Republic of Zambia

THE PROPOSED 2016-2018
MEDIUM TERM EXPENDITURE FRAMEWORK
AND
THE 2016 BUDGET

GREEN PAPER

Ministry of Finance

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FOREWORD

It is my privilege to present Government's fiscal, economic and development policy intentions for the 2016 – 2018 medium term, in the continued spirit of partnership based on stakeholder consultations.

The 2015 fiscal year has faced various external shocks arising from the slowdown in the Chinese economy that has depressed international trade flows and led to a sharp decline in copper prices on the world market. Further, in anticipation of interest rates rising in the United States of America, the US dollar has strengthened significantly. Aside from these external shocks, Government had to accommodate the Presidential by-election and fuel subsidies among other necessary and critical expenditures. Government's response to mitigate the impact of these developments have included rationalising expenditure on some programmes and activities. As such, the 2016 – 2018 medium term objectives have taken into account the 2015 shocks and their anticipated impact on the economy going forward.

Thus the macroeconomic and fiscal objectives for the medium term will aim at maintaining a positive and broad based growth trajectory, macroeconomic stability and consolidating the fiscal position. Programmes targeted at attaining inclusive growth will also be undertaken, as part of Government's efforts towards the achievement of the new Sustainable Development Goals.

During the 2016-2018 medium term, Government will focus on consolidating its fiscal position to create fiscal space for vital public services and infrastructure development. In this regard, Government will protect critical social programmes in the health, education and social sectors. Government will also direct resources in its capital budget to complete on-going projects in order to enhance service delivery and create jobs.

I urge all stakeholders to study the 2016 – 2018 Green Paper carefully and provide comments that will help Government refine and finalize the 2016 – 2018 development objectives and the 2016 Budget.

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MINISTRY OF FINANCE

CHAPTER 1

INTRODUCTION

1. In accordance with the theme of the Revised Sixth National Development Plan (R-SNDP) of achieving “people centred economic growth and development”, the 2016-2018 Medium Term Expenditure Framework (MTEF) reflects the Government’s continued and unwavering commitment to ensure that the benefits of economic growth are shared widely by all citizens of every age and gender, and by all regions of Zambia.

2. At the same time, Government is cognizant of the need to send a clear message that it is steadfast in its resolve to follow a prudent fiscal path. Accordingly, domestic borrowing over the MTEF period is limited to no more than 1.0 percent of GDP so as not to crowd out domestic investment nor put undue pressure on domestic interest rates.

3. Concomitantly, Government will allocate funds raised externally to strategic sectors of the economy, especially transport, communications and energy, and also to key socio-economic infrastructure to enhance the delivery of essential public services, especially health, education and water and sanitation, to its people.

4. The future of Zambia lies in its youth who form the vast majority of its citizens. Government is committed to providing them with a future and an environment where their talents and abilities can be developed and used to achieve both personal and national development. Government is also steadfast in its endeavour to support the most vulnerable in our society as evidenced by an increasing allocation to social protection programmes like the Social Cash Transfer programme. In order to maintain fiscal prudence, limit recourse to further borrowing and create the fiscal space to increase allocations to critical programmes like education and social protection, the Government will continue to realign spending away from other areas.

5. Accordingly, while Government has already resumed recruiting public sector workers in 2015 - especially for frontline services in education, health and public order - and will award pay increases to all public sector workers from 2016, it is imperative that the overall size of public sector pay as a share of GDP does not rise over the MTEF period. Thus, public service pay is programmed to fall to 8.4 percent of GDP by 2018 from 9.0 percent in 2015.

6. Similarly, other reforms will be undertaken to realign spending - especially in the agricultural sector, where the roll-out of the e-voucher scheme is expected to bring efficiencies and cost savings in the operation of the Farmer Input Support Programme (FISP). The operations of the Food Reserve Agency (FRA) will also be refocused onto its core function of maintaining the strategic food reserves.

7. Further, Government will continue with its efforts to increase the mobilization of resources domestically through tax and non-tax revenues. The Zambia Revenue Authority (ZRA) will continue its programmes to raise tax compliance levels. Tax and non-tax revenues are projected to rise to over 20 percent of GDP in 2018.

CHAPTER 2

2.1 MACROECONOMIC OVERVIEW

Developments in the Global Economy in 2015

3 Global output is expected to rise moderately to 3.5 percent in 2015 from 3.4 percent in 2014, reflecting a pick-up in advanced economies. The United States of America, United Kingdom, Japan and Germany will register positive growth, largely driven by an increase in domestic demand due to lower oil prices.

4 In contrast, growth prospects for emerging and developing economies are much lower, projected at 4.3 percent in 2015 compared to 4.6 percent in 2014. This is on account of subdued growth prospects for larger economies such as China, and weaker activity in some major oil exporting countries on account of a sharp decline in oil prices. Sub-Saharan Africa is projected to grow at 4.5 percent compared to 5.0 percent in 2014.

5 In line with the generally weaker global growth prospects, commodity prices are projected to be lower. Copper prices are estimated to average US $5,787.50 per metric ton in 2015 compared to US $6,646.09 per metric ton in 2014. Oil prices will be 40 percent lower at an average price of US $58 per barrel reflecting a significant increase in supply from the United States of America and other non-OPEC countries.

6 Global economic developments have generally been negative for Zambia’s economic prospects. The lower copper prices have resulted in widening of the current account deficit and depreciation of the Kwacha. The decline in oil prices on the other hand has helped cushion pressure on prices, although this has been undermined by the depreciation of the Kwacha.

Developments in the Domestic Economy in 2015

7 In the domestic economy, real GDP growth is projected at 5.0 percent in 2015 down from the projected target of 7.0 percent. This growth is however, still favourable considering the weaker global environment and domestic challenges such as power outages, and the reduction in crop output during the 2014/2015 farming season.

8 The overall budget deficit for 2015 is projected at 6.7 percent of GDP against the budget target of 4.6 percent. On the revenue side, this largely reflects a shortfall in mining taxes due to lower copper prices and the realignment of the taxation regime for the mining sector, while on the expenditure side releases to road projects, purchase of maize and liquidation of fuel arrears were above the budgeted amounts. Additionally, domestic interest rates were substantially higher than projected.

9 Monetary policy implementation continued to be anchored on achieving an end year inflation target of not more than 7.0 percent. As at end July 2015, the inflation rate was 7.1 percent from 7.9 percent in December, 2014. In the foreign exchange market, there was increased volatility in the first half of 2015, compared to the stability generally observed during the second half of 2014. This was due to the global strengthening of the US dollar, the fall in foreign exchange earnings on account of reduced Non-Traditional Exports (NTEs) and the fall in copper prices. To counter the depreciation, the Bank of

Zambia tightened monetary policy, through the upward revision of statutory reserve requirements to 18 percent in April 2015 from 14 percent.

