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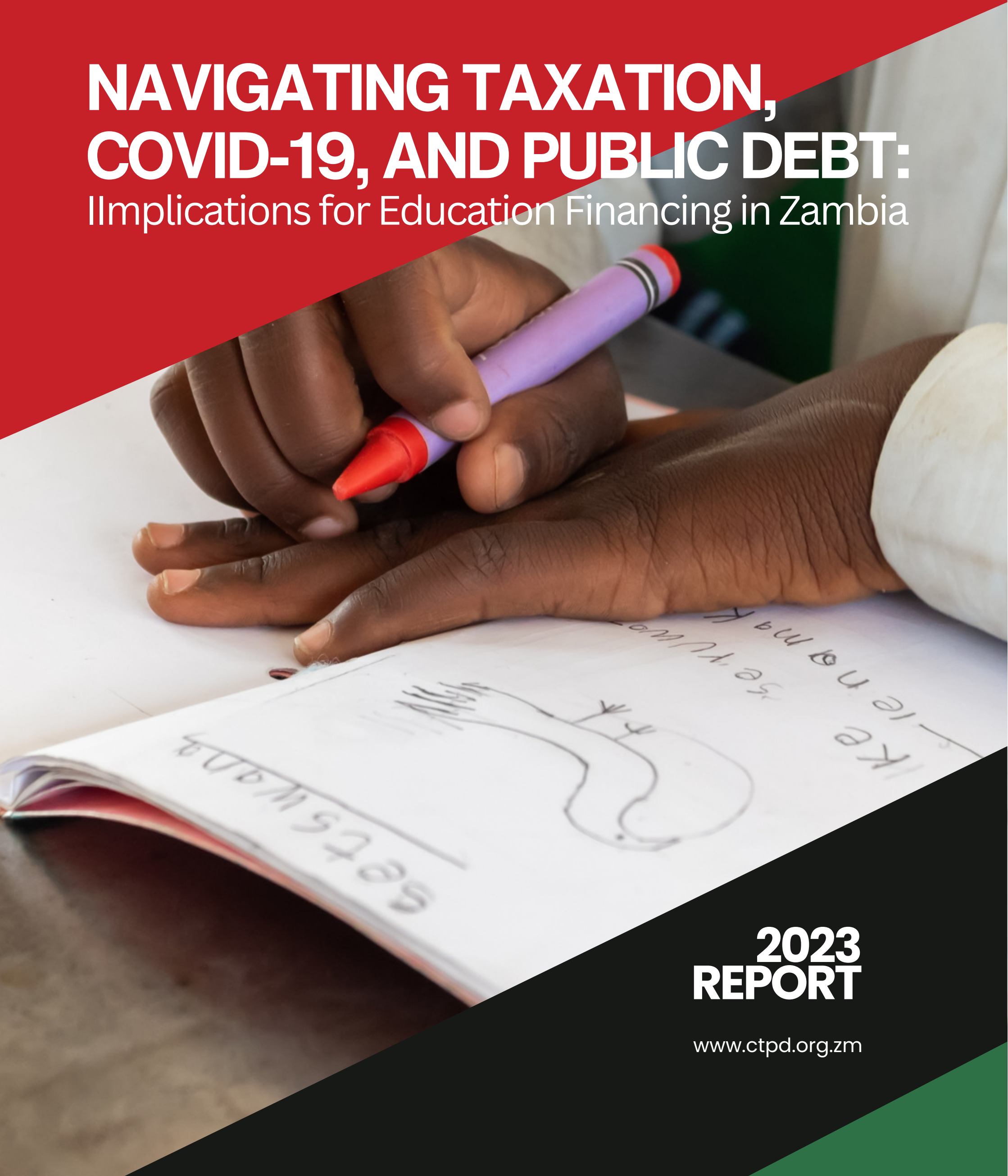
NAVIGATING TAXATION, COVID-19, AND PUBLIC DEBT:

IImplications for Education Financing in Zambia



2023
REPORT

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List of Acronyms

CDF	Constituency Development Funds
CIT	Corporate Income tax
DRM	Domestic Resource Mobilization
DSSI	Debt Service Suspension Initiative
ECF	Extended Credit Facility
GDP	Gross Domestic Product
HIPC	Heavily Indebted Poor Countries
IMF	International Monetary Fund
MOE	Ministry of Education
MOF	Ministry of Finance and National Planning
PAYE	Pay As You Earn
SOE	State Owned Enterprises
TMTRF	Targeted Medium-Term Refinancing Facility
VAT	Value Added Tax
ZMW	Zambian Kwacha
ZRA	Zambia Revenue Authority

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Executive Summary

Zambia, among several African nations, grapples with a substantial debt burden stemming from ambitious infrastructure initiatives pursued over the past decade. The country's economic challenges were exacerbated by the onset of the Covid-19 pandemic in 2020, further straining already weakened financial foundations primarily due to elevated public debt levels. Consequently, Zambia became the first African nation to default on its debt in late 2020[1].

As of March 2023, the country's debt stock surged to $32.8 billion, inclusive of interest arrears accrued by the end of 2022, with $18.6 billion being external debt. This escalating debt burden is noteworthy considering that by June 2022, the total debt with interest arrears stood at $32.5 billion, of which $17.5 billion was external[2].

While the utilization of taxation ideally should be the more sustainable way to finance development, including the implementation of a free education policy by the United Party for National Development (UPND) in 2022, Zambia encounters challenges with low tax collection, amassing only 17.8% of GDP in 2022, Tax of GDP ratio has averaged 16% over the past decade, falling short of the targeted 22% between 2022-2024. This inadequate tax revenue significantly restricts the government's capacity to furnish essential public goods and services required by its citizens. Notably, Zambia is projected to allocate a substantial 30% of its revenue towards debt payments between 2022 and 2024.

This research endeavor focused on exploring the intricate relationship between tax policy, the impact of COVID-19, and the management of public debt, all with the overarching goal of achieving sustainable growth in education financing within Zambia.

The specific objectives of this study encompassed several key areas: first, to analyze the interconnections among COVID-19, debt dynamics, revenue collection, and their direct influence on education funding, utilizing case studies from affected educational institutions. Second, the study aimed to shed light on the gender-specific repercussions of COVID-19 on the educational landscape in Zambia. Additionally, it sought to evaluate how the escalating levels of

[1]See Zambia's Experience In Debt Restructuring (uneca.org)
[2]See 2023 End- March Debt Statistical Bulletin - Ministry of Finance and National Planning (mofnp.gov.zm)

public debt have impinged upon equitable and progressive taxation. Lastly, the research strived to identify and examine viable strategies for both improving and aligning tax policies and debt management practices, ultimately fostering increased allocation of resources towards education financing.

Key Findings

Debt Servicing comes at the cost of education financing:

◊ The study findings underscore a concerning trend where planned expenditure on education, as a share of total expenditure had been reducing, as the amount of debt allocated towards debt servicing increase. This was heightened during the peak of the Covid-19 pandemic in 2020, where education financing hit a three-year low. Although there was a recovery in 2021 due to increased donor support, it is evident that as public education financing reduced, resources allocated to domestic debt servicing escalated.

Diminishing revenue mobilization has been substituted by debt, at the cost of education financing:

◊ The study highlights a decrease in revenue mobilization during the Covid-19 pandemic period, coinciding with the necessity to service the growing debt.

◊ This dual impact of public debt and Covid constrained Domestic Resource Mobilization (DRM) on education funding became apparent as the debt-to-revenue ratio surged considerably while total revenue collections stagnated.

To catch pace with the countries, need to mobilize more resources, more emphasis has been placed on regressive tax instruments ignoring the revenue gap of income taxes.

◊ VAT collections have heighted and contribute more to the revenue base than progressive taxes. The study indicates a negative impact on progressive taxation, with increased VAT collections overshadowing contributions from progressive income taxes,

Challenges in Disbursement of Allocated Education Funds:

◊ The study uncovered instances where schools, intended beneficiaries of expanded Constituency Development Fund (CDF) project financing, meant to complement Zambia's free education policy, faced challenges. Many interviewed schools, spanning various constituencies and districts, reported not receiving any project funding from CDF due to unsuccessful applications or pending verdicts, which hindered the intended flow of funds toward education initiatives. This is besides Government having released 50% of total budgeted funding for CDF by June 2022.

Overview of Recommendations

◊ Based on these findings, the study recommends that bottlenecks in the delivery of CDF be resolved and that grant amounts given to schools be increased in order to enhance support towards the running of schools.

