have a direct impact on the enhancement of individuals' quality of life, such as education and skills development, health care, agriculture support, employment creation and provision of social amenities. To ensure effective programme implementation in these areas, Government will aim at creating additional fiscal space primarily by strengthening policy and administration of tax and non-tax resource mobilization and continue restraining non-priority spending during this period. Further, the implementation of structural reforms will be stepped up as they are cardinal in supporting private sector led growth and strengthening public sector management.

I am, therefore, urging all stakeholders to study this *Green Paper* carefully and provide constructive comments that will assist the Government in achieving the country's economic and development goals that have been set for the next medium term period.

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CHAPTER 1

1.0 INTRODUCTION

1.1 2013 -2015 Medium Term Development Priorities

1. The formulation of the 2013 – 2015 Medium Term Expenditure Framework (MTEF) has been anchored within the context of Government's overall vision to become a prosperous middle income country by 2030, with the benefits of such a country status becoming a reality for every citizen in terms of their standard of living. As such the strategic focus and priorities for the period have been guided by the Sixth National Development Plan (SNDP) and the aspirations of the Government as set out in the Patriot Front (PF) Manifesto.

2. In particular, the Government's focus over the next MTEF period will be centred on getting the basics right in terms of ensuring that growth is inclusive and pro-poor so that the benefits of a stable macroeconomic environment, high economic growth and single digit inflation register positively and practically in the everyday lives of the people. It is evident that while Zambia has recorded relatively good macroeconomic performance during the last five years, the performance registered during the period has not been inclusive, neither has it translated into significant poverty reduction, one of the overarching goals to which the country's macroeconomic policy should be targeted. Overall poverty remains high at around 60 percent whilst rural poverty is much higher at 80 percent. One of the causes of the continued high levels of poverty and poor performance in terms of the internationally recognised human development indicators has been the inability of the economy to provide gainful employment for its ever growing labour force.

3. The continued high poverty levels and poor performance of other human development indicators, despite the good macroeconomic performance, suggests the need for concerted government policy interventions to ensure growth is inclusive and poverty reduction is accelerated for both urban and rural areas. Government will, therefore, while acknowledging and making deliberate efforts to ensure the sustenance of high economic growth and low inflation among others, refocus its efforts beyond the achievement of these basic economic fundamentals. This means translating the economic fundamentals into:

- higher revenues for Government in order to enable it provide the necessary basic services such as health, education , water and sanitation, electricity and road infrastructure;
- more jobs for the majority of the youth;
- higher levels of disposal income (more money in peoples' pockets); and

- a falling lower incidence of poverty in both the rural and urban areas.

4. The key developmental thrust in the medium term will thus be to address the constraints to accelerated growth. Therefore, there will be a move away from the over reliance on copper to other areas of comparative advantage such as manufacturing, tourism, agriculture, and construction to ensure that growth is broad based and inclusive.

1.2 Risks

5. Medium term risks to this MTEF may arise from lower copper prices and exchange rate volatility caused by any slowdown in global demand as a result of the spill-over effects of the Euro zone crisis; higher oil prices if political instability in the Middle East deteriorates; adverse weather conditions; and significant power deficits if there are delays in the commencement of planned power generation projects.

6. These risks are being mitigated by Government which is making the economy more robust and able to withstand external shocks through its policies to diversify the economy away from copper, by investing in irrigation to reduce dependence on rain fed agriculture and by accelerating the investment in the power generation programme.

CHAPTER 2

2.0 MACROECONOMIC OVERVIEW

2.1 Developments in the Global and Domestic Economy in 2012

2.1.1 Global Economy

7. The global economy, which showed signs of recovery in the first quarter of 2012, faced renewed threats from events in Europe coupled with geopolitical uncertainties in the Middle East which exerted upward pressure on oil prices. In light of these risks, global economic activity is projected to decelerate from 3.9 percent in 2011 to an estimated 3.5 percent in 2012, before rebounding to 3.9 percent in 2013[1].

8. Growth in the emerging market economies, notably Brazil, China and India, are projected to slow-down in 2012, partly on account of a weaker external environment due to the euro-zone debt crisis and the high budget deficit in the United States that has constrained additional fiscal stimulus measures. Sub-Saharan Africa is, however, projected to register modest growth of 5.4 percent in 2012, a marginal improvement from the 5.2 percent registered in 2011. This reflects the limited exposure of countries in the region to the spill-over effects of the Euro zone crisis.

9. The deceleration of economic activity in China and India, who are two of the largest consumers of commodities, dampened commodity prices in the first half of 2012. Metal prices, which registered considerable gains during the first quarter of 2012, decelerated during the second quarter of the year below their end 2011 levels. The decline in metal prices was particularly sharp in May 2012 as the debt crisis in Europe intensified and China's growth slowed down. Copper prices on the London Metal Exchange for instance declined to US $7, 428.3 per tonne (US $3.37 per pound) in the first half of 2012 from US$8,324 per tonne (US $3.78 per pound) at the end of 2011. Going forward, the average price of copper is projected to close the year at US $8,001 per tonne (US $3.68 per pound).

10. Oil prices which initially reflected an upward trend in the first quarter of 2012, rising to nearly US $126 per barrel in March 2012, from an average of US $104 per barrel in 2011, receded to just above US $100 per barrel by mid July 2012. For the rest of 2012, supply side concerns, notably the loss in non-OPEC production due to geopolitical tensions, particularly between Iran and the West over Iran's nuclear program may exert renewed upward pressure on oil prices.

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[1] The source is the IMF World Economic Outlook, July 2012 Update

11. International food prices were relatively high in the first half of 2012, averaging US $606.1 for rice and US $267.2 for maize. For rice, the high prices were on account of disruptions in supply due to adverse weather conditions such as floods in major rice producing countries, while for maize, the drought experienced in the mid-west of the United States, the largest producer in the world precipitated reduced supply. Conditions are not expected to improve for the remainder of 2012.

2.1.2 Domestic Economy

12. General economic conditions in 2012 are expected to be favourable, characterized by strong growth, single digit inflation, a low budget deficit and favourable external sector performance coupled with the continued build-up in international reserves.

13. Real GDP is projected to grow by 7.2 percent, 0.5 percentage points lower than earlier forecast due to the lower than targeted performance in the mining sector and weaker growth in the global economy. Growth, however, will be driven by agriculture, manufacturing, electricity, gas and water and construction sectors.

14. In the agricultural sector, output in the 2011/2012 farming season remained strong albeit lower than the 2010/2011 season. Maize production declined by 6.7 percent to 2.8 million tonnes from 3.0 million tonnes recorded in the 2010/2011 farming season. The reduction was mainly on account of commercial farmers substituting maize for other crops and poor rainfall patterns in some parts of the country. Production of other crops such as soya beans, cotton, Irish potatoes, mixed beans, barley and wheat, however, increased significantly due to among other factors, favourable prices.

15. Performance of the manufacturing sector was favourable in the first half of 2012 and is projected to remain positive in line with the trend recorded over the last few years. Increased production of crops such as barley, soya beans and wheat will continue to support growth in the food processing and beverages industries and stock feed. Further, high demand for cement, copper cables and steel in the construction sector is expected to boost demand in the manufacturing sector.

16. In the electricity, gas and water sector, the increased electricity generation witnessed during the first half of 2012 is expected to continue in the second half of the year driven by the completion of rehabilitation and up rating works at some power stations.

17. The performance of the construction sector remained positive and continued to benefit from increased public investment particularly relating to the construction,

rehabilitation and maintenance of roads and the construction of stadia, schools and health facilities. In addition, private sector investments in residential housing and commercial buildings supported the growth of the sector. This trend is expected to continue in the second half of 2012.

18. In the mining sector, copper output is expected to remain strong, though lower than initial projections. This outturn is explained by the lower grade ore mined at some mines and operational challenges.

19. With regard to the social sectors significant milestones were recorded in terms of reduced disease burden and improvements in school enrolments rates. In the health sector, both incidence rates and deaths attributable to the top ten diseases reduced in 2011[2] except for respiratory infection (non-pneumonia) and trauma related conditions. Total deaths attributed to the top ten diseases were 3,674 per 100,000 in 2011 a decline of 30 percent from 5,226 per 100,000 in 2010. In the education sector, the net enrolment at primary school level increased from 2,861,201 in 2009 to 3,045,277 in 2011.

20. Fiscal performance in the first half of 2012 was favourable. Revenue and grants were above target by 6.0 percent, mainly on account of higher collection of income taxes, VAT, customs duty and non tax revenue. Expenditures were slightly lower than projected by 0.1 percent due to non-capture of foreign financed related expenditures.

21. In the monetary and financial sector, performance was favourable during the first half of 2012. Despite annual overall inflation rising to 6.7 percent in June 2012 from 6.0 percent in December 2011, the outturn was broadly in line with the June 2012 projection of 6.5 percent. This outturn was attributed to the rise in food inflation to 7.1 percent in June 2012 from 5.3 percent in December 2011 while non-food inflation declined to 6.2 percent from 6.6 percent during the same period.

22. In order to adopt international best practices and have better estimates of the CPI, Government introduced a new methodology of computing the Consumer Price Index (CPI) in 2012. This has resulted in an increase in the products and districts covered the use of a more recent reference year and adoption of a formula that minimizes the impact of volatile prices.

23. In April 2012, the Bank of Zambia introduced a benchmark BoZ Policy Rate, whose objective is to better anchor inflation expectations and influence commercial banks' decisions on pricing of credit products. This development is consistent with the medium term intention of shifting the monetary policy framework from using

[2] Data on incidence rates is analyzed based on the first half of the year

monetary aggregates (quantities) to using interest rates (prices) to target inflation. The BoZ Policy Rate was set and maintained at 9.0 percent during the second quarter. Following the introduction of the Policy Rate, the operational target of monetary policy changed from reserve money to the overnight interbank rate.