10 External sector developments during the first half of 2015 were unfavourable, evidenced by a worsening of the external balance. Preliminary data shows that Zambia's merchandise trade balance declined sharply, recording a deficit of US $169.5 million from a surplus of US $347.6 million during the same period in 2014. This was on account of unfavourable performance in the balance on goods, services and the primary income account.

11 Copper export earnings declined by 29.9 percent to US $2,603.3 million during the first half of 2015 from US $3,704.0 million over the same period in 2014 on account of a decline in copper export volumes and a fall in the average realized price. Similarly, NTEs declined by 17.2 percent to US $922.0 million from US $1,114.0 million recorded during the same period in 2014. The lower earnings were largely on account of reduced export of sugar, sulphuric acid and gemstones.

2.2 MACROECONOMIC FRAMEWORK 2016-2018

2.2.1 Macroeconomic Objectives

3 In the medium term, the overriding macroeconomic objectives, given the back-drop of fragile global growth prospects and domestic challenges, will be to maintain a positive and broad based growth trajectory, macroeconomic stability and consolidating the fiscal position. Programmes targeted at attaining inclusive growth will also be undertaken, as part of Government's efforts towards the achievement of the new Sustainable Development Goals.

4 The specific broad socio-economic objectives during the 2016-2018 MTEF period will be to:

(a) achieve an average annual real GDP growth rate of 6.0 percent;

(b) maintain single digit inflation;

(c) accelerate the diversification of the economy particularly towards the agriculture, manufacturing, tourism and energy sectors;

(d) increase international reserves to at least 4 months of import cover by end 2018;

(e) increase domestic revenue mobilization to at least 20 percent of GDP by 2018;

(f) limit Government net borrowing to no more than 5.2 percent of GDP in 2016, 2.3 percent in 2017 and 1.5 percent in 2018;

(g) contain domestic borrowing to no more than 1.0 percent of GDP by 2018;

(h) create employment opportunities in the economy which will include the vigorous implementation of the Youth Empowerment Action Plan that targets 500,000 jobs over the medium term; and

(i) focus on completion of all on-going infrastructure projects, particularly in the health, education, transport and water and sanitation sectors.

Table 1: Key Macroeconomic Targets, 2015-2018

	2015	**2016**	**2017**	**2018**
Real GDP Growth (%)	5.0	6.0	6.5	6.8
Inflation Rate (end year)	7.5	7.7	7.8	7.9
Inflation Rate (annual average)	7.4	7.7	7.6	7.8
Nominal GDP (K' millions)	184,252	207,370	232,447	259,891
Current Account Balance (% of GDP)	-1.8	0.7	1.9	2.5
Overall Balance of Payments (% of GDP)	-1.0	-1.6	-1.7	-1.7
Budget Deficit (% of GDP)	-5.5	-5.2	-2.3	-1.5

2.2.2 Economic and Social Sector Policies

Agriculture

5 In the agriculture sector, emphasis in the medium term will be on promoting agricultural diversification and higher productivity in order to ensure food security, income generation, creation of employment opportunities and reduction in poverty levels.

6 In the crop sub-sector, the key reform programme will be the revision of the mechanism for delivery of inputs under the FISP in a phased manner. As a starting phase, 13 districts have been earmarked for piloting of the e-voucher system in 2015/2016 farming season as a tool to promote diversification from maize. Under the system, small scale farmers will have a wider choice of inputs.

7 Government will also empower the rural areas through the establishment of 13 large scale milling plants with a daily production capacity of between 80 and 240 metric tonnes. It is envisaged that this will increase income for the rural population through job creation, increased agriculture production, value addition and youth skills training in milling operations. With increased output of milling products, the prices of maize, feed stocks and other milling products are projected to decline.

8 In addition, Government will promote irrigated farming, aimed at improving the sector's resilience to droughts in view of climate change challenges. The measure will also enable farmers to grow a variety of crops throughout the year. It is the intention of the Government to bring over 17,500 hectares under irrigation by 2018. The target areas are Lusitu in Chirundu District, Mwomboshi in Chisamba and Musakashi in Mufulira.

9 In the livestock sub-sector, the Government will intensify livestock disease prevention and control measures through aggressive up-scaling of livestock extension services to farmers. This will include the establishment of 23 one-stop livestock service centres, 13 satellite artificial insemination centres, as well as restocking of animals in selected districts. Further, the production of livestock vaccines will be up-scaled, while a livestock

identification and trace back system will be established which will facilitate easy tracking of the origins of diseases of national economic importance.

10 In the fisheries subsector, interventions will focus on promotion of aquaculture and combating of illegal, unreported and unregulated fishing. This will mainly be done through the establishment of aqua parks in Rufunsa, Chipepo, Kasempa and Mungwi as well as up-scaling of surveillance and aquaculture research.

Energy

11 In collaboration with development partners such as the World Bank, Government will strengthen its strategy of encouraging private sector investments in alternative sources of energy, such as solar power. To this end, the Government will facilitate the development and installation of at least 600 MW solar power over the medium term. To kick start this agenda, the Government through the Industrial Development Corporation (IDC) will carry out certain upfront project development activities for the expeditious development of two 50 MW solar PV plants by the private sector.

12 Experiences of power deficits in 2015 highlighted the importance of exploiting alternative energy sources and scaling up of traditional energy sources such as hydro power. In this regard, the focus in the medium term will be to increase electricity generation and to build appropriate infrastructure for transmission and distribution.

13 Under the Power System Master Plan (PSMP), the intention of the Government is to build 17 hydro power generation plants and one thermal plant by 2030, which altogether will bring over 4,000 MW of additional power. Additionally, the Rural Electrification Programme will continue to be implemented with a view to raising the rural electrification rate to 30 percent by 2030 from the current 3 percent. In the medium term, hydro power stations expected to come online include the 120 MW Itezhi-Tezhi hydro power project and the 300 MW Maamba thermal plant.

14 In order to ensure private sector investments and to improve efficiency in the provision of electricity services, Government will continue with relevant reforms, such as the review of the legislative framework and the phased attainment of cost reflective electricity tariffs, to encourage investments into the power sector.

15 Government's policy in the petroleum sub-sector will be to ensure a stable supply of fuel to all parts of the country. In this regard, Government will encourage private sector participation in the supply of petroleum products. Government will also continue to ensure that fuel pump prices are fully cost reflective to eliminate the impact of fuel subsidies on the budget.

