Internal Consistency, Realism and Reasonableness of Expenditure Proposals and Forecasts

By

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Review of the Budget Statement – Realism?

- The central problem in Zimbabwe is low production which has caused the country to have twin problem, that is, trade imbalances and fiscal imbalances – *we have a production problem not currency!!.*
- The primary objective of the 2019 Budget is to stabilise the economy by targeting the "twin deficits" of fiscal and current account, which have become major sources of overall economic vulnerabilities, including in inflation, sharp rise in indebtedness, accumulation of arrears and foreign currency shortages.
- With immediate effect, Government embarked on a policy stance to gradually reduce the Budget deficit to single digit level, hence, targeting 5% of GDP for 2019 and 4.1% in 2020, and to 3% in 2021.
- In the same vein, Government committed itself to reduce recourse to Central Bank lending from the 20% of previous year's revenues statutory limit, to a maximum of 5% confined for purposes of smoothening cash ow mismatches.
- In line with these targets, the 2019 budget expenditure is projected to be \$8.2 billion against revenue target of \$6.6 billion leaving a deficit of \$1.6 billion, i.e., 5% of GDP. This is good beginning but the devil lies in implementation

Expenditure Containment Measures

- Salary cut, Government with effective from 1 January 2019 is introducing a 5% cut on basic salary which will be effected for all senior positions from Principal Directors, Permanent Secretaries and their equivalents up to Deputy Ministers, Ministers and the Presidium.
- This is also extended to basic salaries of those in designated posts in State Owned Enterprises (CEOs, Executive Directors and equivalent grades), including Constitutional Commissions and grant aided institutions.
- The 13th Cheque, with immediate effect, civil service bonus will be computed based on Basic Salary only (excluding housing and transport allowances) and will be paid in 2018).
- *Rationalisation of Foreign Service Missions,* Government has resolved to reduce the number of Foreign Missions, thereby optimising the utility value realised from the remaining missions as well as avoiding accumulation of arrears and embarrassing evictions of our diplomats.
- *Retirement of Youth Officers, Government* will retire **2 917** Youth Officers by end of December 2018 and retirement of officials who reached 65 years **– savings of $92 million**

Biometric Register for Civil Servants in 2019 aimed at flushing out '+70,000' ghosts workers

Revenue Retention Policy

- Government noted that as various arms of Government collected revenue, the accountability arrangements have exhibited fundamental weaknesses which undermine efficient utilisation of public resources
- In order to uphold the principle of transparency and accountability in the utilisation of public resources, Government Ministries and Departments will be required to remit all revenue collected into the *Consolidated Revenue Fund*, with immediate effect.
- In dealing with the violation of the Penalties under the Public Finance Management Act, the budget is working on Penalties for financial misconduct by public officers range from fines, to imprisonment, or both.
- This move will help in reining bad behaviour in Government and wastefulness – recall the +$2billion budget deficit which was spend in 2018.

Current Account Deficit

- Government noted with concerns the fact that Zimbabwe exports are largely uncompetitive due to cost and inefficient production. In addition, the country rely on primary commodity exports which are of less value compared to high value processed goods.
- In addition, the import bill has been dominated by a wide range of imports, some of which are not critical or strategic.
- In addressing this problem, through the budget statement, Government measures to address the current account deficit include the following:
  - Supporting export oriented production e.g. horticulture;
  - Strategically manage available foreign currency by prioritising import substitution production e.g. retooling and raw materials;
  - Decisive action on revival of ZISCO Steel and Cold Storage Commission, local drug manufacturing etc. to boost exports while limiting on import demand;
  - Value addition and beneficiation in mining and agriculture;
  - Review import duty dispensation for some of the projects and programmes, e.g. National Project Status.

Production Enhancement Measures

- The 2019 Budget proposes speeding up of ease of doing business reforms, including the long awaited operationalisation of the Zimbabwe Investment and Development Agency, ZIDA.
- Finalise setting up of a Commodities Exchange, hence opening up space to private sector players, thus shifting the burden from fiscus
- In addition, Government committed to forge ahead with rolling out parastatal reforms on a roll out template which categorises the entities under the following:
    - State Owned Enterprises to be partially privatised through JVs and/or listing;
    - State Owned Enterprises to be fully privatised; and
    - State Owned Enterprises facing liquidation.
- Duty in foreign currency for selected products which ranges from agricultural products, manufactured and motor vehicles

Support to Industry

- ***Clothing Manufactures Rebate,*** fabrics that are not locally produced will qualify *Clothing Manufacturers Rebate*, with effect from 1 January 2019.
- ***Dairy Industry, Government*** proposed to increase the ring-fenced milk powder requirements for 2019, with effect from 1 January 2019.
- ***Baking Industry,*** in order to reduce the cost of production, thereby minimising price escalation, particularly on bread, which is a basic household commodity, Government proposed to introduce duty free importation of raw materials under a *Manufacturers Rebate*, with effect from 1 January 2019.
- *Customs Duty on Fertilized Eggs,* In order to mitigate against potential shortage of poultry products as a result of the Avian Influenza and restore viability of the industry, Government proposed to ring-fence duty free importation of fertilized eggs for the year 2019, with effect from 1 January 2019.

Support to Industry

- Fertilizer Manufacturing Industry, in order to enhance competitiveness of locally manufactured fertilizer, Government proposed to ring-fence duty free importation of raw materials, with effect from 1 January 2019, for a period of twelve months
- Tourism Industry, Suspension of Customs Duty on Specified Buses: Tour Operators . In order to assist Tour Operators capitalise their fleets, Government proposed to extend suspension of duty on 75 new buses of a carrying capacity of 8 to 55 passengers, including the driver. The Facility will be availed for a period of twelve months beginning 1 January 2019.

