Republic of Zambia

Ministry of Finance and National Planning

2010- 2012 MEDIUM TERM EXPENDITURE FRAMEWORK AND THE 2010 BUDGET

GREEN PAPER

August, 2009

Contents

Foreword

On behalf of the Government of the Republic of Zambia, I am pleased to present the seventh “Green Paper”, which covers the three year period 2010 - 2012.

As with earlier “Green Papers”, it is published in order to facilitate wider public consultation on Government’s medium term macroeconomic policies and targets; and its fiscal strategy and expenditure allocations for the next three years, and for 2010 in particular.

The format of this “Green Paper” has been changed from the previous ones so as to give more information for the consultative process. Chapter one, for example, includes a discussion of the issues that Government sees as the main threats and challenges to the economy and to Government’s revenue and spending plans over the medium term, if Zambia is to achieve its medium and long term development objectives.

The 2010- 2012 “Green Paper” has been written as the world economy shows signs of emerging from the deepest global recession seen for over 70 years. Fortunately, although the recession has been “deep”, its duration is unlikely to be as long as that experienced in the 1930s. A key objective of Government over the next three years is to reposition the Zambian economy so as to take full advantage of the rebound in global economic activity and trade. A rebound in economic activities globally will enable the country to generate sufficient resources to invest in key socio-economic infrastructure and spend on essential basic public services, so that Zambia’s economic growth and diversification objectives and its poverty reduction targets can be attained.

Following the Constitutional Amendment that was passed by the National Assembly earlier this month, the 2010 Budget will be submitted to Parliament in October 2009. It is the intention of the Ministry of Finance and National Planning to publish the final Medium Term Expenditure Framework for 2010-12 in December 2009, after Parliament has approved the 2010 Budget, so that the approved Budget numbers for 2010 and the final version of the Medium Term Expenditure Framework for 2010- 2012 are fully harmonized.

Finally, as next year is the last year of the Fifth National Development Plan (FNDP), the Sixth National Development Plan will be launched during the course of 2010 after nationwide consultations have been made. I invite all stakeholders to study and provide feedback on this “Green Paper” to the Ministry of Finance and National Planning as it formulates the Budget for 2010. I also ask stakeholders to participate actively in the consultation process for the Sixth National Development Plan that will take place over the next twelve months.

Likolo Ndalamei
SECRETARY TO THE TREASURY

CHAPTER 1

1 INTRODUCTION

1.1 Medium-Term Development Goals and Priorities

1. In line with the Vision 2030, Government's overarching goal over the next two decades is to become a prosperous middle-income country, with a competitive and outward oriented economy, where hunger is eradicated and poverty is reduced to minimal levels.

2. The strategic direction for this Medium Term Expenditure Framework (MTEF) is therefore based on; the policies and priority programmes set out in the Fifth National Development Plan (FNDP) (2006-2010) and the related reforms and programmes set out in the 2009-2011 Medium Term Expenditure Framework (MTEF). These are also in line with the country's intention to attain the Millennium Development Goals (MDGs) by 2015. Work in preparing the successor to the FNDP, the Sixth National Development Plan (SNDP), has already begun and will further guide the formulation of the next MTEF.

3. In this context, over the next three years, the goal of Government is to take further steps to reduce the absolute number of Zambians living in poor and food-insecure households with inadequate access to basic public services, especially education and health services; roads, water and sanitation infrastructure; and agricultural input supply and markets. In particular, there will be renewed commitment to improving living standards and access to services in districts away from the line of rail, as Government builds further on the successes of the community mode of constructing social infrastructure in remote areas and moves forward to implement the National Decentralisation Policy.

4. Improved living standards, enhanced public service delivery and provision of essential socio-economic infrastructure will be attained by repositioning the Zambian economy to take full advantage of the rebound in the global economy, which recent economic indicators have suggested has already started. This repositioning will, among other things, entail raising productivity in smallholder agriculture; adding value in the manufacturing sector from the output produced from the mines and farms; and promoting Zambia as a world class tourist destination. By so doing, Government's aim is to return to the high levels of growth achieved in the early and middle years of this decade by 2012 and thereafter exceed these levels. This will be critical if Zambia's Vision of becoming a middle income country by 2030 is to be realised.

5. As these growth rates are restored and exceeded, increased resources can be mobilised from the domestic economy to finance the infrastructure needed to develop and diversify the economy and provide essential public services to the people. Through these

actions, Government's goal of attaining household food security and reducing poverty will be achieved.

The repositioning of the Zambian economy will be achieved through:

- A scaling-up of efforts to promote economic diversification, with emphasis on the agriculture, tourism and manufacturing sectors;
- Speedy implementation of measures to reduce the cost of doing business - especially in relation to other regional economies; and
- Further promotion of a growth enabling environment while simultaneously addressing the constraints to broad based economic growth.

6. The macroeconomic framework for 2010-12, as set out in this MTEF, outlines the overall policy environment under which these strategies for repositioning the economy will be undertaken. Overall, the economic outlook for Zambia indicates an improving economic environment, and Government will seize this opportunity to see through the reforms started in the last MTEF so that a sound basis can be laid for attaining Zambia's development goals.

1.2 Linkage of the 2009- 2011 MTEF to the 2010-2012 MTEF

7. When relating projections made in the 2010-2012 MTEF Green Paper with those made in the 2009- 2011 MTEF- Green Paper, cognisance should be made of the fact that the 2009-2011 MTEF was written when the full implications of the recent financial crisis in advanced economies, and its knock-on effects on the global economy, were not fully known. The financial crisis and the resultant global recession has impacted the 2009-2011 MTEF numbers significantly and by January 2009, when the current Budget was presented to Parliament, the revenue and expenditure estimates were based on more pessimistic macroeconomic projections.

8. This however, has not deterred Government from focusing on its policy objectives as it implements the 2009 budget. Social sector expenditures have been protected, as has spending on key infrastructure projects aimed at contributing to the economic growth and diversification objectives. However given the lower than budgeted revenues in 2009, the platform upon which the resource envelope for the 2010-2012 MTEF has been based is inevitably lower than envisaged in the 2009-2011 MTEF - Green Paper.

1.3 Threats to the 2010-12 MTEF

9. As the last year has clearly shown, Zambia is not an island and the 2010-12 MTEF remains vulnerable to external shocks. While there are encouraging indicators that the global economy is emerging from the recent recession, and this has already had a positive impact on the Zambian economy through resurgent copper prices, the economic situation remains fragile. If the recovery from the global recession stalls and this feeds into further volatility and lack of confidence in commodity and financial markets, there will be a negative impact on the Zambian economy.

10. It could, for example, prolong the subdued domestic demand conditions that has been experienced in the first half of 2009 and deter a rebound in foreign direct investment. These developments could depress the fiscal projections set out in this MTEF for 2010-12. To this end, the macro-economic targets underlying the fiscal projections in this MTEF are on the conservative side.

1.4 Key Challenges

11. To achieve its medium and long term development goals, the key challenge facing Government is to ensure that the repositioning of the Zambian economy is both speedy and successful. Only then can Zambia take full advantage of the rebound in the global economy thereby facilitating a quick return of domestic growth to trend levels by the end of the current MTEF period and laying the basis for higher growth from 2012.

12. A critical issue to ensuring that private sector led growth returns quickly to trend levels is to ensure that domestic borrowing by Government is controlled so that credit to the private sector - in particular to the agricultural sector - is not "crowded out". Already, for 2010, domestic debt service is projected to require about 10% of domestic revenues.

13. In this light, the main challenge on the revenue side of Zambia's public finances is to first restore the levels of domestic revenue to GDP ratios attained in the middle years of this decade, and thereafter gradually increase this proportion over the medium to long term. Without steady and significant increases in real domestic revenue mobilisation over the next two decades, Zambia will remain overly dependent on assistance from its Cooperating Partners and the resources needed to achieve middle income status by 2030 may elude us.

14. A further challenge facing Government is to ensure that domestic inflation remains in check, especially as (i) world oil prices rise in response to increased global demand for energy as the recession in advanced economies recedes; and (ii) world grain prices rise in response to shifts in global food consumption patterns; increased use of grains for bio-fuels; and any negative effects that may arise from climate change (e.g. El Nino effects) on harvests, especially in grain surplus regions.

15. Another challenge is to ensure that fiscal management continues to remain prudent despite the various threats that arise to budget implementation and revenue mobilisation. It is imperative that the "quality" of public expenditure improves by (i) prioritising programmes and projects that directly contribute to reducing poverty and food insecurity and attaining our economic diversification and growth objectives; and (ii) achieving much better "value for money" for the resources that Government spends on these priority programmes. In this regard, projects with the highest economic and social rates of return will be implemented first and the new Zambia Public Procurement Authority will begin to take active steps to ensure that public procurement achieves much better value for money.

16. Finally, given that civil servants' remuneration absorbs about half of the domestic revenues, a key challenge facing Government over the medium term will be to strike a balance between the need to pay a fair wage to its civil servants while at the same time

allocating sufficient resources to support them to undertake their tasks. Addressing this challenge is critical if sufficient resources are to be allocated to poverty reduction programmes and socio-economic infrastructure projects.

1.5 Overview of the MTEF forecasts:

17. In light of the above, the projected macroeconomic targets for the 2010-12 MTEF are as contained in **Table 1** on page 17. Based on these macroeconomic targets, the key fiscal aggregates are also illustrated in **Table 3** on page 22.

CHAPTER 2:

2 MACROECONOMIC OVERVIEW

2.1 The Global Economy

2.1.1 Growth

18. Positive signs are emerging that the worst of the recession has passed, with signs emerging that a global economic recovery is underway. Continued fiscal stimulus support from advanced economies and coordinated central bank interventions have significantly increased liquidity and availability of finance, the main factors behind the current crisis. Notwithstanding these efforts, revised projections in July indicate that global economic output will decline by 1.4 percent in 2009, representing a marginal, but further, decline from the 1.3 percent projected in April.