24. Reserve money recorded a decline in the first half of 2012, mainly influenced by net sales of Government securities and net Open Market Operations (OMO) borrowings. These influences were, however, partially offset by net Government spending though reserve money remained below the end June ceiling. Broad money (M3)[3] increased during the review period as a result of growth in both Net Domestic Assets (NDA) and Net Foreign Assets (NFA).

25. Domestic credit[4] rose by 9.4 percent during the first half of 2012 compared with 15.7 percent recorded in the second half of 2011. This outturn was largely as a result of increased lending to households with the agricultural sector being the next largest beneficiary of bank lending. Net claims on Government, however, declined while foreign currency denominated loans increased by 12.2 percent.

26. With regard to commercial bank interest rates, the Government put into effect measures to lower the cost of borrowed funds. These included a reduction in the statutory reserve ratios on all deposits to 5 percent from 8 percent effective April 2012, a five percentage points reduction in commercial banks' corporate tax rate to 35 percent and the introduction of a BoZ Policy Rate. These measures contributed to a fall in commercial banks' lending rates, though the savings rates remained unchanged.

27. The Weighted Average Lending Base Rate (WALBR) and the Average Lending Rate (ALR) decreased to 11.6 percent and 18.6 percent in June 2012 from 16.6 percent and 23.6 percent in December 2011, respectively. However, the Average Savings Rate (ASR) for amounts above K100,000 and the 30-day deposit rate for amounts exceeding K20 million both remained unchanged at 4.3 percent and 5.3 percent, respectively. In real terms, lending interest rates declined during the review period due to a reduction in nominal interest rates compared with the slight increase in inflation.

28. In the external sector, Zambia's position continued to be favorable with an overall Balance of Payments (BOP) surplus of US $109.6 million registered in the second quarter of 2012 compared with the deficit of US $0.1 million recorded in the

[3] defined to include foreign currency deposits

[4] defined to include foreign currency loans

first quarter of 2012. This favorable performance was largely driven by an improvement in the current account.

29. The current account deficit narrowed to US $247.2 million in the second quarter of 2012 from US $412.0 million recorded in the first quarter. This was explained by an increase in the net current transfers and narrowing of the net income account deficit, which compensated for the reduction in the trade surplus.

30. Merchandise export earnings declined as a result of a reduction in both metal and non-traditional export earnings. The decline in metal earning was a result of a fall in the average realised copper price which declined by 5.9 percent to US $7,079.37 per tonne in the second quarter of 2012 from US $7,523.47 per tonne recorded in the previous quarter. Export earnings for Non-traditional Exports (NTEs) also declined by 10.6 percent to US $565.4 million in the second quarter of 2012 from US $631.7 million recorded in the preceding quarter. This was on account of reduced earnings from the export of products such as cotton lint, fresh flowers, electricity and maize grain and seed.

31. Merchandise imports also declined due to lower import bills associated with commodity groups, such as food items, chemicals, iron and steel and items made there from and industrial boilers and equipment.

2.2 Macroeconomic Policy (2013-2015)

2.2.1 Macroeconomic Framework

32. In line with the broad objectives of the Sixth National Development Plan (SNDP) and the Patriotic Front (PF) manifesto, the key developmental thrust in the medium term will be to address the constraints to accelerated growth and to ensure that growth is broad based and inclusive so that it translates into job creation and poverty reduction. The focus of the 2013-2015 MTEF will be to maintain a stable macroeconomic environment that will support the attainment of high economic growth, enhance the competitiveness of the economy, create gainful and productive employment and ensure that Zambia attains the Millennium Development Goals (MDGs) and the long-term vision of becoming a prosperous middle income country by 2030.

33. The specific macroeconomic objectives in the medium term will be to:

- Achieve average real GDP growth of at least 7.5 percent per annum;
- Expand and diversify the economy;
- Sustain single-digit inflation;

- Increase domestic resource mobilisation;
- Maintain debt sustainability;
- Limit domestic borrowing to not more than 2.0 percent of GDP;
- Contain the overall deficit within sustainable levels;
- Significantly increase formal sector employment; and
- Lower the cost of doing business, including the cost of credit.

34. In line with the above objectives, real GDP growth is projected to grow by 7.8, 8.1 and 7.4 percent in 2013, 2014 and 2015 respectively (see Table 1). Inflation is projected to remain in single digit, reducing to 5.0 percent in 2015. Domestic revenues, as a percentage of GDP are projected at 19.3 percent in 2013, and 19.9 percent in 2014 and 20.1 percent in 2015. In the external sector, the current account balance is projected to remain in surplus while gross international reserves are projected to increase to 4.5 months of import cover in 2015 from 3.4 months in 2011.

Table 1: Selected Macroeconomic Indicators (2010-2015)

	2010	2011	2012	2013	2014	2015
Real GDP	7.6	6.6	7.2	7.8	8.1	7.4
Inflation (end period)	7.9	7.2	7.1	6.0	5.5	5.0
Inflation rate (annual average)	8.5	8.2	7.5	6.4	5.8	5.5
Domestic Revenue (% of GDP)	18.2	19.3	19.0	19.3	19.9	20.1
Overall Fiscal Deficit (including grants, % of GDP)	-3.2	-2.5	-4.2	-2.9	-2.6	-2.4
Domestic borrowing (% of GDP)	2.0	2.9	1.3	1.5	1.5	1.5
Current account balance, incl. grants (% of GDP)	3.8	5.9	3.3	1.1	0.7	0.5
Gross International Reserves (months of import cover)	3.0	3.4	3.5	3.9	4.3	4.5
Nominal GDP (K' Billions)	77,655	93,342	105,294	121,275	135,744	152,055
GDP Per Capita (US $)	1,206	1,363	1,531	1,756	1,910	2,074
Annual average copper price (US $/lb)	3.86	3.95	3.84	3.8	3.7	3.4
Annual Average Copper Price (US $/mt)	7,538	8,800	9,545	8,269	8,195	7,411
Oil Price (US $ per barrel)	79.03	104.01	108.0	94.16	102.4	101.9

Source: Ministry of Finance, IMF World Economic Outlook

2.2.2 Fiscal Policy

35. The overall objective of fiscal policy in the medium term is to enhance domestic resource mobilisation and create fiscal space to support investment in infrastructure and human capital development, and enhance public service delivery. In this regard, effort will be directed towards increasing domestic revenue from 19.0 percent of GDP in 2012 to around 20.1 percent by 2015.

36. Tax policy objective for the medium term will be aimed at reviewing and reforming the current tax system focusing on eliminating unwarranted exemption and zero-rating of goods and services for value added tax purposes. Further, measures to rationalise existing tax incentives for investment, cushion workers from the effects of inflation, stimulate business, and reduce the burden of compliance will be undertaken.

37. In order to ensure that economic growth is inclusive and pro-poor, Government fiscal policy will focus on the strategic areas of education, health, agriculture, local government and housing development, employment creation and improved governance, with emphasis on rural development.

2.2.3 Monetary and Financial Policy

38. Over the medium term, monetary policy will focus on achieving and sustaining single digit non-food inflation and the adoption of a more responsive monetary framework that targets inflation directly. In this regard, non-food inflation will be adopted as the monetary policy inflation target.

39. With regard to the financial sector, access to finance remains a major challenge in fostering expansion of economic activities. In addressing this challenge, the Government extended the Financial Sector Development Plan (FSDP) into its second phase in order to enhance access to finance, improve market infrastructure and increase competition. In the medium term, the harmonisation of financial sector laws will continue; the full operationalisation of the Independent Financial Intelligence Centre (IFIC) Unit will be completed with the coming into force of new legislation; and the national payments infrastructure will be enhanced, including the adoption of the national switch.

2.2.4 External Sector

40. Over the medium term, Zambia is expected to maintain a positive current account, reflecting strong growth in exports principally driven by demand from the emerging economies. Foreign Direct Investment and portfolio flows are also expected to remain strong providing support for the stability in the exchange rate of the Kwacha against major currencies. Notwithstanding the positive prospects for Zambia's external sector, it is prudent to be cognisant of the risks arising from the projected deceleration in the global economy.

2.2.5 Aid Policy

41. In order to augment domestic resources, the Government will continue to mobilise the support of Cooperating Partners (CPs). Grants and general budget

support remain Government's preferred mode of aid delivery to Zambia. The Government will also continue to work closely with CPs to review the aid strategy. Further, Government will continue to collaborate with the CPs in the implementation of SNDP programmes.

2.2.6 External Debt

42. The reclassification of Zambia as a lower middle income country is a reflection of strong economic growth recorded over the last six years, which averaged 6.4 percent. With this reclassification, access to concessional loans has become more limited but it remains Government's strategy to maximise the use of concessional resources when available. However, non-concessional borrowing for projects with high economic returns will also be considered. The Government will also build on the current B+ sovereign credit rating in order to support the diversification of available sources of external financing and to lower the cost of external borrowing for both the public and private sector.

43. In order to avoid the accumulation of unsustainable debt and ensure value for money in the utilisation of borrowed resources, the Government will continue to strengthen project appraisal procedures to ensure borrowed resources are spent on projects with the highest return. In addition, Government will strengthen its debt management capacity and work towards regular conduct, publication and dissemination of the country's debt sustainability analysis.

2.3 Strategies for Key Growth Sectors

44. Over the past few years, the country has been able to stabilise the economy and achieve high rates of growth. However, this favourable performance has not delivered increased employment opportunities. In the medium term, therefore, Government will focus on interventions that will not only expand output but also create increased employment. The focus in the medium term will be on the agriculture, tourism, construction and manufacturing sectors as they have the greatest potential for achieving the objectives of growth and employment.