Tourism

16 In the tourism sector, Government shall prioritise the development and rehabilitation of key infrastructure such as access roads to tourist sites, airports and cultural centres. In addition, promotional and marketing strategies will be employed in order to increase the sector's contribution to GDP and employment.

17 It is envisaged that the operationalization of the Tourism and Hospitality Act of 2015 will provide for the sustainable development of the tourism industry through effective tourism planning, management and coordination to ensure sustainable and private sector driven tourism.

18 In addition, to increase tourist arrivals and facilitate their internal transportation to tourist sites within the country, Government is examining viable modalities for establishing a national airline.

Manufacturing

19 The focus in the sector shall be investment promotion; technology and skills development and Micro Small and Medium Enterprises (MSMEs) development and economic empowerment. This will be undertaken through the Value Chain Cluster Development Programme whose objective is to add value to local raw materials. In the medium term, value chain projects will continue to be implemented targeting fish farming and processing, mango juice production, rice processing, dairy processing, cotton processing and processing of honey.

20 To promote economic empowerment and raise the participation of Zambians in the economy, Government will continue to recapitalize Development Bank of Zambia (DBZ), Citizens' Economic Empowerment Commission (CEEC) and the National Savings and Credit Bank (NATSAVE). The recapitalisation of these institutions will result in cheaper credit facilities that will be available to MSMEs.

21 Further, product quality improvement, support to private sector development and export development will be prioritised. In this respect, Government will continue promoting and facilitating business enterprise development, encouraging investment and job creation. To ensure the growth of local infant industries, Government will utilize safeguard measures under Trade Protocols where appropriate. Further, Government has introduced measures to restrict ministries and other spending agencies from importing goods that are otherwise locally manufactured. Accordingly, the public procurement guidelines have been revised so that from 1st September, 2015 it will become mandatory for all public sector departments to procure from local manufacturers goods which are locally available for contracts which are valued at three million Kwacha or less.

Mining

22 In mining, Government will continue to promote investments by providing a predictable, consistent and stable policy environment. Government will also protect and secure the many jobs created by the sector. In addition, the operationalization of the revised mining law to streamline issuance of mining licenses, establishment of a tribunal and promotion of local content will enhance development of the sector.

23 Copper output is projected to increase from 741,916 MT in 2015 to 916,767 MT by 2018, largely on account of increased output at Kansanshi mine to be anchored by the new smelter. Production at Konkola Copper Mines is also projected to increase with the coming on line of the Konkola Deep Mining Project in 2016.

24 The development of Kalumbila and Chambeshi West Ore Body will also spur growth in the sector. Further, the mining and quarrying sector is expected to benefit from mineral diversification by enhancing production of minerals such as nickel, gold, iron, manganese and uranium.

Monetary and Financial Sector Policies

25 Government will continue to implement prudent monetary and financial policies to support high and sustained economic growth. In this respect, monetary policy will focus on meeting the objective of achieving end-year inflation of no more than 8.0 percent by 2018. Consistent with this objective, the Bank of Zambia will principally use Open Market Operations to maintain reserve money within the programmed growth path. This will be supported by the primary auction of Government securities, complimented by sound fiscal management.

26 Commercial bank nominal interest rates have been generally stable during the first half of 2015. Despite the stability in the commercial banks' lending rates, the cost of borrowing continues to be inhibitive for the larger section of private investors. In this regard, Government will, in the medium term, reduce its appetite for domestic financing to achieve lower interest rates on the market.

27 In the financial sector, the primary objective will be to continue deepening financial markets and increase access to financial services and credit by individuals and business entities in the economy. In this regard, reforms to harmonize and strengthen the various laws governing the financial sector will continue.

28 With regard to the exchange rate, Government will continue to maintain a market driven foreign exchange rate regime in tandem with other macroeconomic objectives. The Bank of Zambia interventions will be limited to smoothening short-term volatility in the exchange rate of the Kwacha against major foreign currencies so as to maintain stability.

External Sector Policies

29 The primary objective in the external sector will be to improve the current account balance by enhancing the external competitiveness of the economy and maintaining a sustainable external debt position. In this regard, the main strategy remains that of diversifying the economy and promoting export growth.

Education and Skills Development

30 Over the 2016-2018 period, Government will continue to focus on improving the access and quality of education including skills training relevant to the needs of society.

31 Government in the medium term will, therefore, continue with the recruitment of teachers and provision of education materials. Focus will also be placed on the completion of on-going education infrastructure projects including universities, schools and teachers'

houses. This is expected to enhance school enrolment and progression rates, improve completion rates, pupil-teacher ratios and generally improve literacy and numeracy.

32 In order to enhance learning outcomes, Early Childhood Education (ECE) will remain paramount in the medium term, particularly in the rural areas.

Health

33 Over the next three years, Government will focus on completing the construction of health facilities and increasing the number of frontline medical personnel. Further, Government will commence actions to achieve universal health coverage. This will entail undertaking comprehensive social protection reforms, which shall include the establishment of a Social Protection System, such as the National Social Health Insurance Scheme. Government also remains committed in the area of staff recruitment, retention and training as well as the timely provision of drugs and medical supplies, in order to enhance health care service delivery. To this effect, Government will continue with the construction of regional hubs in the remaining regions from which drugs will be distributed to the lower levels.

Water Supply and Sanitation

34 The Government will consolidate efforts to improve access to safe drinking water and basic sanitation in the peri-urban and rural areas. In this regard, Government will continue with the construction and rehabilitation of water points as well as water supply infrastructure under the existing utility companies. Further, Government will scale up works aimed at improving sanitation facilities through various initiatives such as the Lusaka Water Supply, Sanitation and Drainage Project.

2.2.3 Structural Reforms

Public Financial Management Reforms

2 The Government will continue with the implementation of Public Financial Management (PFM) reforms aimed at strengthening the procedures and processes in the budget cycle, including planning, internal controls, procurement, debt management, monitoring and evaluation, and accounting and reporting. The ultimate goal of these reforms is to ensure efficient, effective and accountable use of public resources as a basis for economic development and poverty reduction through improved service delivery.

3 In this regard, the Government will, in the medium term, present the National Planning and Budgeting Bill to Parliament for enactment, review the Public Finance Act and fully operationalize the Treasury Single Account (TSA) which will help Government strengthen cash management. In the area of budgeting, Government will continue piloting Output Based Budgeting (OBB) in the Ministry of Education, Science,

Vocational Training and Early Education and, after evaluation, will roll out to other MPSAs starting in 2017.