Revenue Enhancement: Tax Measures

- ***Customs Duty on Motor Vehicles,*** in order to redirect use of scarce foreign currency to the productive sectors of the economy, Government proposed that customs duty on motor vehicles be levied in foreign currency acceptable as legal tender, with effect from 23 November 2018. This measure will also apply on all import VAT and Surtax.
- ***Payment of Tax in the Currency of Trade,*** Government noted that notwithstanding that companies are appointed as agents that collect revenue on behalf of Government, some companies are not remitting VAT in the currency of trade, taking advantage of the arbitrage opportunities on the informal market.
- In order to contain such practices, Government proposed to compel companies that collect VAT in United States dollars or any other currency to remit VAT using the same mode of payment. This measure will apply on all other taxes.
- ***Excise Duty on Fuel, with effect from 1 December 2018,*** propose to increase excise duty by 7 cents per litre on diesel and paraffin and 6.5 cents on petrol to reduce the arbitrage opportunities.
- **Transfer tax of 2% is expected to generate more than $3 billion.**

Revenue Enhancement Measures – Austerity measures

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Internal Consistency

Consistency

- Transitional Stabilisation Programme linked to the budget
- The budget reaffirmed the continuation of the multiple currency regime with the dollar as the main currency used for accounting;
- The budget, in line with the monetary policy statement, reaffirmed the rate of 1:1 rate for the RTGS and nostro account and underscored the need to tackle the disparities on RTGS balances and real dollars caused by the twins!
- The objective is to build foreign reserves and credit lines, as part of the strategy for the value preservation objective.

Inconsistency

- Justification of the upward review of duty on fuel was based on the argument that our fuel is now the cheapest in the region. The only way to justify this argument is based on the fact that the rate of the RTGS and NOSTRO is not 1:1.
- Charging of duty in foreign currency - serious inconsistency
- Duty Free Importation of Motor Vehicles under the Senior Public Servants Loan Scheme versus **5% reduction on salary** and **duty in USD for the majority**

Questioning Realism and Reasonableness

- The question here is from a realism context, the question is has the budget been truthful to the reality on the ground
- YES!
  - Identifying the twin problems and proffered revenue containment measures as well as production enhancement measures;
  - Reaffirmed the rate of 1:1 between RTGS and NOSTRO account;
- NO!
  - Charging of duty in foreign currency contradicts the reaffirmation on 1:1 thereby creating inconsistency;
  - The revenue enhancement measures are biased towards milking the poor more than anything – e.g., duty free for senior civil servants and limited scope to cut costs in government.
- Reasonableness – YES! The budget targets, allocations and policy measures announced in the budget to deal with fiscal and trade imbalances are reasonable even the move to charge duty in foreign currency.

How should we proceed?

- There are a number of policy areas we have failed to reach a consensus such as currency issues, austerity measures and exchange rate issues. From Tripartite Negotiation Forum (TNF) perspective, we must agree on the following:
    - The rationale of pegging the exchange rate 1:1 regardless of the fact that the rate is not 1:1 at the moment – **here we need to do a cost benefit analysis of keeping the rate at 1:1 and floating**;
    - Agree to decriminalize trading in foreign exchange in view of the fact that we are now charging duty in USD.
    - Agree on the fact that our problem is not a currency one but production. So the discussion on whether we should use the Rand is a misplaced one.
- The TNF should also provide measures aimed at building national consensus on the above

Addition Measures for Consideration by the Minister

- The Minister underscored to finalise the incentive framework and other supportive job creation measures during the first quarter of 2019. In this regard, I submit the following for consideration:
- *Double tax deductibility for all local content supporting programme expenses, for example, interest accrued, extension services costs. The current tax framework allows for the industry to deduct the expenses incurred in production enhancement measures such as out grower schemes development. However, the industry is of the view that double deductibility of the expenses incurred in aiding local production will result in higher production, more jobs, savings on import as well as more taxes going back to Government coming on the back of additional revenue from VAT and PAYE.*
- *Lower tax rates for companies investing in local production. The tax regime should be balance sheet or income statement based. For example, for the next five years, Government must reduce corporate tax by 10% for every additional $1 million support*
- Or Government must reduce the rate of tax from 25% to 15% on annual incremental seed output of at least 5% with 2015 as the base year.

Country Experiences in Promoting Production

- World Bank (2015) estimates local content policies which were backed with tax incentives in the food and beverages sector have been responsible for attracting $5 billion into the local economy and created 38,000 jobs in Nigeria.
- **Zambia:**
  - Reduced corporate income tax rates at 10% on income from Farming and Agro-processing; and 15% on Income from Non – traditional exports (standard rate 35%).
  - Five year tax holidays on approved priority sector activities (e.g. Manufacturing and Tourism) approved investment under the Zambia Development Agency Act).
- **Malawi**
  - Agriculture is considered a "manufacturing" process in Malawi and all manufacturers for income tax are entitled to 100% investment capital allowance on industrial buildings, and plant and machinery.
  - Agriculture is also entitled to special allowances on investment in irrigation, works for prevention of soil erosion and capital allowances on staff housing
  - A tax holiday of 10 years is available for new investors in "agro-processing".
  - Equipment for use in the agricultural, horticultural or forestry sector is imported free of import duties. Plant and machinery for manufacturers including those in the agricultural sector are imported duty free including VAT.