2.3.1 Agriculture, Livestock and Fisheries

45. The agriculture sector has continued to perform favourably over the past few years. The consistent growth has mainly been on account of favourable weather patterns and Government programmes such as the Farmer Input Support Programme (FISP), animal disease control measures and expansion of extension services.

46. Over the medium term, the Government's interventions will focus on reforming the current unbalanced agriculture policies which have favoured maize production and disadvantaged the development of other sub-sectors. The key intervention will be on improving crop production and crop productivity, soil and water management, streamlining the marketing system for both inputs and crops and enhancing competitiveness through infrastructure development. In addition, provision of extension services and technological transfer, promotion of aquaculture, promotion of irrigation, land development and agribusiness and marketing will be enhanced.

47. With regard to promoting crop diversification, improving crop production and productivity, the major thrust will be the implementation of an e-voucher[5] system for subsidized inputs. The e-voucher is aimed at enhancing efficiency in the delivery of subsidized inputs by improving delivery methods to targeted beneficiaries. In addition, the system will allow for flexibility in determining the farming inputs to be accessed by the beneficiaries.

48. In the area of livestock, the main focus will be to increase livestock quality and population, and expand both domestic and international market access. The strategies will include development and rehabilitation of livestock infrastructure such as livestock gene banks, livestock extension service centres and breeding centres; enhancement of supply of breeding stock and disease prevention activities; and establishment of disease free zones.

49. The main thrust in fisheries will be to increase fish production and availability by ensuring sustainable exploitation of fish resources and aquaculture development. Government will thus focus on capture fisheries, aquaculture development, fisheries marketing development and investment promotion as well as research. In this regard, the Government will improve extension services and strengthen fish management in trans-boundary water bodies; and construct fish farms and land sites with processing and storage facilities.

2.3.2 Tourism

50. The tourism sector has the potential to contribute significantly to economic growth and employment creation. To exploit the potential of the sector, Government in 2011 rebranded the tourism product and adopted a new slogan called 'Zambia: Let's Explore' to anchor marketing the Zambian tourism at home and abroad.

[5] Under the e-voucher system farmers are allowed the flexibility to receive inputs to support the production of crops of their choice.

51. The hosting of the United Nations World Tourism Organisation (UNWTO) Conference to be held in 2013 will assist in marketing Zambia as a preferred tourist destination and will support the growth of the sector.

52. Growth in the sector however, has been constrained by poor access to tourism sites, inadequate communication facilities, inadequate availability of finance, limited domestic and international air transport networks and weak marketing strategies.

53. In the medium term, the Government will continue to undertake measures to promote and market tourism, expand tourism products and refocus tourism marketing strategies, and develop and rehabilitate key infrastructure. In addition, the Government will continue with the initiatives on integrated development programmes in the Northern Circuit, Kafue National Park and Greater Livingstone Development Area.

54. In order to accelerate private investment and increase the number of visitors, the Government will continue to streamline processes and simplify the legal and regulatory framework. In this regard, the Government will complete the revision of the Tourism and Hospitality Act of 2007, the Zambia Wildlife Act of 1998, and the National Museums Act of 1966.

2.3.3 Manufacturing

55. Over the last five years, the manufacturing sector growth averaged 4.5 percent largely driven by strong performance in the food, alcohol and beverages sub-sector. Performance of other sub-sectors, such as textiles, however, was unsatisfactory mainly due to competition from imported products.

56. In the medium term, focus will be on strengthening and widening the manufacturing base, facilitating private sector development, promoting the growth of Micro, Small and Medium Enterprises (MSMEs) and developing rural based industrial enterprises. The development of Multi-Facility Economic Zones (MFEZs) will continue with the focus on Chambishi, Lusaka South, Lusaka East and Lumwana MFEZs as well as the Sub-Sahara Gemstone Exchange Industrial Park in Ndola and the Roma Industrial Park in Lusaka.

57. In the MSME sub-sector, the focus will be to facilitate the growth of enterprises through business linkages with large corporations in the mining, agro-processing and manufacturing sectors. This is expected to result in the progressive graduation of small scale firms to medium firm status.

58. The Government will also facilitate access to finance, particularly for rural based enterprises embarking on value addition activities in natural resource rich areas. This will be done primarily through the use of industrial clusters and cooperatives. These measures will be complemented by the provision of Business Development Services and skills upgrading programmes.

2.3.4 Construction

59. The construction sector has been one of the fastest growing sectors, with an average annual growth rate of 10 percent in recent years. This growth has been driven by strong demand from residential, commercial and public infrastructure projects across the country. However, the sector is dominated by foreign contractors and participation of local contractors in the industry is currently marginal. This is attributed to a myriad of problems including local capacity constraints and limited skilled human resources.

60. The construction sector holds enormous potential job creation and alleviation of poverty through the employment of small contractors and the application of labour based technology. To unlock this potential the Government will: adopt new road construction techniques, promote the use of cobblestones and pavers for township roads; strengthen the use of sub-contracting in order to build local capacity and business linkages between small and large contractors; enforce preferential procurement thresholds for public works; enhance training and skills acquisition in road construction, bricklaying and related works; and review the costing of road construction in Zambia, with a view to determining an optimal pricing structure and eliminate rent seeking behavior amongst contractors.

2.3.5 **Mining**

61. The mining sector registered a strong performance over the past decade, with growth averaging 12.7 percent per annum. Copper production for large mines is expected to grow albeit at a lower rate than earlier projected for 2012. Over the medium term, the sector is projected to continue growing. Copper production is expected to increase to over 1,000,000 Mt per annum, on account of increased investment activities contingent on high international demand and prices. The sector is also expected to benefit from mineral diversification which includes production of other minerals such as nickel, gold, manganese, iron and uranium.

62. The Government will in the medium term strengthen public oversight over the exploitation of mineral resources by becoming an Extractive Industries Transparency Initiative (EITI) compliant country. This will be done through reforming mining legislation to ensure consistency with international good practice, address identified

short comings in the legal framework, streamline the management and granting of mineral licenses, and improve the systems and operations of the mining cadastre.

63. The Extractive Industries Transparency Initiative (EITI) was launched in 2006 at the G8 summit in Gleneagles, Scotland. The objective of the initiative was to promote transparency and accountability in the management of natural resources and reduce conflicts arising from the exploitation of natural resource wealth as well as promote social dialogue. In this regard, the Government will ensure that it achieves compliant status under the EITI and that it maintains this status. In addition, the government will strengthen the enforcement of standards by ensuring that the proportion of mining companies' complying with safety, health, and environmental regulations rises from 60 percent to 90 percent.

2.3.6 Energy

64. Despite growth in electricity generation capacity in recent years, the growth in demand for electricity has outstripped supply as evidenced by increased load shedding. Access to electricity has also remained low at 21.9 percent of households at national level and only 4.5 percent in rural areas. The supply of petroleum products was also stable largely on account of increased investment in storage facilities and a supportive regulatory framework.

65. In the medium term, a viable energy sector will be key to achieving sustainable economic growth and development. In the electricity sub-sector, the focus will be to increase installed generation capacity by investing in electricity generation infrastructure, improve the transmission infrastructure and expand rural access. The major projects expected to add to the installed capacity include the 360 Mw Kariba North Bank Extension Project, 300 Mw Maamba Thermal plant, 50 Mw Lunzua and 84.4 Mw Lusiwasi power projects. In addition, construction works of 600-750 Mw Kafue Gorge Lower and Itezhi-Tezhi power projects will be undertaken.

66. In the petroleum sub-sector, the focus will be on facilitating construction and rehabilitation of storage facilities countrywide for strategic petroleum reserves to achieve a 20 day strategic stock. In addition, the Government will streamline the fuel supply chain to make it more efficient and cost effective. The Government will also continue to promote the use of renewable energy and alternative sources of energy such as solar, bio-mass, geo-thermal and wind.

2.3.7 Transport and Communications

67. The transport and communications sector has grown significantly over the past three years, at an average annual growth rate of 12.1 percent largely on account of

positive performance in the transport and communication sub-sectors. Performance in the railway sub-sector, however, continued to be unsatisfactory.

68. Growth in the transport sub sector has grown on account of increased economic activity that has resulted in increased cargo and passenger freight in road and air transport. Performance of the communications sub sector has been buoyant driven by infrastructure developments such as the national fibre-optic infrastructure backbone leading to the introduction of Third Generation (3G) services. In addition, the sub sector benefitted from policy reforms such as lowering of the operator license fees for access to the international gateway to US$350,000 from US$12 million. These interventions have resulted in increased investments in infrastructure by service providers to expand coverage, lower costs and subsequent increase in the subscriber base to over 8million.

69. Notwithstanding the progress recorded in the sector, challenges still remain in both the transport and communication sub-sectors. In the transport sub-sector, the state of infrastructure remains inadequate to enhance the competitiveness of the economy and support growth. The situation is compounded by missing links in the existing infrastructure connectivity networks. In the telecommunication sub-sector, lack of optimal use of the fibre-optic infrastructure has remained a challenge especially in rural areas.

70. Over the medium term, the Government shall commit a substantial part of the national annual development budget to infrastructure development and ensure the completion of on-going projects in the transport and communication sector. In the road sub-sector, focus will be on completing a number of on-going projects under ROADSIP II. These roads include the Mongu-Kalabo, Kalabo-Sikongo-Angola border, and Kabompo-Chavuma, Isoka-Muyombe- Chama, Chipata-Lundazi-Chama, Chipata-Mfuwe, Kasempa-Kaoma, Serenje-Chinsali and the Lake Kariba “bottom” roads among others.