19. Advanced economies continue to face the brunt of the economic crisis, with projections indicating a decline in growth by 3.8 percent this year. A mild recovery, however, is expected in 2010, with growth estimated at 0.6 percent. The economic environment in the United States and Japan has been somewhat more moderate than had been originally anticipated. Growth in the Euro area, however, is expected to remain weak amidst signs of a continued recessionary environment.

20. Growth in Sub-Saharan Africa is projected at 1.5 percent, despite significantly lower projections for South Africa and Nigeria. South Africa in particular is expected to face a decline in economic activity, with negative growth projected at around 1.5 percent. Significantly lower global trade levels have aggravated economic conditions in this region. Growth rates for other emerging markets such as India and China, however, have been revised upwards by around 1 percent amidst signs of a faster than expected turnaround in capital flows and the effects of fiscal stimulus initiatives.

21. The global outlook for 2010 and the medium term have improved significantly since the beginning of the year, although a number of risks still remain. Global growth in 2010 is expected to recover to a projected level of 2.5 percent, with recoveries expected in most advanced and emerging economies. Despite strong signs of a recovery, however, continued unemployment and loss of confidence in the stability of the financial sector could potentially trigger further economic setbacks. There are also rising concerns about the sustainability of public debt in light of large fiscal stimulus packages announced by advanced economies. Emerging economies will also remain vulnerable to global trade levels and intensified financial stress, with potential feedback effects from advanced economies.

22. Global growth during the outer years of the MTEF is projected to rise to 3.2 percent in 2011, and 4.0 percent in 2012. This is premised on a continued global economic and financial recovery, and a rise in global trade volumes as demand recovers in advanced economies.

2.1.2 Commodity Prices

23. Commodity prices during the first half of 2009 improved steadily in line with improving investor sentiments about the recovery of the global economy and a depreciating US Dollar. Base metal prices have risen by around 30 percent during the first half of 2009. Copper prices have risen by over 40 percent from January 2009 levels, and were around US $5,900 per metric tonne in early August 2009. This level is 35 percent above budgeted copper price projections of US $3,575 per metric tonne. This increase can be attributed to improved economic prospects in China and India, which have led to increased demand, with China increasing its copper stockpile reserves. Prices are expected to remain at the current level through the rest of the year, and average 2009 prices have been forecast at US $4,190 per metric tonne.

24. For the purposes of this MTEF, however, copper price assumptions have been maintained at conservative levels of US $4,300, US $4,400 and US $4,500 per metric tonne in 2010, 2011 and 2012, respectively. This is attributed to the fact that current price levels are higher than market fundamentals and some uncertainty remains. The near term copper price is forecast to be around US $4,500 on the back of positive outlook in the global economy.

25. Oil prices have risen on the back of improving demand prospects and reduced production by OPEC countries. Average monthly prices in 2009 have recovered from the lows seen in end-2008, and are currently around US $70 per barrel. Average oil prices for 2009 have been forecast to be around US $60.5 for the year, a 38 percent decline from 2008 average levels. In 2010, oil prices have been forecast at US $74.40, with prices expected to continue steadily rising in the medium term on the back of increased global demand and economic activity. Prices are forecast to be above US $75 in the medium term.

26. Zambia's overall terms of trade have worsened significantly in 2009 as a result of sharply lower international copper prices and steadily increasing oil prices. Unfavourable terms of trade are likely to continue into 2010, albeit at a moderated level compared to 2009.

2.2 The Domestic Economy

2.2.1 Growth Forecasts

27. The Zambian economy is projected to grow at around 4.3 percent in 2009, as a result of a weaker than expected economic activity and domestic demand. This is 0.7 percentage points below the earlier MTEF forecast of 5.0 percent, and comes amidst a challenging domestic and external economic environment. Strong performances are projected in the mining and agriculture sectors in 2009, with a 13 percent increase in copper production, and a bumper agricultural harvest of 1.8 million tonnes in 2009. Notwithstanding these improved performances, sharp slowdowns in key demand-driven sectors such as tourism, manufacturing, and transport and communications, in addition to a decline in wholesale and retail trade, were attributable to the downward reduction in

growth estimates for the year. The tourism sector in particular has faced the full effects of the financial crisis, and is projected to contract by 15 percent this year.

28. A gradual rise in growth is expected in 2010 to 5.0 percent, compared with 2009-2011 MTEF projections of 5.5 percent. Growth in the economy will be driven by a pick-up in the tourism and transport sector, and continued growth in mining, construction, and agriculture. Risks to this forecast, however, continue to remain, particularly in relation to developments in the global economy and international commodity markets. In particular, less favourable sentiments on the global recovery, especially in emerging markets like India and China, could affect commodity prices and global trade levels, and in turn impact domestic economic activity.

29. In the outer years of the MTEF, growth is expected to gradually rise to 5.5 percent in 2011 and to reach 6.0 percent by 2012. It is expected that increased private investment levels, particularly in the energy, tourism, manufacturing and agriculture sectors will drive growth in the medium-term, in line with the Government's diversification strategy. Additionally mining output will continue to rise on the back of productivity gains and also a gradual rise in output at some of the new mines.

2.3 Medium-Term Prospect and Policies Outlook for Key Sectors

30. The impact of the global economic crisis on domestic economic growth has been significant, with lower growth rates projected for the period 2009 to 2011 compared to the previous MTEF. One of the key macroeconomic objectives of Government over the 2010-2012 MTEF will be to restore growth rates to trend levels of around 6 percent.

31. This, however, will simultaneously be supported through targeted Government expenditures and policy interventions that support its economic diversification strategy. These interventions, in the agriculture, tourism, manufacturing, and energy sectors will, over the medium term, increase the productivity of sectors that are currently yet to attain their full growth potential, providing higher overall growth levels, and better resilience to external sector-specific shocks.

2.4 Real Sector

2.4.1 Mining and Quarrying

32. The closed Luanshya Copper Mine is expected to resume full production in 2010**.** The mine has recently been sold to new investors and the process of recapitalization and planning is expected to commence in due course. At other mines, production is projected to rise marginally, with the exception of Lumwana, which is expected to substantially increase output. Total copper production in 2010 is therefore projected to increase by about 5 percent from a projected 664,000 metric tonnes in 2009. Mining prospects in 2010 will also be boosted by the production of non-traditional minerals like nickel and coal. Copper production in the medium term is expected to increase gradually by about 5 percent per annum to reach 750,000 metric tonnes by 2012. There are, however, prospects of a significant rise in both copper and cobalt output when the US $500 million Konkola Deep Mining Project is completed. The positive mining sector outlook assumes

that the global economy recovers in the medium term and the fundamentals for copper remain sound in terms of supply and demand.

33. The Government continues to place emphasis on encouraging investment in the mining sector, particularly in exploration activity for minerals, oil and gas. Long-term growth in the mining sector is dependent on new mining activity and reduction of costs in existing mining operations to ensure long-term profitability amidst a volatile international commodity price environment. In this regard, the Government will continue to support the mining industry in its efforts to improve its competitiveness through a favourable policy environment.

2.4.2 Agriculture

34. Favourable climatic conditions are expected to sustain production in the agriculture sector next year. Fertiliser prices are expected to remain stable in the 2009/2010 farming season, resulting in reduced production costs. In addition, the favourable floor price of maize should provide impetus for increased production of maize in the 2009/10 farming season.

35. The Government continues to view the agriculture sector as a priority area in its diversification strategy. In this regard, the Government, in 2009, announced a number of revenue measures aimed at reducing the cost of imported agricultural equipment. Over the course of the 2010-2012 MTEF, however, focus will shift towards accelerated infrastructure development and a supportive policy environment.

36. Higher levels of investment into the sector by both small-scale and commercial farmers will be essential to improved production levels and yield rates. In line with this, the Government will continue to place emphasis on the development of large farm blocks as the model of growth. Essential infrastructure such as roads, water, and electricity will be made available at these farm blocks, in order to facilitate rapid commencement of cropping by farmers. Significant progress has been made at the Nansanga Farm Block with the completion of essential infrastructure development. It is expected that farming at Nansanga will commence in the 2010/2011 farming season. Focus will now shift over the medium term towards the Luwena farm block in Luapula Province.

37. In recognising that access to credit has continued to remain a challenge for farmers, the Government, in collaboration with Cooperating Partners and other stakeholders, will step up its efforts to improve access to rural finance, particularly in areas that are currently underserved by banking services. In addition, the Government is also engaged with stakeholders in the agriculture sector to examine ways by which the bottlenecks to agricultural financing can be removed.

38. During the 2009-2011 MTEF, the Government had declared its commitment to undertake a comprehensive review of the Fertiliser Support Programme with an aim to improve its efficiency and effectiveness. This review is still underway, and it is expected that improvements will be made to the targeting and distribution of fertiliser starting from the 2009/2010 planting season. Improvements will continue to be made to the programme throughout the MTEF period in order to ensure that it meets its intended objectives.

39. The Government is cognisant of farmers concerns relating to the predictability of the export policy environment. In this regard, the Government will, in this MTEF period, seek to provide a more stable policy environment to farmers.

40. Another key driver of medium-term growth in this sector will be the livestock sector. Zambia's natural competitiveness in this sector can be used to increase growth and reduce poverty. In this regard, the Government is committed to the active development of the livestock sector, with a view to significantly increase livestock exports over the medium-term. To this end, plans to create a separate Livestock Ministry will be undertaken during this MTEF period. This structural change will allow greater Government emphasis to be placed on this vital sector.

2.4.3 Manufacturing

41. Currently, Zambia's manufacturing base is narrowly concentrated on food-processing, and primarily caters for the domestic market. The long-term competitiveness of this sector is dependent upon the diversification of manufacturers into the processing of other primary goods and the provision of services. Furthermore, emphasis will also be placed on improving the export competitiveness of this sector. In recent years, substantial fiscal incentives have been made available to investors in the manufacturing sector, including those under the Zambia Development Agency Act (2006).

42. Complementary to this favourable and investor-friendly policy environment, the Government's medium-term focus will continue to be on the development of Multi-Facility Economic Zones and industrial parks, which will provide significant momentum to growth in the manufacturing sector. The Government will continue to place emphasis on these zones as a model for development in the manufacturing sector. To date, development of the Chambishi MFEZ has reached an advanced stage, with investors expected to start moving in shortly.

