How Erratic Tax Policies Are Impeding Revenue Mobilization in Zambia

Ramos Emmanuel Mabugu and Eddie Rakabe

Abstract

This case study assesses whether Zambia's tax and fiscal policies have been impeded by political and technical constraints. Tax policy is a deliberate—yet intricate—process requiring not just well-measured choices, but also stability. Zambia has undertaken several tax reforms that have included broadening the tax base, establishing a revenue collection agency, and introducing a value-added tax (VAT). A careful examination of developments over the last two decades shows that the process has since been characterized by seemingly unending and erratic tax policy changes. The single most important factor driving this instability is the exemption of the mining sector. The exemption has its roots in how the country handled the privatization process. This has been accentuated by fierce political disquiet over the leniency and the opaque manner with which the sector is treated in tax policy. Incessant tax policy changes designed to rectify this have done little to improve revenue mobilization. What Zambia needs is decisive action on a number of fronts, including consensus-building for balanced minerals benefit schemes; tax stability and predictability; tax expenditure policy reform guided by an explicit benefit cost assessment; direct address of the perverse influence of politics on fiscal policy; and political commitment to further entrench VAT policy and increase both its elasticity and administrative efficiency.

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How Erratic Tax Policies Are Impeding Revenue Mobilization in Zambia

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Foreword

The mineral wealth of Zambia's economy has provided a steady source of income, jobs, and growth over the last 20 years. But at the same time, the lack of social consensus on how to allocate mineral proceeds among mineral company interests and the state have been an ongoing source of volatility. Despite an impressive spurt of economic activity in the middle of the first decade of this century, and respectable sustained growth in recent years, tax revenues have stagnated at about 15 percent of GDP since 2000. Repeatedly Zambia has attempted to boost tax revenues through a variety of tax reforms that have included broadening the tax base, establishing a revenue collection agency, and introducing a value-added tax (VAT). But the reform process has been erratic, characterized by frequent changes or reversals in policies. The most recent example of a policy reversal is a 2018 proposal to eliminate the largely successful VAT in favour of a sales tax, which has now been replaced by a 2019 proposal that argues for keeping a reformed VAT.

The fundamental source of instability in the fiscal system, however, has been the lack of social consensus as to how to tax the mining sector. The broad exemption of copper and cobalt mining from the tax net has its roots in the initial socialization of the mining industry after independence and how the country handled the privatization process forced by global competition in the late 1990s. This has been accentuated by social disquiet over the leniency and opacity regarding the mining sector's taxation. Shifting political dynamics have resulted in seemingly incessant tax policy changes designed to rectify mining taxation, but in the end doing little to improve revenue mobilization.

Zambia has increased its expenditures on health and education from 3 percent of GDP in 2005–07 to 9 percent of GDP in 2015–17. However, Zambia has borrowed aggressively, after receiving debt relief in 2005, and its debt burden has grown substantially; debt service payments now amount to almost 8 percent of GDP. The government wage bill far exceeds its expenditure on goods and services to support its people, as in other developing countries.

This study on the impediments to tax policy changes, revenue mobilization, and expenditure has been carried out by Ramos Emmanuel Mabugu and Eddie Rakabe. It is one of the five country studies (of which four are from sub-Saharan Africa) commissioned by the Center for Global Development to go deep into the political and institutional constraints to raising more revenues domestically. Mabugu and Rakabe take a detailed look at how the lack of political consensus over the control and management of mining assets has had a broader impact on the stability and growth of the revenue system and impeded a more rapid growth in provision of needed social services to the citizens of Zambia. The lessons Mabugu and Rakabe draw will be of interest to students of development economics and public finance elsewhere.

Sanjeev Gupta Mark Plant

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Abbreviations

ATaF	African Tax Forum
CIT	Corporate income tax
DA	Development agreements
DTA	Double taxation agreements
GDP	Gross domestic product
HIPC	Highly indebted poor countries
IMF	International Monetary Fund
NDP	National Development Plan
ODA	Official development assistance
PAYE	Pay-as-You-Earn
PIT	Personal income tax
PRBSP	Poverty Reduction Budget Support Program
SDGs	Sustainable Development Goals
SSA	Sub-Saharan Africa
VAT	Value-added tax
ZCCM	Zambian Consolidated Copper Mines
ZDA	Zambian Development Agency
ZRA	Zambian Revenue Authority

1. Introduction

This study looks at Zambia's economic performance, its fiscal dynamics, and factors that impede tax revenue collection. The study focuses on whether tax and fiscal reforms have been impeded by political and technical constraints. The study is structured as follows: Section 2 briefly reviews recent macroeconomic developments, focusing on how general macroeconomic developments have likely had an effect on fiscal development. Section 3 reviews revenue and expenditure developments more closely. Section 4 dwells at length on political, institutional, and technical constraints to raising domestic revenues. Section 5 looks at the issue of spending quality and capacity-building support by development partners. Section 6 provides a summary and draws key policy implications.

When Zambia attained independence from Britain in 1964, it inherited a dualistic economy with a heavy reliance on the mining sector for government revenue, foreign currency, and employment. Immediately after independence, the country enjoyed the status of being the world's largest copper producer, which enabled it to accumulate resource rents made possible by high copper prices. Buoyed by its dominant position on world copper markets, Zambia embarked on nationalizing the mining sector. This was a departure from the thinking that had swayed in favor of state intervention in the economy, which was, in part, based on Keynesian ideas and planning under the former Soviet Union. Subsequently, a combination of colonial legacy problems, decline of copper prices, unbridled government borrowing, and poor economic management led to protracted economic underperformance. The significant increase of crude oil prices by the Organization of Petroleum Exporting Countries (OPEC) in 1973 was a major turning point. The relatively high cost structure that had come to be associated with mining under the nationalization regime prioritized job security and financing development and eroded profit imperatives. Production and profitability then declined, with countries such as Chile and the United States gaining a higher copper market share at Zambia's expense. This severely hurt the country's tax mobilization efforts.

Over the years that followed, the Zambian government initiated far-reaching tax administration reforms, as well as structural reforms. On the tax policy side, these reforms included broadening the tax base, establishing a revenue collection agency, and introducing a VAT in 1996, among other measures (Fagernas and Roberts 2004; Gumede 1999). On the structural reform side, a far-reaching intervention, with an impact on revenue mobilization, was the privatization of state assets, in particular mining assets. Despite the reforms, however, tax revenue collection has never recovered to the high levels experienced in the 1970s and instead has stagnated at an average of 14.4 percent of gross domestic product (GDP) since 2000. This is even after Zambia successfully raised its average annual economic growth rate. With one of the highest poverty and inequality levels in the world, Zambia is in peril, and it is clear that tax revenues are not growing fast enough to enable it to grow sustainably.

A major impediment to Zambia's growth is its substantial variability of tax policies. At the heart of the unstable and extreme tax and spending policies is the destruction caused by privatizing mining assets and the high degree of political fragmentation. These have led to haphazard tax changes (especially mining taxes); negation of tax administration challenges; and the funneling of state benefits to urban areas or favored constituencies, which in turn has contributed to poverty and income inequality. Such outcomes reflect studies that find that political fragmentation affects both fair distribution of public goods and income redistribution and stabilization (Gaspar et al. 2017). Indeed, there is consensus that politics has been at the center of Zambia's efforts to readjust its tax and fiscal policy regime. Bates and Collier (1993) have, in the past, argued that adjustment programs in the country regularly broke down because of domestic politics but also because of Zambia's extreme debt burden (Andersson et al. 2000). More recently, risks of losing closely contested elections in settings with two dominant political parties have shown that Zambia prefers the status quo, especially on issues such as mining tax policy (Fritz 2009; Taylor and Simutanyi 2007). Often, this further damages efforts to boost tax capacity and improve revenue collection.

2. General Macroeconomic Background

Macroeconomic development can influence tax revenue mobilization, both directly and indirectly, and Zambia has managed to achieve reasonably good economic growth in the first two decades of the 21st century. Table 1 shows status and progress in the last two decades, using, wherever possible, the reference period 2000–2003 and the current period 2014–2017. The analysis does not account for uneven performance triggered by the global financial crisis of 2008–2009. Like many other sub-Saharan African (SSA) countries, Zambia has performed quite well in terms of real economic growth, inflation reduction, and macroeconomic stability during the period shown, when compared to the 1980s and 1990s. GDP per capita (US$ PPP) rose from US$2,183.00 per year, on average, during 2000–2003, to US$3,644.30 per year, on average, during 2014–2017, an increase of 66.9 percent. Growth in real GDP per capita decelerated from 2.3 percent to 0.6 percent between the two periods, a fall of -1.7 percentage points during the 2014–2017 period, compared to the 2000–2003 period. A similar deceleration trend is visible in real GDP growth, falling from 5.2 percent per year during 2000–2003 to 3.7 percent during 2014–2017 (a decline of -1.5 percentage points over the two periods), albeit still in positive territory.

Zambia has, however, performed quite well in controlling inflation, ushering in a high degree of price stability. The high inflation rate of 22.8 percent, on average, during 2000–2003 was reduced substantially during 2014–2017, to reach 10.6 percent, a decline of -12.2 percentage points over the two periods. Even the current account balance improved quite significantly, by 13.1 percentage points, over 2014–2017, compared to 2000–2003. That is, it grew from -16.4 percent to -3.4 percent before and during 2014–2017.

Table 1. Macroeconomic indicators

Metrics	Source	Reference period	Economic crisis period		Recent period	Change between periods (averages 2000–2003 vs. 2014–2017)	
		Average 2000–2003	2008	2009	Average 2014–2017	Value	Unit
GDP per capita (USD, PPP)	WDI	2 183.0	2 881.8	3 060.1	3 644.3	66.9	%
Real GDP per capita growth (%)	WDI	2.3	4.8	6.2	0.6	-1.7	pp
Real GDP growth (%)	WDI	5.2	7.8	9.2	3.7	-1.5	pp
Inflation, consumer prices (%)	WDI	22.8	12.4	13.4	10.6	-12.2	pp
Current account balance (% of GDP)	WDI	-16.4	-3.3	6.0	-3.4	13.1	pp
Official development assistance (% of GNI)	WDI	18.5	6.8	8.5	4.1	-14.4	pp
Central government debt, total (% of GDP)*	WDI	20.8	..	..	39.3	89.4	pp
Primary fiscal balance (% of GDP) *	ASY	3.7	..	..	6.4	2.7	pp

Sources and legends: ASY: African Statistical Yearbook; WDI: World Development Indicators; pp: percentage point; * Calculation from years different from 2001–2003 and 2014–2017 from the ASY and WDI database.

Official development assistance (ODA), as percentage of gross national income, declined from 18.5 percent during 2000–2003 to 4.1 percent during 2014–2017, a decline of -14.4 percentage points, respectively. This indicates that Zambia's dependence on ODA has declined over time, which in normal circumstances could be perceived as a good thing, as it may indicate increased state sovereignty. However, this raises the need for an even greater push for domestic revenue mobilization. Due to sustained fiscal consolidation, Zambia's fiscal deficit narrowed considerably, especially in the initial period. However, the primary fiscal balance, as a percentage of GDP, increased from 3.7 percent per year during 2011–2013 to 6.4 percent during 2014–2016, an increase of 2.7 percentage points over the two periods.