71. In order to link Western and North-Western provinces, Government will in the medium term, upgrade the Kaoma-Lukulu-Kabompo road and also a road link from Kabompo-Mwinilunga district. Other key road infrastructure projects to be undertaken will include the Nchelenge-Chienge-Kaputa–Kasama, Kasempa-Mumbwa, Mpika-Chipata, Mpika-Luchembe-Kopa-Kabinga-Tuta bridge; Kasama-Mporokoso-Kaputa; Shiwang’andu-Kasama; Chiengi-Nchelenge-Kaputa, Mununga-Mporokoso; Kawambwa-Mporokoso; Chinsali-Kasama via Kalondola; Chinsali-Kasama via Mbesuma and Isoka-Kasama. All weather roads between Luwingu and Kaputa mission to Nondo, Samfya to Luwingu and Kawambwa to Luwingu, Kawambwa to Mporokoso, Mununga to Mporokoso will also be upgraded.

72. Construction of the Vubwi road via the palace of paramount chief Mpezeni in Eastern province; the Chadiza-Katete road; the Lusaka-Mikango barracks road to Chirundu-Luangwa bridge via Feira and the Palabana road leading to the lower Zambezi; the Chalimbana road to the lower Zambezi; and Leopards Hill-Kafue river confluence-Luangwa bridge at Great East Road will also be undertaken. Works will also commence on the construction of the Kitwe-Chingola dual carriage way.

73. Furthermore the preparation of the national toll road project is expected to be completed to facilitate the rehabilitation and maintenance of the trunk road network under the Public-Private Partnership (PPP) framework.

74. In the rail sub-sector the focus will be to improve the operational efficiency of the Zambia Railways and TAZARA railway systems, and promote new railway developments using the PPP framework. To this effect, several feasibility studies in the western and northern parts of the country are already underway and will continue over the medium term. The Government also intends to extend the Zambian Railway network to the Botswana railways network via the planned Kazungula Bridge. Other programmes will include completion of the Nacala corridor and the development of the Walvis Bay corridor.

75. In air transport, the Government will continue to improve air transport infrastructure through rehabilitation, expansion and construction of airport and aerodrome facilities as well as improving on safety measures and services. This will include the rehabilitation and upgrading of Kasaba Bay, Kasama and Solwezi airports. Further, government will embark on the upgrading of provincial and district aerodromes into airports. In addition, the Government developed a National Airports Infrastructure Master Plan for new developments and upgrades to the existing infrastructure at the major international airports of Kenneth Kaunda, Simon Mwansa Kapwepwe, Harry Mwaanga Nkumbula and Mfuwe.

76. With regard to the maritime and inland waterways sub-sector, the Government will continue maintaining and rehabilitating canals and waterways. This will be achieved by the procurement and rehabilitation of dredgers. The Zambian Shippers Council will also become fully operational during the medium term in order to help achieve more competitive shipping rates.

77. In an effort to enhance the competitiveness and coverage of the communication sub-sector, Government in the medium term will continue to review various aspects of the ICT policy. In addition, the development of the transmission and backbone infrastructure will be undertaken and a more optimal use of the fibre-optic infrastructure ensured especially in rural areas.

2.4 Social Sectors

78. The ultimate goal of the Government's economic growth and development strategy is to improve the quality of life for all Zambians. The government will, in the medium term, continue to place a high priority on investments in the social sectors especially in infrastructure for the health, education and skills development, housing and water and sanitation sectors.

79. In education, focus will be on expanding access to high school and tertiary education and improving the quality at all levels. This will be achieved through the net recruitment of 15,000 teachers, construction of additional classroom blocks and provision of teaching and learning materials. In addition, emphasis will be placed on improving the efficiency and effectiveness of education and skills development delivery through enhanced access at all levels of education, reorienting the curricula to emphasize life skills and technical subjects and improving the management and governance of institutions. Further, the Government will scale up youth development programmes with the focus on skills development through the construction of and rehabilitation of TEVET institutions. This is aimed at empowering youths and making them active participants in the socio-economic development of the country.

80. Efforts in the health sector will focus on the improvement of service delivery, particularly in rural areas. In this regard, the Government will recruit over 5000 additional frontline medical personnel, construct, expand and upgrade health facilities. In addition, Government will scale up the provision of essential drugs and medical equipment and other supplies. The Government will also explore alternative ways of financing health provision, such as through the social health insurance scheme.

81. In the area of water and sanitation, the strategic focus will be on efficient provision of reliable and safe water and sanitation services in both rural and urban areas. This will be done through the rehabilitation and construction of boreholes in rural areas. In addition, borehole-based water points and water schemes will be established under the National Rural Water Supply and Sanitation programme.

82. In urban areas, development and rehabilitation of water supply and sanitation infrastructure systems will be undertaken. In this regard, the treasury will deliberately scale up budget allocation from domestic resources to this sector. The Government will also facilitate the strengthening of the capacity of utility companies and other institutions in water and solid waste management. Furthermore, with assistance from the Millennium Challenge Corporation (MCC) the implementation of the Lusaka Urban Water and Sanitation Project, which will be the single largest investment in the sector in recent times, will also commence.

83. In the medium term, Government will continue with the development of low cost housing in order to narrow the current housing deficit. In addition, Government will construct institutional houses particularly in the education, health and public order and safety sectors.

2.5 Structural Reforms

84. The focus of structural reforms will be to make the public sector more efficient in service delivery and act as an effective catalyst for national development. The Government will focus on undertaking reforms in public financial management, public service management, private sector development, labor market, decentralization, data and information management and public private partnerships.

2.5.1 Public Financial Management

85. In order to enhance efficiency, transparency and accountability in the use of public resources and better link the planning and budgeting process, the Government over the medium term will continue implementing public financial management reforms. In this regard, Government is developing the new public financial management strategy to guide the reforms following the expiry of the Public Expenditure Management and Financial Accountability (PEMFA) reform programme in December 2012. Areas of focus will include the roll-out of the Integrated Financial Management Information System (IFMIS) across the public sector, implementation of Treasury Single Account (TSA) to enhance the management and control of public funds as well as enact a new Planning and Budgeting Act to strengthen the link between the plans and the budget.

86. To enhance efficiency, transparency and accountability in budget execution and programme implementation, Government will strengthen its monitoring and evaluation systems. In this regard, Government will over the medium term design an integrated, Government-wide, results-oriented Monitoring and Evaluation (M&E) Framework. This framework will also enhance management decision making as it will provide timely feedback on the implementation of Government programmes and projects.

2.5.2 Public Service Management

87. The Government will continue to implement the 2012-2021 Public Service Pay Policy (PSPP), which is a comprehensive framework for remunerating public officers. It rationalises and harmonises pay structures and is anchored on two main principles:

a. _Equal Pay for Equal Work;_ so that public officers doing the same or similar work are remunerated equally. Further, to address current inequalities and distortions, Government will continue to consolidate allowances and observable fringe benefits into basic pay. Also to promote equity in public service pay, Government will apply more generous pay awards to disadvantaged public officers.

b. _Comprehensive Lifespan Conditions of Service_: - this entails that conditions of service in the public sector should comprehensively cover all aspects of a public servant's lifespan to aid them afford needs such as shelter, transport, health care and funeral requisites. The post-employment needs of public servants will also be addressed through a comprehensive restructuring of the current pension system so as to make it more viable and sustainable.

88. The effective implementation of these public service management reforms will enhance the capacity of the public service to attract and retain qualified, competent and well-motivated human resource, which will ultimately result in improved service delivery.

2.5.3 Private Sector Development

89. In the first quarter of 2012, the Zambia Development Agency and PACRA launched the business e-registry and online registration of businesses, respectively. These reforms are aimed at reducing transaction costs and improving efficiency. The country, however, still faces a number of challenges relating to the regulatory framework and ease of doing business. In order to address these constraints, the Government will over the medium term continue with reforms in the areas of licensing, regulatory reform, cost of doing business and trade facilitation. With regards to licensing, the review of the remaining 40 licenses will be undertaken in relation to the 101 that have been abolished and the 21 that have been amalgamated. Furthermore, the Government shall ensure issuance of quality licenses by use of regulatory impact assessments across ministries and introduce a collateral registry.

90. In the area of regulatory reform, activities will include: establishing a regulatory scrutiny unit and regulatory bill for improved regulatory efficiency; improving the regulatory practice of local authorities and streamline construction permits, processes and procedures. Trade facilitation will be enhanced through improvements in the management of border and trade agencies.

2.5.4 Labour market and Employment Creation Strategy

91. The objective of the Government is to translate strong economic growth into meaningful human development and significant poverty reduction by creating 1

million formal sector jobs. These formal sector jobs will in turn expand the quantum and quality of informal sector jobs.

92. To achieve this objective the Government will adopt and implement a job creation strategy that focuses on specific interventions in the agriculture, tourism, manufacturing and construction sectors. Supporting interventions will focus on infrastructure development and Information and Communication Technology (ICT); education and skills training; access to affordable and long term finance; and improving the business environment.

93. The private sector will be the driving force for job creation whilst the Government will address constraints faced by the private sector by undertaking policy reforms that remove undue regulatory constraints to private sector participation; investing in infrastructure and human capital development that boosts both public and private sector productivity; and expanding access to long term credit, particularly for small medium and micro-enterprises (MSMEs).

94. During this MTEF period, the National Employment and Labour Market Policy, and pieces of legislation such as the Employment, NAPSA, PSPF, LASF and Factories Acts will be reviewed. The revision of these pieces of legislation will include the domestication of international labour conventions in order to ensure effective and efficient implementation of the Zambia Decent Work Country Programme. These reforms are aimed at achieving greater flexibility in the labour market to promote employment, increasing labour productivity, upholding workers' rights, and fostering industrial harmony and safety through an improved labour administration system. The reforms are also aimed at broadening coverage of the national pension system.