43. The multi-million dollar Chambishi zone is expected to significantly advance Zambia's ability to process minerals with the aim of enhancing value addition and expanding the manufacturing base. In turn, this is expected to contribute to the creation of skilled jobs and increased foreign exchange revenues. In addition, a master plan has been developed for the Lusaka South Economic Zone, and it is anticipated that implementation of this plan will commence in 2010.

2.4.4 Tourism

44. The tourism sector was significantly affected by the global economic crisis in 2009, with a projected decline in growth by around 15 percent. In 2010, however, a turnaround is expected as global demand for travel picks up and arrivals to Southern Africa increase ahead of the 2010 World Cup. Zambian tourist destinations, particularly Livingstone, are also expected to benefit from the spill-over effects of visitors coming to the region during the World Cup. In addition, tourist arrivals to national parks are also expected to recover from the sharp decline observed in 2009.

45. The Government is cognisant that the tourism sector has continued to perform below its full potential. In this regard, it will continue to promote the harnessing of Zambia's vast expanses of wilderness and rich culture through the development of essential infrastructure in tourist areas. Emphasis will also continue on the development of the Northern Tourism Circuit through the provision of the much needed infrastructure. Furthermore, in 2009 the Government announced its intention to develop the Livingstone Tourism Zone into a major global tourism and adventure destination. It is expected that development planning will be completed in 2009, and implementation expected to be undertaken over the medium term.

46. In addition to these budgetary measures, the Government will also continue to examine ways by which the policy environment in the tourism sector can be enhanced to provide further impetus to the development of this vital sector.

2.5 Enabling Higher Growth

47. In order to achieve the overall macroeconomic objective of economic diversification and raising the economic growth rate, the Government's focus will continue on promoting "growth enabling" sectors and reducing the constraints to growth. In particular, the role of the private sector will be enhanced so that it can play its pivotal role in increasing the level of growth in the Zambian economy given the limited ability of Government to engage in large-scale development projects. In this regard, the Government remains committed to dismantling the barriers to doing business in Zambia.

48. Notwithstanding a supportive policy environment, structural challenges still remain a threat to further private sector participation in economic development. Energy shortages, high transportation and communication costs, and the lack of quality infrastructure pose a major constraint to growth and private sector development in Zambia. A number of measures and steps will continue to be undertaken in the infrastructural sectors to improve performance.

2.5.1 Energy

49. With the completion of the ZESCO power rehabilitation programme in 2009, an additional 210 megawatts in capacity has been added to the power generation. Energy supply, however, still remains a major constraint to the growth of the Zambian economy. In particular, ageing transmission networks and increasing demand for energy have created the potential for significant shortages in electricity supply over the medium term.

50. In order to address these issues, the Government has commenced the development of the Kariba North Extension project, which will bring 360 megawatts in additional generation capacity. Further, the development of the Itezhi-tezhi, Kafue Gorge Lower power projects, which will add between 770 and 870 megawatts to the existing capacity, is also expected to commence shortly. All of these projects are expected to come on stream outside this MTEF period.

51. In the 2009-2011 MTEF, the Government announced its intentions of promoting a number of mini-hydro power projects over the medium term. This is now underway, with

the development of mini-hydro projects in Lunzuwa, Chishimba, Lusiwasi, and Musonda expected to commence in this MTEF period. In addition, private sector development of hydro projects in Kabompo and Kalungwishi are expected to commence in 2011, and will add 235 megawatts when completed.

52. In view of the vast untapped hydroelectric energy potential in Zambia, the focus over the medium term will shift towards inviting greater private sector participation in the energy sector. This will be undertaken by engaging the private sector through the development of PPPs and power purchasing agreements. Incentives to this end have already been announced in 2009, with a granting of 100 percent capital allowance to electricity generation investments.

53. Greater private sector participation in the energy sector still remains hindered by the level of electricity tariffs. To address this, the Government, in 2009, announced that electricity tariffs would increase to cost-reflective levels by 2011. These tariff increases are essential not only to improve the performance of ZESCO, but also to attract additional private investment in the energy sector. In this regard, average tariffs were increased by 36 percent in 2009, and an indicative increase of 26 percent has been announced for 2010. The Government remains committed to ensuring that electricity tariffs reflect the cost of service delivery. Simultaneously, it will also continue to engage with ZESCO on the improvement of its Key Performance Indicators (KPIs).

2.5.2 Transport and Communication

54. The high cost of transportation continues to pose challenges to private sector development in Zambia. This is intrinsically linked to the poor quality of road and rail infrastructure, leading to more frequent replacement costs for transportation providers. Over the past few years, budgetary allocations to infrastructure projects have been stepped up significantly, with the largest of these increases occurring in 2009. These increases, however, are modest compared to the resources needed to significantly improve the surface transportation networks in Zambia.

55. Private sector participation, therefore, is critical to the rapid improvement of transportation services. Over the medium term, it is envisaged that a number of economically viable and essential toll roads will be constructed through Public Private Partnerships.

56. The poor state of rail networks continues to pose an immense strain on the road network. The Government remains committed to addressing this major concern, and will engage concessionaire to invest in improvements to dilapidated infrastructure. With regard to TAZARA, the Government will seek private participation in the management and operation of the rail network.

57. With regard to the communications sector, in recognising the high cost and poor quality of telecommunications infrastructure in the country, the Government has committed to the partial privatisation of ZAMTEL. Further, international telecommunications gateway fees will be reduced to regional averages by the end of 2009. These measures are expected to create significant growth potential for the

telecommunications industry, while simultaneously improving service quality and reducing costs. In addition, the completion of fibre optic network infrastructure this year will bring higher quality data and internet services to the country over this MTEF period, at a significantly lower cost. The Government in the medium term will also work closely with the service providers to improve rural connectivity.

2.5.3 Public Private Partnerships

58. The Government recognises that the private sector must play a vital role in tackling these constraints to growth. With the recent passage of legislation supporting Public Private Partnerships (PPPs), a more transparent legal and supervisory framework can now be used to vigorously engage the private sector in infrastructure building. Accordingly, the Government's preferred mode of major infrastructure development over the medium term will be through the development of Public Private Partnerships.

59. Work is already underway for the development of the Kasumbalesa Border post through a PPP. Over the medium term, the development of toll roads, power plants, and other large infrastructure projects will be undertaken jointly between Government and the private sector through the PPP framework.

2.6 Fiscal, Monetary, and External Sector and Debt Policies

2.6.1 Fiscal Policy Outlook

60. The Government continues to view fiscal policy as the foundation pillar of its overall macroeconomic framework. In 2009, the Government renewed its commitment to maintaining a prudent fiscal framework through the reduction or elimination of non-priority expenditures. The savings from these reductions were diverted towards key priority expenditures such as infrastructure development, education and health. Furthermore, domestic and external borrowing levels continue to remain within sustainable limits. In continuing with this policy, the Government will constrain the fiscal deficit to 2.9 percent in 2010 and below 2 percent in the medium term. Additionally, the Government will continue to reduce non-priority expenditures to ensure that capital expenditures and social sector budgets remain the priority.

61. Notwithstanding these efforts on the expenditure side to ensure focus on priority sectors, there is growing concern over the level of fiscal space available to the Government. About 75 percent of total domestic revenues are used to pay for personal emoluments, grants to statutory bodies and institutions, and interest costs, leaving little room to undertake large capital and social projects. This has already placed a tremendous strain on additional recruitment of essential staff such as teachers, nurses, and doctors.

62. Expanding the revenue base has been a challenge over the years, but remains a necessity. The Government will continue to vigorously explore, with the assistance of stakeholders, ways and means by which the tax base can be expanded and revenue collections enhanced over the medium term.

2.6.2 Monetary Policy Outlook

63. Restricting the growth of prices above the single digit level has continued to remain a challenge during 2009. Inflation projections for December 2009 have been revised to 12 percent from 10.0 percent as a result of higher than expected food prices during the first half of 2009, higher energy prices during the second half of 2009. Food prices, however, are expected to fall going forward as produce from the delayed harvest enters domestic markets.

64. Over the medium term, on the assumption of a stable exchange rate and normal harvest season, the inflation level is expected to fall to single digit at the end of 2010. Further, assumptions of a stable and potentially appreciating local currency will help control import inflation, an influential factor in the overall price level. Key risks to these projections would include a poor agricultural season and rising fuel prices as a result of higher international oil prices.

65. The choice of an optimal monetary policy has become more important as the growing Zambian economy continues to diversify and assume a more dynamic profile. In this regard, the Government will continue to explore ways by which existing monetary policy tools can be improved and new tools introduced to provide a more robust and resilient monetary policy framework that will better manage inflation and interest rates.

2.6.3 External Sector Outlook

66. As a result of improved external economic conditions and investor sentiments on emerging markets, the Kwacha appreciated from levels of around K5,600 per US Dollar to around K4,900 during the second quarter of 2009. Exchange rates are projected to remain fairly stable for the remainder of the year, as a result of improved international copper prices and increased portfolio inflows. Over the medium term, the Government, while cognisant of the need to support the competitiveness of Zambian exports, remains committed to having fully floating market-determined exchange rates.

67. Foreign trade levels fell substantially during the first half of 2009, with both imports and exports registering sharp declines of around 30 and 38 percent, respectively. There was a substantial worsening of the trade balance deficit of US $ 207.3 million compared with a surplus of US $ 140 million for the first half of 2008. The trade balance is expected to worsen further to a projected deficit of US $ 368 million by the end of 2009. The negative trade balance is expected to deteriorate over the MTEF period as a result of higher capital imports and international oil prices. Improvements to these projections could be seen should international metal prices continue their upward trend, or should exchange rates appreciate further.

68. Government policy on trade issues will continue to be focussed towards expanding market access for Zambian manufactured goods, while continuing to promote Zambia as an investor friendly destination through the development of economic zones and industrial parks. Regional integration, particularly with SADC countries and COMESA markets, will be a key area of focus over the medium term.