Two factors have been responsible for the growing fiscal deficit since 2012. The first is the rise in the wage bill, driven by a 45 percent nominal wage hike for public sector workers in 2013, against a budgeted increase of 9 percent (IMF 2013). The second was the scale-up of public infrastructure spending. Zambia has increased its reliance on non-concessional foreign borrowing in recent years to finance many large infrastructure projects, and this is now contributing to faster debt buildup and debt servicing payments. As Table 1 shows, central government debt as a percentage of GDP rose dramatically, from 20.8 percent per year during 2011–2012, to 39.3 percent during 2013–2015, an increase of 89.4 percentage points within a five-year period.[1,2]

Despite broadly positive macroeconomic developments in the last two decades, especially in comparison to the 1980s and 1990s, Zambia's poverty and inequality rates have remained persistently high, however, at more than 50 percent since 2000 (Central Statistical Office 2018a). Income inequality in Zambia is among the world's highest, when measured by the Gini coefficient, standing at 69.0 percent in 2015. On the other hand, 58 percent of Zambia's 16.6 million (2015) people earn less than the international poverty line wage of $1.90 per day, which is considered an indicator of extreme poverty (compared to 41 percent across SSA), and three quarters of these people live in rural areas (Central Statistics Office 2018a). Zambia thus requires substantial resources in order to reduce poverty. This is in line with the United Nations (UN) Sustainable Development Goals (SDGs), to which Zambia is a signatory. With debt levels on the rise, and external financing increasingly hard to come by, mobilizing domestic resources is critical for tax revenue collection.

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[1] Note here that we use different comparison periods, as well as sources of data, due to the absence of data from the WDI source for the relevant periods of interest.

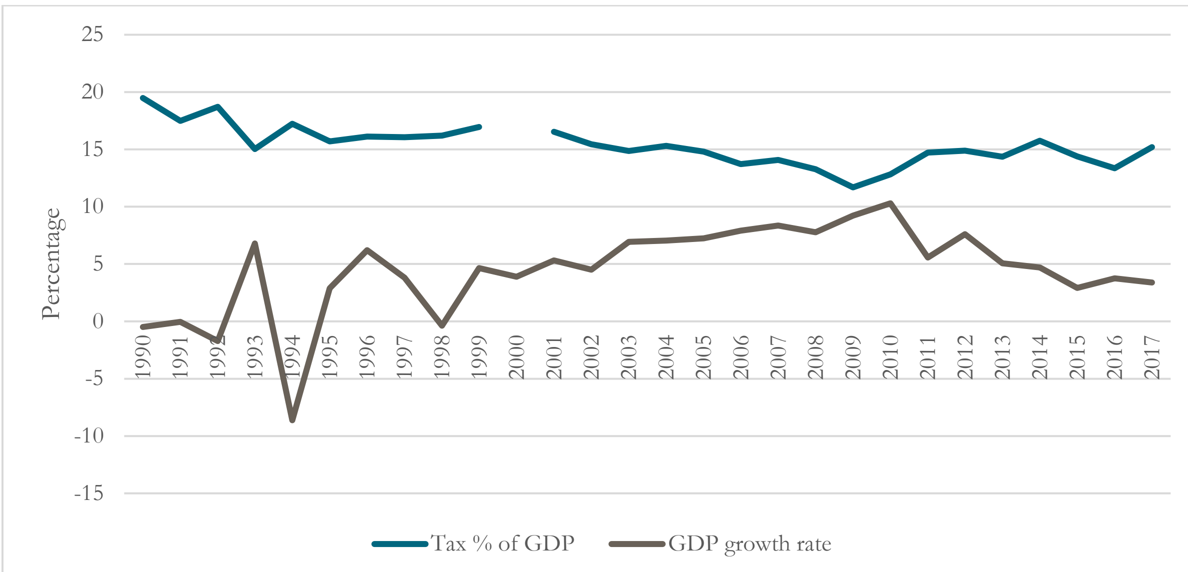
[2] Another contributory factor to debt increases is the low domestic saving rate.

3. Revenue and Expenditure Developments

3.1 Revenue Trends

Tax resource mobilization in Zambia has stagnated just below 15 percent of GDP since 2000. As Figure 1 shows, the tax ratio has fallen from a peak of 30 percent in the late 1970s, and an average of about 20 percent in the 1990s.

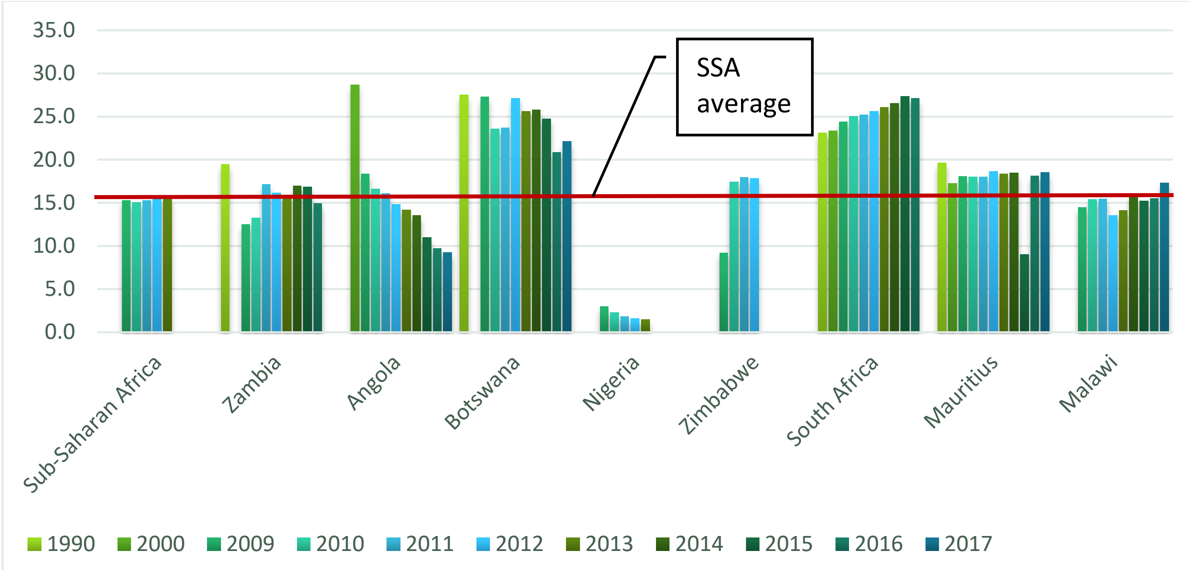
Figure 1. Tax as percentage of GDP



Source: World Development Indicators

Figure 2 shows Zambia's tax collection efforts against SSA and selected countries with similar levels of per capita GDP, as well as against neighboring countries. Zambia's gradual decline in its tax-to-GDP ratio is seemingly converging with the rest of SSA, departing from the pre-reform period, in which the country's tax intake was higher than the average for SSA. Tax revenue mobilization in Zambia is now well below the collection rates observed in the neighboring countries of Botswana, Zimbabwe, and South Africa.

Figure 2. Tax revenue as a percentage of GDP—sub-Saharan Africa comparison



Source and legend: IMF data and author's calculations; SSA = sub-Sahara Africa

To counter falling tax ratios, the Zambian government initiated tax administration reforms starting in the early 1990s. An independent revenue agency, the Zambian Revenue Authority (ZRA), was established in 1994 with the aim of modernizing and streamlining revenue collection and curbing tax evasion (von Soest 2006). Zambia was second only to Uganda in establishing such a semi-autonomous revenue administration authority. Despite Zambia's economic fortunes taking a positive turn after 2000, and efforts to modernize revenue collection, its average tax-to-GDP ratio between 2000 and 2017 remained stagnant, averaging about 14.4 percent. This fell short of the ambitious target of 22.6 percent, set out in the country's sixth National Development Plan (6NDP). The plan, which spanned from 2013 to 2015,[3] subsequently lowered the target to 18 percent in the seventh National Development Plan (7NDP), which spans from 2017 to 2021. This ratio is also below par, as it has been empirically found that countries that reach a threshold of 15 percent of the tax-to-GDP ratio experience higher growth and development (Gasper et al. 2016).

Table 2 clearly shows that reforms on revenue collection have had a muted effect on actual revenue collection. The proportion of total revenue and tax-to-GDP has actually declined by one percent over the two periods compared, 2003–2005 and 2015–2017.

[3] The seventh National Development (7NDP) Program claims that the tax-to-GDP ratio between 2011 and 2015 ranged around 17 percent per annum (Ministry of Finance 2014).

Table 2. Revenue trends (%) (consolidated for center and states, subject to data availability)

	In relation to GDP (%)		In relation to total revenue (%)	
	Mean		Mean	
	2003–2005	2015–2017	2003–2005	2015–2017
Revenue	21	20	-	-
Tax revenue	15	14	71	72
Income tax	7	7	31	34
PIT	6	4	26	22
CIT	1	2	6	9
Tax on payroll	-	-	-	-
Property tax	-	-	-	-
Tax on goods and services	6	6	30	33
General tax on goods and services (VAT)	4	5	21	24
Excise taxes	2	1	9	7
Trade taxes	2	1	9	5
Grants revenue	5	2	27	11
Non-tax revenue	0	3	2	17

Data source: IMF

Zambia's total revenue is made up predominantly of taxes, with an average contribution of 71 percent in 2003–2005, while grants and non-tax revenue accounted for 27 percent and 2 percent, respectively. The tax component of total revenue mainly comprises direct income taxes, which accounted for 34 percent, and goods and sales taxes, which accounted for 33 percent in 2015–2017, a rise from 31 percent and 30 percent, respectively, in 2003–2005. Within both the income tax and goods and services tax categories, personal income tax (PIT) and VAT accounted for the largest share. The two taxes constituted 4 percent and 5 percent of GDP, which was comparable to the rest of the SSA countries. However, the proportion of PIT to GDP and total revenue showed a gradual decline from a share and contribution of 6 percent and 26 percent in 2003–2005 to 4 percent and 22 percent in 2015–2017. This is yet another anomaly of Zambia's tax collection performance, in that the marginal PIT rate has increased from 35 percent to 37.5 percent while formal public employment has increased. What appears to be stalling PIT growth is the prevalence of informal employment, relative to formal employment, estimated at 58 percent of total employment (Central Statistics

Office 2018b). DiJohn (2010) also notes that Pay-as-You-Earn (PAYE) receipts are generally concentrated at the top decile of highest earners, representing 48,000 employees and contributing almost 68 percent of PIT revenue.

Whereas the PIT share of tax revenue shows a steady downward trend, corporate income tax (CIT) is depicting signs of recovery, as illustrated by a slightly increased average contribution to total revenue between 2015 and 2017—from 6 percent to 9 percent. Much of the Zambian CIT base was eroded during the privatization process (1998–2000), which resulted in Zambia's government instating a lower mining tax in order to satisfy debt relief conditions and encourage investment through generous tax holidays. Declining CIT rates are consistent with the developments that have swept across SSA since the 2000s, in which countries lowered the average CIT rates by more than 5 percent (IMF 2018). As a proportion of GDP, Zambia's CIT receipts have grown from 1 to 2 percent, but remain visibly below the SSA average of 3.5 percent (IMF 2017). This is because Zambia exempts the largest export sector in the economy (mining) from the tax base, and also because of Zambia's narrow CIT tax net—only the top 350 companies are responsible for 77 percent of tax receipts. Losses incurred by mining companies because of investment write-downs also have been carried forward over many years, thus reducing taxable profits. DiJohn (2010) estimates that mining companies paid no income tax between 2000 and 2006, and only contributed 5 percent of total taxes, despite being the largest sector in the economy.

VAT has shown a slight improvement in performance, with a GDP share of 5 percent growing to 6 percent between the two periods being compared. VAT growth is partly due to a high contribution by the wholesale and retail sectors to GDP; but VAT also has been suppressed by the prevalence of informal trading activities, as well as by VAT exemptions to mining companies.