◊ The study further recommends for removal or relaxation of grant expenditure guidelines so that schools can spend according to needs, enhanced engagement between policy makers and teachers to appreciate the challenges faced by teachers and continued review of enrolment figures so that grant allocations match the latest number of pupils in a school.

◊ At a broader level, this study calls for enhancement and alignment of tax policy and debt management to increase education financing in Zambia. Some of the options to realize this include formalization of the informal sector by capturing the large companies that are in the informal sector and enhanced capacity for digital economy taxation. There is also need for development of extractives sector taxation policy that enhances revenue collection as well as a diversified extractives sector beyond copper mining.

◊ Further, enhancing the Zambia Revenue Authority's legal and technical capacity to detect illicit financial flows and enacting feasible property taxes can also contribute towards realizing higher tax revenues. In terms of debt management, this study calls for the enacting into law of the public debt management act that promises of heightened parliamentary oversight and transparency in public debt management.

1.0 Introduction

Zambia's economy has been on a nose-dive over the past decade. Growth declined markedly to an average of 1.8% in 2019 after growing by as much as 10% in 2010. Gains in reducing poverty and inequality over this period have been modest. With an already reduced downward trending rate of growth, the COVID -19 pandemic exacerbated existing vulnerabilities and drove the economy into a recession as economic growth contracted by about 3% in 2020 (ZSA, 2022). Pre-pandemic vulnerabilities were largely attributable to a sustained contraction in fiscal fitness owing to a rapidly growing stock of public debt.

The impact of public debt on the economy has been diverse. By 2020, debt service costs claimed nearly half the expenditure envelope of the National Budget with nearly the other half going towards financing recurring government expenditure. This left a meagre tenth of the budget for use in the development of key social and economic sectors such as health and education.

The impact of domestic debt on the other hand manifested through a subdued private sector on account of constrained liquidity due to the 'crowding-out' effect of a significant reliance of government on domestic financing.

As at the end- of December 2020, the stock of public external debt increased by 9 percent to US $12.74 billion from US $11.65 billion as at end-December 2019. This was on account of continued disbursements on existing project loans largely from multilateral institutions and supplier creditors to finance on-going infrastructure projects. As of March 2023, the country's debt stock surged to $32.8 billion, inclusive of interest arrears accrued by the end of 2022, with $18.6 billion being external debt.

The stock of domestic debt contracted though issuance of Government Securities grew by 62.3 percent to K130.2 billion as at end-December 2020 from K80.2 as at end- December 2019. The increase in domestic debt was largely attributed to the contraction of Government securities to finance the 2019/2020 Farmer Input Support Programme (FISP) and liquidating fuel arrears (MoF, 2020).

In the advent of the COVID-19 pandemic, Domestic Resource Mobilisation (DRM) efforts were substantially handicapped, inevitably leading to Zambia becoming Africa's first sovereign country to default on its debt obligations during the pandemic in 2020 and 2021 (MoF, 2021). On the other hand, due to the pandemic, room was opened for conversations with creditors on the need to retain debt to sustainable levels. And in line with this creditor in the Paris Club and the G20 group of countries designed a Debt Service Suspension Initiative (DSSI) to provide heavily indebted developing countries such as Zambia with debt relief and space to reorganize their fiscal aspirations. The government also received several COVID-19 related donations from domestic and external sources thereby abating the impact of the pandemic in the sector but also, potentially alleviating the depth of pre-existing challenges.

The pressure of debt service has also contributed to the tax burden for low-income individuals with increased dependence on consumption taxes such as Value Added Tax (VAT) being observed. As Zambia works to service and manage its debt, it is anticipated that efficiency will receive more attention than equitable and fair tax collection. Further research into the relationship between debt management and tax policy is necessary to expand the fiscal space available for financing for education given the cyclical nature of how tax policy influences debt policy and vice versa.

Education is recognized as a basic human right, and is crucial in giving individuals, communities, and countries a route out of poverty, conflict, and instability. According to the World Vision, Oxfam and Save the Children, public debt crisis in poor countries has exerted a severe impact on access to education. As has been evident in proposed National budgets over the years, education spending has been trending down from 2011 to 2021 as a percentage of total public spending, averaging 16 percent of the total budget and ranging from a minimum of 11.5 percent in 2021 after having reached a maximum share of 20.2 percent in 2015.

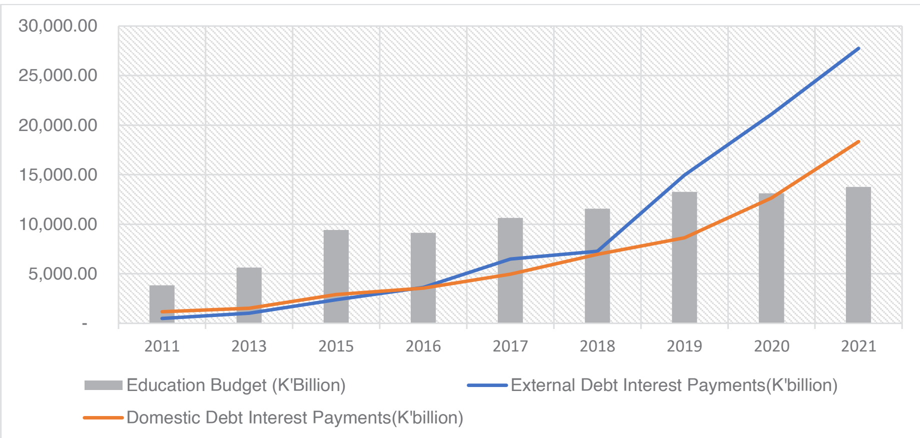
Zambia's educational prospects have slowed down over the past ten years due to insufficient funding. The teacher to pupil ratio has remained high with an average ratio of 1 teacher to 60 pupils and there has been limited access to teaching aids and support infrastructure such as desks. This has been at the backdrop of thousands of trained teaching professionals graduating from various tertiary institutions every year but unable to get employed in the public sector mainly owing to fiscal constraints premised on rising public debt. However, on the positive side in 2022 the government has introduced free education in all public schools as well as recruited teachers.

Since March 18, 2020, when Zambia recorded the first case of COVID-19, education for more than 4.4 million children and adolescents was disrupted, potentially regressing progress made in attaining Sustainable Development Goal (SDG) number 4, including the attainment of high-quality primary and secondary education. The most vulnerable, including those living with disabilities and migrant children were potentially the most affected by the impacts of COVID-19 because of inherent vulnerabilities they face (World Vision, 2021).

1.2 Statement of the Problem

Over the period of analysis, from 2011 to 2021, debt service pressures persisted as budget interest payment targets on both domestic and external debt ranged from a minimum of K1.6 billion in 2011 to a maximum of K46.08 billion in 2021 and posted an average of K16.2 billion. This is compared to the education budgets which averaged K10.04 billion over the review period with a range running from a minimum of K3.8 billion in 2011 and hitting a climax of K13.7 billion in 2021. Further, by 2018, expenditure on external debt had begun outweighing the education budget with domestic debt catching up 2 years later. The substantial deviation between debt servicing budgets and education budgets post 2019 partly reflects the impact of COVID-19 on pre-existing fiscal vulnerabilities.

Figure 1: Trends in public debt and education budgets – 2011 to 2021



Source: National Budget Speeches, 2011 – 2021

The question that needs to be addressed, therefore, is the extent to which debt-driven fiscal constraints affect education financing, more so, in the advent of the COVID-19 pandemic. Against this background, this study will attempt to break the ice in this regard and hopefully stir a conversation towards plausible solutions to emerging financing challenges in the education sector.

1.3 Objectives

General Objective

Assess the nexus between tax policy, COVID-19, and public debt management with the view to sustainably increase financing for education in Zambia. The study will act as a case study for increased regional commitment at SADC to sustainably increase financing for education.

Specific Objectives

- ◊ Ascertain the nexus between COVID-19, debt, revenue collection and their effect on education financing in Zambia providing case studies of affected schools.

- ◊ Assessing how the increasing levels of public debt have affected fair/progressive taxation.

- ◊ Explore options for enhancement and alignment of tax policy and debt management to increase financing for education.

2.0 Literature Review

The Ministry of Education's second National Implementation Framework (NIF/II) implemented from 2008 to 2015 aimed at enhancing human capacity by improving quality education and skills training with particular attention to raising learning achievement levels and mitigating inequalities[3]. Further, over the years the country has made various strides in education such as improved access to primary education with a completion rate at Grade 7 as high as 91.8 percent at Grade 7[4]. However, the quality of education and access especially to early childhood education services has been persistently low.

