CSPR Statement on the 2006 National Budget

"Thanks For Growth, But Where Is The Strategy On Jobs and the Equity in Taxes?" Says CSPR

1.0 Introduction

The Civil Society for Poverty Reduction (CSPR) welcomes the spirit of the 2006 budget to translate the pains endured during the HIPC process into welfare gains that must result into advances in access to education, health care and economic provisioning. It is CSPR's hope that the sacrifices Zambians made will soon translate into lasting freedom - the emancipation from the yoke of poverty. CSPR is particularly enthused with the budget's move to focus on economically empowering Zambians, especially the youth, as a sustainable way of fighting poverty and ensuring the country's future prosperity. CSPR is confident that government's continued thrust for fiscal prudence and tight monetary policy will steer the national economy towards greater prosperity. We implore business houses and industry to respond in ways that will ensure increased national output and thus, improved incomes and standards of living for the ordinary Zambian citizens.

The 2006 budget is not without weakness, however. Within this context, CSPR is concerned that the budget has not addressed itself to the employment problem nor offered meaningful tax relief for the working population. Our expectations on employment creation and tax relief have therefore not been meet. Strangely, could it be by coincidence that the budget has not paid serious attention to issues directly affecting labour? The answer is complicated, at best, beyond the scope of our statement.

CSPR's statement on the 2006 national budget is informed by the network's vision for "a Zambia in which all of its people enjoy all basic needs." The network's mission is to be a leading civil society network contributing to pro-poor development at all levels in Zambia. These are the lenses; the values and convictions CSPR shall use to look at the 2006 budget. So, while saying thank you to government for positive growth, declining inflation and improved fiscal discipline, CSPR is led to ask: where is the strategy on jobs and the equity in taxes?

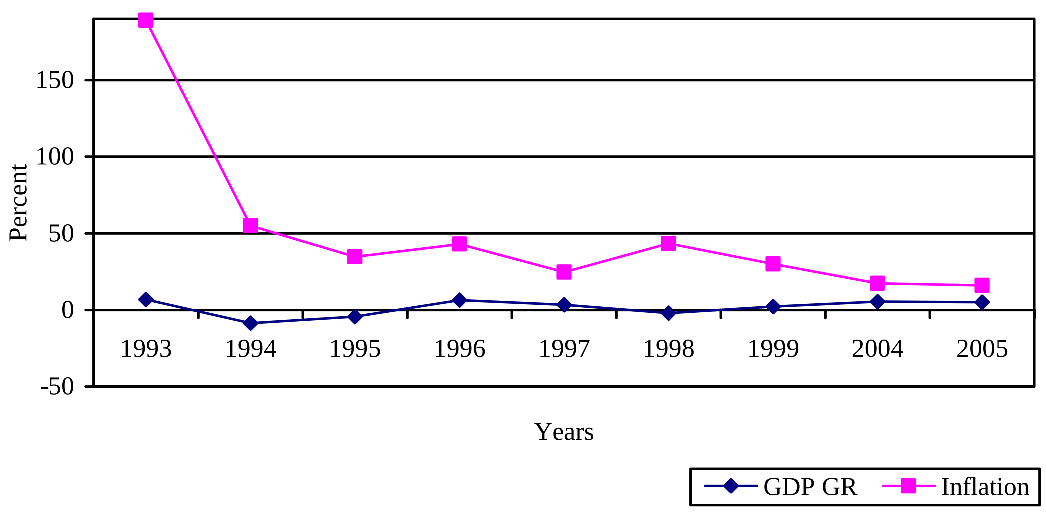
This statement is in five parts. The next section looks at the proposed macroeconomic framework in the context of poverty eradication and job creation. The third section concerns itself with aspects of the proposed budget expenditure framework. The fourth section interrogates aspects of the budget's proposed tax regime. The fifth section makes some recommendations. The last section concludes the statement.

II. The Macroeconomic Framework: *Geared For Job Creation?*

Taken as a whole, there are several reasons to give a good grade to macroeconomic performance in the recent years. The budget reports that the economy has consistently recorded positive growth over the last six years, averaging 4.6 percent. In 2005, however, real GDP growth, though positive, declined from 5.4 percent in 2004 to 5.1 percent in 2005. This decline may not at all be surprising given some supply constraints such as oil shocks and labour disputes in the mines during 2005. Thus, on the basis of a year-to-year comparison, nearly all the key sectors: agriculture, mining, construction and manufacturing recorded declined growth rates in 2005 compared to the previous year. Only tourism posted better growth in 2005 than in 2004. However, the end of year inflation in 2005 closed at 15.9 percent and was reported to be the lowest rate achieved since the advent of the liberalisation of the economy in 1991. In addition, the economy posted an increase in gross international reserves to an equivalent of 1.8 percent of import cover – which was higher than the target of 1.3 percent of import cover in 2005. These are all significant gains that inspire hope and create a basis for optimism that a better Zambia is possible.