2.6.4 *External Debt Strategy*

69. The Government continues to benefit from the availability of highly concessional external resources that have played an important role in reducing the financing gap over the years. These resources, made available by multilateral institutions, have been used extensively both by Zambia as well as other low-income countries to finance development projects that have contributed immensely to economic growth. Examples of these include road projects, water and sanitation facilities, health and education centres, among others. The Government will continue to access these resources in order to finance projects that yield high economic and social returns. At the same time, the Government remains cognisant that any contracted external debt would be done under a clearly defined debt sustainability framework.

Table 1: Macroeconomic Framework: Targets and Assumptions for Medium-term Projections, 2010-2012

					MTEF PERIOD		
	2006	2007	2008	2009	2010	2011	2012
	Actual	Actual	Final	Proj.	**Proj.**	**Proj.**	**Proj.**
Real GDP	**6.2**	**6.2**	**5.7**	**4.3**	**5.0**	**5.5**	**6.0**
CPI inflation (end of period)	**9.0**	**8.9**	**16.6**	**12.0**	**9.5**	**9.0**	**8.0**
CPI inflation (annual average)	9.0	10.6	12.4	13.8	10.8	9.3	8.5
Terms of trade (annual percent change)	5.2	-9.7	-17.0	-28.7	-6.1	-1.5	-1.0
GDP deflator	13.3	13.2	12.6	8.1	9.0	7.9	6.9
Nominal depreciation (end of period exchange rate)	-5.1	1.7	2.0	……	…	…	…
Nominal depreciation (average exchange rate)	-22.6	3.9	1.8	…….	…	…	…
Nominal GDP (in billions of kwacha)	**38,561**	**46,357**	**55,211**	**63,259**	**70,823**	**80,034**	**90,318**
Nominal GDP (in billions of U.S. dollars)	10.7	11.6	14.7	12.6	14.1	17.1	19.3
End-period Exchange rate (kwacha/U.S. dollar)	4,407	3,845	4,834	…	…	…	…
Average Exchange rate (kwacha/U.S. dollar)	3,601	4,002	3,754	…	…	…	…
Commodity Price Assumptions							
Annual Average Copper price (in US$ per pound)	2.8	3.2	2.9	1.9	1.95	2.00	2.04
Annual Average Copper price (in US$ per metric tonne)	6,173	7,055	6,393	4,189	4,300	4,400	4,500
Oil price (in U.S. dollars per barrel)	65.0	73.0	97.5	60.5	74.5	76.5	78.0

CHAPTER 3

3 FISCAL STRATEGY AND FORECAST

3.1 Fiscal Trends and Performance

70. The Government's current fiscal policy has focused on sustaining the macroeconomic stability achieved since the beginning of this decade. In this regard, emphasis has been on ensuring fiscal prudence by containing fiscal deficit and directing more resources to areas that enhance service delivery and promote private sector led growth.

Table 2: Fiscal Trends in K' billion for 2006-2008

	2006	2006	2007	2007	2008	2008	2009
	Budget	Actual	Budget	Actual	Budget	Actual	Budget (Projected Outturn)
GDP	39,223.10	38,560.80	45,283.00	46,357.30	50,716.00	55,210.60	63,258.50
Total Revenue & Grant	8,997.84	8,240.88	10,175.04	10,625.85	12,107.39	12,293.00	13,414.50
Tax	6,672.16	6,316.99	7799.284	8,183.57	9,133.62	9,653.00	10,646.00
Non Tax	287.63	277.22	317.758	338.49	694.86	567.00	454.00
Grant	2,038.05	1,796.89	2,058.00	2,103.79	2,278.90	2,073.00	2,769.00
Total Expenditure	9,942.38	9,051.06	11,853.91	11,209.44	13,646.85	13,101.00	14,978.57
Expenses	7,497.69	7,202.91	11,948.11	9,045.17	10423.78	10,541.00	11,565.00
Assets	2,206.52	1,600.72	2,170.92	1,842.38	2554.22	1,967.00	3,062.00
Liabilities	238.17	247.43	226.958	321.89	668.52	593.00	352.00
Overall Balance	-944.54	-810.18	-1,678.87	-582.59	-1,539.46	-808.00	-1,564.07
Financing	944.54	810.18	1,678.87	582.59	1,539.46	808.00	1,564.00
Domestic	592.00	706.00	742.54	526.98	618.71	551.00	1,069.00
External	352.54	104.18	936.33	55.61	920.76	257.00	495.00
As Percentage of GDP							
Total Revenue/Grant	22.9%	21.0%	22.5%	23.4%	23.9%	22.9%	21.2%
Tax	17.0%	16.1%	17.2%	18.0%	18.0%	18.0%	16.8%
Non Tax	0.7%	0.7%	0.7%	0.7%	1.4%	1.1%	0.7%
Grant	5.2%	4.6%	4.5%	4.6%	4.5%	3.9%	4.4%
Total Expenditure	25.3%	23.1%	26.2%	24.6%	26.9%	24.4%	23.7%
Expenses	19.1%	18.4%	26.4%	19.9%	20.6%	19.6%	18.3%
Assets	5.6%	4.1%	4.8%	4.1%	5.0%	3.7%	4.8%
Liabilities	0.6%	0.6%	0.5%	0.7%	1.3%	1.1%	0.6%
Overall Balance	-2.4%	-2.1%	-3.7%	-1.3%	-3.0%	-1.5%	-2.5%
Financing	2.4%	2.1%	3.7 %	1.3%	3.0%	1.5%	2.5%
Domestic	1.5%	1.8 %	1.6%	1.2%	1.2%	1.0%	1.7%
External	0.9%	0.3%	2.1%	0.1%	1,8%	0.5%	0.8%

71. This has entailed scaling down of both domestic and external borrowing, with external borrowing being generally limited to concessional borrowing. Consequently, the risk of crowding out the private sector and jeopardising debt sustainability has greatly been reduced.

72. It is noted that in 2006, the projected overall deficit stood at 2.4 percent of GDP, rising to 3.7 percent in 2007 and projected at 3.0 percent and 2.5 percent in 2008 and 2009 respectively. In the period under review, the outturn was lower than projected at 2.1 percent of GDP in 2006, 1.3 percent in 2007 and 1.5 percent in 2008.

73. With regard to revenues and grants, the Government's objective over the period 2006 - 2008 was to raise these resources to an average of 23.1 percent of GDP. However, the actual revenue and grants were at 22.4 percent, below target by 0.7 percentage points. The lower outturn was mainly attributed to lower than budgeted project grant receipts.

74. As for the domestic revenues (taxes and non- taxes), Government's strategy in the review period was to reform the entire tax system and improve tax administration with the aim of raising domestic revenues to at least 18.3 percent of GDP. Actual domestic revenues collected were at 18.2 percent and were slightly lower than the target by 0.1 percentage points. The strong performance was attributed to reforms in tax administration and increased economic activities.

75. In terms of public spending, Government directed more resources to capital programmes, accelerated the reduction of arrears while constraining non-priority spending. As a result, budget allocations for current expenditures declined from 26.4 percent of GDP in 2007 to 20.6 percent in 2008 and projected to decline further to 18.3 percent in 2009. In line with Government's objective, budget allocation to reduce liabilities increased from 0.6 percent of GDP in 2006 to 1.3 percent of GDP in 2008. They are projected to fall back to 0.6 percent in 2009. Another consequence of constraining current expenditures was that capital expenditure increased from 4.8 percent in 2007 to 5.0 percent in 2008 and was projected to increase further to 5.1 percent in 2009. The projected outturn for 2009 is now 4.8 percent.

76. The outturn of expenditures in the review period was lower for both expenses and assets. Expenses were on average below the target by 2.7 percentage points while assets were below by 0.9 percentage points. The underperformance was mainly attributed to lower than budgeted resources, especially grants.

77. As for liabilities, the average outturn was slightly below by 0.3 percentage points and this was on account of slower budget execution.

3.2 Medium Term Fiscal Management Objectives

78. In its pursuit to diversify the economy, support growth in the non- mining sectors, and reduce poverty; the Government over the 2010 - 2012 MTEF will remain focused on fiscal prudence and directing resources to growth enhancing and poverty reducing sectors and programmes. This will entail creating the needed fiscal space by expanding the revenue base and improving tax administration while reducing wasteful expenditures.

79. The Government will, therefore, continue to concentrate on enhancing growth in the agriculture, tourism and manufacturing sectors. In addition, the improvement of service delivery and the provision of socio-economic infrastructure in the areas of health, education,

water supply and sanitation, roads and public safety will remain a priority over the medium term, especially in the rural areas.

3.3 Impact of Economic and Policy Factors on the Fiscal Framework for 2009

80. The first half of 2009 has witnessed a deepening of the global financial crisis and economic downturn which has had a more pronounced effect on the domestic economy than anticipated. This has had a telling effect on domestic resource mobilization. While revenues from the mining and mining-related sectors have dwindled in comparison to the 2008 levels; the observed weakening of domestic demand for goods and services has further reduced revenue inflows to the Treasury, from excise duties and import taxes.

81. In determining the resource envelop, the impact the global financial crisis has had on the economy and especially on tax revenues and economic growth have been taken into account. As such, the projected revenues are lower because these are built on a low base of 2009. Similarly for the first half of 2009, grant inflows have been erratic and below target. Consequently, a conservative position for grant receipts has been adopted for 2010 and going forward.

82. Efforts to create more fiscal space for priority programmes, including capital projects, have not just been constrained by the lower resources but also by the higher than budgeted expenditures such as the 2009 wage award to the civil service, maize procurement and interest payments on domestic debt.

83. In light of the weaker revenue and grant performance and the pressures on the expenditure side of the budget, financing is projected to be higher than anticipated in 2009.

84. In view of the above developments, the 2010-2012 MTEF, discussed below, has had to take into account some considerable revision to the original projections of the 2009-2011 MTEF. This is particularly noting that the originally projected revenues may not be achieved and that there will be need to adjust public spending to take into account the key programmes and activities that could not be implemented as originally planned during 2009.