As debt continues to drain countries of resources and economic conditions limit investment in education, the provision of education in many low-income countries is suffering. Teacher shortages are particularly bad in some debt-burdened countries. Sub Saharan Africa for instance, governments spend 11-28% of their budgets on education[5]. Despite these budget shares, public provision of educational services is constrained by availability of public resources which can partly be attributed to diminished DRM[6]. The limitation to collect sufficient resources is further constrained by the trade-off between social welfare spending, increasing taxes and maintaining debt sustainability.

Historically, the Zambian government has shown a strong commitment to educational development by allocating a relatively large proportion of its budget to the education sector. Post the Heavily Indebted Poor Countries (HIPC) completion point, the government increased allocation to the education sector to as high as 3.7- 4.4 percent of GDP in the period 2006-2013 (GCE). Further, the education and skills sector consistently received the highest volume of external aid throughout the 2000 but on a decreasing trend. Despite the sector receiving increased budgets, however, evidence has further shown that the allocations are insufficient to cover both education operations and investments as well as staff emoluments[7].

Saungweme and Odhiambo (2018) conducted a study that investigated the dynamics of public debt servicing – both domestic and foreign – in Zambia, tracing the trends, reforms, and challenges over the period from 1964 to 2015.

[3]https://www.globalpartnership.org/where-we-work/zambia/
[4]https://www.unicef.org/zambia/education/
[5]http://uis.unesco.org/sites/default/files/documents/financing-education-in-sub-saharan-africameeting-the-challenges-of-expansion-equity-and-quality-en_0.pdf/
[6]https://openknowledge.worldbank.org/bitstream/handle/10986/23883/K8640.pdf?sequence=2/
[7]https://openknowledge.worldbank.org/bitstream/handle/10986/23883/K8640.pdf?sequence=2/

Their study showed that the exceptional rise in public debt servicing obligations in Zambia over that period was principally driven by high domestic and foreign interest rates, frequent debt rescheduling at commercial rates, and capitalization of non-liquidated service obligations at commercial rates. Also revealed in their paper is the fact that prior to 2005, Zambia experienced severe public debt servicing problems which eased after 2006 owing to debt relief initiatives and an economic rebound. Among the government debt service reforms discussed in the paper are structural adjustments in foreign exchange management, fiscal and monetary reforms, and aggressive engagement of traditional creditors. Primary among the identified challenges of public debt servicing in Zambia was the insistent economic crises that dogged the country during the study period.

The new dawn government has introduced free education in all public schools starting this year, 2022. Before this, parents used to cover tuition fees and examination fees on top of covering other needs for the child. However, in a study aimed at reviewing literature on financing primary and secondary education in Sub Saharan Africa[8], Chikoko and Mthembu gathered that attempts to provide full access to free education have at times resulted in mass increases in enrolments leading to overcrowded classrooms, high teacher-pupil ratios, failing learner retention and reduced rates of literacy. Proponents of school user fee charging state that the practice improves parental ownership and involvement in education and provides an important income stream for schools. Those against argue that fees are prohibitive for the disadvantaged and perpetuate inequality. The study further revealed that apart from scrapping off user fees, there is need for resource allocation in education towards investing resources to mitigate factors that cause children from disadvantaged backgrounds to drop out of school due to out of pocket expenses.

[8]http://www.iiep.unesco.org/sites/default/files/literature_review_on_school_funding_in_sub-saharan_africa_0.pdf

3.0 Methodology

The study employed both qualitative and quantitative research strategies, involving data collection from primary and secondary sources.

To achieve **objective 1: Ascertain the nexus between COVID-19, debt, revenue collection and their effect on education financing in Zambia providing case studies of affected schools**, primary data was collected from four selected schools: two in rural district (s) and two in an urban district (s). Data was collected using expenditure/revenue tracking forms/questionnaires through interviews with school administrators. To complement the primary data, two key informant interviews with the Planning and Information department at the Ministry of Education, and the budgeting office at the Ministry of Finance respectively were conducted.

To achieve **objectives 2** and **3**, the study relied mainly on secondary data collected through review of several education, tax, and expenditure policy documents, including fiscal tables from the Ministry of Finance.

Conceptual Framework

The analysis was anchored on a conceptual framework that highlights the interlinkages among the key variables of interest namely, public debt, tax policy, COVID-19, and education financing. The conceptual relations begin with public debt affecting the conduct of tax policy as government seeks to raise enough revenues to service debt while implementing other budget programs. This relationship accounts for the possibility of reverse causality as inadequacies and inefficiencies in tax policy could be leading to less revenues relative to expenditure thereby pushing budget implementation to rely on debt. A similar disposition was presented for the relationship between public debt and COVID-19. On one hand, public debt was expected to exert an impact on government's ability to aggressively respond to the pandemic. On the reverse, COVID-19 was expected to exacerbate the debt situation through its dampening impact on DRM prospects and heightening effect on expenditure. At the tail end of all these interlinkages lies the dependent variable of this analysis, education financing which receives the pass-through effects of the alluded to interlinkages. Figure 4 shows the conceptual framework that will anchor the analysis.

4.0 Presentation of Study Findings

4.1 Nexus between Covid-19, Debt and Revenue Collection and Their Effect on Education Financing in Zambia

Covid-19 and the Zambian Economy

The outbreak of the COVID-19 pandemic in Zambia in March 2020 led to 233,549 COVID-19 cases as of December 2021. Of these, 201,134 recoveries and 2,631 deaths were recorded, of which 709 were COVID-19 associated deaths. This strained Zambia's economy, with a contraction of an estimated 3% at the peak of the pandemic in 2020. Efforts to respond to and mitigate the pandemic brought about additional expenditure by the government.

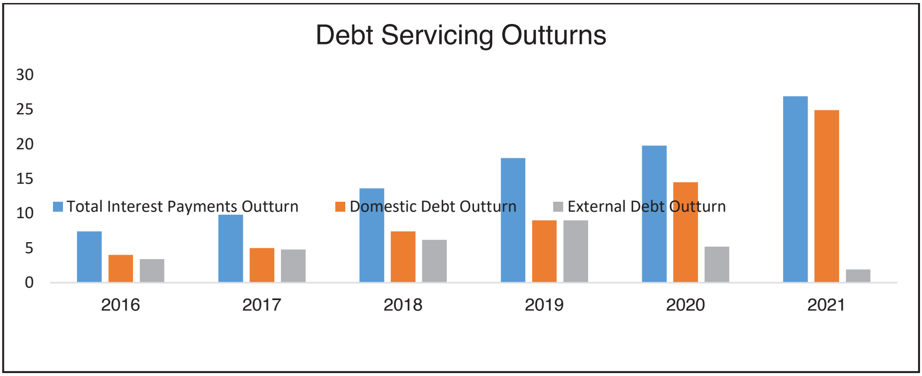
Undoubtedly, these expenses left little resources for use in the development of other key sectors. In the education sector for instance, as the Ministry of Education prepared for the reopening of schools in 2020, funds were disbursed for schools to purchase Covid-19 protection equipment. Because of Covid-19, the government further had to ease liquidity challenges in the economy and prevent liquidity constraints to financial institutions. Some of these measures brought in included release of K500 million to the Public Service Pensions Fund to pay retirees, K 170 million to banks in order to clear third party areas as well as increased funding to social protection. Through the Targeted Medium-Term Refinancing Facility (TMTRF) a further K10 billion was issued by the Bank of Zambia to commercial banks for onward lending to businesses in key economic sectors. Education was, however, not part of the target sectors.

COVID-19 and Domestic Resource Mobilisation in Zambia Covid-19 had effects on domestic resource mobilisation. As a way of shielding businesses from the effects of reduced economic activity at the height of the pandemic, the government came up with various tax suspensions and waivers. These suspensions and waivers included waiver on outstanding tax penalties and interest; reduction of the corporate income tax rate for the tourism sector on income earned from accommodation and food services from 30 percent to 15 percent for the financial year 2021 and 2022 among other interventions. According to the Ministry of Finance, at least K2.9 million was forgone by waiving off customs duty on safari game viewing vehicles alone. There was also suspension of customs duties and VAT on additional medical supplies used in the fight against Covid-19.

COVID- 19 and Zambia's Debt Situation

Zambia's debt burden continued to worsen from 2016 to 2021 as debt servicing continued to gobble up resources that could otherwise be directed towards social and economic development.