Thus, CSPR commends government efforts at macroeconomic stability, fiscal discipline and efforts at improved balance of payment viability. We also generally welcome the key macroeconomic objectives set for 2006 though we think that interest rates are still too high and that the projected GDP growth rate (6%) is rather modest given the incentives allotted to business and industry. Figure 1 below captures the favourable trends in GDP growth rates and inflation recorded in the recent years.

Figure 1: Trends in GDP Growth and Inflation, 1993 - 2005



But more fundamentally, our contention is that positive GDP growth rates, stable inflation, and fiscal discipline are in themselves not enough. These are just means to the end. There is need for a deliberate and substantial redistribution of expenditures in favour of poverty-reducing programmes and activities[1]. In CSPR, improved social and economic welfare and enabling people lead the kind of lives they value is what we long for. For this reason, CSPR would like to see visible correlations between macroeconomic variables and the daily experiences of the people of Zambia. There would be no denying that poverty remains the greatest challenge Zambia is facing. Today, 68 percent of the total population is below the poverty line with the majority living in extreme poverty. Infant mortality rate averages 115 per thousand live births while narrow unemployment is to the tune of 13 percent of the labour force. These human development indicators do not make good reading. Table 1 below summarises the state of human development in Zambia using selected 'ultimate' development indicators.

Table 1: Selected 'Ultimate' Development Indicators, 1993 – 2004

	1980 -1985	1990-1995	2003	2004
Poverty incidence (%)	**	68	73	67
Per Capita Income ($ in 2002 dollars)	630	370	320	320
Adult illiteracy rate (%)	37	32	21	21
Infant Mortality Rate	103	109	115	115

[1] Seshamani et al (1999). *Overcoming Barriers to Zambia's Development: Dismantling the Tripod of Deprivation, Debt and Disease*. GRZ/UNICEF: Lusaka.

<u>Source</u>: World Bank (2004)
** Denotes official statistics unavailable

As can be seen from the table above, the state of human development portrays the most worrisome picture and calls for expeditious actions.

CSPR further notices that in setting the momentum for macroeconomic policies for 2006, the budget clearly acknowledges that, "to address the high poverty levels, we should not only sustain the recent positive economic strides that we have made, but also raise further economic growth to more than six percent per annum in the coming years.[2] CSPR agrees with the Minister's sentiments and posits that higher economic growth rates, in the range of 8 percent per annum, are desirable for poverty reduction. Taking this point further, CSPR reiterates that the current poverty situation in Zambia warrants a reconsideration of the policy of "growth first, distribution later." With existing high poverty levels, it becomes compelling that there should be a substantial redistribution of expenditures in favour of poverty reducing programmes and activities. To wait for poverty reduction to occur mainly through growth may be too risky.

Building on the need for sustained growth, the 2006 budget rightly acknowledges that, "we need to ensure that the growth process benefits more of our people by integrating them in economic activities"[3]. CSPR welcome this policy thrust. But, perhaps a more fundamental question is: how can more people be integrated in economic activities? From CSPR's standpoint, a useful starting point is job creation. As argued in CSPR's submissions to the fifth National Development Plan (NDP), "low income households possess few assets of their own. Instead, the most abundant resource the poor have at their disposal is their labour. Thus, a macroeconomic strategy that more fully employs a country's human resources and raises the returns to labour becomes a powerful tool for reducing poverty"[4]. In other words, when employment expands along with production, the benefits of economic growth will be widely shared. Indeed, better employment opportunities provide people with new, and often improved, sources of income. In this way, improving the quality and quantity of employment opportunities directly links economic growth to poverty reduction.

As such, in a country where over 90 percent of the labour force is outside the formal employment sector such as Zambia is, the national budget must act to place employment creation at the centre of the macroeconomic framework, not as a residual of it. Unfortunately, the strategy for employment generation in the 2006 budget is, at best, unclear. This is worrying. CSPR urges government to adopt a more direct and integrated approach to employment promotion in order for more people to share in the benefits of growth. We want to see employment creation as one of the key macroeconomic objectives in this budget and subsequent ones.