3.4 Measures to Increase Fiscal Space for 2010 -2012 MTEF

85. The Government in its effort to create fiscal space for priority expenditures will mainly focus on the enhancement of revenue collections, reducing domestic arrears through the various MPSAs, improving spending efficiency and reducing wasteful expenditures.

3.4.1 Raising Additional Revenues

86. The need to widen the tax base for mobilization of domestic resources has become more imperative in light of the recent developments. The Government will, therefore continue to rationalize tax incentives, review exemptions under the Value Added Tax (VAT) and customs duties as well as modernising the Zambia Revenue Authority (ZRA), in a bid to improve tax administration and compliance.

3.4.2 Domestic Arrears

87. While Government has over the years made effort to accelerate the liquidation of arrears accumulated up to December 2002, it has been noted that the accumulation of arrears has continued, thereby diminishing the resources for developmental programmes. As a measure to address this issue, the Government in 2010-2012 MTEF will make it mandatory for all MPSAs, including grant aided institutions, to develop liquidation plans and ensure that these are implemented from funds allocated to them over the next MTEF period.

3.4.3 Control of Supplementary Expenditures

88. The Government will take measures to control supplementary expenditures by only allowing these when exceptional and unforeseen circumstances arise in priority poverty reduction sectors identified under the FNDP or those programmes targeted at enhancing the diversification of the economy.

3.4.4 Reassessing Government's Role

89. As a measure to increase fiscal space, during formulation of the Sixth National Development Plan over the next eighteen months, the Government will review its role in the development process to clearly ascertain whether it is supposed to be a provider, facilitator or regulator of the provision of goods and services. This review is likely to have significant implications on the level of resources required to be allocated to several key sectors from the total public resources, if Government's policy is to achieve private sector-led growth.

3.4.5 Obtaining Value for Money from Government Resources

90. It is common knowledge that publicly procured goods and services are over-priced, than if procured by the private sector. The Government over the medium term will take measures to ensure that there is value for money in spending public resources, in order for these funds to have the appropriate impact on the lives of the people of this country.

3.5 Medium Term Fiscal Forecast

91. Over the medium term, domestic revenues and grants are projected to marginally increase from 21.2 percent of GDP in the 2009 budget to an average of 21.4 percent for the period 2010-2012.

92. Tax revenues, as a share of GDP, are projected at an average of 17.9 percent over the 2010-2012 MTEF. For 2010 the share is 16.7 percent of GDP and this is 0.6 percentage points higher than what was anticipated in the 2009 budget. Non- Tax revenues are projected to be at an average of 0.6 percent of GDP over the medium term.

93. Grants as a share of GDP are projected to decline from 4.4 percent in 2009 budget to 4.1 percent in 2010 and sharply fall to 2.1 percent by 2012. This decline is partly attributed to lack of firmed-up commitments from Co-operating Partners on the availability of funds during the medium-term period.

94. In light of the falling domestic revenues and grants, expenditures as a share of GDP are projected to drop over the medium term. By 2012, total expenditures are projected to reduce from 24.3 percent of GDP in 2010 to 22.8 percent.

Table 3: Projected Domestic Revenues and Grants, Expenditures and Financing for 2009 - 2012

	2009 Budget (Projected Outturn)		**2010 Budget Projection**		**2011 Budget Projection**		**2012 Budget Projection**	
	K' billion	% of GDP	K' billion	% of GDP	K' billion	% of GDP	K' billion	% of GDP
GDP	**63,259**	**100**	**70,823**	**100**	**80,034**	**100**	**90,318**	**100**
Domestic Revenues & Grants	**13,414**	**21.2%**	**15,121**	**21.4%**	**17,004**	**21.2%**	**19,465**	**21.6%**
Domestic Revenues	10,646	16.8%	12,251	17.3%	14,902	18.6%	17,598	19.5%
Tax Revenues	10,192	16.1%	11,820	16.7%	14,403	18.0%	17,031	18.9%
Non Tax Revenues	454	0.7%	431	0.6%	499	0.6%	567	0.6%
Grants	2,769	4.4%	2,870	4.1%	2,102	2.6%	1,867	2.1%
Total Expenditure	**14,979**	**23.7%**	**17,197**	**24.3%**	**18,259**	**22.8%**	**20,557**	**22.8%**
Expenses	11,565	18.3%	13,695	19.3%	13,803	17.2%	14,434	16.0%
Assets	3,062	4.8%	3,168	4.5%	4,271	5.3%	5,927	6.6%
o/w Non-Financial Assets	2,972	4.7%	3,073	4.3%	4,130	5.2%	5,774	6.4%
Liabilities	352	0.6%	334	0.5%	185	0.2%	196	0.2%
Fiscal Balance	**-1,564**	**-2.5%**	**-2,076**	**-2.9%**	**-1,255**	**-1.6%**	**-1,092**	**-1.2%**
		0.0%						
Financing	1,564	2.5%	2,076	2.9%	1,255	1.6%	1,092	1.2%
Domestic Financing	1,069	1.7%	1,502	2.1%	837	1.0%	952	1.1%
Net External Financing	495	0.8%	574	0.8%	418	0.5%	140	0.2%

Source: Ministry of Finance and National Planning

95. As a share of GDP, expenses are projected to decline over the medium term from 19.3 percent in 2010 to 17.2 percent and 16.0 percent in 2011 and 2012, respectively. Assets, in contrast, are projected to increase as a share of GDP from 4.5 percent in 2010 to 6.6 percent by 2012. This is in line with Governments objective of realigning resources to development programmes such as infrastructure in particular in the agriculture, tourism, water and sanitation, road, education and health sectors.

3.6 Financing of the Budget Deficit

96. In view of the gap between expected resources and expenditures, Government projects to incur overall fiscal deficits of 2.9 percent, 1.6 percent and 1.2 percent of GDP in 2010, 2011 and 2012 respectively.

To fill up the gap created by lower revenues and grants, Government borrowing over the medium term is expected to increase to an average of 1.4 percent of GDP. In 2010 the fiscal deficit is now projected to be 2.9 percent of GDP and this compares with 1.5 percent of GDP projected in the previous MTEF for the same year.

97. Domestic financing over the medium term is projected to be at 2.1 percent of GDP in 2010 and 1.0 percent in 2011and 1.1 percent in 2012. This will be sourced from the banking and non- banking sectors.

98. With regard to external financing, the Government will continue to resort to highly concessional loans. Consequently, over the 2010 - 2012 MTEF, the projected external financing of K2,341.4 billion will be provided by Multilateral and Bilateral Cooperating partners. In addition, Government projects to pay the principal amount of debt over the medium term of K 1, 210.50 billion bringing net external financing to K1,131.36 billion over the three years of the MTEF.

CHAPTER 4

4 REVENUE MOBILIZATION

4.1 Overview of Revenue Strategy

99. In order to be consistent with the 2030 vision, Zambia needs to increasingly mobilize internal resources to promote even faster economic growth. The pressure for increased revenues to finance essential public services and key development programmes revenues must increase at least proportionately to the growth in GDP. To achieve this, the design of the tax system is critical so as to strike a good balance between encouraging growth while raising sufficient revenues for public expenditures.

100. To achieve this objective, the current tax system shall be reviewed and reformed, focusing on the progressiveness of the tax system, improving the performance of the Value Added Tax (VAT) and rationalizing the investment tax incentive structure. It is envisaged that the review and reform of the tax system will contribute to creating fiscal space and increase the ratio of domestic revenues to GDP, from 16.7 percent in 2010 to 17.9 percent in 2012.

101. With regard to non-tax revenues, a comprehensive audit and strengthening of revenue collection points will be undertaken to enhance collections. Strengthening the current system will involve designing effective collection mechanisms, including providing adequate logistics for collecting agencies, continue reviewing current legislation, adjusting fees and fines to cost effective and appropriate levels, strengthening integrity committees in institutions that collect revenues to curb corruption and pilfering. The introduction of IFMIS will further enhance tracking of revenue collections thereby minimizing possible leakages.

102. Other strategies will include administrative reforms to reduce the burden of compliance, intensifying taxpayer education and refocusing enforcement to highest revenue risks. Particular attention will also be paid to strengthening anti-tax avoidance measures and simplifying administration.

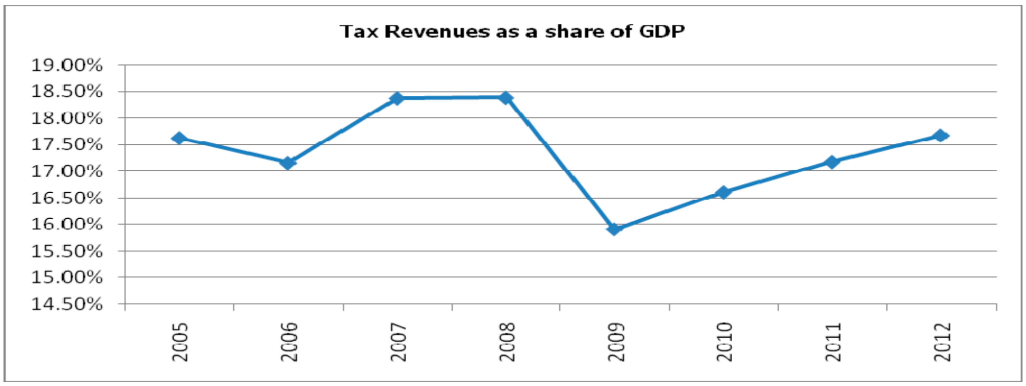
4.2 Recent Trends and Outlook

103. Zambia’s domestic revenues, as a share of GDP, have been falling since the beginning of this decade from around 19.2 percent in 2000 to about 16.4 percent in 2009. This trend suggests an erosion of the tax base through the proliferation of tax incentives and exemptions across and within sectors, including those given under the Zambia Development Agency (ZDA). It has also been caused by the negative effects of tax competition in the region and the poor performance of the indirect tax, in particular domestic VAT, among other factors.

104. The other cause of the decline in revenues is the trade liberalization the regional groupings of Common Market for Eastern and Southern Africa (COMESA) and the Southern African Development Community (SADC), frequent suspensions of excises and customs duty on petroleum to mitigate the effects of high fuel prices.