Figure 3. Trends in Debt Servicing for the period 2016 to 2021

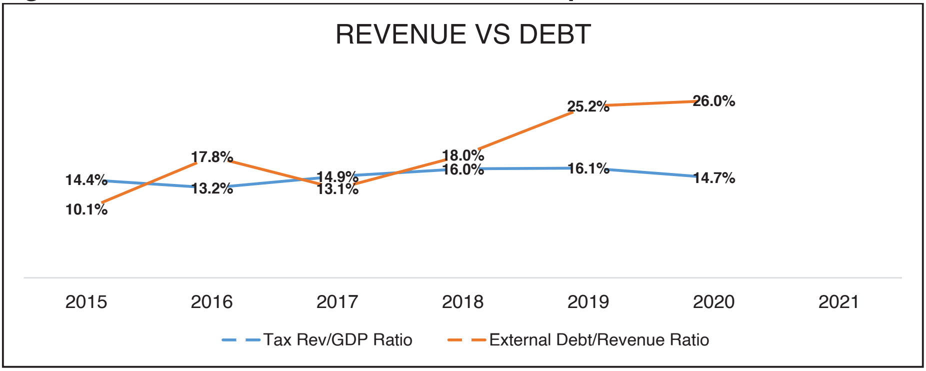


Source: Author's analysis

Expenditure on total interest payments kept an increasing trajectory, rising to K26.9 billion in 2021 from only about K7.4 billion in 2016 as shown in figure 3 above. Expenditure on external debt servicing decelerated during the pandemic as Zambia benefited from the DSSI but also inevitably became Africa's first sovereign country to default on its debt obligations during the pandemic in 2020 and 2021 (MoF, 2021). As a result, interest payments on external debt were only K5.2 billion and K1.9 billion in 2020 and 2021, respectively as shown in figure 7. The stock of public debt as at end-December 2021 increased by 31.6 percent to US $26.07 billion from US $19.8 billion recorded as at end-December 2020. The composition of public debt was dominated by public external debt at US $13.04 billion while public domestic debt and publicly guaranteed external debt amounted to US $11.6 billion and US $1.53 billion, respectively. The increase in public debt was due to a significant increase in domestic debt through issuance of Government securities for Budget Support, as well as the continued disbursements on already contracted public external loans (MoF, 2021).

External debt as a percent of revenue as an indicator of the debt burden exhibits an increasing trend over the data span, increasing to 26% by 2020 after having been more than half less than this five years earlier when it stood at 10.1%. Conversely, the tax to GDP ratio as an indicator of ability to service debt has been generally flat over this period. Tax revenues as a percent of GDP stood at 14.4% in 2015 and lingered around this average for the entire data span, with peaks observed at 16% and 16.1% in 2018 and 2019, respectively before receding to 14.7% by end of 2020. Figure 4 shows these trends.

Figure 4. Trends in Revenue Vs Debt for the period 2016 to 2021



Source: Author's analysis

Domestic Resource Mobilisation in Zambia

Zambia collects most of its revenue through taxes, with a small share coming from non-tax revenues and fees. According to the World Bank, tax revenues above 15 percent of a country's GDP are key ingredients for economic growth and ultimately poverty reduction.

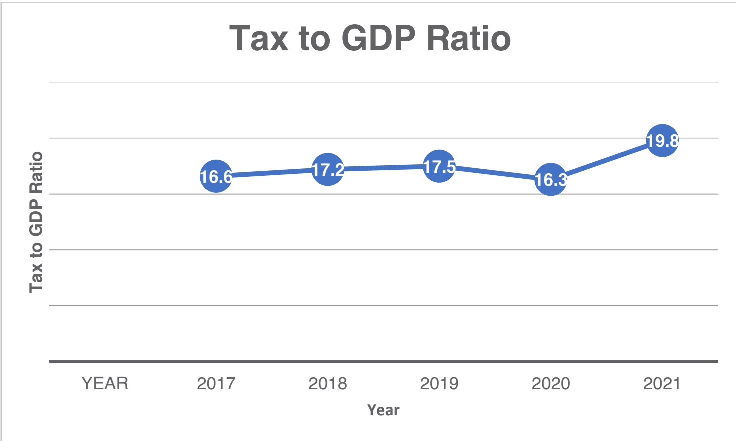
However, despite the Zambia Revenue Authority meeting its annual targets and raising revenue over 15 percent of the country's GDP (figure 5) these revenues are insufficient to cover expenditure as the country has been running in deficit. As shown in figure 5 below, the tax to GDP ratio has generally hovered around 17 percent, with the least revenue, 16.3 percent of GDP collected in 2020 at a time when the country was just adjusting to the realities of a Covid-19.

In 2021, revenue collection rebounded to a high of 19.8 percent of GDP as the economy went on its recovery path. However, as shown in figure 6 below for the period from 2017 to 2021 the country's budget has been consistently in deficit signaling inadequate revenue collection and a higher-than-expected expenditure. From 2017 to 2020 the budget deficit was increasing at an increasing rate, reaching its highest rate of 13.8 percent of GDP in 2020 before starting its path to recovery and resting at 8.7 percent in 2021.

The implication of these budget deficits is the increased debt stock over the same period especially as the country pursued an aggressive infrastructure development agenda.

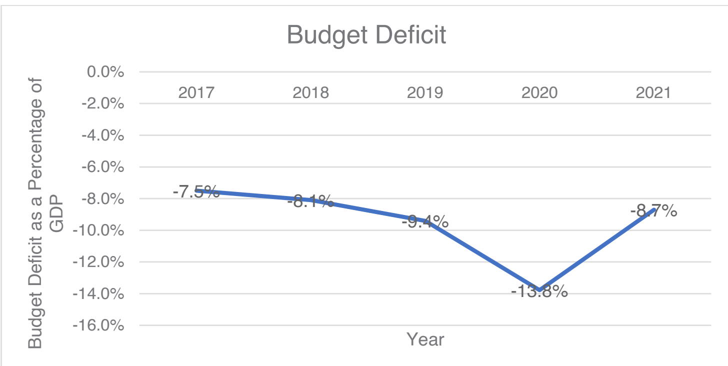
The restricted domestic resource mobilisation beyond leading to increased debt also has implications on societal wellbeing as it leads to reduced spending on social sectors such as education.

Figure 5. Trends in Revenue Collection for the period 2017 to 2020.



Source: Author's Own Analysis of ZRA Tax Statistics 2020 and 2021 Annual Report

Figure 6. Trends in Budget Deficit in Relation to GDP for the period 2017 to 2020



Source: Statista (IMF)

Developing country tax systems fail to raise sufficient revenue for various reasons including internal political factors, administrative constraints, external political factors including multinational tax evasion and avoidance, tax treaties, exemptions as well as the largely informal structure of the economies[9]. Further, the Zambia Fair Tax Monitor Gender Analysis report revealed that tax leakages in Zambia can be accounted for in the large informal economy, corporate tax avoidance and evasion as well as illicit financial flows, especially in the extractives sector[10]. Given this background, the coming of the Covid-19 pandemic further constrained domestic revenue as it reduced economic activity. As shown in figure 5 above the country recorded its least tax to GDP ratio in 2020 at the peak of the Covid-19 pandemic. This reduced revenue collection was indicative of the prevailing conditions in the economy as all sectors contracted and the country's real GDP shrank by negative 2.8 percent.

Education Financing in Zambia

Funding to the education sector over the period of analysis 2019 to 2021 as indicated by the share of the education budget in the national budget and the GDP has been on the decline. This can be attributed to changing spending priorities given that over the same period the nominal size of the national budget has been growing. As shown in the table 1 below, the total education budget as a percentage of both GDP and the national budget has been on the decline. In both 2020 and 2021, the allocation to the education sector fell short of the Incheon declaration on education financing that calls for budgetary allocation of at least 4 percent and 15 percent of GDP and the national budget respectively to education. In 2019, both these benchmarks were met while the consecutive 2020 and 2021 budgets failed to meet the declaration.

In 2019, the education budget was 15.3 percent of the total budget, however in 2020 and 2021 the allocations reduced to only 12.4 percent and 11.5 percent of the total annual budgets respectively. A similar trend is seen when the budgetary allocation on education is assessed in relation to GDP. In 2019, 4.4 percent of the budget was allocated to education, while only 2.6 percent and 2.4 percent of GDP were allocated to education in 2020 and 2021.

The table also shows that donor support to the education sector over the same period has been on the rise. Donor support contributed 2.4, 3.4 and 4.2 percent of the annual education budgets in 2019, 2020 and 2021 respectively.