III Budget Expenditure Measures

Education and Health

Looking at expenditure measures, particularly as they relate to the pattern of expenditure by function, CSPR welcomes the 2006 budget proposition to spend 30 percent of the budget on the social sectors. However, when looked at from a normative perspective, it is the case that social sector allocations are still falling below internationally agreed norms. For instance, taking the health sector as a point of reference, the Abuja Commitment to which our Government is a signatory stipulates an allocation to the

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[2] Budget Address (2006:11)
[3] Budget Address (2006:11)
[4] CSPR (2005). *Fifth National Development Plan for Zambia, 2006 -2011: A Civil Society Perspective*. CSPR: Lusaka.

health sector of not less than 15 percent of the total budget. Comparing this with the 10.7 percent the health sector has received in the 2006 budget; it becomes clear that there is still need to do better.

The 800 medical personnel earmarked for recruitment in 2006 is too infinitesimal, especially when it is considered that the newly launched strategic plan for the Human Resources in Health informs that the manpower deficit in the health sector is in the range of over 20,000. Certainly health and education allocations are still falling short of desired levels.

Anyhow, the consolation presents itself in the noticeable increase in the share of the health and education sectors in the discretionary component of the budget. Evidently, the percentage share of the education sector in the discretionary budget has risen from 24 percent in 2005 to about 27 percent in 2006. Similarly, the percentage share of the health sector in the discretionary budget has increased from 12 percent in 2005 to 18 percent in 2006. Obviously, this upward movement constitutes an important signpost that points to the efficacy of getting national priorities right and telling. This can only mean well, especially if the pattern is sustained.

Social Protection

The allocation to social protection at less that 1 percent of the total budget is inadequate. This needs to be raised to at least 2 percent of the total budget. The reality in Zambia is that many households are falling in destitution from which they are unable to recover without assistance. Addressing vulnerability is, therefore, an integral part of addressing poverty. CSPR therefore urges government to show greater commitment to poverty reduction by allocating more resources to social protection. This will enable vulnerable groups such as the elderly, orphans and the disabled access social services.

Agriculture

In the agriculture sector, CSPR is concerned that the proposed expenditure of 5.7 percent of the total budget fall short of the Maputo commitment to allocate not less than 10 percent of the total budget to the agriculture sector. In the same vein, CSPR urges government to review the Fertilizer Support Program (FSP) in line with its intended objectives. The FSP has taken up around 30 percent of the entire agriculture budgetary allocation but there is very little impact in terms of reducing food shortages, increasing household income and reducing poverty.

General Public Services

Within the context of budget expenditure, CSPR is concerned that the budget line called General Public Services, which, has taken up about 41 percent of the total budget, remains vague about its actual composition. Our recommendation is that this budget line’s composition must be made more explicit.

Youth Empowerment

With respect to youth empowerment, CSPR commends government for the K40 billion allocations to youth empowerment programmes in the 2006 budget. Indeed, youth in Zambia have been disempowered for far too long and it is refreshing to see that government is coming up with specifically youth targeted measures.

Roads

The allocation of K904.5 billion to roads in the budget is welcome. However, CSPR's view is that there are a number of challenges currently facing construction and upgrading of roads in the country. These include poor workmanship largely resulting from contracting persons without sufficient knowledge and equipment in road construction; wrong timing (e.g. awarding contracts during the wet season), late disbursement of resources; among others. Our view is that if these constraints are not addressed, government will continue spending tax payers’ money in a bottomless pit, especially in rural areas.

IV Tax Regime: Where's the Equity?

Regarding tax measures in the budget, CSPR's reaction is specific to three principle areas of concern, namely, the income tax exemption threshold, the Pay As You Earn (P.A.Y.E) and the V.A.T on agriculture products. Noticeably, the 2006 budget has proposed to increase the current exempt threshold of P.A.Y.E from K280, 000 per month to K320, 000 representing a 14 percentage point increase. The contention of CSPR is that the proposed increase in the exempt income from K2800,000 to K320,000 per month is too insignificant to provide meaningful relief to the working population.

The reasons would be clear and well understood. First, the increase in the income tax exempt threshold does not account for the erosion due to inflation that closed the year at 15.9 percent. Second, the increase in the threshold of exempt income does not relate to the reality of the minimum amount required to afford a monthly food basket or indeed the poverty line as defined by both the Jesuit Centre for Theological Reflection(JCTR) and the Central Statistics Office (CSO).

The contention here is that the basis for the income tax exempt threshold must be linked to objective criteria that must exempt from tax income levels equivalent to the minimum amount of money required to meet basic needs of a Zambian household of an average size.

Our specific recommendation, therefore, is that the threshold of tax-exempt income should be increased to at least K500, 000. This increase will effectively exempt income levels below the poverty line as defined by both the Jesuit Centre for Theological Reflection (JCTR) and the Central Statistics Office (CSO).

