ZNCC

ZIMBABWE NATIONAL CHAMBER OF COMMERCE

THE VOICE OF BUSINESS

ANALYSIS

OF THE

2021 MID-TERM BUDGET AND ECONOMIC REVIEW PRESENTED ON 29 JULY 2021

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2021 MID-TERM MONETARY POLICY STATEMENT PRESENTED ON 5 AUGUST 2021

ZNCC National Office
www.zncc.co.zw

PREAMBLE

As ZNCC, we appreciate the continued acknowledgement and consideration of our policy submissions by both fiscal and monetary authorities. This is testimony to the mutual relations that exist between the Chamber and our policymakers. The Minister of Finance and Economic Development, Hon. Prof. Mthuli Ncube, presented the Mid-Term Budget and Economic Review on Thursday, 29 July 2021, followed by the presentation of the Mid-Term Monetary Policy Statement by the Governor of the Reserve Bank of Zimbabwe, Dr J. P. Mangudya on the Thursday 5 August 2021. We note that no significant new policy measures were introduced by both fiscal and monetary authorities, signifying their commitment to maintaining fiscal and monetary policy complementarity.

Positives from the Mid-Term Budget and Economic Review and Monetary Policy Statement

- Bumper harvest across almost all crops in the 2020-2021 season feeding into improved growth prospects, with growth projections revised from 7.4% to 7.8%
- Sustained efforts in reducing inflation have seen a significant decline in annual inflation from 837.5% in July 2020 to 56.37% in July 2021.
- Gains from fiscal consolidation, as evidenced by a ZWL$570 million surplus being realized, hoping that there will be alignment with monetary policy to achieve both fiscal and monetary consolidation.
- Introduction of interest on savings and fixed deposits accounts and removal of bank charges thereon.
- The spirited vaccination campaign has put Zimbabwe on 8th position in Africa, and 2nd position in SADC (after Seychelles) with 15.31 vaccine doses per 100 people.
- Operationalization of the much-awaited commodity exchange, the Zimbabwe Mercantile Exchange (ZMX), which will improve price discovery for agricultural commodities.
- Various infrastructure projects underway including the Beitbridge-Harare-Chirundu Highway, the Emergency Roads Rehabilitation Programme Phase II, R.G. Mugabe International Airport and the Hwange Unit 7 and 8 works.

ZNCC REACTION TO THE MID-TERM BUDGET AND ECONOMIC REVIEW

Economic Growth

Growth projections for 2021 were revised upwards from 7.4% to 7.8%, on the back of improved performance in agriculture, electricity generation, tourism, as well as financial services. However, the current lockdown due to the spike in COVID-19 cases is highly likely to arrest the 7% and 6.4% expected growth in manufacturing and tourism in the second half of the year. It is also doubtful that domestic tourism will anchor growth in tourism to compensate for the fall in international tourist arrivals, given the low and highly eroded domestic incomes. Furthermore, expected growth in electricity and financial services was revised downwards, and cement shortages are likely to reduce growth in construction. All these factors negatively impact the headline revised growth target of 7.8%. Given these COVID-19 realities, a conservative GDP growth projection of 4.5% to 5% seems more practical. Hopes remain pinned not only on increased vaccination but also on the effectiveness of the vaccines against potential new variants that may see further waves emerging.

Public Debt

According to the Public Debt Management Office, Zimbabwe's total public and publicly guaranteed external and domestic debt stood as of December 2020 stood at US$10.7 billion, comprising US$8.4 billion (external) and US$204 million (domestic). This translates to a total debt to GDP ratio of 72.6%, made up of external debt to GDP ratio of 71.2% and domestic debt to GDP ratio, 1.4%. The total debt to GDP ratio of 72.6% exceeds the 70% provided for in the Public Debt Management Act (Chapter 22:21) of GDP, implying that the country is in debt distress. The 2020 Joint World Bank-IMF Debt Sustainability Analysis also came to a similar conclusion.

It is important to note that the debt figure does not include other RBZ running facilities not guaranteed by Government, amounting to US$379 million and blocked funds amounting to US$2.8 billion (still under due diligence pending debt assumption). Furthermore, the US$3.5 billion for the compensation of former farm owners under the Global Compensation Deed of July 2020 shall also be included once the farmers sign a cessation agreement. Adding these amounts to the reported debt gives an estimated total debt figure of US$17.379 billion which translates to an indicative Total Debt to GDP ratio of 118%. This is somewhat closer to the real picture than the figures reported by the Ministry.