105. The consequence of the decline in the tax-to-GDP ratio, particularly in indirect taxes, has been that the tax burden has now skewed towards the Personal Income Tax (PIT) while the shares of VAT, excises and import duties have declined.
106. With regard to non-tax revenues, its ratio to GDP has declined over the years from around 0.7 percent in 2003 to 0.5 percent in 2009. This has partly been attributed to the decline in dividends, on-lending and the generally low collection levels of fees, fines and other charges.

Table 4: Percentage of Tax Revenues as a share of GDP for 2005 - 2012



107. The baseline scenario over the medium-term, tax revenues as a share of GDP, is projected to start improving in 2010 from 16.1 to above 18.0 percent in 2012. This increase is anticipated to be driven by improvements in administration supported by the recovery from the effects of the global recession.

108. Direct taxes are projected to remain stable at an average of 7.4 percent of GDP over the medium term. This is on account of the expected improvements in the mining industry and ancillary services and the related increase in employment levels.

109. Non-tax revenues as a share of GDP are projected to improve marginally over the medium term from 0.5 percent of GDP in 2009 to an average of 0.6 percent over the MTEF period. It is expected that the improvements in the economy will result in increased collections under fees and other levies.

4.3 Progress with Tax Policy and Administration Reforms

110. The Government takes cognisance of the challenges that it faces in tax policy administration. In this regard the following reforms and measures have been undertaken:

- the personal income tax has been adjusted every year taking into consideration the basic/food basket;
- the introduction of a 3 percent presumptive tax, which is a replacement of VAT and income tax registration, aimed at capturing the hard-to-tax activities whose turnover is less than K200 million;.
- the introduction of Advanced Income Tax, currently at 6 percent of gross import value aimed at compelling non-registered traders, particularly those involved in cross-border trade, to register for income tax and pay their fair share of income tax;

- the introduction of the new fiscal regime for the mining sector which has improved the performance of mineral royalty and company income tax; and
- the provision of incentives and the realignment of tariffs on machinery, equipment and capital goods so as to attract investments.

4.4 Medium - Term Measures

111. In the medium term, the key objective remains to expand the tax base. As indicated earlier the bulk of the tax burden falls on formal sector workers through personal income tax. This means that broadening the tax base will largely focus on the following:

- broadening of the VAT base by limiting and revisiting exemptions and zero rated categories;
- expanding the income tax base by limiting tax concessions;
- eliminating or reducing ad hoc exemptions on the import duty tax base;
- ensure efficient customs administration so as to facilitate the movement of goods and services;
- On the non-tax revenue front, the Government will strengthen all revenue points by adequately providing the necessary logistical support and monitoring system. Further, various laws relating to fees and other levies will be reviewed so as to reflect cost of providing the related services.

4.5 Revenue Forecasts

112. Taking into account the past performance and the prevailing conditions, the domestic revenues and grants are projected as indicted in the table below:

Table 5: Revenue Projections for the Period 2010-2012

PERIOD	2009 Outturn	% of GDP	2010 Proj.	% of GDP	2011 Proj.	% of GDP	2012 Proj.	% of GDP
Domestic Revenue & Grants	**11,907**	**18.8**	**15,121**	**21.4**	**17,004**	**21.2**	**19,465**	**21.6**
Domestic Revenue (a + b)	**10,356**	**16.4**	**12,250**	**17.3**	**14,902**	**18.6**	**17,598**	**19.5**
(a) Tax revenue	**10,035**	**15.9**	**11,820**	**16.7**	**14,403**	**18.0**	**17,031**	**18.9**
Income Tax	4,821	7.6	5,318	7.5	6,210	7.8	7,129	7.9
Company Income Tax	1,276	2.0	1,315	1.9	1,579	2.0	1,767	2.0
o/w Non-Mining	1,009	1.6	1,014	1.4	1,247	1.6	1,389	1.5
o/w Mining Tax	267	0.4	301	0.4	333	0.4	378	0.4
Personal Income Tax	3,357	5.3	3,779	5.3	4,383	5.5	5,081	5.6
o/w Pay As You Earn	2,778	4.4	3,111	4.4	3,611	4.5	4,188	4.6
Royalty	189	0.3	224	0.3	248	0.3	282	0.3
Value Added Tax	2,642	4.2	3,410	4.8	4,444	5.6	5,563	6.2
Domestic VAT	190	0.3	220	0.3	256	0.3	294	0.3
Import VAT	2,452	3.9	3,190	4.5	4,187	5.2	5,269	5.8
Customs & Excise Duties	2,572	4.1	3,092	4.4	3,749	4.7	4,339	4.8
Customs Duties	1,315	2.1	1,575	2.2	1,905	2.4	2,181	2.4
Excise Duties	1,257	2.0	1,517	2.1	1,844	2.3	2,158	2.4
(b) Non-tax Revenue	**321**	**0.5**	**431**	**0.6**	**499**	**0.6**	**567**	**0.6**
Grants	**1,551**	**2.5**	**2,870**	**4.1**	**2,102**	**2.6**	**1,866**	**2.1**
Programme Grants	561	0.9	771	1.1	703	0.9	681	0.8
Project Grants	990	1.6	2,099	3.0	1,399	1.7	1,186	1.3
SWAPS	195	0.3	555	0.8	303	0.4	303	0.3
Sector Budget Support	245	0.4	146	0.2	120	0.1	120	0.1
Project Grants	549	0.9	1,399	2.0	976	1.2	763	0.8

CHAPTER 5

5 EXPENDITURE POLICY AND STRATEGY

5.1 Overview of Strategy

113. Government's overall expenditure policy for the period 2010 – 2012 is focused on positioning Zambia to take full advantage of the upturn in the global economy as the recession recedes. This will be based on the prudent use of the public resources to ensure the effective and efficient delivery of public services and development of vital socio economic infrastructure. Government's strategy, therefore, will be to constrain expenditure on non-priority programmes and directing resources towards programmes that improve service delivery and expedite sustained recovery in the domestic economy. This will entail, among other things, allocating considerable resources to programmes that are aimed at boosting food production to ensure national and household food security, and the development of infrastructure in key sectors such as agriculture, water and sanitation, energy, road, education, health and public safety.

5.2 Recent Trends in Spending

114. Over the period 2007 - 2009, Government's expenditure policy focused on creating sufficient fiscal room to facilitate increased spending on strategic programmes of the FNDP. As such Government's aim was to double domestically financed capital expenditure between 2007 and 2010. However, this has only been increased by 34 percent due to the lower than anticipated revenues projected for 2010 as the economy recovers from slower growth caused by the current global recession.

115. In view of this, Government spent a total of K11, 209.44 billion or 24.6 percent of GDP in 2007 and K13,101.3 billion or 24.4 percent of GDP in 2008; and is projecting to spend K14,978.57 billion or 23.4 percent of GDP by the end of 2009. Out of these amounts, current expenditures accounted for 80.7 percent of total expenditures in 2007, 80.5 percent in 2008 and projected to decline to 77.2 percent in 2009. Capital spending accounted for 16.4 percent in 2007, 15.0 percent in 2008 and projected to increase to 20.4 percent in 2009. Liabilities accounted for 2.9 percent in 2007, 4.5 percent in 2008 and projected to be at 2.4 percent by end 2009. This was in line with the Government objective of redirection resources to priority spending such as infrastructure.

116. With regard to personal emoluments, Government spent K 3,531.0 billion or 7.7 percent of GDP in 2007, K 4,465.0 billion or 8.3 percent of GDP in 2008 and is projecting to spend K5,100.0 billion or 8.5 percent of GDP in 2009. As a share of domestic revenues, personal emoluments accounted for 41.4 percent of the domestic revenues and are projected to increase to 47.9 percent in 2009. The rise in the proportion of personal emoluments to GDP is mainly attributed to salary increments of 13 percent, 16 percent and 15 percent in 2007, 2008 and 2009, respectively. The other reason for this rise was the continued recruitments particularly in the health, education and public safety sectors in line with the FNDP objective of improving service delivery.

117. With regard to general operations and maintenance, Government spent about K2,437 billion in 2007, K2,491 billion in 2008 and projects to spend K3,513 billion by the end of 2009. Some of the notable expenditure items, during this period, included those on awards and compensation, the constitution review process and the by-elections, which together used up resources amounting to K105 billion in 2007 and K350 billion in 2008; while projecting to use up to K227 billion in 2009. Government further spent K1,955 billion in 2007, K2,316 billion in 2008 and K1,728 billion is estimated to be spent by the end of 2009 on transfers and subsidies. Some of the notable areas on which these funds were spent are the fertiliser support programme, the food subsidies and the pensions, which together account for about K675 billion in 2007, K694 billion in 2008 and K784 billion in 2009.

118. Government also continued to service its debt obligations in the medium term. In this regard, interest payments amounted to K776 billion in 2007, K950 billion in 2008 and are projected to reach K1,068 billion by the end of 2009. Of these amounts, about 92 percent were in respect of domestic debt obligations and only 8 percent was on external debt servicing. As a share of domestic revenues, domestic debt interest payments accounted for about 9 percent, over the past medium term.

119. Further, Government spent K1,842.0 billion or 4.1 percent of GDP in 2007 on various capital investment programmes including the construction and rehabilitation of roads, schools and health centres and the establishment of the Youth Empowerment Fund (now part of the '*Citizens Economic Empowerment Fund'* - a programme that is aimed at harnessing and developing business ideas and entrepreneurial potential among local citizens). Most of these FNDP infrastructure development programmes that were implemented in 2007 also continued into 2008 and 2009. Government, therefore, spent a total of K 1,967.0 billion or 3.7 percent of GDP in 2008 on capital investment programmes and K3,062 billion or 5.1 percent of GDP is projected in 2009.This was in line with the FNDP objective of directing more resources towards capital formation.