On the proposed structure of tax income bands, the announced budget change offers less than significant tax relief. For instance, the announced changes mean that a 35 percent rate will apply to incomes above K1.1m per month; and a top rate of 37.5 percent will apply to incomes above K5.7m per month since the budget has maintained the existing personal tax rates of 30 percent, 35 percent and 37.5 percent for low, middle and higher income categories, respectively. Table 2 shows current and proposed income bands and respective tax rates.

Table 2: Proposed 2006 Tax Structure

Current Rates Per Annum	Proposed Rates Per Annum
First K3, 360,000 per annum @ 0%	First K3, 840,000 per annum @ 0%
Next K8, 640,000 per annum @30%	Next K9, 858,240 per annum @30%
Next K48, 000,000 per annum @35%	Next K54, 768,000 per annum @35%
Above K60, 000,000 per annum @ 37.5%	Above K68, 466,240 per annum @37.5%

<u>Source</u>: ZRA Tax Advice Centre

This means that the majority of the working population will not benefit from efforts at tax relief. Besides, the nature of the existing tax structure implies that the heavier burden of tax will fall on low-income categories compared to high-income groups within the personal income tax net. This can never be fair. Where is the equity?

Overall, the proposed personal tax rates are certain to have adverse implications for the productivity of workers. Indeed, there is irrefutable evidence that there is a close link between the tax system and a nation's productive capacity. In labour dependent countries such as Zambia, the link between the tax system, worker remuneration, economic growth and poverty is critical. More worker effort means more output, more output means more savings and more profit. This in turn means more growth and less unemployment and less poverty. The converse is true: higher taxes means less effort and less incentive to invest in productive assets (including labour) and less growth. In the ultimate, this means less growth than is possible and more unemployment and more poverty.

Besides, the effects of a destructive tax system can also be seen in terms of corruption, poor service delivery which ultimately lock the country into a vicious cycle of poverty and underdevelopment. Our recommendation is that the entire P.A.Y.E regime must be restructured to comply with the canons of equity. Otherwise, cosmetic tax relief measures can only feed more rent seeking and fraud.

CSPR is also concerned that capturing of animal products; milk, fish, agricultural supplies and products in the value added tax (VAT) net will negatively affect small scale farmers. Small farmers will not be able to claim VAT on their inputs because they are not VAT registered, which means that they will pay more for farm inputs and supplies. In turn, food prices will rise thereby hampering accessibility for the majority of ordinary citizens. Inevitably, the measure to standard rate animal products, milk, fish, agriculture supplies and products will negate efforts at poverty reduction. CSPR urges government to re-look at this tax measure in the interest of both consumers and producer.

V Summary Recommendations

To ensure that the 2006 budget benefits many and meets the expectations of the poor and needy, CSPR makes the following recommendations:

- i) There should be substantial redistribution of expenditures in favour of poverty reducing programmes and activities. Thus, allocations to health, education and social protection must be raised up. Within this context, the budget allocation to defence must be reduced;
- ii) Employment creation must be adopted as one of the macroeconomic objectives with clearly quantifiable outputs for the year - end;
- iii) Government must act to bring down interest rates consistent with the declining trend in the inflation rate;
- iv) The income tax exempt threshold must be increased to K500, 000 per month in line with the poverty line as defined by both JCTR and CSO;
- v) Government must consider scrapping off the standard rating of animal products, milk, fish, agricultural supplies and agriculture product for VAT purposes in order to protect the small scale farmers and consumers;
- vi) Government must consider restructuring the entire Pay As You Earn (P.A.Y.E) income tax regime to make it more equitable and productive.

VI Conclusion

The 2006 Budget provides a unique opportunity for the country, as it is the first post HIPC Initiative budget. CSPR urges government to reflect total commitment to disbursement towards poverty reduction since poverty reduction was central to the attainment of HIPC completion. This year's Budget is, for CSPR, a litmus test as to how government is going to plough savings from the HIPC Initiative. CSPR looks forward to effective implementation of the 2006 Budget. This should be reflected in timely release of social sector allocation and full disbursement of budgeted resources for poverty reducing programmes. We urge Government to continue pursuing public expenditure reforms that promote transparency, accountability and prudence in the usage of public resources. Government should also stay the course on macroeconomic stability.

Lastly, while the Budget may have been well crafted, it is the actual implementation that is vital to eradicate poverty. A moral and committed approach to poverty reduction can begin to manifest itself in Zambia if the 2006 Budget can truly act to ***Rank Poverty Eradication First!***

Delivered by

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