In contrast, the contribution of both excise and trade taxes to total revenue is on the decline. Reductions in trade taxes were set in motion by general import tariff reductions in the 1990s, undertaken as part of trade liberalization. The reduction is also partly due to custom duty exemptions given to mining companies. Unlike many other low-income SSA countries that held on to trade taxes as key source of revenue, however, Zambia has been able to abate the fiscal consequences of trade liberalization by diversifying its tax sources (DiJohn 2010).

The grant component of total revenue has diminished over time, to 11 percent in 2015–2017. This is due to both declining donor interest and modernization of resource mobilization instruments. It also is due to the fact that grant revenue is generally erratic, unpredictable, and largely dependent on meeting stringent debt relief conditions (Fagernas and Roberts 2004). Substantial foreign aid contribution to total revenue in the early 2000s has not deterred domestic revenue mobilization efforts, however, as has been the case with other grant dependent SSA countries. The Zambian government has found a replacement in non-tax revenue sources, which increased from a small contribution of 2 percent between 2003 and 2005 to 17 percent in 2015 to 2017. Non-tax revenue is made up of mineral royalties, skill levies, insurance premiums, fees, fines, and service charges.

Historically, given the large presence of mining in the country, the Zambian government has received little fiscal revenue from it. A number of studies (Lundstøl and Isaksen 2017; DiJohn 2010; Jibao 2016) indicate that mining contributions have performed below expectation for an economy, which until the 1990s, depended largely on copper taxes. Coming from a very low contribution rate, recent estimates suggest that mining contributions to revenue started to increase in 2010, and reached 28 percent of Zambia's total revenue in 2015 (World Bank 2016). Despite the increase, however, concerns remain about transfer pricing or illicit transfers and lost revenues from the sector (Readhead 2016).

The shift away from resource rents does not seem to have significantly affected the performance of non-resource domestic revenue. Instead, sporadic changes to mining taxes may have boosted the ability of revenue administrators to predict revenue and project taxes. Mining taxes have changed eight times between 2008 and 2016 (World Bank 2016), due to a combination of ongoing industrial and political bargaining and low global copper prices. This was true especially in 2014, when macro instability, privatization, and debt swap conditions occurred as a result.

Following the dire macroeconomic situation that prevailed in the early 1990s, Zambia was forced into taking out structural adjustment loans and privatizing its debt-ridden copper mines. In return for assuming the industry's debt and reviving the mines, foreign mining companies, together with selected political elites, managed to solicit generous tax bargains. To this day, these measures continue to stir abrupt tax policy changes and renegotiation of fiscal terms. At the inception of privatization, for instance, mining royalties were set at 0.06 percent of gross value. This was increased to 3 percent in 2007, 6 percent in 2012, and 8 and 20 percent[4] in 2015, before being lowered again to 6 percent the same year. Similarly, the CIT rate was reduced from 40 to 35 percent in the early 1990s, and then dropped to 25 percent as part of the mining sector reductions, before it was once again increased to 30 percent in 2007—the rate at which it currently remains. (See Box 2 and Table 4 for further discussion and illustration on tax policy changes.) The hike in mining royalty taxes was an attempt by the Zambian government to circumvent the profit-based tax system and instead funnel revenue into an ad valorem-based system that would purportedly offer transparency.

Structural transformation of the Zambian economy has been slow (Mulungu and Ngombe, 2017), notwithstanding the structural reforms that were implemented between the late 1980s to late 1990s,[5] and has only changed marginally since the first 10 years of the 21st century. Major structural shifts have largely shown up in the declining share of the mining sector's contribution to Zambia's GDP. Another manifestation of structural transformation, as noted in Resnick and Thurlow (2014), has been the shift of employment away from agriculture into more productive sectors, including informal urban trade, where the direct tax net cannot reach. These changes did not affect much overall tax revenue performance, as can be seen from Table 2. Instead, the commodity booms of the early 1990s and 2000s seem

[4] Eight percent for underground and 20 percent for open cast mines.

[5] By structural transformation, we refer to the movement of economic activity from the least productive sectors toward the most productive sectors.

to have countered the structural transformation trajectory through currency appreciation that, by extension, thwarted exports and curtailed the growth of agriculture and manufacturing activities. The result of this dire macroeconomic climate can be deduced from the sluggish growth in the CIT.

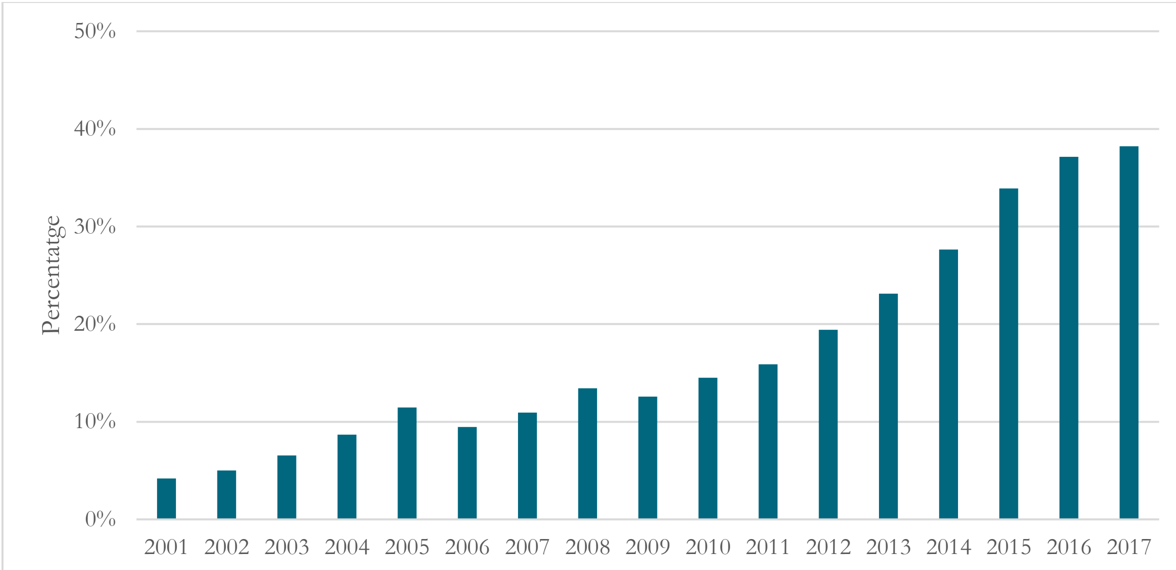
To conclude this section, it is quite evident that a large proportion of Zambia's budget is funded by tax revenue. The tax growth trajectory and its composition show a country that has been attempting to reduce its tax burden, especially in trade and personal income taxes. It is clear, however, that tax ratio stagnation exists amid high economic growth, and that tax base erosion has occurred, either through evasive practices or through ill-considered erratic tax policies and tax incentives in the mining sector. While DiJohn (2010) attributes the general decline in tax intake to the government's conscious decision to lower the tax burden, other factors, such as erratic tax policies; tax administration challenges; the changing structure of the economy; and structural adjustment reform conditions that imposed reductions on copper mining taxes also contributed to the decline. The tax ratio outcome contrasted sharply with the rapid economic growth period experienced in the early part of the 21st century, and with measures taken during that period to broaden the tax base (Jibao 2016; Gray and Chapman 2001).

3.2 Expenditure Trends

Zambia's economic classifications of public expenditures consist of goods and services; personnel costs; interest payments, or debt service costs; social benefits; and capital expenditures.[6] Other outlays comprise expenditure items as wide-ranging as financial restructuring, food reserves, fertilizer support, and contingencies. Figure 3 illustrates the trajectory of aggregate expenditure in comparison to GDP from 2001 to 2017. Total expenditure, as a percentage of GDP, grew from a very small base of just under 4 percent in 2001, and grew eightfold in 17 years to reach 38 percent in 2017. This shows the mismatch between public spending and the capacity of Zambia's economy to support such spending. Rapid growth in expenditure, however, also reflects the government's desperate attempt to address underdevelopment, especially given the poor socio-economic conditions inherited from President Kaunda's tenure. Large expenditure growth has occurred because of rising public debt, and has been fueled, in part, by the exchange rate deterioration (IMF 2017).

[6] Note that Fagernas and Roberts (2004) are of the view that Zambia's expenditure classification is not rigorous and, as a result, some of the expenditure categories may be overly distorted. For instance, a social benefits allowance for government employees is classified separately from compensation of employees, and capital expenditure may include salaries and wages for donor-funded projects.

Figure 3. Aggregate expenditure as percent of GDP (local currency)



Sources: IMF and World Economic Indicators

Table 3 expresses the size of each expenditure line item, both as a proportion of GDP and in relation to total expenditure for the two periods spanning 2001–2003 and 2015–2017. As can be seen, the average shares of all expenditure items to GDP increased rapidly over the 17-year period, with the exception of social benefits. Compensation of employees' share in GDP grew the fastest, from 2 percent between 2001 and 2003 to 14 percent between 2015 and 2017. It also accounts for a bigger share of total expenditure, followed by goods and services, then capital spending, respectively. In the period 2001–2002, personnel costs averaged 43 percent of total spending, but this has since been reduced to 39 percent in the period 2015–2017, which is still very high.

The marginal reduction in salaries, relative to total spending, was achieved through structural adjustment imposed on wage policy reforms in the late 2000s. Other measures contributing to the reduction included a wage freeze between 2014 and 2015, recruitment restrictions on all but frontline staff in 2015, and a cleanup of the payroll, implemented during 2015–2017 (Nalishebo and Muleya 2018; IMF 2017). These efforts had minimal overall effect, as Zambia's share of the wage bill to total spend still remains one of the highest, relative to its peers in SSA (IMF 2017). Also, the 45 percent nominal wage hike for public sector workers in 2013, against a budgeted increase of 9 percent, is largely responsible for negating efforts at reigning in the wage bill.

Table 3. Expenditure trends (%)

	In relation to GDP		In relation to total expenditure	
	Mean		Mean	
	2001–2003	2015–2017	2001–2002	2015–2017
Outlays on goods and services	1	9	23	25
Compensation of employees	2	14	43	39
Interest payments	1	8	18	21
Social benefits1/	0*	1	2*	2
Capital expenditures	3*	8	21*	21
Other outlays	3*	1	26*	27

Source and legend: World Economic Indicators; *2007–2009; 1/Includes mainly government employees' pension contributions.

Debt and accompanying service costs remain one of Zambia's foremost macroeconomic risks. This is despite Zambia's having benefited from the highly indebted poor countries (HIPC) and multilateral debt relief initiatives that left the country almost debt-free in the mid-2000s, after a debt level of more than 120 percent of GDP in 2005. However, a decade or so later, and after Zambia attained the HIPC completion point in 2005, the Zambian government has again accumulated new debt amounting to 39 percent of GDP. This growing public indebtedness is fueled not only by domestic debt but also by external debt, as both categories have risen. According to Smith et al. (2016), non-concessional external borrowing more than doubled from 8.3 percent of GDP in 2011 to 17.9 percent in 2014, as the government issued a Eurobond in 2012 for US$750 million, a second in 2014 for US$1 billion, and a third in 2015 for US$1.25 billion. The proximate factors that have contributed to the debt buildup include the global financial crisis, the 2014 terms-of-trade shock, large infrastructure spends amid rapidly growing urban populations, and institutional weaknesses.

