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Fiscal Policy and Economic Growth in Zambia

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ABSTRACT

This study examines the evolution and effectiveness of Zambia's fiscal policy in promoting economic growth and stability. It identifies key trends and challenges through a comprehensive analysis of fiscal policy and economic indicators, including budget deficits, GDP growth, public debt, and sectoral contributions. Despite efforts to diversify and reform fiscal practices, Zambia faces persistent hurdles such as high external debt and dependence on copper exports. The findings underscore the importance of a balanced fiscal approach that includes targeted social spending, prudent debt management, and sectoral diversification to achieve sustainable economic development. In addition, effective coordination between fiscal and monetary authorities, transparency in governance, and strategic investments in key sectors are essential to address these challenges and promote long-term prosperity in Zambia.

Questo studio esamina l'evoluzione e l'efficacia della politica fiscale dello Zambia nel promuovere la crescita economica e la stabilità. Identifica le tendenze e le sfide principali attraverso un’analisi completa degli indicatori fiscali ed economici, inclusi deficit di bilancio, crescita del PIL, debito pubblico e contributi settoriali. Nonostante gli sforzi per diversificare e riformare le pratiche fiscali, lo Zambia deve affrontare ostacoli persistenti come l’elevato debito estero e la dipendenza dalle esportazioni di rame. I risultati sottolineano l’importanza di un approccio fiscale equilibrato che includa una spesa sociale mirata, una gestione prudente del debito e una diversificazione settoriale per raggiungere uno sviluppo economico sostenibile. Inoltre, un coordinamento efficace tra le autorità fiscali e monetarie, la trasparenza nella governance e gli investimenti strategici nei settori chiave sono essenziali per affrontare queste sfide e promuovere la prosperità a lungo termine nello Zambia.

Keywords: Fiscal policy, economic growth, debt management, diversification

1 – Introduction

Government attempts to change the course of the economy by changing taxes or spending are referred to as fiscal policy (Ali *et al*., 2010). The term 'fiscal policy' refers to the authority granted to the government to regulate the amount of money it spends, borrows and taxes in order to achieve specific macroeconomic objectives. Reducing the budget deficit is the primary goal of fiscal policy in order to stabilise the government debt to GDP ratio (Makhoba *et al*., 2019). By creating responsible macroeconomic policies that balance government spending, borrowing and revenue in a way that supports long-term sustainable economic growth, fiscal policy aims to promote social and economic development (Ocran, 2011). The robustness of fiscal policy are essential tools that could save a country from economic circumstances and political influences (Abdullah *et al*.,2019). To ensure steady and balanced economic growth, policymakers typically combine monetary and fiscal policies. In terms of influencing economic activity in the country through public revenues, this policy is the most important macroeconomic stabilisation tool available to the government and policymakers. According to Sepashvili (2020a), in order for national economies to meet the contemporary needs brought about by the rapid growth and spread of information and communication systems, they need to change their policies.

One of the most discussed and controversial topics in economics is the impact of fiscal policy on economic growth (Ali, 2005). The debate on the macroeconomic effects of fiscal policy is still very controversial, despite its importance and the volume of research published recently (Karagyozova-Markova *et al*., 2013). Government involvement in the economy is seen by some as essential for growth, while others argue that government activities are fundamentally inefficient and bureaucratic, stifling rather than promoting growth (M'Amanja & Morrissey, 2005). The size and even the sign of fiscal multipliers are indeed a matter of debate among scholars, as new and classical Keynesian macroeconomic models produce different predictions for real wages, employment and private consumption in response to fiscal shocks. Although some aspects of the relationship between the composition of government expenditure and growth have been studied, a comprehensive econometric analysis for developing countries has yet to be undertaken (Onwe, 2014).

The macroeconomic imbalances and lack of economic stability that Zambia has been experiencing highlight the importance of public finance as a field of study that specifically addresses issues of public revenue and expenditure. Zambia's high government expenditure and dependence on copper exports as a source of revenue have created difficulties for the country's fiscal policy. This combination makes revenue collection erratic and necessitates borrowing. In addition, ineffective subsidies put further pressure on the budget. According to De La Fuente *et al*. (2017), the government's current fiscal objectives are to improve macroeconomic stability and address imbalances, including reducing public debt and arrears to sustainable levels. Kim and colleagues (2021) argue that macroeconomic stability depends on fiscal sustainability. This is also crucial for economic growth, given the country's high deficit and increased risk of macroeconomic instability, which could discourage private investment (Tendengu *et al*., 2022). This study was therefore conducted to evaluate the effectiveness of Zambia's current fiscal policy in promoting economic growth and identify areas for strategic adjustments to optimize its contribution to the nation's long-term economic development.