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[9]https://opendocs.ids.ac.uk/opendocs/bitstream/handle/20.500.12413/13053/K4D_HDR_Tax%20capacity%20barriers%20.pdf?sequence=126&isAllowed=y

[10]https://cuts-lusaka.org/pdf/zambia-fair-tax-monitor-gender-analysis-report-2022.pdf

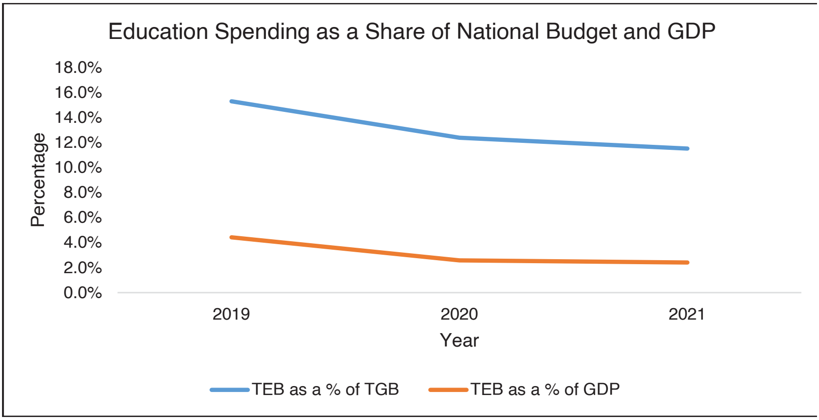
Table 1. Donor Support to the Education Sector

Source of Funds	2019	2020	2021
GDP	300,433,774,000	354,339,520,000	424,270,030,000
Total Government Budget	86,807,894,729	106,007,612,236	119,616,011,615
Total Education Budget	13,274,546,421	13,121,648,466	13,772,752,981
Total Education Financing	8,842,160,799	9,117,574,075	10,213,353,659
Domestic Education Financing	8,631,037,495	8,803,076,454	9,784,102,567
Donor Education Financing	211,123,309	314,497,618	429,251,092
TGB as a % of GDP	28.9%	29.9%	28.2%
TEB as a % of TGB	15.3%	12.4%	11.5%
TEB as a % of GDP	4.4%	2.6%	2.4%
DEF as a % of TEF	2.4%	3.4%	4.2%

Source: Author's analysis of Ministry of Education, BOZ data

Figure 7, below shows the generally downward trend that education spending has taken as indicated by the GDP and total budget share of the education budget.

Figure 7. Education Spending as a Share of National Budget and GDP

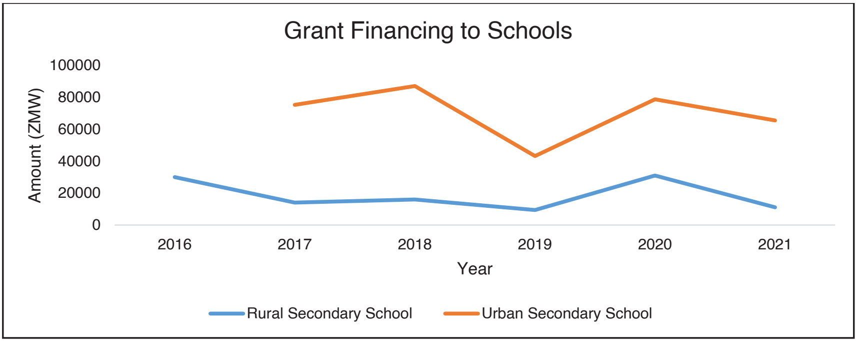


Source: Author's Own Analysis of ZRA Tax Statistics 2020, BOZ and Nationals Budgets

TEB=Total Education Budget, TGB=Total Government Budget

Using actual disbursements, however, paints a different picture. According to statistics from the Ministry of Education, spending to the sector rose between 2020 and 2021. This contradiction may be accounted for by the fact that some of the funding for education comes through donor support that does not pass through the treasury.

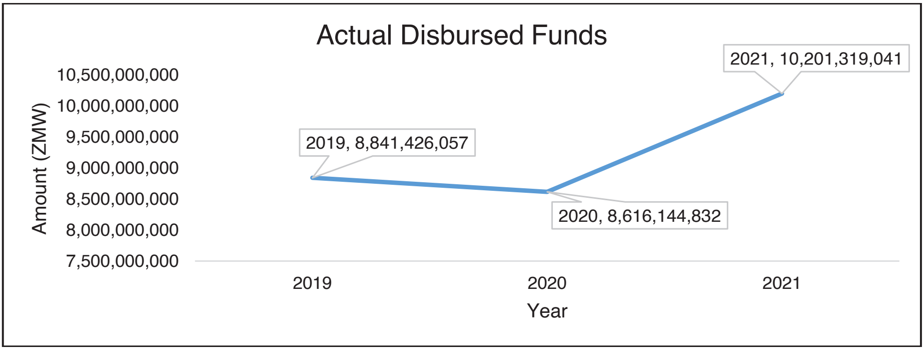
Figure 8. Education Budget Disbursements



Source: Author's Own Analysis of Ministry of Education Data

Despite the increase in disbursements by the Ministry of Education, an analysis of data on the amount of grants schools received from the government showed that funding to both urban and rural schools has been unsteady, reaching its peak in 2020 before falling to their lowest in the in 2021.

Figure 9. Grant financing to schools

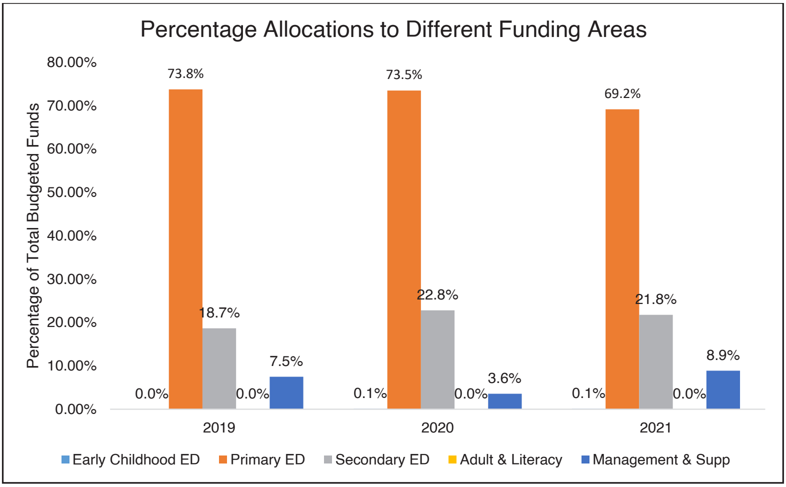


Source: Author's Own Analysis of Primary data from school

Allocations of the Education Budget to Different Education Levels

From table 10 below, it is clear that government has placed emphasis on primary education. Over the three-year period from 2019 to 2021 a larger proportion (about 70%) of education funds have been budgeted to primary education with secondary education taking the second largest chunk of the education spending. The small allocation to maintenance is consistent with information obtained from schools who revealed that only a small percentage of the grants is planned go towards infrastructure maintenance, which poses a threat to the condition of school infrastructure. The least allocation has however been towards adult literacy programmes.

Figure 10. Percent allocations of the Education Budget

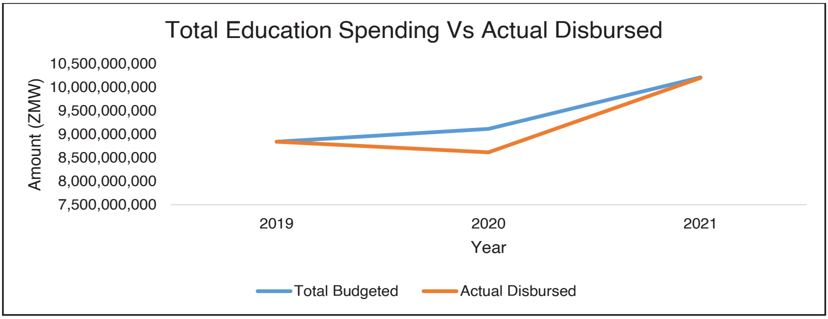


Source: Ministry of Education

Financing of Education with the Coming of Free Education

With the coming of free education, schools are fully dependent on government grants. However, boarding secondary schools are allowed to charge a boarding fee that is prescribed by the government. The rural secondary school that was interviewed for this study charges K1, 000 boarding fee per term. Disbursement of grants is done quarterly, directly into the accounts of the schools by the Ministry of Finance. 1 out 4 schools (75 percent) interviewed revealed that receipt of grants was inconsistent. As shown in the figure 16 below there is a disparity, which increased substantially in the year 2020 between the budgeted and disbursed amounts of funds to schools. The Ministry accounted for this as being due to unavailability of funds at Ministry of Finance.