Inherent problems of weak governance, along with weak institutions and limited accountability, have likewise not assisted with curbing unwarranted public debt increases. The country has a loans and guarantees act to put safeguards on the acquisition of public debt, and authority to borrow outside a set limit rests with Parliament. Since 2012, the debt limit (with Parliament approval) has been adjusted upward three times to accommodate each of the Euro bond issues. This could indicate that Parliament has been gracious in granting that permission, or it could mean that Parliament lacks the technical prowess to understand or factor in the implications of its decisions on spending and debt requirements. As argued by Alesina and Perotti (1996), a fiscal council in such situations would be crucial for prudent fiscal policy, especially in the presence of such political fragmentation as exists in Zambia. A credible fiscal council that would provide independent information and analysis, and that would monitor compliance with the government's legislated debt rule, would be less vulnerable to political biases in fiscal policy. Indeed, recent evidence points out that countries with stronger budget institutions have more sustainable public finances (Dabla-Norris et al. 2010; IMF 2014).

4. Political and Institutional Constraints in Raising Domestic Revenues

The international diffusion of good governance and the new public management agenda have triggered an unprecedented focus on state capability to raise revenue, the dearth of which has been a major obstacle holding back developing countries (von Soest 2006). While Zambia has had numerous tax revenue enhancement reforms since gaining independence, and while some continue to this day, it is clear that these have not been very successful in enhancing tax revenue performance. This section starts by looking at what the reforms entailed and the political environment in which they were made. It ends with looking at administrative and revenue performance issues that have imposed barriers on enhanced tax collection.

4.1 Political Constraints in Raising Domestic Revenues

Politics has played—and continues to play—a central part in Zambia's tax policy regime, and recent political maneuvers aptly demonstrate this. Zambia's fiscal regime evolves from an era in which revenue was dominated by mining royalties, and the tax system is characterized by a mixture of fixed-rate profit and revenue taxation and multi-year write-downs of investments. Following Zambia's independence in 1964 and its subsequent adoption of the one-party rule under Kenneth Kaunda, the tax agenda was part of the country's effort to break free of the colonial economic structure and enter into a modern economy able to raise revenue through diversified taxes. During the early post-independence golden years, copper accounted for as much as 94 percent of total exports and 50 percent of government revenue. The post-independence era saw the introduction of a progressive copper royalty export tax and ended with state control of copper mines, where mining rents became the main source of revenue. Mining was saddled with a very high cost structure, but it was shielded by Zambia's dominant share of the world copper market. The combined effects of higher taxes, exchange rate policy blunders, and state ownership of mines hindered investments and subsequently led to a sharp decline in copper production and minerals revenue (Lundstøl and Isaksen 2018). Subsequently, a decline of copper prices, intense competition from Chile and America for the world's copper market share, unbridled government borrowing, and poor economic management led to protracted economic underperformance. Like many other SSA countries, Zambia then went through a series of structural and institutional reforms aimed at restoring economic growth and equilibrium. During these reforms, the country relied heavily on external developments (von Soest 2006). The reforms sought to reduce state involvement in the economy (in particular privatization) and to remove restrictions on imports, banking, and exchange controls. President Kaunda, together with the one-party rule that he instated, were subsequently replaced in 1991, following a popular uprising and subsequent election of President Chiluba, which ushered in a competitive political regime.

Much of the country's tax reforms were undertaken during the long incumbency of Chiluba's Movement for Multiparty Democracy. The resulting debt crisis of the late 1990s, as a legacy from the Kaunda era, precipitated large-scale revenue reforms that began with privatizing mines and other parastatals. The privatization process coincided with exemptions from withholding taxes, customs and excise duties, and the lowering of the royalty tax and the CIT to 0.6 percent and 25 percent, respectively. With the state's waning share in mining and associated rents, government upwardly adjusted the royalty tax to 3 percent, the CIT to 30 percent, and the withholding tax on dividends to 25 percent in 2008, after renegotiating the fiscal terms signed under development agreements (DAs) (Lundstøl and Isaksen 2018). Box 1 illustrates the decisive role that privatization played in the body politic of Zambia and in subsequent erratic tax policy changes still being experienced today.

Box 1. The role of privatization in Zambia's body politic
Zambia's decision to privatize its copper mines was driven by a culmination of unavoidable economic and political factors. A combination of falling copper prices, declining mining output, and resource rents in the 1980s forced government into debt and aid dependency, thus leading to adoption of a debt relief program. Exchange rate policy blunders plunged the state-owned Zambian Consolidated Copper Mines (ZCCM) into a cost crisis, making the conglomerate one of the world's biggest money drains. At one stage, the mines were reportedly making losses of up to $1 million a day. Privatization was then introduced as a consequence of the debt crisis and formed a part of the conditions for debt relief. The Privatization Act was enacted in 1992, but it was not until 1996–97 that the Zambian government started actively disposing of assets. The delay was due to political machinations within the ruling Movement for Multiparty Democracy. A former chief executive of ZCCM was appointed to oversee the process, which to many was a signal of the state's desire to maintain political influence. The push for the sale of the assets is credited to the World Bank and the IMF's debt relief conditions that were in turn attached to broader economic reforms. The Zambian government chose the privatization route not only because of coercion from development partners but also because of the dire economic conditions caused by many years of economic mismanagement. Zambia's government could neither afford nor sustain any further delays in privatization, as ZCCM had become the dominant risk to macro stability. The precarious debt crisis position the country found itself in, coupled with the derelict state of some mines, created favorable conditions for privatization and for mines to negotiate modest tax regimes that continue to hurt tax mobilization today. Over and above privatization, Zambia had to reduce the size of its civil service, loosen interest rate controls, and eliminate subsidies in order to access financial assistance. The process of privatization evoked widespread community resentment because of job cuts and the tendency of mining firms to employ skilled expatriates.

Following successive waves of public discontent over perceived deprivation of revenue, particularly by mining companies not paying their share and by unjust distribution of wealth, tax policy took center stage in Zambia's body politic. The main opposition party at the time, the Patriotic Front, led by Michael Sata, capitalized on this and focused its electoral campaign message on reducing personal income tax. This message resonated with Zambia's urban population and boosted the party's political fortunes in the 2006 elections (Resnick and Thurlow 2014). The risks of losing elections led the Movement for Multiparty Democracy to increase the CIT for mining from 25 percent to 30 percent and to raise the royalty tax to 6 percent by 2012. The lackluster social impact of the Movement for Multiparty Democracy's growth strategy in turn provided useful political fodder for Michael Sata, who ultimately claimed election victory in 2011. The Patriotic Front's political victory was followed by an increase in mining royalties and the abolition of fertilizer and maize price subsidies. With the death of Michael Sata in 2014, his successor, Edgar Lungu, hinted at reverting to the lower mining tax regime and reducing the mineral royalty rate from 20 percent to 9 percent for open cast mines and from 8 percent to 6 percent for underground mines (Fjelstad et al. 2016). These reductions eventually did take effect, as shown in Box 2 and as illustrated in Table 4.

As Box 2 highlights, tax reforms have continued incessantly ever since, with almost every tabled budget. Reforms first took the shape of variable tax rates for different industries (i.e., 15 percent for agriculture, 30 percent for mining, and 35 percent for other industries) (Jesuit Center for Theological Reflections 2011). In 2015, variable taxes were abolished and standardized at 30 percent, while royalties increased to 8 percent and 20 percent for underground and open cast mining, respectively. The 2018 tax structure shows a progressive PIT, with a marginal tax rate of up to 37.5 percent; a one-off presumptive tax for public transport vehicles; and a variable corporate income tax for different business activities (10 percent for farming, 15 percent for manufacturing of fertilizers and copper cathodes, and 35 percent for Lusaka Stock Exchange-listed companies). Mining companies continue to enjoy a lower CIT rate of 30 percent and a range of capital allowance deductions, carry-forward tax losses of up to 10 years, and rebates on imports of mining equipment (KPMG 2019). The 2018 budget further proposes possible abolition of the VAT and a replacement of it by a sales tax, beginning in April 2019, with implementation having been postponed at the time of writing this case study, in September 2019.

The single most important factor driving tax policy instability is the exemption of the mining sector from a large component of the tax net. This is accentuated by fierce political disquiet over the leniency and opaque manner in which the mining sector is treated. Over the years, mining companies have been able to wield their bargaining power and forge political alliances that have enabled them to negotiate and renegotiate lower taxes. Some of the signed agreements resulted in income taxes dropping from 30 percent to 25 percent and royalties dropping to 0.06 percent. Mining tax policies have changed several times over the past 18 years, and they continue to remain a source of tension between government, mining companies, and society. In 2008, the Zambian government decided to annul the development agreements, as it was facing mounting pressure from the public over its blatant inability to earn revenue from mines. Predictably, this was much to the displeasure of mining companies.[7] Perceptions of underreported mining output and skewed benefit sharing have renewed tensions between the Zambian government and mining companies, with the government threatening to renationalize mines in response to threats by mining companies to close down the shafts.

Box 2. Erratic tax policy changes
Zambia's tax regime, especially in mining, has undergone numerous alterations since 1964. The changes have at times appeared chaotic as the country sought to navigate effective ways to reduce reliance on aid and to capture resource rents. The tax policy regime changes can be categorized in four phases. These include the period between independence and when the country adopted a multi-party democratic system in 1991; the period during the debt crisis and the reform era of 1991 and 2001; the period during the growth spurt between 2001 and 2010; and the period during the post-financial crisis slump from 2010 to 2018. A notable tax policy change associated with the post-independence era is the introduction of the 40 percent export tax on copper for a given threshold price. This was an initial attempt to introduce a windfall tax in order to maximize revenue gains from rising international copper prices. This era also is marked by a policy shift toward nationalization of mines that rendered tax policy changes futile. A high export tax and declining copper prices eroded profits, thus making CIT virtually unpayable. Development agreements that enabled individual mines to negotiate separate tax emoluments accompanied the next phase of the tax policy, which entailed a push for privatization. This period coincided with a 25 percent mining CIT, a 6 percent royalty tax, and miscellaneous tax incentives. Zambia was in no position to institute other tax instruments or maximize revenue collection, due to its lack of capacity in tax administration. This was the case until the ZRA was established in 1994. Phase 3 of the tax regime occurred under an environment of growth and relative political and institutional stability. Threats of electoral loss by the Movement for Multiparty Democracy in 2006 triggered the introduction of a new tax regime in 2008, placing greater emphasis on a gross tax-rate base and on variable rates. An important policy package was a copper price-dependent progressive windfall tax (at 25 percent, 50 percent, and 75 percent, respectively), with a clause to increase tax intake when prices and profits were high and reduce the tax burden when the situation reversed. These tax changes meant that certain mines faced the possibility of a 100 percent marginal tax rate, leading to the abolition of the windfall tax in 2009. The fourth phase of the tax regime changes has been marked by sporadic variations and changes. In 2008, the CIT for all mining operations was equalized to 30 percent, departing from variable rates negotiated during development agreements. During this time, a

[7] Mining companies disputed the 2008 tax changes, arguing that they constituted a direct violation of the stability clauses in the mining development agreements that were supposed to override and protect against legislative changes made locally.

variable profit tax of up to 15 percent also was introduced. After winning the election in 2011, Michael Sata desperately attempted to fulfill electoral promises, which initiated drastic tax policy changes. In 2012, the royalty tax rate was increased from 3 percent to 6 percent, and was increased further in 2016 to between 8 and 20 percent. This was followed the next year by a drop to 4 and 6 percent. The increase in royalty taxes also was accompanied by a temporary removal of the 30 percent income tax, effectively changing the mining tax from a profit-based to a revenue-based system.

In 2015, the variable profit tax was abolished, but income tax was kept at a standard rate of 30 percent. A pushback from the mining sector resulted in the lowering of royalty taxes yet again, along with the reintroduction of variable profit and income taxes (30 percent for operations and 35 percent for processing) and the reinstatement of the standardized 30 percent income tax in the following years. On the capital allowance front, the rate was reduced from 100 percent to 25 percent per year in 2008, reinstated to 100 percent in 2009, and dropped again to 25 percent in 2013.