Fiscal Decentralization

4 In line with Government's commitment to decentralization, the Local Government Equalization Fund (LGEF) was established in 2015 and is included in the 2016-2018 MTEF as a central pillar in Zambia's Inter-Governmental Fiscal Architecture. Further, actions to devolve functions, such as primary education, disaster management and mitigation and primary health care, have commenced and will continue in 2016. However, the implementation of fiscal decentralisation will be phased with line ministries continuing to hold the budget lines for devolved functions in 2016 and then, through the TSA, resources will be transferred directly to the districts. As the capacity of districts develops and as the arrangements envisaged under the draft planning and budgeting legislation are operationalized, the resources for these functions will progressively be transferred to the districts.

2.2.4 Risks to Attainment of Macroeconomic Objectives and Targets

5 The macroeconomic objectives and targets outlined above are premised on a number of assumptions, which have potential down side risks. In the external sector, any further slowdown in projected global economic growth could adversely affect domestic growth prospects. For instance, a reduction in world trade volumes and the likely downward trend in prices for commodities such as copper could dampen growth in the mining sector. Additionally, a rise in oil prices could adversely affect the cost of domestic production and induce inflationary pressures.

6 On the domestic front, non-adherence to the set fiscal policy objectives and targets in the medium term may potentially undermine overall macroeconomic stability. In particular, unplanned increases in the public sector wage bill and public works, as well as the persistence of power deficits could be injurious to the economy.

7 Additionally, non-implementation of agricultural reforms aimed at sector diversification and adverse weather conditions (given the projected strong El Niño in 2015/2016) could have a disproportionate impact on agriculture.

CHAPTER 3

3.1 FISCAL OVERVIEW

Review of Fiscal Performance 2012-2014

8 During the 2012 – 2014 MTEF period, Government's fiscal policy was expansionary. The objective was to induce high economic growth, human development and diversification that would translate into job creation and accelerated poverty reduction. To this end, emphasis was placed on broadening the tax base, fiscal prudence and channelling more resources to sectors that stimulate economic growth. In addition, Government focused on improvement of service delivery.

9 Total revenues and grants were slightly above the target and averaged 18.0 percent of GDP during the period under review compared to a projected average of 17.9 percent. This was attributed to among others, the streamlining of incentives, rationalization of exemptions and the adjustment of various tax rates.

10 In terms of public spending, total expenditure increased from 20.4 percent to 23.2 percent of GDP over the 2012-2014 MTEF period. The increase was mainly attributed to recurrent expenditure (Expenses) which averaged 17.5 percent of GDP for the 2012-2014 MTEF period against the projected target of 15.5 percent of GDP.

11 The deficits as a share of GDP in 2012, 2013 and 2014 stood at 2.2 percent, 5.7 percent and 5.2 percent, respectively. These were financed through domestic and external borrowing which averaged 2.5 percent and 1.8 percent of GDP, respectively.

Table 2: Fiscal Framework (Kwacha millions)

	2012		2013		2014	
	Budget	Actual	Budget	Actual	Budget	Actual
GDP	**134,506.0**	**128,370.1**	**145,368.0**	**144,722.4**	**166,480.2**	**165,900.6**
Total Revenue & Grants	**21,794.6**	**23,134.6**	**26,271.0**	**25,551.0**	**32,165.4**	**30,576.9**
Tax	19,192.4	20,719.1	23,536.0	23,083.0	24,457.1	25,837.1
Non Tax	708.3	1,653.2	1,210.0	1,450.0	5,081.6	4,460.0
Grants	1,894.0	762.0	1,526.0	1,019.0	2,626.6	279.8
Total Expenditure	**26,339.6**	**26,152.2**	**31,685.0**	**33,790.0**	**41,049.4**	**38,541.6**
Expenses	18,147.4	20,631.3	22,132.0	25,501.0	29,755.0	31,339.4
Assets	7,856.0	5,059.5	9,140.0	7,868.0	10,918.8	6,772.7
Liabilities	336.3	461.4	414.0	421.0	375.5	430.2
Overall Balance	**(4,469)**	**(2,771)**	**(5,414)**	**(8,205)**	**(8,884)**	**(8,696)**
Financing	**4,469**	**2,771**	**5,414**	**8,205**	**8,884**	**8,696**
Domestic	1,324	1,464	1,863	5,949	2,902	3,685
External	3,145	1,307	3,551	2,139	5,982	5,011

Table 3: Fiscal Framework (Percent of GDP)

	2012		2013		2014	
	K'000		K'000		K'000	
	Budget	Actual	Budget	Actual	Budget	Actual
GDP	**134,506.0**	**128,370.1**	**145,368.0**	**144,722.4**	**166,480.2**	**165,900.6**
Total Revenue and Grants	**16.2%**	**18.0%**	**18.1%**	**17.7%**	**19.3%**	**18.4%**
Tax	14.3%	16.1%	16.2%	15.9%	14.7%	15.6%
Non Tax	0.5%	1.3%	0.8%	1.0%	3.1%	2.7%
Grant	1.4%	0.6%	1.0%	0.7%	1.6%	0.2%
Total Expenditure	**19.6%**	**20.4%**	**21.8%**	**23.3%**	**24.7%**	**23.2%**
Expenses	13.5%	16.1%	15.2%	17.6%	17.9%	18.9%
Assets	5.8%	3.9%	6.3%	5.4%	6.6%	4.1%
Liabilities	0.3%	0.4%	0.3%	0.3%	0.2%	0.3%
Overall Balance	**-3.3%**	**-2.2%**	**-3.7%**	**-5.7%**	**-5.3%**	**-5.2%**
Financing	**3.3%**	**2.2%**	**3.7%**	**5.7%**	**5.3%**	**5.2%**
Domestic	1.0%	1.1%	1.3%	4.1%	1.7%	2.2%
External	2.3%	1.0%	2.4%	1.5%	3.6%	3.0%

Revenue and Grants

12 Over the 2012 to 2014 period, total revenue and grants as a share of GDP increased from 18.0 percent in 2012 to 18.4 percent in 2014. In particular, domestic revenues increased from 17.4 percent of GDP in 2012 to 18.3 percent of GDP. This outturn was attributed to tax policy and administrative measures which were undertaken to enhance domestic revenue mobilization. Some of these measures included the streamlining of tax incentives, reduction of exempt and zero rated supplies for value added tax purposes and improved enforcement activities in tax administration.

13 Grant receipts from Cooperating Partners (CPs) declined from 0.6 percent of GDP in 2012 to 0.2 percent in 2014. This was attributed to the completion of a number of projects and reduced resources available from CPs after Zambia attained the lower middle income country status.