The International Monetary Fund (IMF) has just approved a US$650 billion Special Drawing Rights (SDR) Allocation. To what extent can our these be used towards arrears clearance, complementing the token payments that have resumed.

Turning to the Global Compensation Deed, the Minister reported that Treasury engaged a Financial Advisor - Newstate Partners UK, to lead and assist in the mobilization of the US$3.5 billion for compensation. What is not clear is whether due process was followed in engaging the advisor; the cost implications to Government, whether Parliament was advised of the move, and whether or not local experts were considered.

The Chamber continues to propose that no debt should ever be procured without the involvement of the Parliament of Zimbabwe in the interest of transparency, accountability and confidence building. This also applies to the assumption of debts by the RBZ, which, if not interrogated, will see the public paying for other people's private debts.

Budget Out-turn

There was an expenditure overrun of ZWL$7.8 billion for the half-year, beyond the targeted ZWL$189.8 billion. However, this was compensated for by a positive variance in revenue collections which exceeded the ZWL$182.1 billion target by ZWL$16.1 billion. As a result, a targeted budget deficit of ZWL$7.7 billion has been replaced by a surplus of ZWL$570 million. While the surplus is a positive outcome, the expenditure overrun is a red flag for the second half of the year. In the absence of the overrun, the budget surplus would have been much higher at ZWL$8.4 billion.

In terms of budget utilization, social benefits and subsidies have already surpassed the full-year targets, standing at 119% and 102% of their annual target, respectively. Budget deficit pressures for the 2021 fiscal year are likely to emanate from these social expenditures, especially if COVID-19 cases continue to increase, necessitating the extension of the lockdowns and increasing vulnerability. Notwithstanding the importance of social expenditures given the status quo, the ZNCC reiterates the need for subsidies to be targeted and limited to vulnerable groups only.

On the contrary, the 11% utilization of the Transfers to Provincial Councils and Local Authorities vote seems too low. This can negatively affect the devolution agenda through delays in the various projects funded by this vote. Ultimately, service delivery in the local authorities can be affected if the pace of draw-downs (disbursements) does not pick up. Devolution funds had a profound development effect in the previous budget year. There is a need to determine whether the bottlenecks lie with the provincial councils and local authorities or Treasury and corrective measures undertaken. This also applies to all votes with low utilization, as it means that the entities will not be delivering on their mandate at the expense of targeted social welfare and development outcomes.

The Minister said that there would be no supplementary this year, as was the case in the previous year. Of concern is the fact that, if the need arises, as did last year, will the Minister not resort to unauthorized excess expenditure without parliamentary approval. Unauthorized expenditures are becoming the norm, and the trend seems to indicate that the Minister does it with impunity, as noted in the 2019 Auditor-General's Report findings. Treasury must respect the law of the land, and the Parliament of Zimbabwe needs to exercise its oversight powers.

Civil Servants Welfare

Employee compensation was 41% of total expenditure, slightly above the half-year target of 38.9%. While this represents a significant decline from yester-year levels of above 80%, it has also negatively impacted civil servants' welfare. Clearly, the celebrated budget surpluses are primarily attributable to the civil service salaries moratorium. Currently, civil servants are estimated to be earning an average of US$200 per month, which translates to about ZWL$17,000 at the official auction exchange rate. On the other hand, as measured by the Total Consumption Poverty Line (TCPL) for one person, the poverty datum stood at ZWL$4,987.00 in January 2021, increasing to ZWL$6,126.00 in July 2021; hence a family of six now requires ZWL36,756 to at least survive. The implication is that, on average, civil servants are earning less than half (50%) of the TCPL; hence their salaries are akin to slave wages. The ever-increasing parallel foreign exchange market premium, which is now ranging between ZWL$45 to ZWL$60, with some entities now using the US$1: ZWL$145 to price their products, further worsens the plight of low-income earners, civil servants included.

While Government is wary of the destabilizing effects of salary increases economic recovery and re-engagement efforts (especially with the IMF Staff Monitored Programme in mind) achieved under the Transitional Stabilisation Programme (TSP), it should bear in mind the effect of poor remuneration on labour productivity and corruption in the public sector. These have their own undesirable effects, especially on the cost and ease of doing business. Therefore, a living wage for civil servants is very much in the best interests of Government. In this light, the key measure on '*Operationalising and strengthening the Tripartite Negotiating Forum (TNF)*' under the NDS1 Pillar: *Effective Institutions and Governance Pillar,* should be expedited.