Apart from the scattershot mining tax regime, the 2018 budget contained yet another surprise, with the proposal to abandon the VAT in favor of reviving a sales tax—the very tax that had previously been abolished in 1995 and replaced by VAT. The 2019 budget speech then does yet another turnabout by reversing introduction of the sales tax, exactly six months after tabling of a Sales Tax Bill, in favor of strengthening VAT management.

The 2018 proposed shift away from the VAT to a sales tax is counterintuitive, given that the VAT has been one of the major drivers of revenue growth, with a 19 percent annual average growth rate. The VAT further provides an added benefit for self-enforcement and for preventing tax cascading. The main criticism of the VAT appears to revolve around its complexity and limited applicability in countries where so much economic activity takes the form of natural resource extraction or trading, as is the case in Zambia. Authorities perceived a sales tax as a more effective instrument for revenue collection. This view was likely bolstered by the fact that 70 percent of VAT collections come from just 1 percent of enterprises, while 5 to 10 percent of VAT collections come from 90 percent of small and medium enterprises (GIZ 2015). According to Siwale (2018), the motivation for abolishing the VAT was linked to the Zambian government's intention to reduce growing VAT refunds from zero-rated goods and services destined for the export market. VAT refunds have been a subject of considerable controversy in Zambia, with refunds constituting as much as 46 percent in 2017 of total VAT collections (90 percent claimed by the mining sector), a situation that is further marred by hefty unpaid VAT claims and legal disputes (IMF 2018; Siwale 2018). Withholding of VAT refunds by countries experiencing budget pressures and mounting debt is not peculiar, as is noted by Harrison and Kralove (2005). However, what is peculiar, as is noted by Siwale (2018), is the way in which the Zambian authorities are going about plugging the fiscal gap with a sales tax.

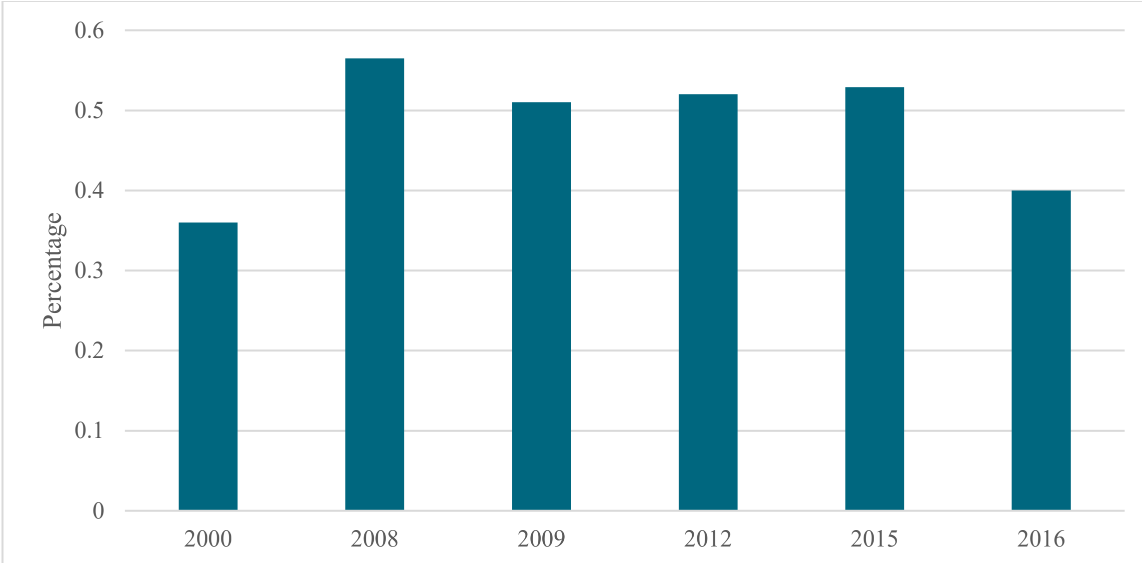
The imposing of a sales tax has been shown to be inferior, both in theory and in practice, to the imposing of a VAT, since a sales tax carries the risk of tax evasion and increases the cost of goods production, thereby leading to a reduction in indirect tax collection. Furthermore, according to calculations of VAT efficiency and C-efficiency recently performed by the World Bank (2018a), Zambia's VAT productivity compares favorably to other SSA countries. Calculations show that not only does Zambia have a C-efficiency higher than that of the average SSA, but that its C-efficiency is higher than the fellow Southern African Development Community (SADC) countries of Lesotho, Mauritius, Eswatini, Zimbabwe, and Malawi. The C-efficiency in Zambia, however, is lower than that of Botswana, Namibia, and South Africa, which suggests that there are "lost" revenues, in relative terms, that could be recouped from changes within the VAT.

The mooted move to sales tax in 2018 is yet another manifestation of an erratic and indecisive tax policy position in Zambia because government recently announced a decision to abandon its imposition, during the 2019 budget speech, coming merely six months after tabling of the Sales Tax Bill. The decision to retain VAT and strengthen its administration augurs well for future revenue mobilization efforts because the revenue yield of the VAT is relatively higher than other SSA countries, but issue of VAT refunds continues to persist and plague the tax's administration.

Overall, the politics of erratic tax policy changes have resulted in an unstable and ineffective tax rate situation, as the measures caused the tax burden to fluctuate in accordance with the mining tax regimes. Zambia transitioned from having the lowest effective tax rate in the 1990s to having the heaviest tax burden in the late 2000s as the country attempted to improve fiscal benefit sharing between the government and mining companies. As a result, the average effective tax rate has swung dramatically since 2008, sometimes hinging on whether a mine is a high- or low-cost mine. Lundstøl and Isaksen (2018) estimate that the average effective tax rate for Zambia ranged between 33 percent and 56 percent after 2000.

As can be seen from Figure 4, a lower average effective tax rate was observed in 2000. This was largely because of the generous capital allowance deduction (up to 100 percent) that was associated with privatization-era investment incentives. The 2008 mining tax regime shows the highest average effective tax rate and reflects Zambia's growing push for balanced benefits sharing from mineral extraction. The average effective tax rate has since stabilized at around 50 percent since 2016, following the lowering of the royalty tax, which caused discontentment when it was increased sharply in 2015.

Figure 4. Average effective mining tax rate



Zambia's erratic and frequent changes to its tax policy regime has done little to improve its revenue mobilization. If anything, the policy chaos has damaged the credibility of tax policy and inflamed mistrust between the government, the private sector, and the general citizenry of Zambia (Fjelstad 2013). Most important, the absolution of the mining sector—the sector with the largest resources—from taxes is likely to discourage compliance from other taxpayers, especially telecommunications companies that are taxed at hefty CIT rates.

Table 4. Historical tax regime policy changes in Zambia, 1964–2019

Tax regime (numbers in %)		1964	1966	1970	1983	1986	2000	2008	2009	2012	2015	2016	2017	2018	2019
Mining taxes	Royalty	13.5	13.5				0.6	3	3	6	6-9	8 & 20	4-6	4-6	5-6
	Export tax		40		4-8	13	13						5-15	10	10
	Mineral tax			51	51	51	51								
	CIT	37.5		45	45	45	25	30	30	30	30	30	30	30	30
	Variable profit tax							15	15	15	15	15			
	Windfall tax							25-75							
	Capital allowance		5	5	100	100	100	25	100	100	25	25	25	25	25
CIT - Selected non-mining activities	Manufacturing										35	35	35	35	35
	Manufacturing (copper cathodes)										15	15	15	15	15
	Manufacturing (fertilizers)										15	15	15	15	15
	Farming and agro processing										10	10	10	10	10
	Lusaka stock exchange listed cos.										35	35	35	35	35
	Telecommunications														
	Up to ZMW 250 000										35	35	35	35	35
	Above ZMW 250 000										40	40	40	40	40
Marginal PAYE rate											37.5	37.5	37.5	37.5	37.5
VAT											16	16	16	16	16
Property tax	Land and shares										10	5	5	5	5
	Mining rights										10	10	10	10	10

Sources: Lundstøl and Isaksen (2018); Manley (2012); KPMG (2019, 2017); PWC (2016).

4.2 Revenue Performance and Administration

What, then, besides instability, has been the impact of all these reforms on revenue performance? As noted earlier, Zambian tax revenue performance has remained relatively stagnant, notwithstanding soaring commodity prices, a phenomenon that occurred in the recent period (i.e., refined copper prices averaged $1,779 in 2003 and grew to $8,822 in 2011). (World Bank 2016). This period resulted in an unprecedented rise in government revenue rents from the copper industry, which increased from 0.8 percent to 30.5 percent in this time frame (UNCTAD 2017). Zambia was able to maintain a positive revenue mobilization effort beyond 2011 and managed to reduce grant dependency. In recent years, however, expenditure growth has outpaced revenue growth, throwing into doubt the tax system's ability to meet the country's growing needs.

Measuring tax collection performance has been a subject of numerous scholarly debates (von Soest 2006; Ade et al. 2018; Gupta 2007). It is fraught with practical challenges, due to divergent economic structures, varying levels of development, and demographic trends. This means that the mere act of collecting more revenue may not necessarily be an indication of better tax dollar performance. Notwithstanding these limitations, however, tax-to-GDP ratio is generally used as an indicator of fiscal performance, especially in cross-country comparisons—this even in spite of the fact that the measurement gives no indication of taxable capacity and tax effort within a country. Some studies (World Bank 2018b) regard a tax-to-GDP ratio of 15 percent as a reasonable level at which the country is able generate sufficient revenue to support growth and development. In applying this measure to Zambia, then, with its rising public spending, growing fiscal deficits, and tax-to-GDP ratio that has remained below 15 percent for most recent years, it is clear that revenues are not growing fast enough.

Collection of direct taxes, in comparison to other types of taxes, is another important and indirect indicator of tax effort. As is the case with tax-to-GDP ratio, there is no widely accepted or standard measure of direct tax collection.

One known measure that would increase tax revenue would be expanding the tax net into informal economic activities. Two long-standing obstacles to collecting these taxes, however, are administrative weaknesses and political resistance (Liberman 2002). The Zambian revenue structure also shows that indirect, or consumption, taxes contribute a significant proportion of total revenue. This is, perhaps, unsurprising, since the informal sector contributes to more than 50 percent of Zambia's GDP (Nalishebo and Halwampa 2014; Central Statistical Office 2018b) and a significant part of the country's economic activity is unreachable to the tax net. Arguments compete, however, over whether direct or indirect taxes provide better revenue buoyancy and sustainable growth performance.

Bird and Zolt (2003) are of the view that a growth-oriented revenue mobilization strategy would likely tax consumption more than income, because the latter discourages savings and investments. Notwithstanding such an argument, though, the composition of taxes, and the tax structure itself, varies widely across countries. For instance, Denmark collects approximately 60 percent of its revenues from personal and corporate taxes, and the corresponding rate for France and the United States is below 25 percent and 20 percent, respectively. The differences reflect national choices informed by prevailing national economic and social priorities (Jesuit Centre for Theological Reflections 2011).