2 – Literature Review

The method by which a government changes its spending to track and influence a country's economic conditions is known as fiscal policy. It is used in conjunction with monetary policy, which is used by the central bank to manage the country's money supply (Agu *et al*., 2015). The main concern regarding the economic agenda of national policies is what role state policies should play in supporting and facilitating this process (Sepashvili, 2020b). The government uses demand-side policies such as fiscal policy to achieve macroeconomic objectives. According to Kibiwot *et al*. (2012), macroeconomic goals are balance of payments equilibrium, unemployment reduction, price stability and economic growth. Fiscal policy can do one of two things: either increase or decrease taxes, or increase or decrease government spending (Havi & Enu, 2014).

2.1 – *Empirical Review*

Using an autoregressive distributed lag model, Tendengu *et al*. (20-22) investigated the impact of fiscal policy tools on economic development in South Africa from 1988 to 2018. Based on the empirical results, fiscal policy tools such as taxes, public consumption expenditure and public sector expenditure have a positive correlation with economic growth.

Al-Kasasbeh (2023) examined how Malaysia's fiscal policy has affected the country's economic expansion. The study found that opinions are divided on the relationship between fiscal policy and economic growth. The relationship could be neutral, hostile or good. Overall, this analysis shows that the relationship between fiscal policy and economic growth is non-linear and depends on a variety of heterogeneous factors, including the research methodology used, the level of development of the countries studied, the relative size of the public sector, the quality of institutions, the composition, and the control variables selected, among others.

Alzghoul and Alhanatleh (2022) examined the impact of trade liberalisation and fiscal policy on economic growth. According to the study, public debt has a small but negative impact on economic growth, while government spending and taxes have a positive impact. Trade liberalisation has a large impact on economic growth.

In their study, Stoilova and Todorov (2021) examined the impact of three fiscal instruments - government consumption expenditure, indirect tax revenue and direct tax revenue - on the economic expansion of 10 new Central and Eastern European member states of the European Union. The study found that while economic growth in the euro area, exports and gross capital formation are positively related to economic growth, the growth rate of real output in the ten new EU member states is negatively affected by direct tax revenue. The data also suggest that the growth rate of real output in the ten Central and Eastern European countries studied is not significantly affected by government consumption or indirect tax revenue.

Kim *et al*. (2021) examined the salient features of China's fiscal system and how they affected the country's economic expansion. They found that liquidity constraints hampered the ability of output growth to respond to expected fiscal adjustments. In the industrial sector, the largest expansion of public investment occurred in the early stages of market-oriented reform, which in turn led to higher output. More recently, public funding of research and development has played an important role. In addition, data suggest that long-term debt has a significant impact on China's fiscal system, particularly on government revenue.

The study by Makhoba *et al*. (2019) examines the impact of South Africa's fiscal policy on economic growth. The empirical results show that gross fixed capital formation and government revenue have a large positive long-run impact on South Africa's economic growth. Although public debt and government expenditure have a negative long-run relationship with economic growth, government expenditure has grown faster than revenue.

Tasnia (2018) examined how the fiscal policies of four South Asian countries affected economic growth. According to the empirical findings, there is no discernible relationship between tax revenue and government expenditure and the actual GDP growth of these South Asian countries.

The impact of fiscal policy variables on economic growth in sub-Saharan African countries was investigated by Ugwuanyi and Ugwunta (2017). The results of the study showed that fiscal balances of sub-Saharan African nations have a small, but positive impact on the growth of their economies.

Quashigah *et al*. (2016) examined the impact of fiscal policy in Ghana on the country's economic expansion. The empirical results showed that government consumption expenditure had a negative impact on economic growth, while government investment, transfer payments and tax revenue had a positive impact.

Danu and Bucoi (2016) concluded that in order to restore the sustainability of public finances, the need arises for considerable fiscal consolidation effort, as well as for deep structural reforms, with a view to creating favourable conditions for sustainable economic growth.