Expenditure

14 Expenditures as a share of GDP increased from 20.4 percent in 2012 to 23.2 percent in 2014. This increase was mainly attributed to the increase in Expenses from 16.1 percent of GDP to 18.9 percent of GDP. The increase in Expenses was mainly due to the need to address the imbalances in the public service pay structure, procure more maize due to the bumper harvest, and settle dues arising from fuel subsidies. Expenditure on Assets rose from 3.9 percent of GDP in 2012 to 4.1 percent of GDP in 2014 and was mainly attributed to the increase in expenditure on road infrastructure. Expenditure on Liabilities declined from 0.4 percent of GDP in 2012 to 0.3 percent of GDP in 2014.

3.2 2015 Fiscal Review

2015 First Half Budget Performance

15 During the first half of 2015, Government planned to raise a total of K17.1 billion in revenues and grants, spend a total of K21.6 billion and borrow K4.5 billion. A total of K16.1 billion was raised in revenue and grants while K20.9 billion was spent. The balance of K4.8 billion was financed by borrowing from both domestic and foreign sources.

16 Total domestic revenues collected during the first half of 2015 amounted to K16.1 billion and were below the projected figure of K16.5 billion by K398.4 million or 2.0 percent. Of the total domestic revenues collected, tax revenues amounted to K12.9 billion and non-tax revenues amounted to K3.2 billion. Tax revenues were above target by 4.0 percent while non-tax was below target by 29.0 percent. The underperformance was due to the fall in copper prices, reduced production in minerals which affected mineral royalty collections under non-tax revenues and reduced import volumes which affected trade taxes.

17 A total of K117.1 million was recorded as received in form of grants from CPs against the projection of K606.8 million for the period. The funds mainly related to project support to the agricultural sector.

18 In terms of expenditure, the Treasury released a total of K20.9 billion (including amortisation) against a target of K21.6 billion for purposes of facilitating various Government programmes and activities. Of the amount released, 83.1 percent went to Expenses, 15.9 percent to Assets while Liabilities accounted for 1.0 percent. Under Expenses, the major expenditure items related to salaries and debt service, which together accounted for 62.1 percent of the releases. Other items included subventions to grant aided institutions such as the Zambia Revenue Authority, use of goods and services and pensions.

19 Releases towards Assets stood at K3.3 billion against the projection of K4.6 billion. The major items in this category related to releases to the road sector, Zesco power rehabilitation, construction of student hostels in public universities and water supply and sanitation infrastructure.

2015 Second Half Outlook

20 In the second half of 2015, the general performance of domestic revenues and grants is expected to improve with receipts projected at K18.6 billion. This is mainly premised on enhanced tax enforcement.

21 Total expenditures are projected to rise to K26.2 billion during the second half of the year with higher releases expected to be made toward various infrastructure projects including roads, personal emoluments as well as debt payments. The K7.6 billion difference between revenue and grants on one side and expenditure on the other will be financed through borrowing.

3.3 Fiscal Policy for the 2016-2018 MTEF

22 During the 2016-2018 MTEF period, Government will focus on consolidation of its fiscal position to safeguard macro-economic stability and create fiscal space for vital public services and infrastructure development. In this regard, Government will realign its fiscal trajectory while protecting critical social programmes in the health, education and social sectors. Over the medium term, Government will also direct resources in its capital budget to complete on-going projects in order to enhance service delivery and create jobs.

23 In addition, Government will continue with the improvement of domestic resource mobilization by employing both policy and administrative measures. To achieve this, some key areas and strategies that will be targeted are as follows:

- Enhance IT solutions to augment VAT collections and trade taxes;
- Introduce measures to encourage the use of electronic payments;
- Focus on enhancing capacity and skills in tax auditing, addressing transfer mispricing, base erosion and profit shifting;
- Stiffen sanctions imposed on tax evaders; and
- Review legislation pertaining to fees and other levies so as to reflect the cost of providing the related services.

24 Government will increasingly use fiscal policy to influence interest rates. In particular, Government will limit domestic borrowing to not more than 1.0 percent of GDP. This will also avoid the crowding out effect of the private sector to access financing.

3.4 Medium Term Revenue and Expenditure Forecast

25 Over the medium term, total domestic revenues and grants are projected to grow from 17.4 percent of GDP in 2016 to 20.1 percent in 2018, an average of 18.8 percent of GDP (See table below). This growth is premised on expected increase in economic activities, tax policy and administrative reforms.

26 Total expenditures are expected to decrease from 22.6 percent of GDP in 2016 to 21.5 percent of GDP in 2018. Expenditure on Expenses is expected to average 16.5 percent of GDP by 2018. Assets are projected to average 5.2 percent of GDP per annum over the MTEF period.

Table 4: 2016 – 2018 Fiscal Projections

	2016 Budget Projection		2017 Budget Projection		2018 Budget Projection	
	K'thousand	**% of GDP**	**K'thousand**	**% of GDP**	**K'thousand**	**% of GDP**
GROSS DOMESTIC PRODUCT	**207,370,000**	**100.0%**	**232,404,000**	**100.0%**	**259,847,000**	**100.0%**
TOTAL DOMESTIC REVENUE	**36,089,961**	**17.4%**	**44,265,477**	**19.0%**	**52,114,228**	**20.1%**
TOTAL EXPENDITURE	**48,828,921**	**23.5%**	**51,202,077**	**22.0%**	**57,880,299**	**22.3%**
o/w Domestically Financed	46,992,816	22.7%	45,321,080	19.5%	52,746,511	20.3%
Foreign Financed	1,836,105	0.9%	4,380,156	1.9%	3,167,601	1.2%
EXPENSES	35,886,353	17.3%	38,013,479	16.4%	41,206,037	15.9%
ASSETS	10,935,829	5.3%	11,413,508	4.9%	14,425,647	5.6%
LIABILITIES	119,167	0.1%	274,249	0.1%	282,428	0.1%
FISCAL BALANCE: Surplus(+)/Deficit(-)	(10,851,388)	-5.2%	(5,435,758)	-2.3%	(3,799,884)	-1.5%
FINANCING	**10,851,388**	**5.2%**	**5,435,758**	**2.3%**	**3,799,884**	**1.5%**
Net Domestic Financing	1,969,852	0.9%	2,556,444	1.1%	2,598,470	1.0%
Net External Financing	8,881,536	4.3%	2,879,314	1.2%	1,201,414	0.5%

CHAPTER 4

4.1 REVENUE MOBILISATION AND FINANCING

27 Over the medium term, Government will continue to implement measures aimed at strengthening domestic resource mobilisation and realise improved public service delivery which is a cornerstone of inclusive broad-based development. Institutional capacity building interventions to augment domestic resource mobilisation will be fashioned to retain a fair, efficient and buoyant tax system. To this end, efforts to modernize tax administration and strengthen tax compliance will remain paramount.