A more accurate measure of a country's revenue performance is one that takes into account taxable capacity and tax dollar effectiveness, focusing on the possible determinants of taxes (Mihn Le et al. 2012). The most influential factors affecting tax capacity are both quantitative and qualitative. Quantitative variables include tax rate, per capita income, level and distribution of employment, the share of the rural and urban populations, and the balance of trade and firm size. Qualitative aspects, on the other hand, range from political stability to willingness to pay to the independence and efficiency of tax-collection agencies to transparency and the rule of law. Gathering all this data, however—and computing empirical estimations of taxable capacity and effort for most developing economies—is fraught with challenges, and Zambia is no exception.[8]

Figure 5 attempts to countervail the data deficiency by looking at the buoyancy coefficient of total tax revenue. The data presented in the figure suggest that Zambia's revenue mobilization efforts are responsive to changes in GDP. Tax revenue increases by an average of 2.7 percent for every percentage increase in GDP. There are studies that conclude that Zambia's revenue collection performance has reached a plateau—but there remains a sizable tax base awaiting further utilization (Nalishebo and Halwampa 2014; Gray and Chapman 2001; Von Soest 2006). Recognizing this challenge, Zambia's government launched the "Zambia Plus" economic recovery plan in 2017, in efforts to improve domestic revenue collection. An important aspect of the recovery entails improving tax administration, growing the tax net, curbing individual and corporate tax evasion, and increasing the tax-to-GDP ratio to 22.6 percent, as set out in the 6NDP (Policy Monitoring and Research Centre 2018).

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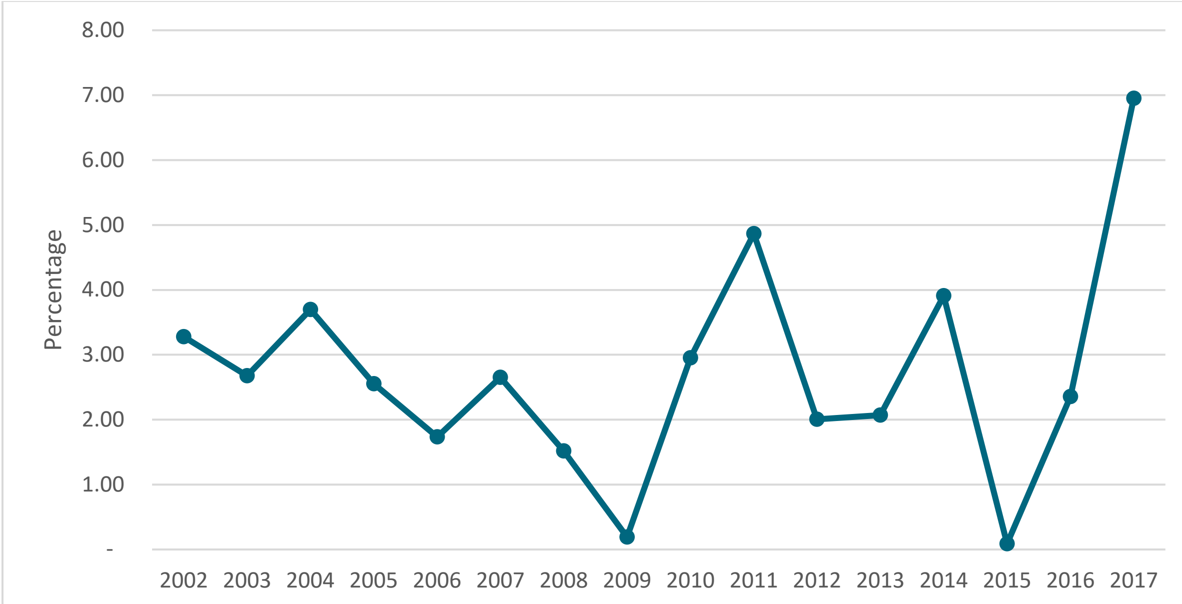
[8] Time series data on most determinants of tax capacity are not readily available.

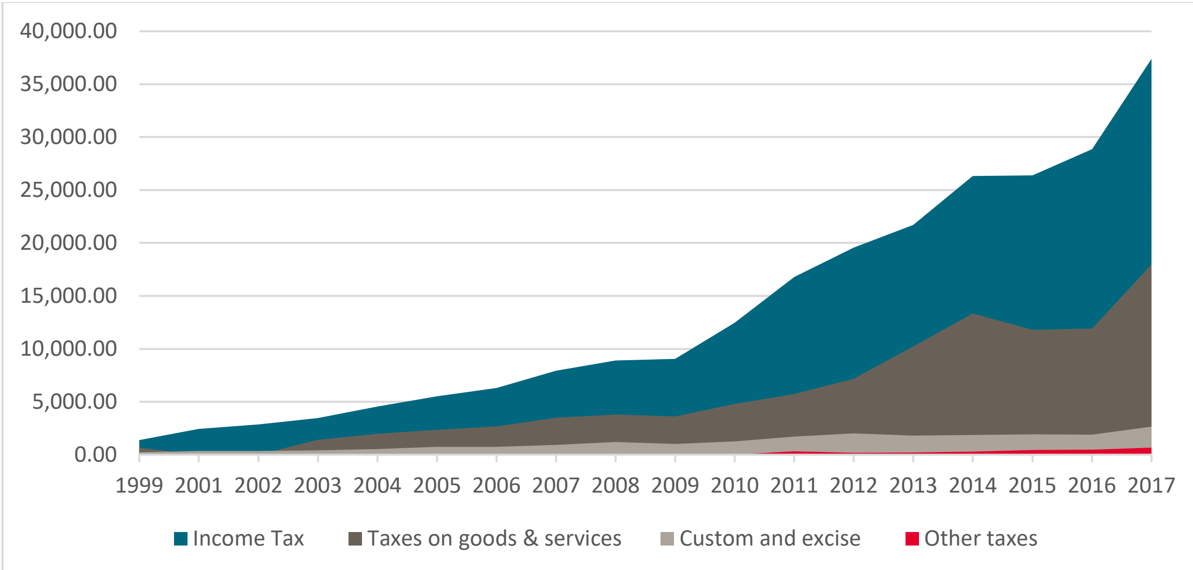
Figure 5. Tax buoyancy coefficient



Sources: IMF data and authors' calculations

The question of whether Zambia has realized its full potential in raising different taxes cannot be conclusively answered. Income tax and VAT have grown 231 percent and 59 percent in real terms since 2000, respectively (see Figure 6), which is quite impressive. Revenue mobilization impediments are numerous and well-documented, however (Fjeldstad et al. 2016; Nalishebo and Halwampa 2014; Gray and Chapman 2001), and include challenges with multiple tax rates, a constantly changing tax regime, international tax administration complexities, a low tax compliance, bilateral treaties, poor traceability of taxpayers, tax evasion, the dominance of informal sector activities, and the generous tax incentive regime.

Figure 6. Growth trend in the composition of taxes since 1999 (domestic currency)



Source: Authors' computations based on IMF data

A recent *Tax Administration Diagnostic Assessment Tool* [9] report from the ZRA (Rojas et al. 2016) found that the agency has a sound tax administration system that encourages compliance. Several shortcomings, however, were observed. These include a high number of untimely tax filings, a high number of tax arrears incidents, a VAT refund backlog, and an inaccurate tax registration database. These shortcomings influence the negative compliance rate, which is also affected by the strong presence of the informal sector. Zambia isn't alone in these difficulties, either. Tax administration challenges are widespread in developing countries that lack modern IT infrastructure, property registers, and skilled personnel to run an effective revenue administration authority (Mills 2017).

Both internal and external political factors are also key impediments to increased revenue collection performance. Internally, tax regimes tend to favor taxpayers with bargaining power and with the power to serve politicians with nefarious intentions. Powerful interest groups are able to evade taxes or simply prevent introduction of taxes they do not like—for example, wealth taxes. Externally, some developing countries have signed away their powers, through bilateral treaties, to tax multinational companies, particularly those companies operating in the extractive sectors. Estimates suggest that Africa has forgone more than $70 billion in tax revenue from the mining sector between 2003 and 2008, because of lenient tax structures (Mills 2017). Similar losses for Zambia have been projected in the order of 800 billion Zambian Kwachas between 2002 and 2009 (Jesuit Centre for Theological Reflections 2011). The Zambian government has been incessantly reluctant to instate the capital gains

[9] Assesses the performance of a country's tax administration based on ten outcome areas, including the integrity of the taxpayer database, effective risk management, the support of voluntary compliance, the timely filing of tax declarations, the timely payment of taxes, accurate reporting in declarations, effective tax dispute resolution, efficient revenue management, transparency, and accountability.

tax, the property transfer tax, and the tax on immovable properties, resulting in significant tax base erosion (Jibao 2016).

The World Bank attributes such resistance to three factors. First, there is opposition from the vested political and economic elites who are invested in properties. Second, the tax system isn't designed for administering property taxes. Third, the prevailing communal land tenure system makes it difficult to appraise and tax properties.

Additionally, other entrenched obstacles exist. After the privatization of mines, the tax system became a key source of dispensing patronage and privilege through outright tolerance for tax evasion and elite tax bargaining (DiJohn 2010); and the fact that Zambia's local governments administer property taxes, and that many municipalities lack sufficient property records and the capacity to valuate properties every five years, as required by law (World Bank 2016), makes record-keeping impossible.

Another important cause of low tax take is tax avoidance and evasion from CIT and PAYE. Companies are notorious for their creative accounting methods, and they regularly reduce or avoid taxes altogether, through transfer pricing and over-inflated inter-company loan agreements. Overreporting of costs and underreporting of outputs is prevalent. The Zambia deputy minister of finance asserted that the country's government was losing $2 billion per year to tax avoidance and that the mining sector contributes the most to this loss (Fjeldstad et al. 2016). Another American-based Global Financial Integrity report noted that $8.8 billion in illicit financial flows left Zambia from corruption, crime, and tax evasion over a 10-year period ending in 2011. More than 50 percent of this amount is attributed to erroneous trade invoicing[10] (War on Want 2015). By way of illustration, the Mineral Value Chain Monitoring Project Baseline Report (2015) indicates that only two mines out of nine major copper mines in Zambia have consistently paid CIT in recent years. The rest have reported losses or marginal profits. Tax evasion is not limited to company taxes, either. Nalishebo and Halwampa (2014) demonstrate that a sizable number of self-employed and paid employees are underreporting their incomes. This implies that a PAYE tax of 6.7 percent of Zambia's GDP, or 40.3 percent of its total revenue, potentially goes uncollected.

Zambia is also known for having a generous tax incentive regime (Nepad-OECD 2011; Nalishebo and Halwampa 2014; War on Want 2015; Fjeldstad et al. 2016). The Zambian Development Agency (ZDA) Act offers different categories of tax exemptions and concessions to companies that invest or expand business operations in the country. The incentive structure includes generous PIT exemption thresholds, tax holidays, tax exemptions, credits, and reduced CIT rates, among other incentives. Companies investing more than US$10 million, or US$500,000 in the multi-facility economic zones and priority sectors, are eligible for accelerated depreciation, profit tax holidays for up to five years, and differentiated tax rates thereafter, among other perks. Provided that the company makes a profit, other incentives include duty-free importation of equipment and machinery for five years, investment guarantees, and free processing of immigration permits and other licenses.

[10] Falsification of the value and volume of international commercial transactions.

Furthermore, mining companies can claim up to 25 percent in capital reductions and are allowed to carry forward losses for tax purposes. Additionally, the incentive regime grants even more concessions to companies that invest more than US$10 million, which are allowed to negotiate special tax deals separately with the government.[11]

Tax incentives translate into huge tax expenditures and losses for the Zambian government, and generally benefit only large foreign companies. To add insult to injury, most of the tax revenue lost, and the beneficiaries who gain, are veiled in secrecy. Neither the ZDA/ZRA, for instance, nor Zambia's Ministry of Finance, has data on tax exemption beneficiaries and forgone revenue.

Nevertheless, there is evidence suggesting that mining benefits the most from this fiscal largesse. According to DiJohn (2010), and further corroborated by Lundstøl and Isaksen (2018) and Makano (2019), mining companies—and in particular Anglo American Corporation and American Metal Climax—paid almost no taxes between 2000 and 2008, when the development agreements were finally abolished.