2.5.5 Decentralisation

95. In line with the goal to take service delivery as close to the community as possible, Government will accelerate the implementation of the Decentralization Policy over this MTEF period. In tandem with Government's continued effort to build the capacity within local authorities, two practical steps will be taken in 2013 to put in place an equitable, efficient and transparent intergovernmental fiscal regime as a necessary foundation for the successful devolution of functions to councils.

96. First, in 2013 the Government will begin implementation of revenue sharing arrangements with local authorities. Efforts will also be made to assist councils dismantle their debt overhang and ensure they keep current with their statutory and contractual obligations thereafter. These measures will place them on a more secure financial footing ahead of further fiscal decentralization measures from 2014 onwards. Second, finances currently controlled centrally for capital projects in sectors earmarked

for devolution will be decentralized in 2013 to provincial level as a first step towards further decentralization once the financial position of councils is improved.

2.5.6 Public Private Partnerships

97. Over this MTEF period, Government will continue to collaborate with and encourage the private sector to participate in financing key public sector projects (refer to annex I). The Government will also draw lessons from the Public Private Partnerships (PPP) projects already implemented with the view to strengthening project identification, development and implementation.

2.5.7 Data and Information Management

98. The Government recognizes that to effectively plan, monitor and implement its social and economic agenda, the availability of timely and accurate statistics on social and economic developments is vital. This also has implications for the external assessment of Zambia's performance by investors and sovereign credit rating agencies. In addition, as Zambia advances to become a prosperous middle income country, there will be need to generate a wide range of social and economic data to facilitate appropriate policy design that enables the delivery of sustainable and inclusive growth.

99. Over the medium term, the Government will review the institutional and operational arrangements of the Central Statistical Office (CSO) so that it can effectively discharge its functions as the key institution with the mandate to collect data and disseminate information on economic and social developments in Zambia.

2.6 Risk Factors in the medium term

100. The macroeconomic framework and policy environment outlined above was premised on a number of domestic and external assumptions. These assumptions have various downside risks which could affect macroeconomic outcomes over the course of this MTEF.

101. The financial instability in the Euro zone, may lead to another global financial and economic crisis. Such an occurrence would lead to instability in the international capital markets, and portfolio and capital outflows. This may weaken the

exchange rate of the Kwacha against the major foreign currencies and lead to rising domestic inflation.

102. The outlook for oil markets remains uncertain given the volatile political situation in the Middle-East. If the situation persists, it may lead to inflationary pressure.

103. The MTEF also assumes that weather patterns will remain favourable. Any adverse weather conditions, are likely to negatively affect agricultural production, with a disproportionate impact on small scale farmers. This would result in lower supply of agricultural commodities such as food, and subdued manufacturing activity particularly in the food, beverages and tobacco subsector. Lower food supply would also induce higher food prices and, consequently, higher inflation.

104. The other risks include supply constraints across some segments of the labour and capital market which may slow down the pace of capital projects. Further, as Zambia creates fiscal space and accesses non-traditional sources of financing for development, it is important that all contingent liabilities that may arise from programmes undertaken through arrangements such as the PPP are to be taken into account to ensure that Zambia does not fall back into an unsustainable debt burden.

105. The MTEF assumes continued financial support from cooperating partners (CPs), although at a reduced level. Any significant reduction and non fulfilment of pledged CPs support during this MTEF period, may impact negatively on the attainment of the macroeconomic objectives.

CHAPTER 3

3.0 FISCAL OVERVIEW

3.1 Review of Fiscal Performance 2009-2011

106. During the period under review, Government's fiscal policy was anchored on increasing resource mobilisation to facilitate enhanced expenditure on infrastructure and social services. This was in line with the objectives of reducing poverty, promoting economic diversification and enhancing competitiveness.

107. Total revenues and grants were broadly within the target and averaged 20.5 percent of GDP. This was mainly on account of higher than projected receipts of tax revenues particularly from the mining sector. The higher receipts from the mining sector arose from the rebound in economic activities following the recovery from the global financial crisis and the implementation of the 2008 mining tax regime.

108. Total expenditure increased from 21.1 percent to 24.0 percent of GDP in the same period. Expenses (current expenditure) increased by 1.7 percentage points while domestically financed capital expenditure increased by 1.4 percentage points.

109. During the period under review, the budget deficit averaged 3.0 percent and was broadly within annual targets. However, domestic borrowing averaged 2.5 percent of the GDP against the target of 1.7 percent over the same period. This was attributed to significant outlays on maize purchases and other central government operations.

Table 2: Fiscal Framework (Kwacha Millions)

	2009 Budget	2009 Actual	2010 Budget	2010 Actual	2011 Budget	2011 Actual
GDP	**60,186.00**	**65,754.00**	**76,191.00**	**76,015.00**	**86,327.00**	**93,354.00**
Total Revenue & Grant	**13,414.50**	**13,105.00**	**14,533.70**	**15,198.40**	**17,356.79**	**20,121.29**
Tax	10,191.60	9,661.00	11,385.20	13,112.10	15,230.12	18,885.91
Non Tax	454.00	654.00	722.00	697.00	538.99	633.05
Grant	2,768.60	2,790.00	2,426.70	1,389.40	1,587.69	714.05
Total Expenditure	**14,978.57**	**13,847.40**	**16,422.70**	**17,634.40**	**20,122.21**	**22,385.36**
Expenses	11,894.70	11,556.80	13,103.00	14,797.20	14,569.03	18,002.97
Assets	3,083.90	2,290.50	3,049.53	2,259.70	5,236.86	4,020.94
o/w domestically financed	1,849.40	1,742.20	1,813.64	2,188.20	2,967.96	3,961.80
Liabilities	351.60	277.50	269.20	253.90	316.33	361.44
Overall Balance	**(1,564.10)**	**(1,643.20)**	**(1,888.00)**	**(2,445.50)**	**(2,765.42)**	**(2,992.35)**
Financing	**1,564.10**	**1,643.20**	**1,888.00**	**2,445.50**	**2,765.42**	**2,992.35**
Domestic	1,069.00	1,676.30	1,487.00	2,205.70	1,219.80	1,858.10
External	495.00	(33.10)	401.00	239.80	1,545.62	1,134.25

Table 3: Fiscal Framework (Percent of GDP)

	2009 Budget	2009 Actual	2010 Budget	2010 Actual	2011 Budget	2011 Actual
Total Revenue	**22.30**	**19.90**	**19.10**	**20.00**	**20.10**	**21.55**
Tax	16.90	14.70	14.90	17.20	17.60	20.23
Non Tax	0.80	1.00	0.90	0.90	0.60	0.68
Grant	4.60	4.20	3.20	1.80	1.80	0.76
Total Expenditure	**24.90**	**21.10**	**21.60**	**23.20**	**23.30**	**23.98**
Expenses	19.80	17.60	17.20	19.50	16.90	19.28
Assets	5.10	3.50	4.00	3.00	6.10	4.31
o/w domestically financed	2.90	2.80	2.40	2.90	3.40	4.24
Liabilities	0.60	0.40	0.40	0.30	0.40	0.39
Overall Balance	**(2.60)**	**(2.50)**	**(2.50)**	**(3.20)**	**(3.20)**	**(3.21)**
Financing	**2.60**	**2.50**	**2.50**	**3.20**	**3.20**	**3.21**
Domestic	1.80	2.50	2.00	2.90	1.40	**1.99**
External	0.80	(0.10)	0.50	0.30	1.80	1.21

3.1.1 Revenue and Grants

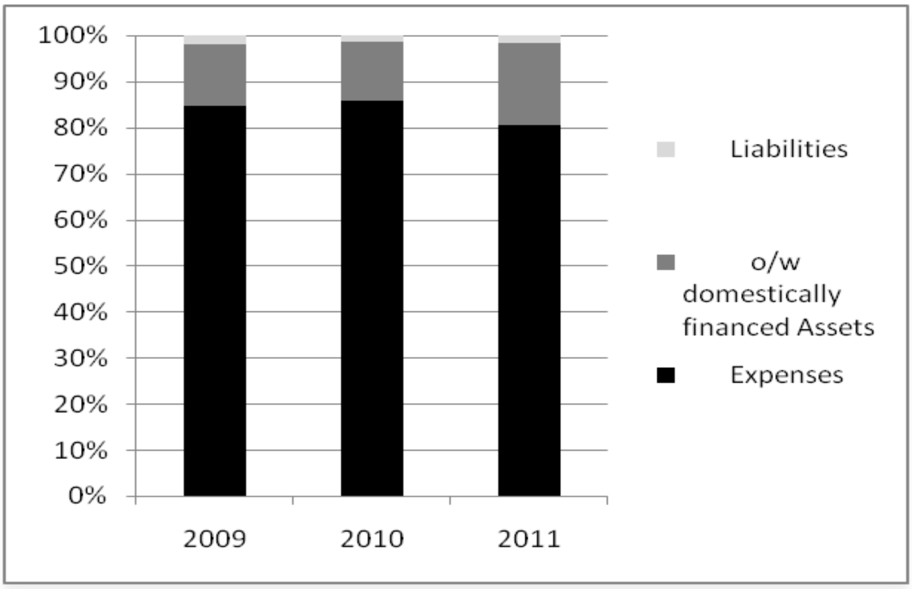
110. Over the MTEF period, domestic revenues as a share of GDP increased from 15.7 percent of GDP in 2009 to 20.9 percent of GDP in 2011. This outturn was attributed to the general increase in economic activities, especially in the mining sector following the gradual recovery of the sector from the effects of the global economic crisis. Further, tax policy and administration measures were undertaken to enhance domestic revenue mobilisation. Some of these measures included the introduction of the new fiscal and regulatory framework for the mining sector and improved enforcement activities in tax administration.