Tax-free Threshold

Despite the depressed salaries obtaining in the economy, there was no upward tax-free threshold adjustment. The ZNCC recommends an adjustment of the tax-free threshold from ZWL$10,000 to a conservative ZWL$25,000. While moving the tax-free threshold to match the poverty datum line would be more desirable for labour, we are cognizant of the need for Government to balance its books and also avoid the resultant potential inflationary effects of salary increases. An increase in the tax-free threshold would have cushioned low-income earners and also reduced the effect of bracket creep on the few who were awarded salary adjustments in some sectors. Part of the 3% positive variance on the personal incomes tax revenue in the first half has been attributed to bracket creep, hence lessening the overall effect of the salary adjustments on disposable income. '*The more things change, the more they remain the same*'. There is a need to adjust the tax brackets to ensure that salary adjustments have the desired effect on disposable incomes. The obtaining low salaries are weighing down aggregate demand in the economy, hence dressing growth.

Special Excise Duty on Airtime (SED)

Historical Background of SED

SED was first introduced in Zimbabwe with effect from 1 October 2014 (not 15 September 2014) through the National Mid Term Fiscal Budget for the year. The tax was to be levied at 5% on airtime.

Amendments to the charging of SED were made on 27 November 2014 in the 2015 National Budget proposal where the Minister of Finance stated the following:-

"I, therefore propose that special excise duty be levied on sale of airtime and data by licenced operators, with effect from 1 October 2014"

The rate of SED was later increased to 10% in March 2017.

When SED was first introduced, the unit price of airtime charged then incorporated the cost of production of the airtime, other charges, service providers' mark-up and VAT. At the time service providers were not allowed by the regulator POTRAZ to increase the unit price of airtime and hence had to accommodate the element of SED within that unit price.

SED Legislation

SED is levied in terms of section 172 (E) as read with 172 (F) of the Customs and Excise Act.

Section 172 (E) of the Act provides for the definition of airtimes and it reads as follows.

> ***"airtime" means the minutes of voice calls, short message service (sms), multimedia service (mms), internet band width or such other service as a licensed operator may offer through a cellular telecommunication system or any other electronic communications service;***

Section 172 (F) of the same Act provides for the charging of SED and reads as follows.

"Subject to this Part, there shall be charged, levied and collected, for the benefit of the Consolidated Revenue Fund, a special excise duty on the sale value of the airtime."

The above means that SED is charged on the sale value of airtime.

What is the nature of SED?

The above question leads to the following questions, which have to be answered.

a) Is SED a tax on the sales income of a service provider and, therefore, a form of income tax?; or

b) Is SED a consumption tax and hence the reason why it is charged on the sale value of airtime?; and

c) Who should bear the tax and why?

The responses to the above questions should lead us to the correct propagation of SED in the country and to the service providers. This should assist us in determining how SED should be treated for income tax purposes.

Our Position on SED.

Our position which is based on section 172 (E) as read with 172 (F) of the Customs and Excise Act as stated above is that SED is a consumption tax hence the reason why it is based on sale value of airtime just like VAT. If it is based on consumption, the tax is paid by the consumers and hence the more they consume the service, the more they pay SED. We, therefore, believe that service providers act as agents of ZIMRA in the administration of the tax until it is remitted to ZIMRA.

Our Position on the Base Value of Airtime

Again based on section 172 (E) as read with 172 (F) of the Customs and Excise Act, SED should be charged on the sale value of airtime which should comprise the cost of production, other costs, service provider mark-up. SED should be charged on that sale value.

In summary, we are saying that the sale value for airtime should be the value net of any taxes.

Our Position on treatment for income tax

SED, if it is included in the gross income of a service provider, should be allowed as a deduction for income tax purposes.

ZIMRA's Position

ZIMRA's position is that SED is a tax that is charged on the sale value of airtime and that it is a direct tax and not a consumption tax. They go on to say that the sale value upon which SED is charged forms part of gross income for income tax purposes and that this kind of income tax is charged in terms of section 172 (E) as read with section 172 (F) of the Customs and Excise Act.

ZIMRA further states that this is why this tax is called a special excise duty because it is an income tax charged on the sale value of airtime and that it is different from other forms of excise duty whose value for excise duty purposes is determined in terms of section 116 of the Customs and Excise Act. Section 116 states that the sale value for excise purposes is the value net of taxes.

According to our understanding, this value equates to the value as stated in section 172 (E) and 172 (F) of the Customs and Excise Act.

Finally, ZIMRA states that SED is not allowable as an income tax deduction in terms of section 16 (1) (d) of the Income Tax Act.

Section 8 and Section 16 (1) (d) of the Income Tax Act

We quote below what Section 8 and Section 16 state.

