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The 2021 National Budget: A Fair Tax Monitor Analysis

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Introduction

On Friday September 25 the Ministry of Finance presented the proposed national budget for the year 2021. This was against the backdrop of Covid-19 and the subsequent negative effects that have resulted in a projected real GDP growth of negative 4.2 for 2020 – the first recession since 1998.

CUTS Lusaka's analysis of the budget is through the lens of the recently launched Zambian Fair Tax Monitor (FTM) report which gives an in-depth analysis of the country's tax system in order to highlight the challenges and shortcomings of the regime and guide policy formulation. The report analyses issues such as the effectiveness of the tax administration, revenue sufficiency, government spending, the distribution of the tax burden, and tax incentives.

The purpose of this analysis therefore, is to analyse the projections in the 2021 national budget against the findings of the relevant sections in the Zambia FTM report to provide policy guidance in the implementation of programmes as outlined in the budget.

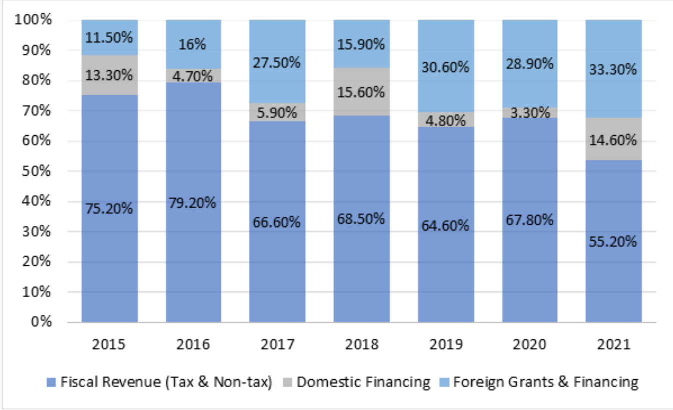
Revenue Sufficiency

The FTM report highlighted that in recent years, the Zambian government through the Zambia Revenue Authority (ZRA) have consistently managed to beat their annual revenue targets. However, according to the budget speech, domestic resource mobilisation (DRM) for the year has been subdued significantly with revenues and grants now projected at K65.9 billion by the close of 2020, which is 12.0 percent below the target of K75.0 billion.

In an effort to increase DRM there is a need for the Government to outline long-term targets for revenue collection and take into consideration progressive tax practices such as developing a department within the revenue authority that is dedicated to High Net Worth Individuals

As illustrated in the figure below, there has been an increasing reliance on foreign sources of revenue. Foreign grants and financing made up only 11.5 percent of the national budget in 2015, but this share has tripled to 33.3 percent in the 2021 budget – making up a third of the revenue envelope for the year. This indicates the need to improve domestic resource mobilisation

Figure: Revenue sources (2015-2021)

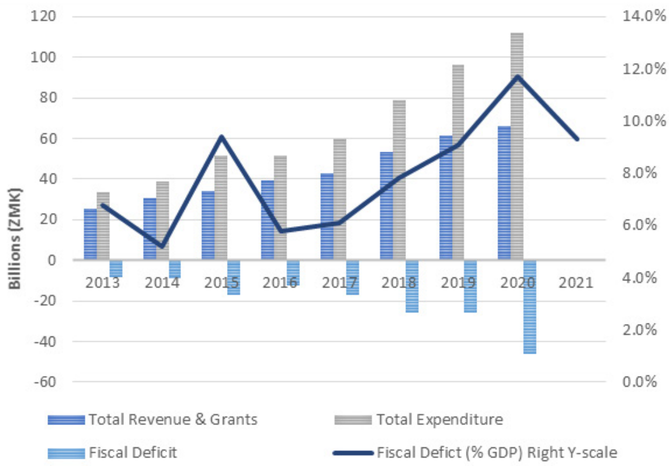


Source: Ministry of Finance

Government Spending

Government spending has consistently outpaced domestic resource mobilisation (DRM) over the past decade resulting in a growing fiscal deficit. As a percentage of GDP, the fiscal deficit stood at 5.6 percent in 2016 and over the years has steadily increased to 11.7 percent in 2020. The national budget states that expenditure is projected to be K111.9 billion at the end of 2020, which is 5.6 percent above the target of K106.0 billion and is budgeted to to rise to K119.6 billion in 2021which extends this negative trend further. As illustrated in the table below, the fiscal deficit is projected to be 11.7 percent of GDP for the year of 2020 which indicates the increasing need for financing to bridge the gap between the expenditure and resource mobilisation.