Babalola (2015) examined the short and long term effects of fiscal policy on Nigeria's economic progress. The result showed that government investment and recurrent expenditure had a significant positive impact on economic development over the study period, both in the short and long term.

Using a dynamic analysis technique, Srithongrung and Kriz (2014) examined the impact of subnational fiscal policies on economic growth. The results of the study showed that taxes do indeed have a negative impact on economic growth, but only in the short run. Growth is positively affected by public investment in both the short and medium term.

Literature review present mixed findings on the relationship between fiscal policy and economic growth.

2.1.1 – Government Spending

Studies that examine the impact of government spending on economic growth show mixed results. Some studies, such as those by Alzghoul and Alhanatleh (2022), Kim *et al*. (2021) and Ba-balola (2015), find that government spending, especially on infrastructure and human resources, can have a positive effect on economic growth. However, Makhoba *et al*. (2019) suggest that spending can have a negative effect if it grows faster than revenue. Srithongrung and Kriz (2014) add that government spending can have a negative effect in the short term, but a positive effect on growth in the medium term.

2.1.2 – Taxation

Findings on the relationship between taxation and economic growth are more mixed. Alzghoul and Alhanatleh (2022) and Quashigah *et al*. (2016) find that taxation can have a positive impact on growth. In contrast, Stoilova and Todorov (2021) and Ugwuanyi and Ugwunta (2017) suggest a negative impact, especially for direct taxes. Tasmania (2018) even found no discernible relationship between tax revenue and economic growth in some South Asian countries. Srithongrung and Kriz (2014) add another layer of complexity, suggesting that taxes may have negative effects in the short run, but not in the long run.

2.1.3 – Public Debt and Trade Liberalization

Studies suggest that public debt can have a negative impact on economic growth, although the effect may be small (Alzghoul & Alhanatleh, 2022; Makhoba *et al*., 2019). On the other hand, trade liberalisation has been shown to have a positive impact on economic growth (Alzghoul & Alhanatleh, 2022).

2.2 – *Overview of the Evolution of Fiscal Policy in Zambia*

Since independence, Zambia has undergone significant changes in fiscal policy, reflecting changing priorities and difficulties facing the economy.

2.2.1 – Early Independence (1964-1990s)

After independence, Zambia pursued state-led economic development from the 1964s to the 1990s. As part of this strategy, foreign-owned financial institutions were taken over with the intention of strengthening national economic sovereignty. State-owned banks were established by the government to provide funds for its development objectives. They also introduced policies to regulate interest rates and the distribution of credit. This allowed them to direct funds to areas such as domestic industry and rural development, which they believed were essential for growth. These sectors were given preferential access to credit at reduced interest rates in an effort to promote economic diversification and improve rural communities.

While well-intentioned, this approach proved unsustainable in the long run. State-owned enterprises often lacked productivity and found it difficult to compete effectively (Callaghy, 1989). The government's ability to allocate credit could be rigid and stifle free market forces. Although intended to stimulate growth, subsidies may end up being too costly for the government. As a result, Zambia's economic model ran into serious difficulties in the late 20th century, leading to a change in fiscal policy.

2.2.2 – Structural Adjustment Era (1990s)

Zambia's economic realities in the 1990s called for a major change in fiscal policy. Economic stagnation and a heavy debt burden were the result of years of government control and directed spending. Together with the World Bank and the IMF, Zambia adopted a new approach to solving these problems (Coulombe, 2000), and the introduction of structural adjustment programmes (SAPs) marked this era. These initiatives promoted market liberalisation and fiscal restraint with the aim of transforming Zambia's economic structure. Fiscal restraint became the main tenet of the new strategy. Reducing the budget deficit was the government's top priority, as it had significantly increased debt levels. To achieve this, it introduced a series of austerity measures. Reducing subsidies was an important step, especially for staples such as fertiliser and maize. This was a difficult decision because many Zambians had been able to afford food prices thanks to these subsidies. The government countered that the subsidies were unaffordable and had distorted the market for agricultural products.

Privatisation of state-owned enterprises (SOEs) was a key component of fiscal restraint. Many SOEs had become inefficient wasters of public funds. The aim of privatisation was to increase efficiency and promote competition in these sectors. In addition to paying off debt, the proceeds from the sale of SOEs were used to finance important government programmes. While there were potential benefits to privatisation, there were also concerns about job losses and the emergence of possible monopolies in some industries. The introduction of SAP in Zambia has been a difficult and controversial process with both positive and negative outcomes.