111. In terms of domestic revenues categories, tax revenues increased from 14.7 percent of GDP in 2009 to 20.2 percent of GDP in 2011 particularly due to the higher than projected collections under customs duty, excise duty and import VAT. Grant receipts from cooperating partners declined from 4.2 percent of GDP in 2009 to 0.8 percent in 2011. This was attributed to the scaling down of some projects by cooperating partners.

3.1.2 Expenditure

112. Expenditures as a share of GDP increased from 21.1 percent in 2009 to 24.0 percent in 2011, with assets rising by 0.8 percentage points of GDP despite the decline in receipts of grants from cooperating partners. Spending on domestically financed assets increased by 1.7 percentage points of GDP, reflecting government's commitment to increase infrastructure development.

Figure 1: Expenses, Assets and Liabilities as a share of GDP- 2009- 2011



3.2 2012 Fiscal Review

3.2.1 2012 First Half Budget Performance

113. During the first half of 2012, total revenues and grants were projected at K9,552.1 billion, while expenditures were estimated at K11, 754.8 billion and the balance was to be financed through borrowing. As at end June 2012, total revenues and grants stood at K10, 126.6 billion whilst expenditures (excluding amortisation) stood at K11, 549.5 billion.

114. Domestic revenues over performed by 12.8 percent. Generally, all tax types in the period under review performed well. The positive performance under income tax was mainly attributed to an adjustment of public service salaries and improved compliance. The positive performance of VAT and excise duty was attributed to the increase in the value for duty purposes on taxable transactions. Regarding non tax revenue, the positive performance was on account of favourable receipts from fertilizer recoveries.

115. Current expenditures, as at end of June 2012, amounted to K9, 968.7 billion and were above the target by 17.7 percent. Of the total releases, 43.8 percent was for personal emoluments, 22.1 percent for use of goods and services and 13.1 percent for grants and other payments. The balance of 22.4 percent went towards the payment of interest on debt, social benefits, liabilities and other expenses. The higher than programmed releases on recurrent items during the period under review, was largely due to increased resource requirements for the wage bill, the financial

restructuring programme and other government programmes such as the Farmer Input Support Programme and the Strategic Food Reserve.

116. With regard to the acquisition of non-financial assets (capital expenditures), a total of K1, 406.6 billion was released and this was below target by 54.0 percent. This is primarily due to the non-capture of foreign financed programmes. Nonetheless, domestically financed assets were below target by 17.3 percent. Specific expenditure items under this category included K672.9 billion, K671.1 billion and K62.5 billion for ordinary non-financial assets, roads and the Rural Electrification Programme, respectively.

3.2.2 Outlook for the Second Half of 2012

117. The general performance of domestic revenues is expected to remain favourable, characterized by strong performance in corporate income tax, PAYE, and VAT. The performance is also expected to be buoyed by the planned audit and enforcement activities by the Zambia Revenue Authority. However, movements in the exchange rate and developments in the global economy such as fluctuations in copper prices could affect revenue mobilization.

118. Total expenditures are projected to remain within the end year budget targets in order to achieve fiscal prudence. However, given the higher than budgeted for civil service pay award, it is expected that some expenditure categories (recurrent expenditure) will be curtailed in order to achieve this outcome. It is further anticipated that the assets budget may not be released in full due to capacity limitations in implementing agencies particularly in the road sector.

3.3 Fiscal Policy for the 2013-2015 MTEF

119. During the 2013-2015 MTEF period, Government will embark on an expansionary fiscal policy so as to maintain high economic growth that will translate into job creation and accelerated poverty reduction. To achieve the foregoing, the Government will enhance domestic resource mobilisation and vigorously pursue cheap foreign financing. With regard to enhancement of resource mobilisation, the Government will undertake an overall review of the tax system. As for commercial borrowings, it is envisaged that resources arising from the same will only be utilized for commercially viable projects such as those in the energy, agriculture and transport sectors. With regard to domestic borrowing, this will be kept within sustainable levels so as to maintain macroeconomic stability.

120. In terms of public expenditures, Government will focus on stepping up pro-poor service delivery in the four core areas of education and skills development,

health care provision, agriculture support services and local Government and housing development in accordance with the aspirations of the current Government as outlined in the PF manifesto. This will involve resource realignment across the various government spending functions.

3.4 Medium Term Fiscal Forecast

121. Over the MTEF period, total domestic revenues and grants are expected to slightly increase from 20.8 percent of GDP in 2012 to 21.5 percent by 2015 mainly on account of increasing domestic tax revenues. On the other hand, domestic revenues as a share of GDP are expected to increase from 19.0 percent in 2012 to 20.1 percent by 2015. Tax revenues are projected to be at 18.3 percent of GDP in 2012, rising steadily to 19.6 percent of GDP by 2015. This increase is expected to be driven by improved direct and value added tax collections arising from sound economic policies and tax reform. As for non-tax revenues, they are expected to remain stable around 0.6 percent of GDP over the medium term.

122. Total grants over the medium term are expected to be around 1.8 percent of GDP in 2013, 1.6 percent of GDP in 2014 and 1.4 percent of GDP by 2015. However, the figures are conservative since consultations with cooperating partners are still on-going.

123. Total expenditures are expected to slightly decrease from 25.2 percent of GDP in 2013 to 24.0 percent of GDP by 2015. Spending on expenses (current expenditures) is expected to average 17.2 percent of GDP by 2015. On the other hand, assets (capital expenditure) are projected at 7.0 percent.

124. Liabilities (arrears) over the medium term are expected to decline from 0.24 percent of GDP in 2013 to 0.21 percent of GDP by 2015. This reduction is consistent with Government's commitment to dismantle arrears.

125. In view of the gap between expected resources and expenditures, Government projects to incur an overall fiscal deficit of 4.1 percent of GDP in 2013, 2.6 percent of GDP in 2014 and 2.4 percent in 2015. Therefore, the net domestic financing requirement is expected to stand at 1.5 percent of GDP by 2015. Similarly, net external financing is projected to decline from 2.6 percent of GDP in 2013 to 1.0 percent of GDP by 2015.

Table 4: 2013-2015 Fiscal Projections

	2013 Budget Projection		2014 Budget Projection		2015 Budget Projection	
	K'million	% of GDP	K'million	% of GDP	K'million	% of GDP
GROSS DOMESTIC PRODUCT	121,275,229	100.00%	135,744,646	100.00%	152,055,394	100.00%
TOTAL REVENUE AND GRANTS	25,623,428	21.13%	29,099,252	21.44%	32,740,599	21.53%
TOTAL REVENUE	23,404,428	19.30%	26,978,252	19.87%	30,580,599	20.11%
Tax revenue	22,666,200	18.69%	26,194,372	19.30%	29,746,144	19.56%
GRANTS	2,219,000	1.83%	2,121,000	1.56%	2,160,000	1.42%
TOTAL EXPENDITURE	30,627,623	25.25%	32,637,162	24.04%	36,456,364	23.98%
o/w Domestically Financed	27,165,623	22.40%	29,208,162	21.52%	32,920,364	21.65%
Foreign Financed	3,462,000	2.85%	3,429,000	2.53%	3,536,000	2.33%
EXPENSES	21,446,096	17.68%	23,337,948	17.19%	25,347,184	16.67%
ASSETS	8,885,988	7.33%	8,964,433	6.60%	10,785,111	7.09%
LIABILITIES	295,539	0.24%	334,780	0.25%	324,068	0.21%
FISCAL BALANCE: Surplus(+)/Deficit(-)	(5,004,194)	-4.13%	(3,537,910)	-2.61%	(3,715,765)	-2.44%
FINANCING	5,004,194	4.13%	3,537,910	2.61%	3,715,765	2.44%
Net Domestic Financing	1,863,438	1.54%	2,095,897	1.54%	2,204,946	1.45%
Net External Financing	3,140,757	2.59%	1,442,012	1.06%	1,510,819	0.99%

CHAPTER 4

4.0 REVENUE MOBILISATION AND FINANCING

4.1 Overview of Revenue Strategy

126. In order to be consistent with the declaration of Zambia as a middle income country, there is need to increasingly mobilise internal resources to promote and sustain economic growth which will translate into meaningful generation of employment opportunities, marked reduction in poverty levels (especially in rural areas) and improved standards of living. To achieve this, reforms will be undertaken aimed at ensuring that revenues generated increase at a faster rate than the growth in GDP.

4.2 Medium Term Measures

4.2.1 Reforming the Zambian Tax System

127. Over the medium term, Government will embark on specific strategies which will include a comprehensive tax reform to improve the performance of the Value Added Tax (VAT), rationalise the investment tax incentives regime and increase progressivity of the tax system. In addition, the Government will develop mechanisms to enhance the monitoring and auditing of mining activities to ensure correct declaration of mineral production volumes and content. Government will continue to pursue tax policy measures which encourage investment and promote local value addition.

128. With regard to non-tax revenues, the Government will strengthen the current system by designing more effective collection mechanisms such as use of point-of-sale facilities and dedicated payment counters in banks. Other interventions will include providing adequate resources for collecting agencies, reviewing current legislation and enhancing monitoring through programmes such as the roll-out of the IFMIS. Further, the Government will review legislation for some statutory bodies with a view to channel all revenues through the Treasury and enhance accountability.

129. It is envisaged that the above tax and non-tax interventions will create fiscal space and increase the ratio of domestic revenues to GDP.

4.2.2 *Revenue Forecast*

130. Taking into account enhanced levels of economic activities and reforms in both tax policy and administration envisaged over the medium term, domestic revenues as a share of GDP are projected to increase from 19.0 percent in 2012 to 20.1 percent in 2015. See Table 5 below.