28 To achieve this objective, Government will implement among others, the following policy and administrative measures:

Tax Administrative Measures

28.2 **Introduction of enhanced IT solutions to improve VAT collection such as the use of electronic devices including Fiscal Cash Registers:** This is intended to improve the performance of Value Added Tax (VAT) by ensuring that the revenue collector monitors directly the transactions of suppliers of taxable goods and services. It has been observed that countries using such IT monitoring systems such as Kenya have improved their VAT collections considerably as output VAT collected by vendors is accounted for.

28.3 **Introduce measures to encourage the use of electronic payments in order to limit cash transactions:** This is expected to enhance availability of information on transactions that take place in the economy which is essential for tax purposes. This measure will simplify tax administration and boost revenue collection. The objective will be achieved through collaboration with, and effective participation of key stakeholders.

28.4 **Enhance capacity and skills in tax auditing:** Government will continue to focus on addressing transfer mispricing, base erosion and profit shifting. Therefore, Government will pursue bilateral and multilateral collaborations for exchange of information, updating of legislation to modernise laws and documentation rules applied on transfer pricing and enhance training in tax auditing, including collaborating with other tax authorities to enable transfer of tax audit knowledge and skills through a "learning by doing approach".

28.5 **Update and renegotiate Avoidance of Double Taxation Agreements:** Government will continue to update old and unfavourable agreements that have facilitated tax planning.

28.6 **Implementation of Electronic Cargo Tracking System (ECTS):** This will facilitate real time monitoring of goods in transit and those for export. It will mitigate the revenue leakage arising from cases associated with transit fraud and false exports.

28.7 **Enhancement of Tax Compliance:** The Government will continue to implement tax payer education campaigns aimed at encouraging compliance, deterring tax avoidance and evasion. This will be complemented by stiffening the penalty regime.

Non-Tax Revenue Measures

28.8 With regard to non-tax revenues, the Government will increasingly modernise mechanisms for collection of non-tax revenues to eliminate human factors by among others, the use of ICT systems. Further, Government will continue to strengthen existing revenue collection mechanisms such as point-of-sale facilities, dedicated counter services by commercial banks, teller-in-plants and E-banking. In addition, Government will introduce innovations such as mobile licencing of economic activities and revise fees, fines and penalties, where applicable.

Revenue Forecast

29 Total revenues and grants are projected to grow from 17.4 percent of GDP in 2016 to 20.1 percent in 2018, which is an average of 18.8 percent of GDP per annum over the medium term. This growth is premised on changes in tax policy to broaden the base and tax administrative reforms to raise the compliance rates.

Table 5: Revenue Forecast 2016-2018

	2016	2016	2017	2017	2018	2018
	Target	% of GDP	Target	% of GDP	Target	% of GDP
I Revenue and Grants	**36,089,961**	**17.4%**	**44,265,477**	**19.0%**	**52,114,228**	**20.1%**
III Domestic Revenue	**36,089,961**	**17.4%**	**44,265,477**	**19.0%**	**52,114,228**	**20.1%**
a. Income Tax	**14,519,350**	**7.0%**	**18,009,849**	**7.7%**	**21,515,682**	**8.3%**
Company Tax	3,534,822	1.7%	4,225,265	1.8%	5,256,282	2.0%
o/w Mining	1,022,000	0.5%	1,360,013	0.6%	1,716,523	0.7%
Other Income tax - Withholding Tax	2,606,833	1.3%	3,231,897	1.4%	3,727,412	1.4%
b. Value Added Tax (VAT)	7,822,164	3.8%	10,192,893	4.4%	11,851,101	4.6%
Customs (Import Tariffs)	2,590,336	1.2%	3,014,022	1.3%	3,490,695	1.3%
Rural Electrification Fund	89,369	0.0%	101,903	0.0%	115,222	0.0%
d. Export Duties	29,601	0.0%	36,643	0.0%	42,942	0.0%
2. Non Tax Revenue	7,154,235	3.4%	8,230,394	3.5%	9,807,136	3.8%
o/w Mineral Royalty	2,236,274	1.1%	2,975,892	1.3%	3,755,985	1.4%

CHAPTER 5

5.1 EXPENDITURE POLICY AND STRATEGY

Overview of Strategy

30 Government's overall expenditure policy for the period 2016 – 2018 is to channel resources towards improved service delivery in key socio-economic sectors. These include education and skills development, health care provision, agricultural support, transport and energy infrastructure, and local government and housing. Government's strategy, therefore, will be to rationalize expenditure and direct resources towards programmes that improve public service delivery and ensure sustained economic growth and job creation.

31 This entails, *inter alia*, reorienting expenditures to allow for additional recruitment of frontline personnel in the health, education and agricultural sectors, provision of school and medical requisites and scaling up allocations to the Social Cash Transfer Scheme. Further, the capital budget will be focused on completion of ongoing projects and programmes before embarking on new projects.

Expenditure Strategy for 2016 – 2018

32 Government will focus on implementing programmes that will roll back the frontiers of poverty by rationalising expenditure and directing resources towards programmes that improve public service delivery and ensure sustained economic growth and job creation. This will include concentrating resources on the completion of on-going projects, particularly in the roads, health, education, agriculture and water and sanitation sectors considering current budget constraints. Any new projects over the medium term will only be undertaken after the requisite designs and appraisals have been done and then implemented appropriately in a phased manner. Public Private Partnership (PPP) mode of financing will be given priority in financing commercially viable projects.

33 Total expenditure over the period will amount to K157.9 billion out of which, K48.8 billion will be spent in 2016, K51.2 billion in 2017 and K57.9 billion in 2018. As a share of GDP, these amounts translate to 23.5 percent in 2016, 22.0 percent in 2017 and 22.3 percent in 2018. Out of the projected K157.9 billion, 83.9 percent will be financed from domestic revenues and the balance through domestic and external borrowing. Table 6 below shows the budget by broad economic classification as a share of GDP.