2.2.3 – Post-SAP Era (2000s-Present)

Zambia's fiscal policy entered a new era at the turn of the millennium. Recognising the shortcomings of both the austerity of the SAPs and the state control of the pre-SAP era, Zambia adopted a more balanced approach (Abrahamsen, 2010). The aim of this "mixed approach" was to strike a careful balance between targeted social spending and fiscal restraint. To ensure long-term economic stability, fiscal consolidation aimed to keep public debt and expenditure at manageable levels.

Prioritising key government expenditures and improving tax collection were two measures included in this focus on responsible spending. Nevertheless, the Zambian government recognised the need to address social inequalities and empower marginalised communities. Targeted social spending programmes were introduced, focusing on social safety nets, health and education. The aim was to empower people and build a more equitable society by promoting both fiscal restraint and long-term economic growth.

Despite early successes, Zambia has struggled to maintain a balanced budget, with fluctuations in the global price of copper a major obstacle (Physioc-Biggs, 2013). Copper remains Zambia's main export, and changes in its price have a significant impact on government revenues. In addition, Zambia's fiscal space is still constrained by a high external debt burden from previous periods.

The country also has huge infrastructure needs, which could strain its financial resources and require large investments. Overcoming these obstacles will be crucial for Zambia's continued social and economic progress.

3 – Theoretical Framework

The Keynesian theory of economic development was developed by Keynes, who pioneered the use of government to control economic growth through changes in taxes and public spending. The Keynesian law states that government spending is the main driver of economic growth through its expansionary and contractionary effects on aggregate demand. To increase aggregate demand, the government can take expansionary measures such as increasing spending or reducing taxes. An expansionary process leads to increased output, job creation and ultimately economic growth. In contrast to Keynes, Wagner argues that fiscal policy is largely determined by economic growth (Makhoba *et al*., 2019). According to Ismal (2011), if growth is shown to be a deterministic component of government spending, economic development policies should prioritise improving economic activity. In order to accurately prescribe economic policy, it is crucial to evaluate both Keynes' and Wagner's theories to identify the main drivers of economic development. Both theories have been considered and adopted in this study.

4 – Methodology

The study adopts a descriptive approach and compares historical, proposed and assumed values of fiscal deficit fluctuations and economic growth using data from the World Bank's Data and Trade Economics website. The study examines the efforts and outcomes that led to changes in GDP components, economic growth and the elimination of large fiscal deficits in the analysis of Zambia's fiscal policy.

5 – Presentation and Analysis of Results

Table 1 presents the budgetary deficit, economic growth, final consumption and GDP formation between 2012 and 2022.

Table 1 – Zambia's Budgetary Deficit, Economic Growth, Final Consumption and GDP formation between 2012 and 2022 (Source: Word Bank data, Trading Economics and Statista)

Year	Budgetary deficit (%)	Economic growth GDP (%)	GDP (Billion US$)	Final consump-tion (%)	Gross capital formation (%)	Manufact uring (%)	Public Debt (%)
2012	-2.6	7.6	25.5	64.6	32	16	24.9
2013	-7.5	5.1	28.04	64.4	34	16	25.9
2014	-4.1	4.7	27.14	66.8	34	16	33.9
2015	-9.4	2.9	21.25	65.4	43	16	61.9
2016	-5.8	3.8	20.96	67.5	38	16	58
2017	-5.8	3.5	25.87	60.7	41	16	63.4
2018	-7.6	4	26.31	57.7	39	16	75.2
2019	-9.1	1.4	23.31	59.9	39	16	94.4
2020	-14.2	-2.8	18.11	53.2	32	16	140.2
2021	-9	6.2	22.1	47.5	31	17	110.8
2022	-7.8	5.2	29.16	49.9	27	16	98.5

As shown in Table 1 and Figure 1, economic growth has fluctuated throughout the period, ranging from -2.8% in 2020 to 7.6% in 2012. The country has a budget deficit in each of the years shown in the Table. The deficit ranges from -2.6% of GDP in 2012 to -14.2% of GDP in 2020. Public debt increases significantly over the period, from 24.9% of GDP in 2012 to 140.2% in 2020.