Table 5: 2013-2015 Revenue and Grant Projections

	2013 Budget Projection		2014 Budget Projection		2015 Budget Projection	
	K'million	% of GDP	K'million	% of GDP	K'million	% of GDP
GROSS DOMESTIC PRODUCT	**121,275,229**	**100.00%**	**135,744,646**	**100.00%**	**152,055,394**	**100.00%**
TOTAL REVENUE AND GRANTS	**25,623,428**	**21.13%**	**29,099,252**	**21.44%**	**32,740,599**	**21.53%**
TOTAL REVENUE	**23,404,428**	**19.30%**	**26,978,252**	**19.87%**	**30,580,599**	**20.11%**
Tax revenue	22,666,200	18.69%	26,194,372	19.30%	29,746,144	**19.56%**
Income taxes	12,286,400	10.13%	14,489,451	10.67%	16,555,520	10.89%
o/w Mining	2,696,600	2.22%	3,062,190	2.26%	3,555,840	2.34%
Excise Duties	2,543,400	2.10%	2,862,636	2.11%	3,221,671	2.12%
Value-Added Tax (VAT)	5,702,100	4.70%	6,433,271	4.74%	7,251,300	4.77%
Domestic VAT	276,000	0.23%	309,097	0.23%	346,133	0.23%
Import VAT	5,426,100	4.47%	6,124,174	4.51%	6,905,167	4.54%
Customs duty	2,134,300	1.76%	2,409,014	1.77%	2,717,653	1.79%
Nontax revenue	738,228	0.61%	783,880	0.58%	834,455	0.55%
GRANTS	**2,219,000**	**1.83%**	**2,121,000**	**1.56%**	**2,160,000**	**1.42%**
Program (General Budget Support)	542,000	0.45%	553,000	0.41%	580,000	**0.38%**
Project	1,677,000	1.38%	1,568,000	1.16%	1,580,000	**1.04%**

4.2.3 *Financing Strategy (Borrowing)*

131. The Government's policy on financing has been to limit borrowing within sustainable levels. As such, fiscal deficits, financed through both domestic and foreign borrowing have been contained at an average of 2.7 percent of GDP in the past three years. In 2012, financing is projected to be at 4.2 percent of GDP which is comparatively high due to the expected issuance of Zambia's first sovereign bond. Over the medium term the fiscal deficit is expected to average 3.1 percent of GDP of which domestic financing will average 1.5 percent.

4.2.4 *Debt Position and Strategy*

132. Government debt has remained fairly stable and maintained below 25 percent of GDP since 2009. This has primarily been as a result of the Government's conservative approach following a significant reduction in the debt stock under the Highly Indebted Poor Countries (HIPC) and Multilateral Debt Relief Initiative (MDRI) of 2005. These initiatives significantly improved Zambia's external debt sustainability, with the debt service to revenue ratio falling to less than 3 per cent in 2009 from 10.5 percent in 2005. Zambia's external debt service has since been maintained around 2

percent of revenues since 2009. Table 6 below shows the public debt stock from 2009 to 2011.

Table 6: Public Debt Stock (2009-2011)

Year	Public Domestic Debt (K' billion)	Public External Debt (K' billion)	Total Public Debt (K' billion)	As a Percent of GDP
2009	9,502.06	6,118.51	15,620.57	24.17
2010	9,961.06	6,142.94	16,104.00	20.73
2011	13,122.41	8,188.43	21,310.83	22.83

133. During the medium term, Government will continue to ensure that debt levels remain within sustainable levels. To achieve this Government will continue to pursue the following strategies:

- Containing the fiscal deficit to approximately 3 percent of GDP.
- Target more of concessional borrowing
- Limit non concessional borrowing to projects that are of a high economic rate of return
- Limit domestic borrowing to not more than 2 percent of GDP to avoid crowding out local investments and increasing interest rates.

134. The Government's policy also seeks to consolidate debt management by improving oversight procedures with a view to enhance transparency and accountability in line with the on-going financial management reforms.

CHAPTER 5

5.0 EXPENDITURE POLICY AND STRATEGY

5.1 Overview of Strategy

135. The Government will, over the medium term, provide significant resources in the four areas of education and skills development, health care provision, agricultural support and local government and housing development. Specific emphasis will be on the development of infrastructure, the provision of requisites and increasing the number of frontline personnel.

5.2 Expenditure Strategy for 2013 – 2015

136. The Government's expenditure strategy for the period 2013-2015 will be focused on stepping up pro-poor service delivery through effective reprioritisation of programmes and efficient utilisation of limited resources.

137. Total expenditures over the MTEF period will amount to K101, 562.8 billion out of which, K31,069.6 billion will be spent in 2013, K33,323.9 billion in 2014 and K37, 169.3 billion in 2015. As a share of GDP, this will amount to 25.6 percent in 2013, 24.6 percent in 2014, and 24.4 percent in 2015. Table 7 below shows the budget by broad economic classification as a share of the budget and GDP.

Table 7: Public Expenditure by Economic Classification 2013-2015

	2013 Budget Projection		2014 Budget Projection		2015 Budget Projection	
	K'million	% of GDP	K'million	% of GDP	K'million	% of GDP
EXPENSES	21,446,096	17.68%	23,337,948	17.19%	25,347,184	16.67%
ASSETS	8,885,988	7.33%	8,964,433	6.60%	10,785,111	7.09%
LIABILITIES	295,539	0.24%	334,780	0.25%	324,068	0.21%
AMORTISATION	441,993	0.36%	686,738	-0.51%	712,931	-0.47%
TOTAL EXPENDITURE	31,069,616	25.62%	33,323,900	24.55%	37,169,295	24.44%

EXPENSES

5.2.1 Personal Emoluments

138. Personal emoluments in the medium term, as a share of GDP, are projected to decline from 9.1 percent in 2013 to 8.8 percent in 2015. The spending pattern on personal emolument is consistent with Government's strategy to contain

the wage bill within sustainable levels and ensure sufficient fiscal space for developmental programmes.

139. On average, personal emoluments for education, health, agriculture and public order and safety will account for 76.7 percent of the total wage bill. (See Table 8).

Table 8: Net Recruitment Plan (2013-2015)

	2013	2014	2015	Total
Medical Personnel	2,303	2,303	2,303	6,909
Teachers	5,000	5,000	5,000	15,000
Agriculture	1,000	900	900	2,800
Public Order and Safety	2,100	1,000	2,500	5,600
Other Government Institutions	1,010	-	710	1,720
Total	11,413	9,203	11,413	32,029

5.2.2 Use of Goods and Services

140. In order to create fiscal space for developmental programmes, operational expenses of Government are projected to decline over the medium term. As a share of GDP, expenditure on use of goods and services is projected to reduce from 4.1 percent in 2012 to 3.7 percent in 2013. This will further decline to 3.4 percent and 3.3 percent of GDP in 2014 and 2015, respectively. This pattern is mainly driven by Government's policy of curbing non-critical administrative costs while protecting the provision of essential requisites such as drugs and educational materials.

5.2.3 Interest Payments

141. In 2012 Government increased its borrowing levels in order to meet the economy's need for infrastructure development. Therefore, interest payments on debt are expected to remain at around 1.6 percent of GDP over the medium term.

5.2.4 Transfers and Other Payments

142. The Government projects to spend K2,566.7 billion in 2013, K2,705.5 billion in 2014 and K2,851.4 billion in 2015 on transfers and subsidies. Within these provisions, allocations have been made to support the operations of key institutions such as road agencies, Zambia Revenue Authority and public universities. As a commitment to sharing resources between central Government and local authorities, additional transfers amounting to K100 billion, have been provided for local authorities. In order to ensure food security, the Government has made provisions of

K532 billion in 2013, K562.9 billion in 2014 and K593.8 billion in 2015 for the Farmer Input Support Programme.

5.2.5 Social Benefits

143. Social benefits are planned to increase from K549.7 billion in 2012 to K681.3 billion in 2013, further rising to K1,317.3 billion in 2015. This is mainly on account of the increase in the allocation to the Public Service Pension Fund (PSPF) in an effort to narrow the financing gap which has been created through the diminishing levels of contributions to the scheme.

5.2.6 Other Expenses

144. Expenditure on financial restructuring has been projected at K96.7 billion in 2013 and is expected to decline further to K65.6 billion in 2015. As for the unforeseen and unavoidable expenditure items, a contingency of K255.0 billion has been set aside in 2013. This amount is meant to cover activities such as the UNWTO conference which had not been fully costed at the time of this publication. Further, K300 billion, K317.4 billion and K334.8 billion has been allocated to the Food Reserve Agency for 2013, 2014 and 2015, respectively, to facilitate the purchase of grain strategic food reserves.

ASSETS

145. The Government recognises the role that capital investment plays in accelerating economic growth. In this regard, expenditure on assets is projected to average 7.0 percent of GDP over the medium term. Nominal allocations to the formation of capital assets are projected at K8,886.0 billion in 2013, K8,964.4 billion in 2014 and K10,785.1 billion in 2015.

5.2.7 Non-Financial Assets

146. Expenditure on the acquisition of non-financial assets has been projected at K8,716.0 billion in 2013, K8,764.4 billion in 2014 and K10,585.1 billion in 2015. The notable domestically financed expenditures under this category include spending on water and sanitation facilities and roads. The allocation from domestic revenues towards water and sanitation will increase by 67 percent in 2013 to K250 billion. Government contributions to the road fund are projected at K2,205.5 billion in 2013, K3,054.4 billion in 2014 and K3,544.4 billion in 2015.