Table 6: Broad Classification of Total Expenditure

	2016 Projection		*2017 Projection*		*2018 Projection*	
	K' 000	*% GDP*	*K' 000*	*% GDP*	*K' 000*	*% GDP*
Expenses	35,886,353	17.3	38,013,479	16.4	41,206,037	15.9
Assets	10,935,829	5.3	11,413,508	4.9	14,425,647	5.6
Liabilities	119,167	0.1	274,249	0.1	282,428	0.1
Amortisation	1,887,572	0.9	1,500,842	0.6	1,966,187	0.8
Total Expenditure	**48,828,921**	**23.5**	**51,202,078**	**22.0**	**57,880,299**	**22.3**

34 In order to address structural challenges faced in managing public finances, the Government will undertake expenditure rationalization measures which include:

(a) Focusing on completion of on-going projects in order to enhance service delivery;

(b) Realigning spending to enhance allocations to programmes that have a direct impact on the quality of frontline public services;

(c) Restructuring the Farmer Input Support Programme to support diversification of the sector, and achieve better targeting and cost efficiency;

(d) Refocusing the grain marketing arrangements anchored on a revival of Provincial and District Cooperatives;

(e) Prioritising the construction and rehabilitation of rural roads through the Zambia National Service (following the shift of mandate from the Rural Roads Unit) so as to accelerate the opening up of rural areas to tourism, commerce and trade;

(f) Ensuring implementation of full cost reflective pricing of petroleum products;

(g) Enhancing the budgeting and planning process by the enactment of the National Planning and Budgeting Act; and

(h) Precluding the financing of projects which have no designs and *ex ante* appraisal to reduce costly budget overruns and the financing of projects which risk being unviable.

Personal Emoluments

35 Government proposes to spend K18.9 billion on Personal Emoluments in 2016, translating to 52.4 percent of domestic revenue and 9.1 percent of GDP. This is an increase compared to 2015 levels of 49.6 percent of domestic revenues and 9.0 percent as a share of GDP, which is mainly attributed to the lifting of the wage moratorium and projected net recruitments in 2016. Further, Government plans to spend K20.7 billion or 8.9 percent of GDP in 2017 and K21.7 billion or 8.4 percent of GDP in 2018. In 2017 and 2018, Government plans to spend a falling proportion of GDP on public service wages so as to create more fiscal space for public service delivery and infrastructure development programmes.

Use of Goods and Services

36 Government projects to spend K4.2 billion or 2.0 percent of GDP in 2016 and K3.7 billion or 1.6 percent of GDP and K4.4 billion or 1.7 percent of GDP in 2017 and 2018, respectively, on its operations. Notable allocations under this category include the 2016 general elections, voter registration, drugs and medical supplies, school requisites and compensation and awards to honour judgments made against Government in the courts of law.

Interest Payments

37 Interest payments on domestic and external debt will amount to K17.4 billion over the medium term, representing 11.0 percent of total expenditure.

Transfers and Other Payments

38 A provision of K14.5 billion has been allocated for subventions to grant–aided institutions such as public universities, local authorities, road agencies and the Zambia Revenue Authority. Of this amount K3.1 billion has been provided for the Farmer Input Support Programme (FISP) over the medium term aimed at ensuring food security and the diversification of the agricultural sector through the E-voucher scheme.

Social Benefits

39 Social Benefits are projected to increase from the 2015 levels of K999.9 million to K3.1 billion in 2018. This is attributed to the increase in the domestically financed allocation towards the Social Cash Transfer from K150.0 million in 2015 to K350.0 million in 2018. In addition, K805.0 million has been planned for the Public Service Pension Fund (PSPF) in 2016, K1.8 billion in 2017 and K2.8 billion in 2018.

Other Expenses

40 To ensure and maintain food security for the country, Government proposes to spend K750.0 million in 2016, K808.5 million in 2017 and K872.4 million in 2018 for the strategic food reserve. These allocations will facilitate the purchase of the annual strategic reserve requirement of 500,000 metric tons of grain.

41 In order to cater for unforeseen and unavoidable events including those of an emergency nature, a contingency of K50.0 million has been provided in 2016, K300.0 million in 2017 and K350.0 million in 2018.

Assets

42 Expenditure on Assets is proposed to be K10.9 billion in 2016, K11.4 billion in 2017 and K14.4 billion in 2018. This translates to an annual average of 23.2 percent of total expenditures. Of these amounts, 95.4 percent, 86.8 percent and 84.0 percent, respectively will be allocated to Non–Financial Assets (capital expenditure).

Non-Financial Assets (Capital Expenditure)

43 Expenditure towards the procurement of Non–Financial Assets has been proposed at K10.4 billion in 2016, K9.9 billion in 2017 and K12.1 billion in 2018. The main areas of focus under this category will continue to be that of road construction, energy generation and distribution as well as water and sanitation. In this regard, Government has allocated K10.0 billion to the road sector, over the medium term, with the aim of facilitating the construction of various road projects under the Link Zambia 8000 programme, as well as the enhancement of township roads under the Pave Zambia 2000 programme. Rural roads will also be prioritized over the medium term for which an initial allocation of K375 million has been provided in 2016.

44 In order to support sustainable economic growth over the medium term, Government has allocated K500.0 million towards fostering of electricity generation and distribution. A further K306.5 million has been provided for the Rural Electrification Programme so as to increase access to electricity in outlying areas. In addition, K972.9 million has been allocated towards improving access to clean water and sanitation facilities.

Financial Assets

45 The Government recognizes the significant role entrepreneurship plays in the development of our economy. In this regard, the Government proposes to allocate K120.0 million towards empowerment funds in 2016. This allocation will further rise to K200.0 million in 2017 and K300.0 million in 2018. In addition, an allocation of K450.0 million has been provided for the recapitalization of State Owned Enterprises (SOEs) over the medium term.

46 Government also proposes an allocation of K380.9 million in 2016 to establish a Sinking Fund which will be used to settle the Eurobond repayments which commence in 2022. This allocation will increase significantly to K1.0 billion in 2017 and K1.6 billion in 2018.

Liabilities

47 In keeping with Government efforts to reduce arrears owed to suppliers of goods and services, Government proposes to spend K675.8 million over the medium term.

CHAPTER 6

6.1 MEDIUM TERM ALLOCATIONS BY FUNCTIONS OF GOVERNMENT

Overview of Strategy

48 Government spending by functional classification has been determined by the need to consolidate the fiscal position over the medium term. The Classification of Functions of Government (COFOG) is a categorization of all public expenditures in accordance with the purpose for which such allocations are intended to achieve.