Table: Fiscal deficit (2013-2020)



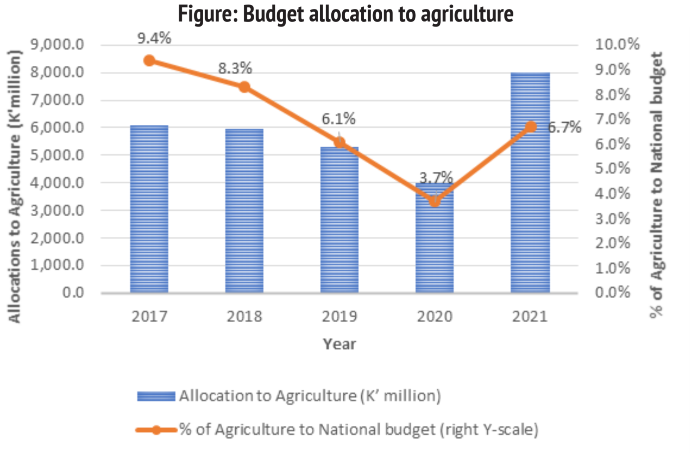
Source: Ministry of Finance

Despite the expenditure projection of K111.9 billion, total expenditure (including amortisation) between January and August 2020, amounted to K72.1 billion and was 27.2 percent below the target of K99.0 billion. This outturn was due to the underperformance on revenues and lower disbursements on foreign financed projects.

Spending in the Agriculture Sector

The budgetary allocation to the Ministry of Agriculture and the Ministry of Livestock and Fisheries has been declining over the years. The Maputo Declaration on Agriculture had an objective of all signatories designating 10 percent of their national budget to agriculture. As shown in the figure below, Zambia is a long way from achieving this objective as the agriculture budget currently only constituted 3.7 percent of the 2020 national budget.

Figure: Budget allocation to agriculture



Source: Ministry of Finance

While the allocation of 6.7 percent may appear to be a step in the right direction as it is approximately double the allocation given to the agriculture sector in 2020, a significant proportion of the expenditure in the agriculture sector is channelled towards the Ministry of Agriculture's flagship Farmer Input Support Programme (FISP). The Direct Input Supply (DIS) method has been found to be much more expensive for the government to implement, while the E-voucher method is much more cost effective and promotes diversification when delivered as correctly. Given the tight fiscal space expected in the year of 2021 it would have been more prudent to use the E-voucher delivery channel and rather redirect agriculture spending to more effective investment in the agriculture sector[1].

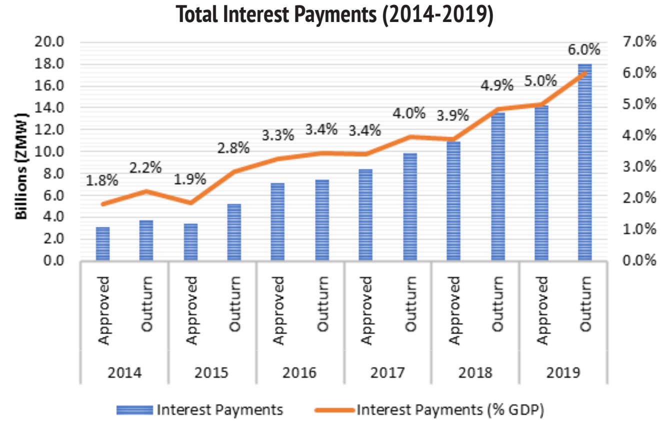
Public debt

In order to bridge the gap caused by the growing fiscal deficit, the Zambian government has looked to domestic and external financing. This has caused an unsustainable debt burden that has been further exacerbated by the global economic fallout caused by Covid-19.

The Budget highlighted a significant increase in the country's debt stock. External debt at the end of June 2020 was US $11.97 billion increasing by 6.9% since the end of 2019. Similarly, domestic debt in the form of government securities stood at K114.3 million at the end of August 2020 from K80.2 million at the end of December 2019.

The debt contracted by the Zambian government is serviced periodically with both interest and principle payments. The table below shows how debt interest payments have been increasing in monetary terms and as a percentage of GDP.