Finally, Zambia also is losing substantial tax revenue to long-term and poorly negotiated double taxation agreements (DTAs) signed with 22 countries. An example is the Zambian–Ireland treaty, signed 40 years ago, which exempts Irish companies operating in Zambia from paying any taxes. Such exemptions have created a legacy of deep problems for the country, with companies now competing to exploit all the loopholes. Many companies, for instance, deliberately under-declare profits in order to benefit from the profit tax incentive or to use the DTA as a tax-free conduit for transactions between Zambia and other countries (Makano 2109). Zambia's government clearly lacks the institutional capacity to administer the tax incentives and to quantify the commensurate revenue losses—or benefits—in terms of productivity.

5. Spending Quality

5.1 Quality of Spending

Table 5 gives a functional classification of aggregate spending in Zambia, making a comparison in changes for functional expenditure shares in relation to GDP and total expenditure over the periods 2005–2007 and 2015–2017.

One of the major concerns affecting public finances in developing economies is how changes in the composition of expenditure undermine—or facilitate—the attainment of overall development goals, and how efficient spending is. Table 5 shows that education takes

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[11] These generous incentive regimes originate from the privatization era, during which government entered into uneven tax deals with mining companies through DAs, lasting up to 20 years.

priority as a spending area in Zambia, and that its proportional share of GDP has increased from 2 percent in 2005–2007 to 6 percent in 2015–2017. The average shares of health and defense expenditures of GDP increased by 2 percent and 1 percent, respectively, over the same periods, while social protection[12] spending is seemingly non-existent. When individual functional expenditure allocations, in relation to total expenditure, are compared, the trend shows a decline—except in the case of interest spending. The average expenditure shares of education, health, and defense declined by 2 percent, 1 percent, and 7 percent, respectively, from 2005 to 2017. The picture that emerges, with respect to expenditure trends and interest spending, in particular, is that spending by the Zambian government has been growing faster than the country's GDP (and revenue), and that Zambia's subsequent borrowing requirement is being used to service debt rather than finance key developmental obligations.

Table 5. Spending trends by function (%)

Numbers in percentages	In relation to GDP		In relation to total expenditure	
	Mean	**Mean**	**Mean**	**Mean**
	2005–2007	2015–2017	2005–2007	2015–2997
Education	2	6	19	17
Health	1	3	1	9
Interest payments	1	8	12	21
Social protection	0	0	0	1
Defense	2	3	15	8

Sources: World Economic Indicators and IMF data

According to the World Bank (2018c), spending has been accompanied by much better development outcomes in health and education. The Millennium Development Goals (MDGs) linked to the education sector were achieved (including universal primary education and the elimination of gender disparity in primary education). Although not met, many health indicators progressed. For example, child malnutrition, the infant and under-five mortality rate, and the maternal mortality rate decreased, while success was recorded in combating HIV/AIDS, malaria, and other diseases. Keeping the momentum is a challenge, however. For example, according to the World Bank (2016), Zambia is reneging on its past performance of managing accumulated spending arrears. Arrears accounted for just 2

[12] It should be noted that there are discrepancies in the data between the IMF and official budget estimates reported by the Zambian Ministry of Finance. Government data available between 2001 and 2017 indicate that social protection constitutes 4 percent of total spending. IMF data is used for consistency.

percent of Zambia's total expenditure in 2009, and this has since increased to more than 20 percent in 2016, a rate that still persists. The root cause of expenditure arrears by the Zambian government lies in poor spending management. Increasing government arrears leads to late payment of contractors, delayed pension contributions, and stalls on imported fuel and electricity. Growing accrued spending reflects weaker regulation on budget commitments control, budget credibility, and oversight. Mounting arrears further increases the Zambian government's interest spending, and may likely damage the country's creditworthiness, eventually stalling much-needed economic growth, if left unchecked.

Growth in spending continues to soar amid concerns about the quality of such spending. Wasteful expenditure is a regular occurrence in the auditor general's annual reports. For example, the auditor general's reports of 2013, 2014, and 2015 show that there has been a significant rise in irregular payments, undelivered materials, overpayments, and wasteful expenditures. More recently, audit reports lament a failure to comply with government regulations; weak internal control that undermines revenue collection and management; an inability to account for expended funds; and delays in the completion of projects (GRZ 2017). This is a direct result of scaling up public expenditure without building the necessary systems to manage spending effectively. Judging from the auditor general's reports, the mere existence of procurement legislation and oversight is not enough to guarantee reliable and efficient resource flows and transactions. Indeed, the reasons noted by Zambia's auditor general for wasteful expenditure also include corruption. Payments are made without invoices, or delivered goods fail to follow procurement procedures and are over-invoiced (World Bank 2016). This partially explains the coexistence of the increase in per capita economic growth with high national poverty and inequality. While losses incurred through corrupt activities divert resources away from poor and needy beneficiaries, the politics of patronage also have meant that the government spends more on urban areas, where "swing voters" reside. This, in turn, has meant that poor populations in rural areas have grown between 2010 and 2015 (World Bank 2018c).

5.2 Capacity-Building Support by Development Partners

Traditionally, capacity-building for Zambia was never tailor-made to support tax revenue mobilization, but was focused instead on expenditure. This was the case for many SSA countries, but in the case of Zambia, it was only after the 1990 transition to a multi-party governance system that budget support was introduced—and when it was, it was embedded within the broader aid agenda. The support of development partners also affected Zambia's tax revenue mobilization by attaching privatization as a condition to debt write-offs. It is not an exaggeration to say that the negative effects of this intervention are still being felt today.

Development support at first took a sector-by-sector approach and focused on the various areas of state functionality. These areas included, in particular, agriculture, infrastructure, health, and education, and aligned to donor interests. In the 1990s, a period that coincided with political transition from Kaunda's National Independent Democratic Party to Chiluba's Movement for Multiparty Democracy, balance of payment support consisting of import support and debt relief became an important aspect of the World Bank–Zambia technical assistance portfolio. The IMF, on the other hand, focused on macroeconomic stabilization and growth as part of their official development assistance (ODA) disbursement conditions. As the Movement for Multiparty Democracy displayed a genuine commitment to reform, through their establishment of the ZRA, cash budgets, and looser exchange controls, Zambia was able to attract more assistance from multilateral and bilateral partners (Rakner et al. 1999).

The involvement of multiple donors with divergent policy goals meant, however, that capacity support was fragmented, duplicated, and misaligned to national goals (Rakner et al. 1999). As Zambia began to demonstrate an inability to manage expenditure, and in the absence of ODA coordination, bilateral donor funders assumed full responsibility for planning and executing their own programs and projects in Zambia, which undermined state sovereignty. Additionally, bilateral partners abused their support by withholding ODA disbursement in order to influence political developments and to forcefully expedite the sale of copper mines. Finally, another pitfall faced by many of these technical assistance interventions was their intrinsic weakness. Many lacked the necessary institutional capacity to deliver and sustain programs and development within Zambia, and in many cases the promised measures never materialized. This is a classic problem of aid fungibility: funding can easily be reallocated, thereby lessening the need for program follow-through.

In 2005, nine donors—the European Commission, the World Bank, the African Development Bank (AfDB), the Department for International Development (DFID), the Netherlands, Sweden, Norway, Germany, and Finland—organized themselves to form part of the budget support group to Zambia. The group signed a joint memorandum of understanding with Zambia in 2005 as part of the Poverty Reduction Budget Support Program (PRBSP). This memorandum set out common areas of support, namely macroeconomic stability, good governance, public financial management reforms, and poverty reduction (Fjelstad and Heggstad 2011). To Zambia's credit, the PRBSP was an initiative led by the country's government to address disintegration in donor support programs and to foster alignment of donor interest to the 5NDP. The hallmark of PRBSP and the 5NDP was to encourage greater stakeholder involvement in policymaking, transparency, and priority-setting. More important, Zambia adopted a number of principles to guide its government and its development partners through the aid policy and strategy document. These principles are outlined as follows:

- Country ownership
- True partnership through dialogue and coordination
- Process and procedural simplicity
- Intra- and inter-country justice and equity
- Grants rather than concessional loans
- Demand-driven capacity-building and technical assistance
- Partnership with non-state actors

In recent years, Zambia has been party and signatory to a number of international collaborative initiatives designed to mobilize domestic revenues. The 2002 United Nations Conference on Financing for Development looked at numerous funding sources to achieve MDGs and Development Cooperation (United Nations 2003). The international community agreed on a range of instruments to improve revenue mobilization, including promoting macroeconomic stability and trade, reducing corruption and tax evasion, and increasing ODA disbursement of rich countries to 7 percent of national income. Later reviews of the agreement by Francois et al. (2017) found that the consensus suffered from implementation deficit.

A third installment of the Financing for Development, held in Ethiopia in 2015, birthed yet another revenue optimization initiative—the Addis Tax Initiative—designed to improve the transparency, effectiveness, and efficiency of tax systems in Africa. Resources pledged for this initiative have also, to date, not materialized, with only 2 percent of aid going to tax support in 2015 (Owolegbon-Raji 2018).

In 2011, the international community of 160 countries recommitted itself to the Paris Declaration and Accra Agenda through the Busan Agreement. The agreement was to use the developing countries' public financial management systems as a default for managing development finance (OECD 2012). African countries have also, of their own accord, established the African Tax Forum (ATaF), composed of 38 member states, to offer technical support and advisory services to each other on tax-related matters. Since its inception 10 years ago, ATaF claims to have contributed to the review of tax structures, transfer pricing legislation, and the establishment of rules designed to curb tax avoidance and evasion in 20 countries. Another revenue mobilization cooperative initiative, the Platform for Collaboration on Tax (PCT), was launched in 2016 by the IMF, the Organisation for Economic Co-operation and Development (OECD), the World Bank, and the United Nations. This initiative coordinates capacity development for revenue mobilization and develops toolkits on base erosion and profit sharing (United Nations 2018). While well-intentioned, what these international initiatives have shown, however, is a clear element of proliferation, incrementalism, and a lack of tailoring to address individual countries' revenue mobilization challenges.

In spite of the many domestic revenue mobilization initiatives with development partners, an overwhelming view exists that technical assistance given to Zambia for help with revenue mobilization has been less than satisfactory (Wohlgemuth and Saasa 2008; Fraser 2007; Rakner et al. 1999; World Bank 2002). McPherson (1995) describes Zambia's technical assistance program as a stop-and-start effort that eroded confidence, exacerbated fiscal imbalance, and undermined local institutions, such as the ZRA, which could, without the meddling, have helped to restructure the economy. In his disapproval of aid's impact, Fraser (2007) sums up his findings as follows:

"*If the Zambian case tells us anything about how to understand change in contemporary donor-recipient relations and about the potential for recipients reclaiming sovereignty, it is that the focus on administrative systems does not get to the heart of the question. Change at that level is unlikely to allow aid recipients to make [a] decisive break from donor dominance. Rather, in situations of material dependence, ideological and political change within aid recipient countries is a pre-condition of any substantive recovery of sovereignty.*"

The observed low impact of capacity-building programs on revenue mobilization and aid-funded projects has resulted in political apathy and public resentment for aid. Furthermore, political parties are becoming increasingly reluctant to accept ownership of aid-imposed reforms (and their outcomes), opting instead to shift the blame to the funders (Fraser 2007).

To the credit of development partners, however, Zambia has made notable improvements in at least one area. This area includes establishing a sound budget process, managing expenditures, and monitoring public accountability systems.