Figure 11. Percent allocations of the Education Budget



Source: Author's Own Analysis of Ministry of Finance Data

The IMF Programme and Education Financing

The IMF board approved a 38-month US$1.3 billion ECF for Zambia in August 2022[11]. The objectives of the ECF are to restore macroeconomic stability and foster inclusive growth, a reflection of the aspirations of the country's Eighth National Development Plan (8thNDP)[12] which aims at socioeconomic transformation for improved livelihoods. The restoration of macroeconomic stability under the ECF coupled with successful debt restructuring is expected to underpin a gradual economic recovery over the years. One of the objectives of the ECF is creation of fiscal space for social spending in order to cushion the burden of adjustment through revenue and expenditure reforms.

In terms of revenue, the ECF intends to improve DRM and increase non-grant fiscal revenues by 3.25 percent by 2025 from the pre-covid-19 level of 19.6 percent. According to the terms of the programme[13], to achieve this a number of key reforms are planned some of which were implemented by end of year 2022. The proposed reforms include policy changes to increase tax collection from company income tax (CIT), VAT and excises by broadening the VAT base, unifying the CIT to around 25-30 percent as well as raising excises on luxury products like tobacco and alcoholic beverages. Further DRM interventions will be through improvements in tax administration using measures such as implementation of a comprehensive tax payer compliance program, improved tax audits and increased use of electronic fiscal reporting. Removal of implicit subsidies on fuel is another tax revenue enhancing measure highlighted in the programme terms. This was implemented starting October 2022 and the country is now collecting VAT and excise tax on petrol and diesel with the estimated

[11] https://www.imf.org/en/News/Articles/2022/08/31/pr22297-imf-executive-board-approves-new-extended-credit-facility-arrangement-for-zambia
[12] https://www.sh.gov.zm/wp-content/uploads/2022/09/EIGHTH-NATIONAL-DEVELOPMENT-PLAN-2022-2026-05-07-2022.pdf
[13] https://www.imf.org/-/media/Files/Publications/CR/2022/English/1ZMBEA2022001.ashx

1.7 percent of GDP in tax revenue that the subsidies were costing recovered. This measure followed the removal of explicit subsidies as well as changes in the fuel pricing review period from 60 days to 30 days which had earlier been introduced.

The ECF terms have also heighted various measures that are aimed at fiscal consolidation with the key measures being removal of explicit fuel subsidies as well as scaling back on public investments that are poorly targeted and do not yield sufficient growth or fiscal revenues. Other measures aimed at reducing fiscal imbalances include improvements in governance and efficiency of agricultural subsidies which are aimed at reducing the cost of agricultural subsidies in the national budget.

A key objective of the ECF is to gradually increase the level and quality of social sector spending in order to reduce poverty and inequality as well as improve access to social services such as education, especially in rural areas. It is expected that the DRM and expenditure reforms suggested by the programme will contribute to freeing up resources which can be directed towards spending on social sectors such as education. Despite being on the ECF the government has so far made various key expenditures in the education sector such as the introduction of free education in public schools, recruitment of 30,000 teachers and introduction of school bursaries financed by CDF in 2022.

The 8thNDP on which the IMF ECF programme is based has put improved education and skills development as one of the development outcomes under the human and social development strategic development area to be pursued through strategies such as enhancing access to quality, equitable and inclusive education. And it is worth noting that despite the ECF putting forward fiscal rationalization measures such as removal of subsidies, the DRM and expenditure reforms it proposes will result in freed up resources for increased education spending.

Nexus between Covid-19, Debt, Revenue and Education Financing

As show in the results presented earlier (figure 4), the subdued economic activity during the Covid-19 period led to further increases in debt levels as the government had to source additional resources for Covid-19 mitigation. Further, the pandemic led to constrained economic activity which resulted in reduced domestic resource mobilisation. Further, incentives given to businesses during the pandemic called for the government to forgo certain tax revenue streams hence the tax revenue collected at the peak of the Covid-19 pandemic reduced revenue collection as indicated by the low tax to GDP ratio in 2020.

Increased debt levels over the period the country grappled with Covid-19 also meant that debt service, especially domestic debt service rose. And given that debt service in the absence of avenues to restructure the debt is a major priority, resources had to be reprioritised and put towards debt service. All of these factors resulted in reduced resource allocation to the education sector over the period. Therefore, at national level, spending on education as indicated by the national budget has declined over the period 2019 to 2021 despite increases in budget size.

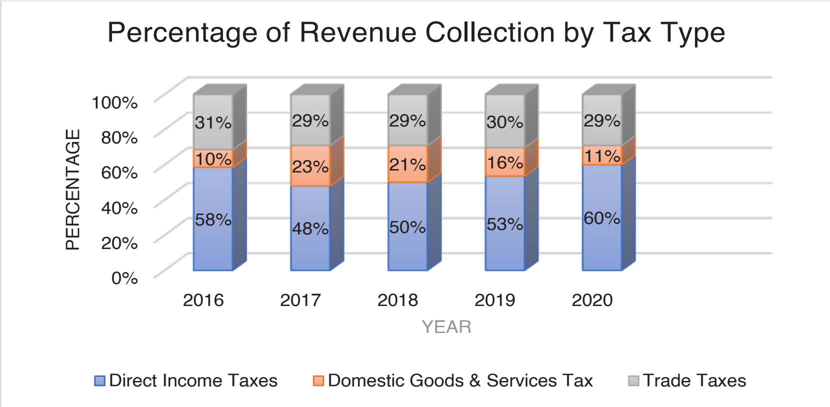
4.2 Effect of Public Debt on Progressive Taxation

Fair or progressive taxation implies taxation in which those with higher incomes pay more while those with less income pay less (ActionAid, 2018); the opposite indicates regressive taxation. Progressive taxes normally use graduated tax bands for various income levels and the level of taxation increases as income increases while regressive taxes apply a single tax rate for all taxpayers.

The Zambian tax system is comprised of three major categories of taxes; Direct Income Taxes (Company Income Tax, Pay as You Earn, Withholding Tax, and Extraction Royalty), Domestic Goods and Services Taxes (Excise Duties, Domestic Value Added Tax, and Insurance Premium Levy) and Trade Taxes (VAT on Imports, Import Tariffs and Export Duty). Of these taxes, the direct income taxes are progressive while the goods and services taxes that are of concern for this analysis are regressive.

To assess the effect of debt on progressive taxation this paper focused on the share of indirect taxes in tax revenue over the period 2016 to 2020. A look at all the tax categories as in figure 11 below indicates that on average direct income taxes account for the larger share of the annual tax revenues with income taxes have contributing on average 54 percent to annual tax revenue. In the period 2016 to 2020, the least contribution of income taxes was 48 percent in 2017 with the highest being 60 percent of total revenue in 2020. The second largest contributor to tax revenue is trade taxes contributing about 29 percent to total revenue on average with the least being domestic goods and services tax which on average contributed 17 percent to tax revenue over the five-year period. The indication of this is that on average the tax system as a whole is progressive as it relies greatly on taxing incomes progressively.

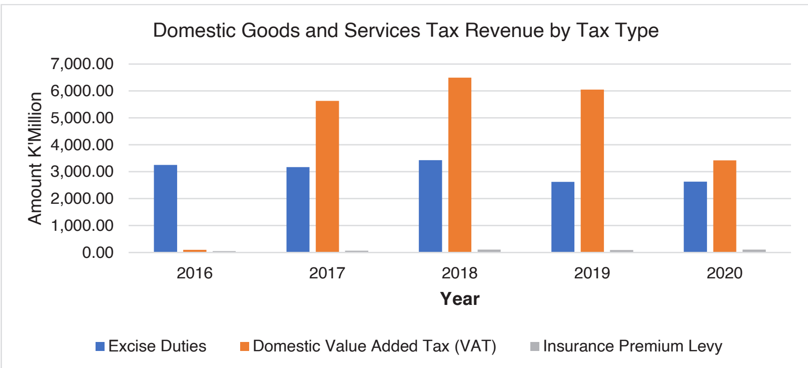
Figure 12: Trend in Tax Revenue by Tax Type, 2016 – 2020 (Percentage)



Source: Author's own analysis of data from ZRA Tax Statistics in Zambia 2020

A deeper look at domestic goods and services taxes (figure 13) shows that domestic value added tax (VAT) is the largest contributor to domestic goods and services tax revenue.