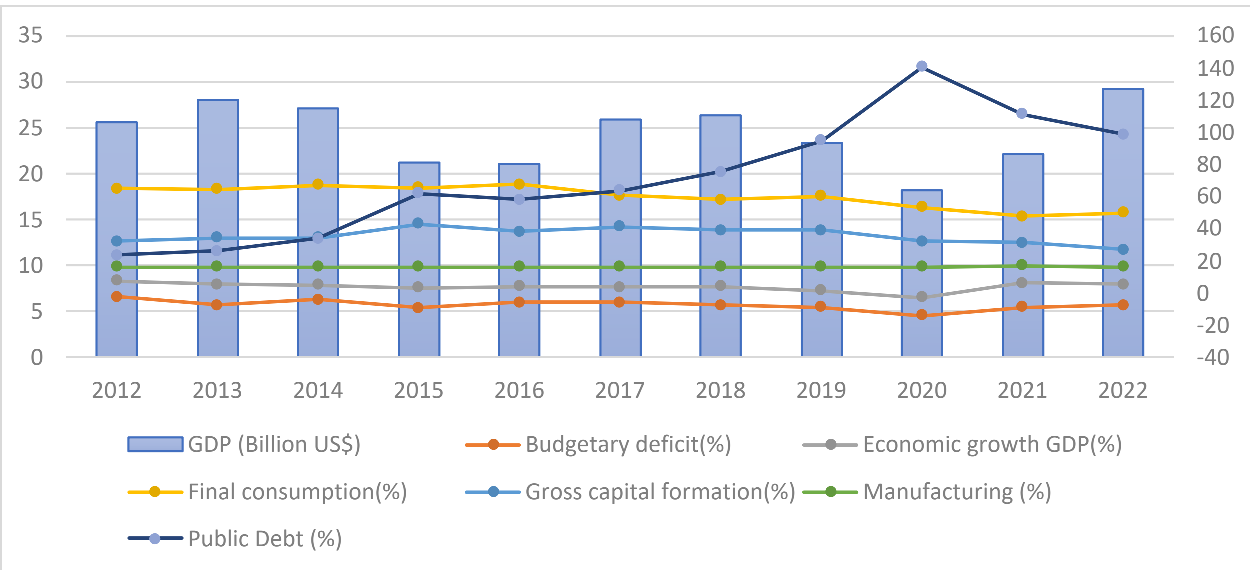

Fig. 1 – Zambia's budgetary deficit, economic growth, final consumption and GDP formation between 2012 and 2022

5.1 – Negative correlation between budgetary deficit and economic growth

In general, there seems to be a negative correlation between the budget deficit and GDP growth. For example, in 2012 the budget deficit was relatively low (-2.6%) and GDP growth was high (7.6%). Conversely, in years with higher budget deficits, economic growth tended to be lower.

5.2 – Impact of fiscal stimulus

Years with higher budget deficits often coincide with periods of economic slowdown or recession. For example, in 2020 there was a significant increase in the budget deficit (-14.2%), which coincided with negative economic growth (-2.8%). This suggests that fiscal policy measures, such as increased government spending or tax cuts, may have been implemented to stimulate the economy during downturns.

5.3 – Debt sustainability concerns

While deficit spending can be used to stimulate economic growth, it also leads to an accumulation of public debt. Over time, high levels of government debt (as a percentage of GDP) can pose risks to fiscal sustainability and economic stability. For example, public debt as a percentage of GDP rises significantly in 2020 and 2021, indicating potential concerns about debt sustainability.

5.4 – Need for balanced fiscal policy

The data underline the importance of maintaining a balanced fiscal policy, taking into account both short-term stimulus objectives and long-term fiscal sustainability goals. While deficit spending can support economic growth during downturns, policymakers should also aim to reduce deficits during expansions to mitigate the risks associated with high levels of public debt.

6 – Discussion

Zambia's path to economic stability faces two major hurdles: managing its high external debt and diversifying its export base. The current level of external debt severely restricts the government's room for fiscal manoeuvre. This "limited fiscal space" means that the government has fewer resources to spend on key investments and social programmes.