5.2.8 Financial Assets

147. The Government recognises the significant contribution of entrepreneurship in the development of our economy. In this regard, the Government proposes to increase the allocation to empowerment funds from K87.7 billion in 2012 to K100.0 billion per year throughout the medium term period.

LIABILITIES

148. It is Government's intention to dismantle outstanding bills in order to free up fiscal space to facilitate effective implementation of developmental programmes in the near future. In this regard, a total of K954.4 billion has been set aside in the medium term to pay for the goods and services consumed by Government institutions in the past.

5.3 Medium Term Spending Principles

149. Over the medium term, the Government will continue to implement spending principles that promote efficiency and effectiveness in the utilisation of public resources. To this end, the following principles have been proposed for implementation during the medium term:

a) Benchmark pricing for commonly used items

150. It has been observed that prices of commonly used items (such as stationary, computers, motor vehicles, etc) vary from institution to institution. Therefore, Government will develop a *'price database'* that will serve as a benchmark against which the procurement of all commonly used items, across government institutions, will be gauged. This will ensure that government's procurement of most assets, goods and services are at competitive prices.

b) Accumulation of arrears

151. Government has noted that resources are being misdirected in several institutions through the uncontrolled consumption of various goods and services. Further, a number of government institutions have continued to inadequately budget for the utilisation of utility services such as electricity, water and telephone. In some cases, statutory obligations such as taxes and pension contributions are not remitted as well. As a result, there has been a significant accumulation of arrears across several Government institutions, thereby undermining Government's commitment control systems and diminishing its fiscal capacity to implement programmes. Therefore, over the 2013-2015 medium term, Government will ensure the following:

- Prioritisation of Liquidation of arrears;
- Installation of prepaid services in all government institutions with the exception of strategic institutions, such as medical facilities; and
- Strengthening the commitment control systems to curb over commitments

c) Strengthening Monitoring and Evaluation

152. It has been observed that there are weaknesses in monitoring and evaluating programmes in MPSAs. This has led to Government not deriving the intended value from the expended funds on various programmes and projects. In this regard, all MPSAs will provide resources for the institutionalisation of monitoring and evaluation activities in their respective budgets to support evidence-based decision making.

d) Other Cost Saving Measures

153. Other potential areas of saving public funds include the reduction of expenditure on local and foreign travel, workshops and seminars, motor vehicles and annual events.

e) Strengthening Project Appraisal and Monitoring Systems for Public Investment Decisions

154. The Government will establish formal project appraisal and monitoring mechanisms to guide all public investment decisions. This is to ensure that these projects support the government's growth and development objectives, are financed in the most cost effective manner, and do not lead to the accumulation of an unsustainable debt burden.

CHAPTER 6

6.0 MEDIUM TERM ALLOCATIONS BY FUNCTIONS OF GOVERNMENT

6.1 Overview of Strategy

155. The classification of functions of Government (COFOG) is a categorisation of all public expenditures in accordance with the purpose for which such allocations are intended to achieve. In the 2013-2015 medium term, Government spending by functional classification will be guided by the Government's social and economic priorities, policies and strategies. Therefore, Government will provide significant resources in the areas of education, health, agricultural and local government. Specific interventions in these areas will focus on the development of infrastructure and human capacities, the provision of service delivery requisites and the scaling up of frontline personnel. Government will also remain committed to promoting diversification of the economy in various key sectors in order to stimulate and sustain broad-based growth.

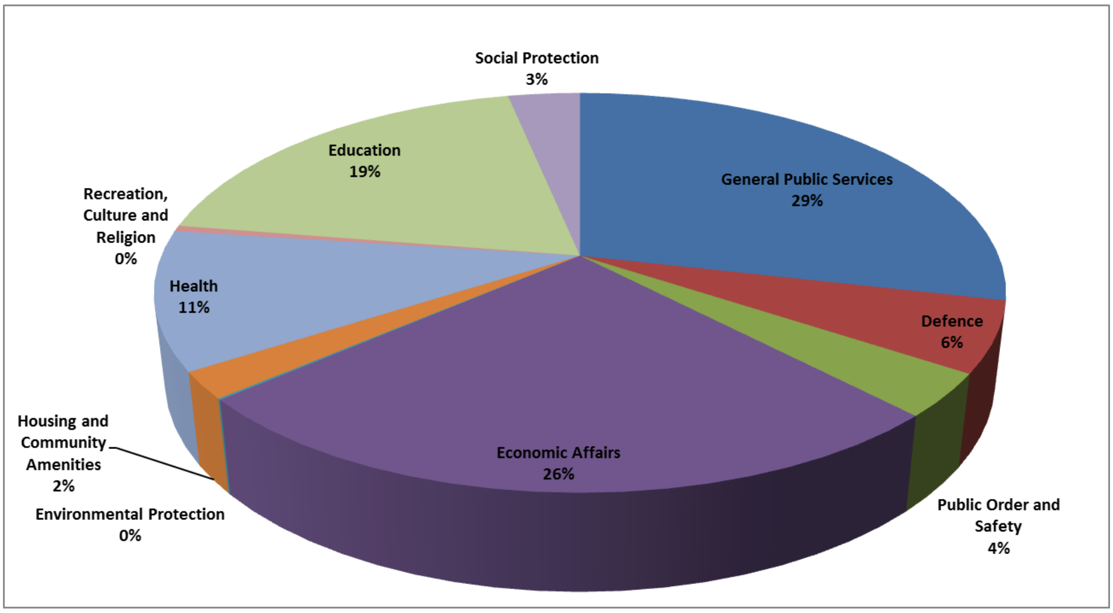
6.2 Functional Resource Allocation Priorities (2013 – 2015)

156. Over the medium term, the functions of education, health and economic affairs will together take up about 56 percent of total expenditures over the medium term. The bulk of the balance of 44 percent will be allocated to General Public Services, which includes debt service costs and intergovernmental fiscal transfers to councils. These allocations are in line with government's strategic focus to allocate more resources to social sectors and growth enhancing sectors such as agriculture, roads and energy. Table 9 and Figure 2 below show budget allocations by functions of Government as a share of total expenditure for the entire medium term period.

Table 9: 2013-2015 MTEF Allocations by Functions of Government)

Function	2012 Approved Budget	2013 Projection	2014 Projection	2015 Projection	2013-2015 Average
General Public Services	29.9%	29.9%	28.8%	27.0%	28.6%
Defence	6.0%	6.1%	5.6%	5.4%	5.7%
Public Order and Safety	3.7%	3.8%	3.5%	3.3%	3.5%
Economic Affairs	29.4%	26.3%	25.5%	25.6%	25.8%
Environmental Protection	0.1%	0.1%	0.1%	0.1%	0.1%
Housing and Community Amenities	1.4%	2.2%	2.2%	2.1%	2.2%
Health	9.3%	10.3%	11.2%	12.1%	11.2%
Recreation, Culture and Religion	0.5%	0.5%	0.5%	0.4%	0.5%
Education	17.5%	18.2%	19.2%	20.2%	19.2%
Social Protection	2.3%	2.6%	3.5%	3.7%	3.3%
Total	100.00%	100.00%	100.00%	100.00%	100.00%

Figure 2: 2013-2015 Budget Allocations by Function of Government



6.2.1 General Public Services

157. Over the medium term, General Public Services will continue to take up a larger share of total expenditure at an average of 28.6 percent per annum. This is on account of significant outlays on debt obligations, administrative costs of Government, and intergovernmental transfers to councils. In this regard, it is projected that General Public Services will account for 29.9 percent in 2013, 28.8 percent in 2014 and 27.0 percent of total expenditures in 2015.

6.2.2 Economic Affairs

158. The share of the Economic Affairs function is projected to average 25.8 percent over the medium term. Allocations under this category will be directed toward scaling up investments in agriculture and infrastructure development particularly in the transport and energy sectors. It is anticipated that these outlays will facilitate and complement private sector involvement in the economy. In the agriculture sector, efforts will among others, be directed toward extension and research services to facilitate crop diversification and enhanced sector productivity.

6.2.3 Education

159. Expenditure in the Education sector is projected to rise to 20.2 percent of total expenditures in 2015 from 17.5 percent in 2012. In terms of interventions, these resources will facilitate the construction and expansion of schools, colleges and universities; procurement of teaching and learning materials; and curriculum improvement. In addition, it is envisaged that a total of 15,000 teachers will be

recruited over the medium term to complement other efforts being undertaken to ensure equitable access to quality education for all.

6.2.4 Health

160. Over the medium term, the allocation to the health function is projected to increase from 9.3 percent in 2012 to 12.1 percent in 2015. The allocation will continue to address challenges posed by high disease burden, inadequate medical staff, equipment and supply of essential drugs. In this regard, Government will place more emphasis on preventive health care as opposed to focusing only on the curative aspect.

6.2.5 Housing and Community Amenities

161. The Housing and Community Amenities function allocation has been projected at an average of 2.2 percent of total expenditure over the MTEF period. Under this function, domestic resources for the water and sanitation programme will double to K300 billion by 2015 in order to accelerate the implementation of the programme in under-served areas of the country.

6.2.6 Public Order and Safety

162. 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 an average of 3.5 percent of total expenditure each year to go towards this function over 2013-2015 MTEF period. Outlays in this area will include infrastructure development, procurement of modern police service equipment and supplies under the modernisation programme and the recruitment of about 1,800 additional police officers.

6.2.7 Other Functions

163. The allocation to the remaining functions[6] over this MTEF period will average 9.6 percent of total expenditure. The bulk of these funds will be spent on pension obligations and national defence and security. This pattern of allocation represents a realignment of resources to key strategic areas that Government has identified in the medium term in line with the aspirations of the PF Manifesto and strategic focus of the SNDP.

[6] Defence; environmental protection; social protection; and recreation, culture and religion.