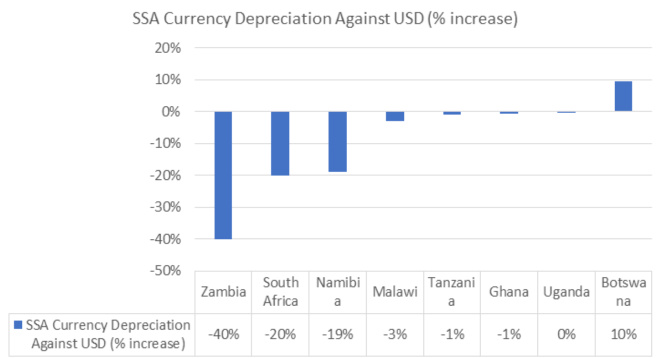
Total Interest Payments (2014-2019)



Source: Ministry of Finance

The cost od debt servicing can be expected to increase significantly for the year 2020 with the Kwacha depreciating by over 40 percent (from K12.1 in January to K20 as of September 2020) since the start of the year which has significantly increased the cost of external debt servicing. The table below gives a comparative illustration of the performance of the Zambian Kwacha against other Sub-Saharan countries in 2020.

Currency Depreciation Against the USD (December 2019 – September 2020)



Source: Ministry of Finance

The government has, however, been making an effort to slow down debt contraction and restructure existing debt to reduce the debt burden and restore sustainability. This is important given the negative impact it is having on all other sectors and on the lives of average citizens.[2] US$1.1 billion pipeline loans have been cancelled and US$280.0 million has been saved from the re-scoping of projects. Further to this the government is approaching its creditors to suspend debt payments.

Tax Incentives (Tax reforms)

According to the findings of the FTM, revenue generated from corporate income taxes has been outpaced by personal income taxes over the past ten years. The national budget has made a significant number of tax reforms that are mostly targeted at easing the economic impact of Covid-19 while also improving the efficiency of collection and compliance levels.

The 2021 national budget outlined a number of tax reforms to increase the disposable income of Zambian citizens and stimulate economic activity. For example, the increase in presumptive tax rate for the gaming and betting industry from 10 percent to 25 percent of gross takings will increase the corporate tax revenue collected by the tax administration. In addition, there was an increase in the PAYE thresholds which is expected to ease the burden on average citizens and reduce the amount of revenue collected as personal income tax by K455.6 million and would hopefully result in a progressive shift away from the dependence on PIT as the main contributor to direct taxes in Zambia to CIT.

According to the FTM report findings, over the past three years (2017-2019), data from ZRA shows that the tax administration has collected more revenue through indirect taxes than direct taxes. Given the indiscriminatory nature of indirect taxes, they are considered less progressive than direct taxes. It must be noted however that as of the second quarter 2020, data from The Ministry of Finance' Second Quarter Economic Review shows that more revenue has been collected through direct taxes which are more progressive.

Recommendations

Revenue sufficiency

• Zambia's tax-to-GDP ratio is significantly lower than the unweighted average for SADC (23.7 percent of GDP) therefore Zambia needs to improve its collection by incentivizing tax compliance and the pressing on with the adoption of new technologies to improve efficiency.

One major oversight that needs to be addressed and could contribute to a more equitable increase in revenue collection is the introduction of wealth taxes. To do so the ZRA could benefit from having a specific unit that deals with the High Net Worth Individuals (HNWIs)Government spending.

• The fiscal deficit is projected to rise to 11.7 percent of GDP for the year of 2020. The government must however exercise prudent and efficient use of the scarce resources available to them in order to reduce this gap and reduce the need for financing.

• The government must consider reducing the FISP allocation through the use of the more efficient E-voucher program in 2021 and consider redirecting the agriculture spending to a more effective investment in the agriculture sector.

Public Debt

• Government expenditure on debt servicing and amortisation has been increasing in recent years while expenditure on key sectors such as agriculture, education, healthcare, and social protection has been reducing. The Government must, therefore, continue to take steps to restructure existing debt while reducing further debt contraction to maintain debt sustainability in the long term.

Tax incentives

• The 2021 budget speech offers various tax reforms in various industries in an effort to stimulate economic activity. However, Zambia still needs to reduce its corporate tax incentives and offer a consolidated tax rate that offers investors simplicity, predictability, and certainty without having to apply for discretionary tax incentives

• Increases in the presumptive tax rates for the gaming and betting industry can be progressive. However, increases in the rates, specifically targeted at the informal sector, may be counterproductive in the ZRA's quest to increase tax compliance in the sector. The Zambian government can learn from other African countries such as Uganda that have much lower presumptive tax rates to encourage tax compliance and formalisation for the informal sector.

Endnotes

1. ***Savings, Jobs and Climate Resilience: The Heightened Significance of E-V*** *https://cuts-lusaka.org/pdf/policy-brief-savings-jobs-and-climate-resilience.pdf*
2. ***Are Zambians Feeling the Crunch?*** *– A Perception Survey on Debt and the Economy https://cuts-lusaka.org/pdf/policy-brief-are-zambians-feeling-the-crunch-a-perception-survey-of-debt-and-the-economy.pdf*

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