5.3 Key Expenditure Issues

120. Government's expenditure strategy, during the 2010 – 2012 MTEF period, will be mainly influenced by some constitutionally required processes that have to be undertaken during this period, such as the national census of population and housing, the preparation and the holding of the 2011 tripartite elections and the national constitutional making process. This is in addition to the need to meet the cost of personal emoluments which already take up close to 50.0 percent of the domestic revenues. Since these activities will take precedence and given the revenue constraints as illustrated in chapter 4, there will be, therefore, limited fiscal space for implementing other programmes. In view of this, it remains imperative that Government puts in place measures that will ensure effective utilisation of scarce resources. Some of these measures will include focusing on programmes that will make a direct contribution to improved service delivery while curbing any observed wasteful expenditures, and programmes that have a significant contribution to economic growth and poverty reduction.

121. In view of the anticipated fiscal challenges in the 2010 – 2012 MTEF period, Government projects to spend a total of K17,632.5 billion or 24.9 percent of GDP in 2010, K18,644.7 billion or 22.3 percent of GDP in 2011 and K20,945.9 billion or 22.0 percent of GDP in 2012. Of these amounts, current expenditures will account for 77.7 percent of total expenditures in 2010, 74.0 percent in 2011 and 68.9 percent in 2012. Capital investment

programmes will account for 18.0 percent of total expenditure in 2010, 22.9 percent in 2011 and 28.3 percent in 2012. This is in line with the Government's objective of re-prioritising budget activities by constraining non-priority spending and redirecting the savings to priority spending such as infrastructure.

5.3.1 Personal Emoluments

122. Government's objective on personal emoluments is to pay civil servants a fair wage while providing them with adequate resources to perform their duties. As already indicated personal emoluments take up about 50.0 percent of the domestic resources and once other constitutional and statutory obligations are considered these together take up about 90.0 percent of the domestic resources thereby constraining expenditures on developmental programmes.

123. To this end, spending on the government wage bill as a percentage of GDP is projected to decrease from 8.40 percent in 2009 to below 8.0 percent by 2011. As a share of domestic revenues, this will reduce to below 45.0 percent by 2011. To achieve this goal, wage awards will have to be contained within the inflation levels. Further, Government will generally continue to suppress recruitments except where replacements are necessary; and where natural attrition occurs, Government will consider redeployments prior to replacements. This effort is aimed at forestalling the growth of the current wage bill to levels that might be unmanageable, while allowing for room to refocus its strategy on resolving the current human resource challenges. Net recruitments will however continue in the health, education and public safety sectors and this is projected at total of about 18,500 persons, over the medium term.

124. Further, the utility allowances, which are meant to cater for water and electricity bills for staff in the defence forces and the police service, will be paid through the payroll in order to ensure efficiency in the administration of the allowance and promote accountability, transparency and responsibility.

5.3.2 Use of Goods and Services (Operations and Maintenance Spending)

125. In line with the objective of creating fiscal space, the Government's strategy is to restrict spending on operations and maintenance, especially on non-priority goods and services such as the hosting of workshops outside the work station, the procurement or usage of motor vehicles, the frequency of foreign travels and other avoidable expenses. In this regard, Government has reduced budget allocations on the use of goods and services from 5.84 percent of GDP in 2009 to 5.17 percent in 2010 and to below 4.0 percent in 2011 and 2012.

126. Some of the major programmes that will account for significant share of resources in 2010, are the National Census of Population and Housing, the Voter Registration programme (in readiness for the 2011 tripartite elections), and the continued sittings of the National Constitution Conference. These programmes will, respectively, cost K122.0 billion, K145.6 billion and K82 billion. In 2011, Government projects to spend K239.4 billion on the tripartite general elections.

127. One of the areas where Government continues to spend significant amounts of resources is Awards and Compensation, and this limits the scope to create extra fiscal space. Government is projecting to spend K173.0 billion in 2010 and increase to K189.2 billion in 2011 and K205.2 billion in 2012. Over the medium term, Government will review the factors contributing to the increase in these expenditures.

5.3.3 Transfers and Subsidies

128. During the medium term, Government will continue providing support to grant aided-institutions such as the Zambia Revenue Authority (ZRA), the three Road Fund Agencies and other semi-autonomous institutions. In terms of subsidies, Government will continue to provide grants to the Fertiliser Support Programme, the Strategic Food Reserve programme, and the Food Security Pack, in order to ensure food security in the country. To this end, Government has allocated annual amounts of K435 billion for the Fertilizer Support Programme, K100 billion for the Strategic Food Reserve and between K10 billion to K15 billion to the Food Security Pack throughout the medium term period.

5.3.4 Capital Investment Programmes

129. Government will continue with the implementation of its investment programmes that are aimed at fostering growth and alleviating poverty. In this regard, budget allocations to physical capital for both economic and social infrastructure have been scaled up, in the medium term. Infrastructure development programmes, such as the rural electrification, roads, schools, health centres, etc, will account for about 4.34 percent of GDP in 2010 and expected to increase to 4.93 percent of GDP in 2011 and 6.06 percent of GDP in 2012. The bulk of capital expenditures will go to road infrastructure, K852.8 billion is projected to be spent on the construction and rehabilitation of roads throughout the country in 2010, K1,263.2 billion in 2011 and K 2,155.0 billion in 2012. Other large capital expenditure will be for schools, health centres, farm blocks and the development of the Lusaka South Multi-Facility Economic Zones. Government will also increase allocation to the Citizens Economic Empowerment Fund from K40.0 billion in 2010 to K80 billion 2011 and K86.8 billion in 2012.

5.3.5 Liabilities

130. In terms of liabilities, Government will continue with the strategy of dismantling arrears during the medium term. In this regard, Government projects to spend K334.3 billion in 2010 on dismantling its liabilities to the pension, suppliers of goods and services, housing allowances and other liabilities. Of this allocation, the K50 billion provided to pension is expected to completely clear pension arrears. The allocations in 2011 and 2012 in relation to arrears to suppliers of goods and services and other liabilities are K184.9 billion and K195.6 billion, respectively.

5.3.6 Other Spending

131. Government will continue to honour its debt obligations in terms of paying both the principal and the interest amounts. While the cost on external debt has significantly reduced, the major concern is with domestic debt which continues to attract substantial amounts in interest payments. In this regard, Government projects to pay interest on domestic debt of K1,188.0 billion in 2010, K1,196.9 billion in 2011 and K1,185.7 billion in 2012. As a share of domestic revenues, these will be at 9.7 percent, 8.0 percent and 6.7 percent in 2010, 2011 and 2012 respectively.

132. With regard to social benefits, Government will continue to provide for pension benefits and gratuities to retiring public servants and political leaders over the medium term. In addition, Government will scale up resources as part of the measures to reduce the financing gap being experienced by the Public Service Pension Fund (PSPF). In this regard, Government projects to spend a total of K193.1 billion in 2010, K504.1 billion in 2011 and K522.0 billion in 2012 on pension benefits. This allocation includes the last component of the mid-term gratuity to Members of Parliament in 2011.

133. In this medium term, Government will also continue to restructure and recapitalise some of the strategic parastatal companies which are cardinal to the fulfilment of Government objective to improve service delivery in various sectors. In this regard, Government will spend K189 billion in 2010, K179 billion in 2011 and K287.9 billion in 2012 on financial restructuring and contingent liabilities.

5.4 Medium-Term Spending Reform Priorities

134. Government's resolve and commitment to reforming its general spending strategy, during the 2010 - 2012 medium-term period, remains cardinal to the success of its overall strategic policy for the period. In view of this, Government has prioritised the following spending reforms in the medium term:

i. *Multi-Year Wage Negotiations*

   Government will engage in multi-year wage negotiations with unions with the aim of bringing stability to the budgeting and allowing the Government to better align expenditures and avoid shifting of resources in the course of budget implementation;

ii. *Improving Rural Service Delivery*

   In an effort to narrow the gap in living conditions between rural and urban areas, Government will pay special attention to investment programmes, such as infrastructure development in rural areas. In particular the early successes of building education infrastructure, especially in remote rural areas, using the community mode will be further developed during the medium term. In addition, Government will increase funding to the operational requirements of the rural roads equipment, rural electrification and rural institutional housing for sectors such as police, immigration, health and education.

iii. Implementation of Capital Investment Projects

In order to streamline and improve capital project implementation, Government will adhere to the following guidelines in the medium term:

- All new capital projects above a pre-determined threshold that are proposed for the 2010- 2012 MTEF and for inclusion in the Sixth National development Plan will be accompanied by project documents that will contain complete project appraisal including cost benefit analysis and economic rate of return calculations; and

- The monitoring and evaluation function of Government will be strengthened to ensure effective implementation of projects. This will be done in part by making project information more transparent so as to facilitate increased accountability of project implementers to the communities benefiting from these projects.

iv. Transfers to Councils

In support of the National Decentralisation Policy and in order to make the provision of grants to local councils more transparent, equitable and predictable, Government will, with effect from 2010, implement formula-driven grant allocation and disbursement procedures. These formulae will be based on population but weighted by poverty and other district deprivation factors so as to assist poorer councils to deliver basic local services.