Figure 13: Trend in Domestic Goods and Services Tax Revenue by Tax Type, 2016 – 2020 (K' Million)

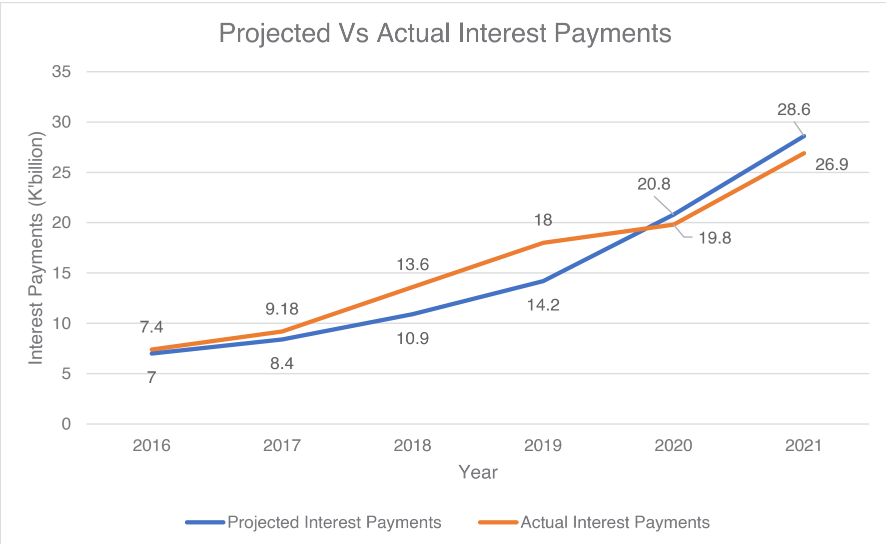


Source: Author's own analysis of data from ZRA Tax Statistics in Zambia 2020

Although VAT is a major contributor to tax revenue, the tax is regressive as it uses a single tax rate on all taxpayers regardless of income. VAT therefore has a greater effect on low-income earners than high-income earners and hence poses a threat to the standard of living of the poor. In a tax system like the one in Zambia where very few commodities are zero rated and tax exempt, a rise in VAT's contribution to tax revenue would raise concerns for the welfare of the poor.

Figure 13 below gives an indication that debt interest payments were on the rise over the period 2016-2020; in most of the years, the actual interest payments outran the approved payments. The expectation from this is that given the tight fiscal space, to pay off the interests the government would have to move resources from other expenditure lines; borrow; raise additional revenue through taxes.

Figure 14: Trend in Interest Payments, 2016 – 2020 (K' billion)

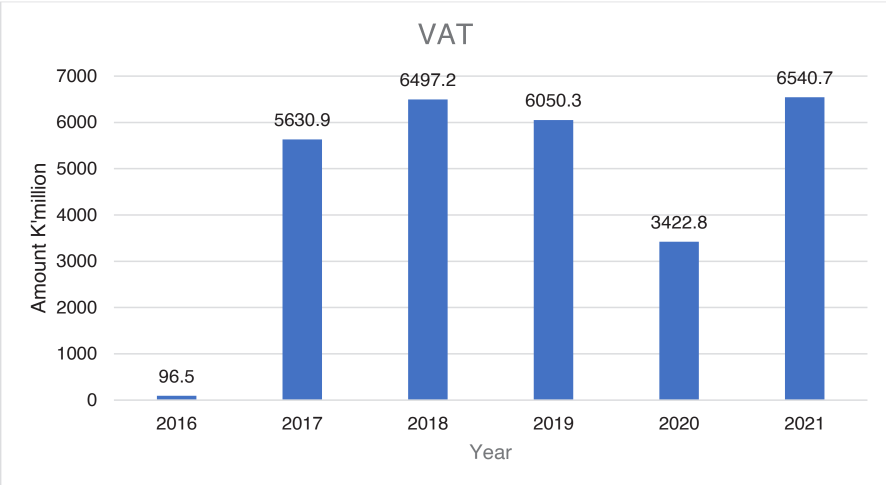


Source: Author's own analysis of data from Ministry of Finance Annual Reports

As shown in figure 13, the share of VAT in taxes increased over the period 2016 – 2021. Further there were also increases in terms of VAT collected as shown in figure 15 below. The VAT collections moved from K 96.5 million in 2016 to K5, 630 million in 2017 reaching its apex of K6, 540.7 million in 2021. There was, however, a decline in VAT revenue in 2020; the VAT collections fell to a low of K3, 422.8 million that can be attributed to the reduced economic activity during the period due to COVID-19.

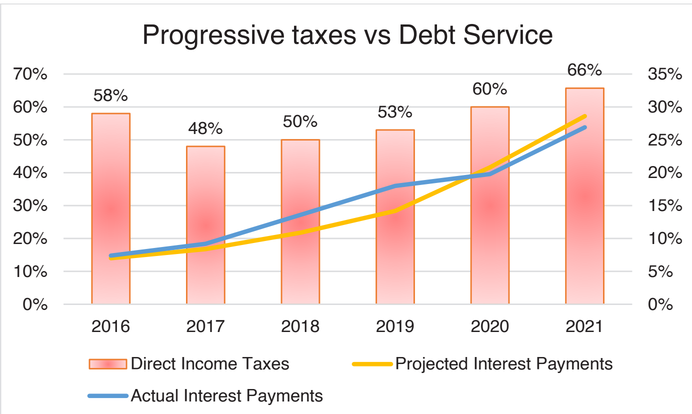
Therefore, as the debt interest payments increased there was also an increase in VAT collections. Although progressive direct income taxes remain the largest contributor to tax revenue there has been an increase in regressive taxation as well given the rise in the amount of VAT collected over the period of analysis (2016 to 2021).

Figure 15: Trend in VAT Collections, 2016 – 2020 (K' Million)



Source: Author's own analysis of data from ZRA Tax Statistics in Zambia 2020

Figure 16: Trend in Direct Taxes and Debt Services, 2016 – 2021



Source: Author's own analysis of data from ZRA Tax Statistics in Zambia 2021

4.3 A Case Study of Selected Rural and Urban Schools

A case studied was built using four schools, two (2) from urban districts and two (2) from rural districts. The urban district schools were from Lusaka while one (1) rural school was from Chongwe and the other from Rufunsa district. Three of the schools interviewed were secondary schools while one was a primary school. Of the secondary schools, one was a boarding secondary school while two were day secondary schools.

This study revealed that the Ministry of Finance disburses funds directly into the school accounts, ideally based on school enrolment. Some schools however revealed that the grants they receive are less than what they should get if enrolment is considered. These enrolment numbers are however, not updated in time. As one of the school head teachers explained: “our funding this year has reduced because we were funded according to 2021 enrolment figures, meanwhile we have more pupils now”

The grants received by the schools are spent according to financial guidelines given by the Ministry of Finance that specify how much should be spent in a particular area. These guidelines were in place even when the schools used to get tuition fees from pupils. The schools use the funds to finance the day-to-day running of the institution such as on stationery, learning and teaching materials, cleaning agents, infrastructure maintenance and administration. However, the head teachers revealed that the grant expenditure guidelines are limiting, as the schools cannot spend money according to their needs. The comments of the school managers around the grant spending guidelines include “the guidelines make spending on certain areas difficult; the guidelines provide for percentages of how much of the grant should go towards certain areas which results in areas such as maintenance not having enough funding”. Another head teacher stated, “The grants should come without allocations so that the school can be free to use the money depending on the needs, extra-curricular activities should also be catered for in guidelines”.

In the 2022 National Budget, Government announced the scaling up of the Constituency Development Funds (CDF) to about K25.7 million from the previous K1.6 million. The expanded CDF is supposed to go towards three areas namely Community Projects (60 percent), Youth, Women and Community

Empowerment (20 percent) and Secondary Boarding School and Schools Skills Development (20 percent)[14]. Under the community projects, communities may apply part of CDF towards school infrastructure projects. However, all the schools interviewed in this study and emanating from different constituencies and districts revealed that they had not received any project funding from CDF. The only school that had benefited from CDF was the boarding secondary school who's head teacher revealed that a large number of pupils had received CDF boarding fee grants. In the absence of the CDF bursary, a pupil in boarding school would be required to pay K1, 000 boarding fee per term.

Nonetheless, by June 2022, the Ministry of Finance and National Planning had released a total of K1.3 billion for the Constituency Development Fund (CDF), social cash transfer programme, food security pack, and purchase of drugs and medical supplies. Of the total amount released, the Constituency Development Fund (CDF) got K605 million for on-going constituency-level capital projects countrywide which brought the total CDF releases in 2022 to K2 billion – representing 50% budget performance on this expenditure item. The fact that none of the schools had received CDF grants suggests that although the ministry of finance releases funds, there are some bottlenecks in the transmission mechanism that are hindering the successful delivery of these funds to the constituents.