49 Substantial resources will be allocated to the functions of economic affairs, general public services and education.

Functional Resource Allocation Priorities (2016 – 2018)

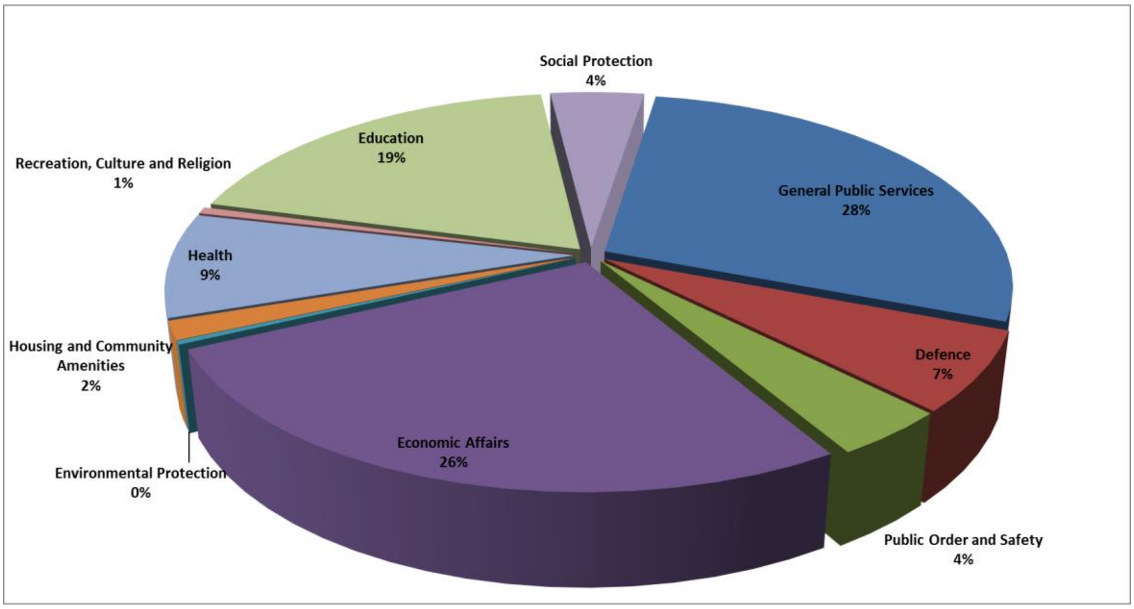
50 Over the medium term, Government proposes to spend an average of 53.4 percent per annum of the total projected resources on the priority functions of Education, Health and Economic Affairs. The balance of 46.6 percent will be allocated to the other functions such as Defence, Public Order and Safety and Social Protection.

51 Table 7 and Figure 1 below show budget allocation by functions of Government as a share of total expenditure for the medium term period.

Table 7: 2015 and 2016-2018 Allocation by Functions of Government (as share of Total Budget)

Function	2015 Approved Budget	2016 Projection	2017 Projection	2018 Projection	2016-2018 Average
General Public Services	24.3%	28.7%	28.8%	27.5%	28.3%
Defence	7.0%	6.8%	7.0%	6.3%	6.7%
Public Order and Safety	4.7%	3.5%	4.4%	3.9%	3.9%
Economic Affairs	28.8%	29.5%	23.4%	26.6%	26.5%
Environmental Protection	0.4%	0.3%	0.3%	0.3%	0.3%
Housing and Community Amenities	1.7%	1.4%	1.7%	1.6%	1.6%
Health	9.6%	8.2%	9.3%	8.8%	8.8%
Recreation, Culture and Religion	0.7%	0.5%	0.6%	0.5%	0.6%
Education	20.2%	18.5%	19.7%	18.6%	18.9%
Social Protection	2.7%	2.6%	4.8%	5.9%	4.4%
Total	**100.00%**	**100.00%**	**100.00%**	**100.00%**	**100.00%**

Figure 1: 2016 – 2018 Medium Term Budget Allocation by Functions of Government



General Public Services

52 The allocation to General Public Services is projected to account for a significant proportion of total expenditure over the medium term and Government proposes to spend K14.0 billion in 2016, K14.7 billion in 2017, and K15.9 billion in 2018. Domestic debt payments will account for an annual average of K3.2 billion and external debt payments will account for an average of K4.4 billion per annum over the medium term. Other notable allocations include K530.4 million for the tripartite elections and the concurrent referendum on the Bill of Rights, scheduled for 2016 and 5.0 percent of income taxes allocated to the LGEF in each of the years from 2016 to 2018. This translates to K726.0 million in 2016, K900.5 million in 2017 and K1, 075.8 million in 2018.

Economic Affairs

53 Government has allocated a total of K41.8 billion to be spent on the Economic affairs function over the medium term. Of this amount, Government projects to spend K14.4 billion in 2016, K12.0 billion in 2017 and K15.4 billion in 2018. This translates to an average of 26.5 percent of the overall expenditure during the medium term. In these amounts, road infrastructure will account for a total of K10 billion.

54 Government proposes to spend over K3.1 billion during the medium term on the Farmer Input Support Programme (FISP). This amount will facilitate the provision of farming inputs to one million beneficiaries annually. Further, K2.4 billion is proposed to be spent over the medium term on the Strategic Food Reserve Programme.

55 Government intends to spend K306.5 million over the medium term on Rural Electrification in order to further increase access to electricity to the rural areas.

56 In order to encourage and support citizens' participation in the economy, a total of K620.0 million has been allocated to the Empowerment Funds over the medium term.

Education

57 Expenditure in the education sector is projected to be at 18.9 percent on average of the total expenditures over the medium term. In terms of interventions, these resources will facilitate the procurement of school requisites and the ongoing net recruitment of teachers to improve the pupil to teacher ratio.

58 Over the medium term, Government will continue with infrastructure projects under the education function including; construction and rehabilitation of primary and secondary schools, completion of new universities and hostels at existing universities and construction of teachers' housing facilities.

Health

The allocation to the health function is projected to be at an average of 8.8 percent of the total expenditure over the medium term. This allocation will continue to address challenges posed by the high disease burden, as well as inadequate health infrastructure, medical staff, equipment and essential drugs and medical supplies.

Housing and Community Amenities

59 The housing and community amenities function has been allocated K2.5 billion over the medium term. Within this amount, Government plans to spend K972.9 million over the same period in order to provide sustainable and equitable access to potable water and adequate sanitation to citizens.

Public Order and Safety

60 Government intends to spend over K6.2 billion over the medium term to maintain public order and safety. This will include construction and rehabilitation of security infrastructure like prisons and modernization of security wings.

Other functions

61 The remaining functions of defence, environmental protection, social protection and recreation, culture and religion will account for an average of 12.0 percent of total expenditures over the medium term. Significant allocations under these functions include the Public Service Pension Fund (PSPF) with an allocation of K5.4 billion and the Social Cash Transfer Scheme with a provision of K900 million over the medium term.