The Zambian government adopted the Public Financial Management Reform Strategy in 2013, which, among other things, identified domestic revenue optimization as a key focus area. The interventions identified to meet the set objective include improving compliance; broadening the tax base; strengthening and modernizing tax collection capacity and infrastructure; and enhancing non-tax revenue collection (GRZ 2013). The combined effect of these budgetary reforms enabled Zambia to complete its highly indebted poor countries (HIPC) milestones in 2005, after which the country was required to privatize state entities, reduce civil service, and end subsidies of fertilizer, among other measures. The successful completion of the program also triggered a cancelation of the country's debt with international finance institutions under the G8 debt relief initiative (Wohlgemuth and Saasa 2008).

Reaching the HIPC milestone posed serious political threats to the ruling Movement for Multiparty Democracy, however, as its domestic electoral constituency rejected an outright privatization of mines. Local citizens and civil movements with leftist leanings were against the handing over of what they perceived to be national treasures to foreign companies. At the same time, the government needed foreign capital to ameliorate the debt crisis. In the end, the debt relief imperatives prevailed over the prospect for electoral losses. Interestingly, the HIPC success became an electioneering advantage for the Movement for Multiparty Democracy during the 2006 elections, in which they retained control (Fraser 2007). In retaliation, the Patriotic Front managed to garner protracted nationwide hostility against foreign ownership of mines and associated tax break largesse, gaining them sufficient support for electoral victory in 2011.

The public resentment for HIPC was, perhaps, justified. As Wohlgemuth and Saasa (2008) put it, aid strictures interfered with democratizing Zambia and undermined state sovereignty. With the demise of structural adjustment, HIPC processes took over as a measure of external control. Donors were able to closely influence and supervise Zambian policies far more than they had been able to under the structural adjustment program. In some cases, emboldened by the government's inability to manage spending, donors even became more involved in the management of their ODA disbursements and in the actual implementation of projects. Others withheld ODA disbursements in order to influence political developments and to expedite the sale of copper mines.

In recent years, donor partners have committed to a unique aid cooperation framework, called the Joint Assistance Strategy for Zambia, to reinforce local ownership of development processes and to improve aid effectiveness and mutual accountability. As part of the new aid management regime, government also has recommitted itself to strengthening planning, budgeting, and financial management to ensure better resource absorptive capacity and use, both internally and externally. Zambian resources generated domestically and externally are now subjected to a national budgeting process and allocated in accordance with priorities set in the national development plans (Wohlgemuth and Saasa 2008).

6. Conclusion and Policy Implications

The focus of this study has been to assess whether tax and fiscal reforms in Zambia have been impeded by political and technical constraints. One of the main findings has been that Zambia displays substantial variability of tax policies. Despite two decades of impressive economic growth, Zambia's tax-to-GDP ratio has stagnated at a low level, thereby constraining financing for much-needed economic development. As a country with one of the world's highest levels of poverty and income inequality, this is unsustainable.

At the heart of Zambia's unstable tax and spending policies is the mining sector, which disproportionately affects the country's debt burden and overshadows policymaking. In the current environment, the polarized political terrain, with two dominant political parties and elections being won with narrow majorities, also has meant that politics are to blame for haphazard tax changes and the refusal to address tax governance and administrative challenges. Although democracy is now entrenched, institutions that oversee legislated fiscal rules have not been able to leverage sufficient power to prevent fiscal mismanagement or its consequences. Proactive measures to address these concerns are critical to raising tax revenue. Below are some key highlights.

Consensus-building for balanced benefit sharing: Conflicts between mining companies, general citizenry, and trade unions are commonplace in most mineral resource-dependent developing economies, and Zambia is no exception. In many parts of the world, conflicts in the mining sector arise because of the toll the industry takes on labor, human capital, and the environment. Tensions result in loss of productivity for the mines, loss of income for employees, and loss of tax revenue for the government. Unequal mining benefit sharing and perceptions of unbridled bargaining power by large corporations are at the root of mining tensions in Zambia. Underpinning these tensions are a series of historical industry compacts facilitated by the international financial institutions and negotiated to lead the economy out of its severe debt crisis and economic disequilibrium. At their inception, mining investment incentives, or development agreements, failed to incorporate social welfare imperatives, especially in the areas of job creation and local economic benefits. Consequently, community disgruntlement over mining benefit sharing emerged routinely as electioneering leverage for rival political parties.

Changing the fiscal benefit allocations requires stakeholder involvement. Those concerned need to forge a consensus on how mining companies should contribute to Zambia's national development plan. Consensus building should be premised on an active, organized, and civic-minded society and on a transparent budget process free of political interference. Likewise, clear policies, legislation, and consolidation of budget roles need to be addressed by the Ministry of Finance, which also needs to scrutinize tax incentives. Efforts to build lasting consensus for tax reform and compliance should be premised on the following crucial steps:

- *Reestablishing public trust* – A relationship of mutual trust between the public, businesses and government is a fundamental foundation of a successful taxation system. In order to quell the ongoing tensions over skewed benefit sharing on mining proceeds, the government should institute a multi-stakeholder consultative forum on tax. The forum should comprise civil society, private sector and government representatives to discuss among other things, the fairness of mining tax rates, environmental damage concerns, health and safety of workers, rehabilitation of old mines and contribution to community upliftment projects. Further, this forum should further explore ways through which proceeds of the royalty tax or parts thereof could be disbursed or redirected to communities on whose jurisdictions mining takes place.

- *Commitment to transparency* – At the core of building trust should be commitment to transparency, particularly on the part of government and corporate taxpayers. The ongoing tensions over payment of VAT refunds to mining companies is a result of prevalent information asymmetries. As a rule of thumb, mining companies should openly disclose information about "beneficial owner," concession agreements, project level production figures, tax and royalty payments as well as audits and inspection reports. Government should in turn, disclose the amount of taxes received from extractive activities and the portion of subnational revenue flowing from mining taxes. Disclosure of such information will not only curb corruption but will further strengthen governance and public debate on matters of benefit sharing.

Tax stability and predictability: There is no denying that Zambia's mining tax regime has been inordinately volatile. An unstable and unpredictable tax regime not only hinders long-term business planning but also ossifies tax compliance and thwarts tax collection efforts. Zambian tax authorities need to build the institutional capacity to assess the effect of nonuniform and unstable tax rates on different sectors, sizes, and ownership structures of businesses. The assessment is necessary in order to determine whether annual tax variations across businesses of different sizes and industrial backgrounds is justifiable. At the moment, tax policy changes are being carried out without this logic, and they tend to be reactive and detrimental to tax mobilization efforts. Committing to a stable tax regime will further enhance consensus building and minimize resistance to royalty taxes as has been the case in Zambia.

Dealing with the influence of politics on fiscal policy: Zambia has been an established democracy since the demise of the one-party rule in 1991. However, it suffers from weak fiscal institutions and limited accountability, largely because of the fragmented and polarized nature of its politics. This has resulted in large fiscal deficits, rising debt service, and rising domestic expenditure for payments in arrears. This is taking a toll on Zambia's economic growth, as Parliament does not enforce legislated debt limits. A root cause of the debt is that parliamentarians are themselves politicians, and accountable to their respective political parties. A need, therefore, exists to depoliticize and democratize fiscal policy. For example, since 2012, the Zambian debt limit (with Parliament approval) has been adjusted upward three times to accommodate each of the Euro bond loans. This either indicates that Parliament has been gracious in granting that permission or that it is oblivious to the dire consequences of its decisions on spending and debt limits. A credible fiscal council, or an independent parliamentary budget office, should provide independent information and analysis, as well as monitor compliance with the Zambian government's legislated fiscal rules. Such an independent institution would be less vulnerable to political biases in fiscal policy and thereby would address a main shortcoming of Zambia's fragmented political setting.

VAT replacement: The push in 2018 by the Zambian government to replace the VAT with a sales tax needs to be reconsidered, and instead more effort needs to be devoted toward addressing the generous list of exemptions, as well as toward the policy of extending the VAT net to cover "hard-to-tax" sectors and commodities. VAT benefits are rife with loopholes for abuse and tax avoidance and evasion. To strike a balance between VAT efficiency and equity, given the tax's productivity, policy reform should focus on strengthening VAT administration, rather than on replacing it wholesale with an inferior sales tax. Recent developments announced for the 2020 budget suggest that the government has indeed decided to move in this direction as it has decided to abandon the sales tax in favor of a more improved VAT management system. Among the administrative measures proposed to improve VAT efficiency and compliance are upgrading the Tax Online system and interfacing it with custom system to validate imports VAT refund claims as well as making it mandatory for merchants to use Electronic Fiscal Devices that capture and transmit tax information to the ZRA. The new measures seek to improve tax data analysis and timely audit of tax refunds. Government should guard against the reversal of these sound administrative measures as happened in the past because such reversals have a dampening effect on VAT compliance and VAT revenues. VAT refund administration needs to be at the heart of an improved VAT administration in order for this tax to remain in force and not be questioned with each new political/electoral/budget cycle.

Improving tax capacity: While Zambia is characterized by activities that are difficult to tax, such as smallholder agriculture, informal activities, and extractive industries, the country also suffers from weak tax administration, as identified by the auditor general. These weaknesses include a high number of untimely tax filings, a high number of tax arrears incidents, a VAT refund backlog, and an inaccurate tax registration database. These shortcomings, as well as negative compliance, must be addressed. Also, at the heart of all these weaknesses is a data challenge. In order to improve efficiency, a robust tax administration system must be established. A tremendous need exists to modernize IT infrastructure, update property registers, and train skilled personnel to run an effective revenue administration authority. Taking these measures will improve the Zambian government's ability to collect taxes from diverse groups, as well as from the informal sector. As discussed above reforms are underway to improve VAT administration: however new system must be accompanied by the requisite expertise, systems and monitoring capacity. As examples:

- The ZRA should develop good fiscal modelling capabilities, first to assess the impact of tax changes on various industries and second to link expected production profiles, prices, capital and operational expenditure and the prevailing CIT rates to the expected tax collections for a given year. While on its own fiscal modelling is not a panacea to overall capacity weaknesses, it constitutes a useful tool to inform technical discussion on maximising tax collections.

- Over and above fiscal modelling, ZRA must develop the capacity and sophistication to use available information to enhance compliance monitoring of large tax contributing activities in four key areas: registration, timely filling, reporting complete and accurate information and payment of taxation obligations on time.

- Another area that requires capacity improvements is in respect of risk analysis, client relations management and tax audit capabilities particularly in relation to VAT refunds and transfer pricing. ZRA's revenue mobilisation efforts can benefit from investment in taxpayer education improvement specifically targeted at the informal sector. Underlying the tax system capability development is a need for ongoing staff development not just in the knowledge of IT and law but also in understanding taxpayer behaviour as well as factors that may impede compliance.

Development partners and capacity-building: Zambia needs to find a transparent approach for equalizing tax rates independent of the influence of development partners and mining companies. Development partners should direct their support programs at improving ZRA capabilities in:

- regulating, monitoring, and enforcing compliance independently;

- information security management and data integrity;

- administering VAT refunds; and

- undertaking tax capacity and effort analysis.

Development partners also could assist in strengthening civil society coalitions for implementing tax reforms by promoting community budget advocacy, publishing total taxes collected from the mining sector, and involving civil society in policy discussions about taxes.

Finally, Zambia needs to continue efforts begun under the Addis Ababa Action Agenda, including initiatives on technology; infrastructure; social protection; health; micro-, small-, and medium-sized enterprises; foreign aid; taxation; and climate change. The specific objective for tax policy in this context should be to create coherence among multiple goals and targets set at the national, continental, and global levels for revenue mobilization. The objective also should be to prioritize public investments, to set milestones to guide actions, and to track progress in Zambia. Development partners could assist with all these initiatives.

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