All the schools interviewed had applied for grants from CDF for school infrastructure projects but were unsuccessful, even those who had not yet received the verdict were not optimistic due to the competing needs in the constituency that had to be covered by the CDF funds. They further revealed that the CDF had delayed and even the procedures for getting the funds were not clear to them. Some of the comments of the school head teachers on CDF project grants include: "the school applied for CDF, but we have not been given since there are many schools in the constituency and not enough funds for all". Other comments include "we had applied for a grant to build a science laboratory, but we don't think we will be funded due to other competing needs in the constituency." One head teacher further revealed, "CDF has delayed and procedure to access it is not so clear".

Implied in the scaling up of CDF is the introduction of free education at primary and secondary level in public schools. The coming of free education has

[14]https://www.mlgrd.gov.zm/wp-content/uploads/2022/04/CDF-GUIDELINES-2.pdf

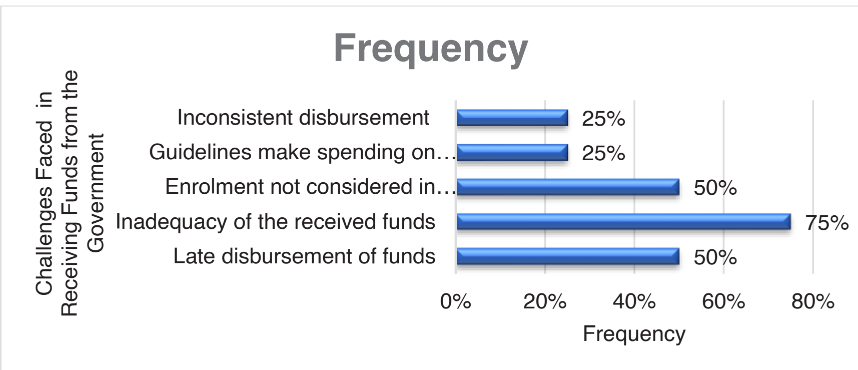
however brought mixed feelings amongst school head teachers. Rural schools interviewed felt that relying on government grants alone allowed them to do their school programmes on time. They explained that they are able to spend as budgeted given that they do not have to depend on user fees which most pupils had challenges paying. One of the rural school head teachers revealed, “there is enough money for teaching and learning materials”. Another head teacher revealed, “We are getting more now depending solely on government grants than we used to get with user fees from pupils because parents were not paying”.

On the flipside, urban schools and rural boarding schools that used to collect sufficient funds feel that the grant funds are insufficient to ensure smooth operations of the school. They explained that when they used to collect user fees, they had sufficient resources rather than now when they were not getting enough per pupil enrolled from the government. The comments from the head teachers who felt they were not getting enough now include “with the coming of free education operations of the school are suffocated because funds are not adequate”. Another head teacher revealed the funds received are inadequate, introduce user fees in schools and bring back exam fees”.

According to the Ministry of Education and schools there is no gender specific funding for schools. However, part of the grants given to schools have provisions for the purchase of sanitary towels for female pupils at a small scale under counselling and guidance.

Some of the challenges faced by schools in receiving funding from the government were highlighted as in figure 20 below.

Figure 17: Challenges Schools Face in Receiving Funds from the Government



Source: Author’s own analysis of primary study data

5.0 Conclusion and Recommendations

Growth of Zambia's economy contracted by an estimated 3% at the peak of the COVID-19 pandemic in 2020. The pandemic exacerbated pre-existing economic vulnerabilities leading Zambia to become the first African country to default on its debt obligations during the pandemic era. This study interrogated the implications of; inter alia, the nexus between taxation, COVID-19, and public debt on education financing.

Results indicate that expenditure on domestic debt servicing heightened during the pandemic while expenditure on external debt servicing was modest owing to the G20 supported Debt Service Suspension Initiative (DSSI) and the default on repayments. The increased expenditure on debt service without corresponding increases in revenue resulted in changed priority in spending from social sectors such as education to debt service.

From the findings of this study, the negative impact of public debt on education financing among other social sectors is as apparent as is, the gloomy impact of COVID-19 on fiscal fitness via implications on the debt burden. With uncertainties surrounding the COVID-19 pandemic reducing, securing a successful debt restructuring process for Zambia will potentially help matters in the education sector.

The debt burden worsened as the debt-to-revenue-ratio increased quite substantially while total revenue collections stagnated. Generally, there was diminished revenue and increased debt service that led to reduced spending on education. The findings further indicate that the debt situation have negatively affected progressive taxing through increased VAT collections despite progressive income taxes continuing to be the largest contributor to tax revenue. Planned expenditure on education trended downwards with disbursements hitting a three-year minimum at the peak of the pandemic in 2020 before recovering in 2021 at the backdrop of increased donor support. In 2021, the number of students supported under the Higher Education Loans and Scholarship Board at public universities reduced to 9,709 from 13,908 in 2020, potentially signaling financing challenges during the pandemic.

A case study of selected rural and urban schools revealed that in most cases, the grants that they receive are seldom commensurate with enrollment levels. The schools interviewed in this study, emanating from different constituencies and districts revealed that they had not received any project funding from CDF yet as their applications were unsuccessful, and those who had not yet received verdicts were not optimistic. This is besides Government having released 50% of total budgeted funding for CDF by June 2022.

Based on these findings, the study recommends that bottlenecks in the delivery of CDF be resolved and that grant amounts given to schools be increased in order to enhance support towards the running of schools.

The study further recommends for removal or relaxation of grant expenditure guidelines so that schools can spend according to needs, enhanced engagement between policy makers and teachers to appreciate the challenges faced by teachers and continued review of enrolment figures so that grant allocations match the latest number of pupils in a school.

At a broader level, this study calls for enhancement and alignment of tax policy and debt management to increase education financing in Zambia. Some of the options to realize this include formalization of the informal sector by capturing the large companies that are in the informal sector and enhanced capacity for digital economy taxation. There is also need for development of extractives sector taxation policy that enhances revenue collection as well as a diversified extractives sector beyond copper mining.

Further, enhancing the Zambia Revenue Authority’s legal and technical capacity to detect illicit financial flows and enacting feasible property taxes can also contribute towards realizing higher tax revenues. In terms of debt management, this study calls for the enacting into law of the public debt management act that promises of heightened parliamentary oversight and transparency in public debt management.

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7.0 Appendix I

Financing of Education with the Coming of Free Education

Rural Schools	Urban Schools
Government Grants	Government Grants
CDF bursaries (Boarding Schools)	CDF bursaries (Boarding Schools)
Boarding Fees (Boarding Schools)	Boarding Fees (Boarding Schools)

Source: Ministry of Education and Schools

Kinds of Financing received from the government

Rural Schools	Urban Schools
Government Grants	Government Grants
Orphans and Vulnerable children grant	Orphans and Vulnerable children grants

Source: Ministry of Education and Schools

Needs Covered by Government Grants with the Coming of Free Education

Rural Schools	Urban Schools
User fees	User fees
Staff salaries	Staff salaries
Learning materials	Learning materials
Medical fees	Medical fees
PTA Fees	PTA Fees
Examination Fees	Examination Fees
Maintenance	Maintenance
All operational costs	All operational costs

Source: Ministry of Education and Schools

Needs Covered by Parents and Guardians with the Coming of Free Education

Rural Schools	Urban Schools
Boarding fees (Boarding school pupils not on CDF bursary)	Boarding fees (Boarding school pupils not on CDF bursary)
Other personal pupils needs	Other personal pupils needs

Has the School Received Funds from Constituency Development Funds (CDF)

Rural Schools	Urban Schools
No	No

Is the School Expecting to Receive CDF Funds?

Rural Schools	Urban Schools
Yes	Yes

Source: Author's Own Analysis of Ministry of Finance Data

Disparity between the budgeted for funds and the disbursed fund.

	2019	2020	2021
Total Budgeted	8,842,160,799	9,117,574,075	10,213,353,659
Actual Disbursed	8,841,426,057	8,616,144,832	10,201,319,041
Difference	734,742	501,429,243	12,034,618

Source: Ministry of Education

Financing of Education before the Coming of Free Education

Rural Schools	Urban Schools
User fees	User fees
Government Grants	Government Grants
PTA	PTA

Source: Ministry of Education and Schools

DESIGN & LAYOUT
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