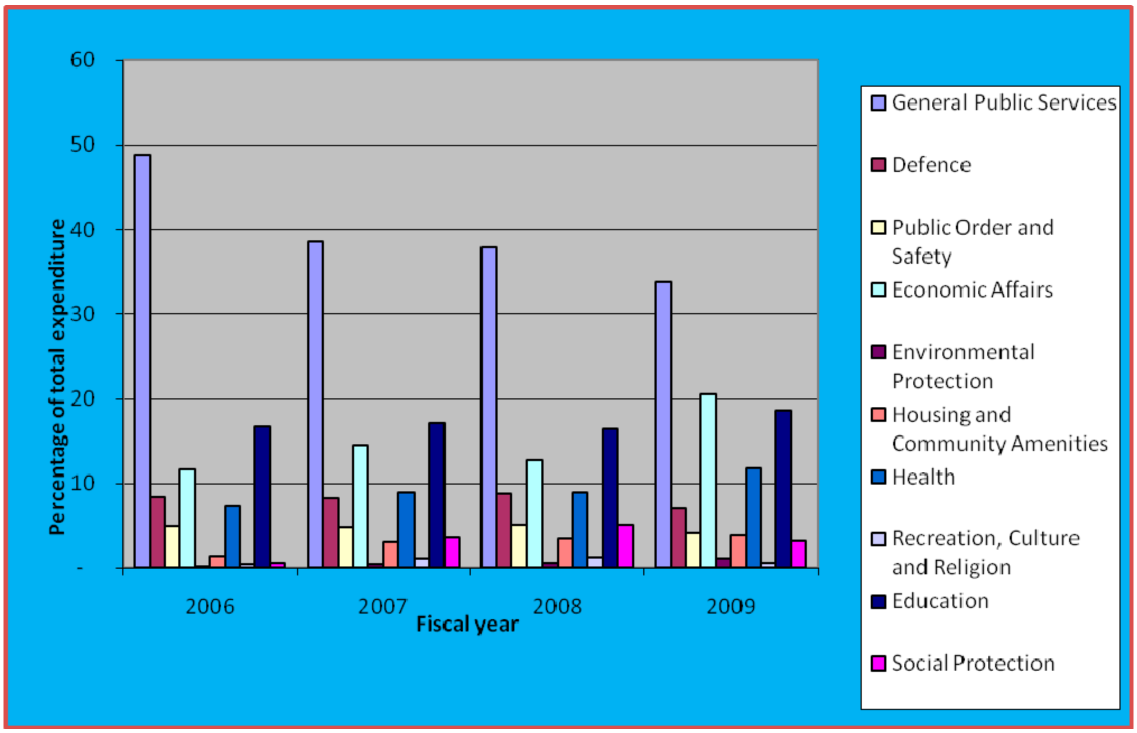
CHAPTER 6

6 FUNCTIONAL SPENDING PRIORITIES AND ALLOCATIONS

135. Over the medium term, Government will continue to anchor resource allocation on the FNDP priorities and in accordance with functions of Government as guided by the Government Financial Statistics (GFS) 2001 manual.

6.1 Recent Trends in Spending

Figure 1: Sectoral Budget Allocation by Function for 2006 - 2009



136. Over the period 2006-2009, General public services have accounted for the highest proportion of the total budget. However, the proportion has been reducing from 49 percent in 2006 to 33 percent in 2009 in line with Government's objective to direct more resources to growth enhancing and service delivery programmes. In this regard, expenditure on the economic affairs function increased from 12 percent of total expenditure in 2006 to 20 percent in 2009. This is indicative of Governments efforts in developing the agricultural, tourism and manufacturing sectors through the development of livestock, irrigation, fisheries, infrastructure and farm blocks.

137. Expenditure in the health and education sectors rose from 7 percent to 12 percent and 17 percent to 18.5 percent between 2006 and 2009, respectively. As for the social protection sector, expenditure increased from 1 percent to 3 percent in 2009. These trends tally with Government's effort to improve social service provision in the health and education sectors through recruitment of frontline personnel and construction of schools, technical colleges and

health facilities. Particular attention has also been paid to the clearance of pension arrears under the social protection function.

138. With regard to public order and safety, the expenditure share was maintained at 4 percent throughout the period under review. This is in line with Governments commitment towards safeguarding its people and creating a safe environment to attract investment through the increase of human resource and infrastructure in this sector.

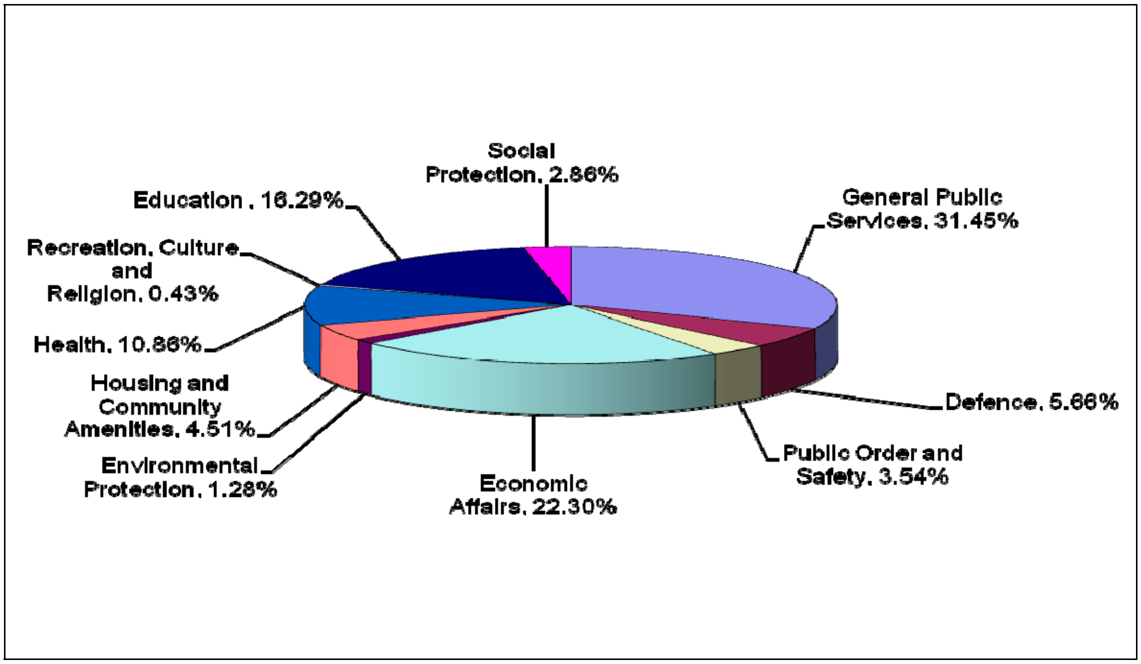
139. The housing and social amenities function increased from 1 percent of the total budget in 2006 to 4 percent in 2009. The increase is a reflection of Government's commitment to develop the water supply and sanitation sectors through sinking of boreholes to increase access to safe drinking water.

6.2 Functional Resource Allocation Priorities for the 2010 Budget

140. In 2010, Government will continue to place a strong emphasis on economic diversification through a number of measures aimed at stimulating growth in the non-mining sectors of the economy. These sectors include agriculture, tourism, and manufacturing. It is expected that interventions that were undertaken in these sectors during 2009, such as the Nansanga Farm Block, Kasaba Bay, and Multi-Facility Economic Zones, will yield economic returns over the medium term, as investors move in and commence business activities.

141. Furthermore, Government will remain committed to safeguard the vital social services to the public. In this regard, Government will continue with human resource recruitment and infrastructure development in the health, education, public order and safety and water supply and sanitation sectors. Government will also continue to improve both urban and rural infrastructure, particularly roads and water and sanitation.

Figure 2: Proposed Spending by Function in 2010, as percentage of Total Expenditure



Source: Ministry of Finance and National Planning

6.3 Resource Allocations to Functions and Strategic Programmes 2010 - 2012

Table 6: Functional Classification as a Percentage of Total Expenditure, 2009 - 2012

Function	2009	2010	2011	2012
General Public Services	33.72	31.45	30.83	29.08
Defence	6.99	5.66	5.58	6.00
Public Order and Safety	4.09	3.54	3.28	3.37
Economic Affairs	20.55	22.30	24.35	26.31
Environmental Protection	1.16	1.28	1.18	1.13
Housing and Community Amenities	3.77	4.51	4.33	3.89
Health	11.77	10.86	10.15	10.09
Recreation, Culture and Religion	0.55	0.43	0.44	0.45
Education	18.54	16.29	15.86	15.89
Social Protection	3.20	2.86	4.01	3.79
Total	100.00	100.00	100.00	100.00

Source: Ministry of Finance and National Planning

6.3.1 General Public Services

142. It is expected that General Public Services will continue to take a larger share of total expenditure albeit with decreasing proportions over the medium term from 33.7 percent in 2009 to 29 percent in 2012. This is in line with Government's efforts in eliminating wasteful expenditures. Notable outlays under this function are local government transfers and the constitutional review process.

6.3.2 Economic Affairs

143. Expenditure in the Economic Affairs sector as a percentage of total expenditure is projected to take the second largest share of resources after General Public Services in the medium term, increasing from 20.5 percent in 2009 to 26.3 percent in 2012.This is as a result of a good number of priority sectors falling under this function including agriculture, tourism and manufacturing. Among the programmes to be undertaken are livestock development, irrigation, fisheries, transport infrastructure, farm blocks, heritage sites and Multi- Facility Economic Zones (MFEZ).

6.3.3 Education

144. Expenditure in the Education sector as a percentage of total expenditure is projected to fall in the medium term, decreasing from 18.5 percent in 2009 to 15.8 percent in 2012. The decrease is expected to be as a result of the fall in donor contribution in the terms of Sector Wide Approach (SWAPs) which is projected to decline by about half. Furthermore, most projects are expected to end in 2010. The strategic programmes under this sector are the recruitment of teachers and construction of schools and technical colleges.

6.3.4 Health

145. With regard to Health, the allocations as a percentage of total expenditure are also projected to slightly decrease from 11.7 percent in 2009 to 10 percent in 2012. This decline is

mainly due to the reduced donor contributions in form of SWAPs and project grants over the medium term. Most of these resources are intended for the continuation of the construction of health infrastructure, recruitment of personnel and procurement of drugs and medical equipment.

6.3.5 Public Order and Safety

146. Expenditure proportions for programmes under the Public Order and Safety function are expected to decrease slightly over the medium term from 4.0 percent in 2009 to 3.4 percent in 2012. This is one of Government's earmarked sectors for development in the medium term so as to improve security for both persons and their properties. The key programmes are recruitment of personnel and infrastructure development.

6.3.6 Housing and Community Amenities

147. Over the medium term, Government proposes to further improve the allocations to housing and water and sanitation programmes. To this effect, the proportion of total expenditure on Housing and Community Amenities is expected to be maintained at 4 percent over the medium.

Other functions covered in the medium term include Defence, Environmental Protection, Social Protection, and Recreation, Culture and Religion where there has been no significant change in terms of resource allocation.

ANNEXES

- Fiscal Framework for 2010 - 2012.

- MPSAs Resource Ceilings:
  - Aggregate Ceilings
  - PEs Ceilings
  - Non- PE Ceilings

- Budget Allocation by Function.