High debt burdens are often the result of borrowing to finance government spending. While borrowing can be a useful tool for economic development, excessive debt can become a stranglehold. In Zambia's case, debt servicing (interest and principal payments) consumes a large share of government revenues. This leaves less money for essential areas such as infrastructure development, health and education. High debt levels also make Zambia vulnerable to external shocks. For example, if global interest rates rise, Zambia's debt servicing costs could increase significantly, putting further pressure on the budget.

The second major challenge is Zambia's heavy reliance on copper exports. Copper is an important source of revenue for the government, but its price can fluctuate dramatically on the world market. When copper prices are high, Zambia enjoys a boost in government revenue and economic growth. But when prices fall, as they have in recent years, government revenues plummet. This vulnerability to price fluctuations creates economic instability and hinders long-term planning.

To address these challenges, Zambia should continue its diversification efforts. This means encouraging the development of other sectors beyond copper mining. These could include industries such as agriculture, tourism and manufacturing. It is evident that the contribution of the manufacturing sector to GDP has remained constant over the past decade. A number of studies have shown that industrialisation has a positive and significant impact on a country's economic growth (Yangailo & Chambani, 2023; Yangailo, 2023). Diversification would make Zambia's economy less dependent on a single commodity and therefore less vulnerable to global price fluctuations. In addition, a more diversified economy would create new jobs and opportunities for Zambians, thereby promoting broader economic growth and development.

The government and the central bank should coordinate their policies to ensure that they are working towards common goals such as stable economic growth, low inflation and low unemployment. Close communication and cooperation between the fiscal and monetary authorities can help avoid policy inconsistencies and maximise their effectiveness.

During economic downturns, the government can use expansionary fiscal measures, such as increased government spending or tax cuts, to stimulate demand and support economic activity. Conversely, during periods of strong economic growth, fiscal policy should aim to reduce deficits and build up fiscal buffers to prepare for future downturns.

While deficit spending may be necessary to support economic growth, governments should ensure that public debt remains sustainable over the long term. This requires careful management of the size and composition of public debt, as well as monitoring of debt service costs to prevent debt levels from becoming excessive.

The central bank should maintain its independence in setting monetary policy to achieve its mandated objectives, such as price stability and full employment. Monetary policy instruments, such as interest rate adjustments and open market operations, can be used to influence aggregate demand and the level of inflation.

Encouraging everyone to meet their basic needs and live a better life without sacrificing the quality of life of future generations is the goal of sustainable development (Gazzola & Pellicelli, 2019). Both fiscal and monetary authorities should adopt a forward-looking approach to policy-making, taking into account the medium- to long-term implications of their actions. This involves analysing economic data and forecasts and taking into account potential risks and uncertainties in order to make informed policy decisions.

Clear communication and transparency by both the government and the central bank are essential to build credibility and maintain public confidence in their policies. This includes explaining the rationale behind policy decisions and providing regular updates on economic developments and the policy outlook.

7 – Conclusion

Zambia's economic landscape poses two major challenges to its path to stability: managing its high external debt and diversifying its export base. These hurdles constrain the government's fiscal space and limit investment in critical areas such as infrastructure and social programmes. While borrowing can facilitate economic development, excessive debt burdens can stifle growth by diverting resources from essential sectors such as health and education. In addition, heavy reliance on copper exports exposes Zambia to volatile global market fluctuations, creating economic instability and hampering long-term planning.

To overcome these challenges, Zambia needs to continue its diversification efforts and promote the development of sectors beyond copper mining, such as agriculture, tourism and manufacturing. Diversification would reduce dependence on a single commodity, making the economy more resilient to price fluctuations. In addition, a diversified economy would create new employment opportunities, thereby promoting broader economic growth and development.

Effective coordination between the government and the central bank is essential to address these challenges. Fiscal and monetary policies should be aligned to achieve common objectives such as stable economic growth and low inflation. During economic downturns, expansionary fiscal policies can stimulate demand, while during periods of growth, fiscal consolidation can build fiscal buffers. Moreover, responsible debt management is crucial to avoid negative effects on growth and stability.

Transparency and good governance play an important role in building the confidence of foreign partners and investors. Demonstrating a commitment to responsible economic management can attract significant foreign investment to support development projects that diversify the economy and promote sustainable growth.

Despite the fiscal challenges facing Zambia, effective collaboration between the government and the central bank can pave the way for greater prosperity. By implementing prudent fiscal policies, diversifying the economy and promoting transparency, Zambia can overcome its economic challenges and build a more stable and prosperous future.

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