Extracts of Part III of the Income Tax Act

Section 8 (1) provides for the definition of income, and it reads:

For the purposes of this Part—

"income" means the amount remaining of the gross income of any person for any such year after deducting therefrom any amounts exempt from income tax under this Act;

Section 16(1)(d) of the Income Tax Act, which falls under the same Part III reads:

1) ***Save as is otherwise expressly provided in this Act, no deduction shall be made in respect of any of the following matters—***

(d) tax upon the income of the taxpayer or interest payable thereon, whether charged in terms of this Act or any law of any country whatsoever;

Section 16 disallows a deduction in respect of tax upon the income of a taxpayer…i.e. tax calculated on gross income less exemption, not tax on a sale value.

We do not believe that SED is an income tax as it is charged on the sale value of airtime by service providers and that the tax that is spoken about should be charged on the profit of the service provider.

Double Taxation Effect of Treatment of SED as an Income Tax

The resultant effect of charging SED on the sale value of airtime will mean that income to a service provider will suffer income tax based on the gross sales and later on the profits after the deductions of exemptions and allowable deductions. The worst thing will be the non-deduction of SED which ZIMRA requires to be added back to taxable income since they are saying it is a prohibited deduction in terms of section 16 (1) (d) of the Income Tax Act.

This treatment of SED will negatively impact the profitability of the service providers and is likely to affect their viability.

This taxation, therefore, does go against the principles of taxation, which are equality or fairness, convenience, flexibility and finally, economic.

Our request

We request as follows;-

a) Clarity be provided that SED is a consumption tax based on the sale value of airtime; and

b) That SED's valuation be based on the net of tax value. i.e. Selling price less VAT less excise duty be equal to the value for excise; and

c) That section 172 (E) be amended to include the definition of the value of airtime; and

d) That where excise duty is included in income tax, it be allowed as a deduction for income tax purposes; and

e) That the above clarity be back dated to 1 October 2014

Deductibility of lunch/meal provisions to employees

Section 16 (1) (m) of the Income Tax Act prohibits the claim of entertainment costs against gross income, and it reads

"any expenditure incurred by any taxpayer on entertainment whether directly or by the provision of any allowance to any employee to incur expenditure or entertainment on behalf of the taxpayer.

For the purposes of this paragraph—

"*employee*" *includes a director;*

"Entertainment" includes hospitality in any form;" (*underlined for emphasis*)

Recently The Zimbabwe Revenue Authority (ZIMRA) has interpreted the above to include the provision of any meals and/or teas to employees in the definition of entertainment, and hence ZIMRA has sought to disallow any expenditure incurred by taxpayers for the provision of food to employees for income tax purposes.

From the decision in ITC 1394 (1984) 47 SATC 119(Z) it can be deduced that the term "hospitality in any form" cannot be interpreted to being all-inclusive. There is room for exceptions if it can be demonstrated that the provision of the meal was necessary for the purpose of the business operations more than mere provision of "hospitality", in which case there is room to explore the deductibility of the expense.

We believe the element of entertainment or hospitality disappears under the following conditions:

The prevailing economic situation has reduced employees' disposable income significantly, and most employees no longer afford lunches. In an effort to counter the difficult situation at the same time motivating and improving employee's productivity and welfare, taxpayers have reverted to providing a basic meal to employees.

In addition, Food Manufacturing Industry health and safety regulations do not allow staff to bring food for fear of contamination of the food produced in the business. Employees and employers in the food industry, therefore, do not have an option but to rely on meals provided by the employer during working hours. In this regard, no entertainment exists as the employees do not have an option but to consume what the employer has provided them with.

Furthermore, certain industries are situated far from restaurants, and employers have no option but to provide employees with a meal during working hours to save on time.

Health and safety regulations for employees who provide manual labour require that employers provide meals to their employees. This is usually in the form of tea at 10.00am and lunch between 1.00pm and 1.30pm. Some entities also run 24-hour shifts, and those on night shift have nowhere to buy food during the night. The 24-hour shifts operate continuous processes, and factory workers do not have lunch hours but take quick short breaks in turns to avoid switching off machines or equipment. The maximum time each employee is away having lunch is 15 minutes.

Note that In terms of section 8(1)(f), ZIMRA considers the provision of meals a taxable benefit in the hands of the employees and seeks to tax the employee on the same amount that has been disallowed in the hands of the employer as entertainment in terms of section 16(1)(m). We do not believe that this was the intention of the legislature when the above section was enacted.

ZIMRA's interpretation of the above section does not only increase the costs of improving employee welfare but also reduces the disposable income of the said employee.

Our request

In light of the above, we believe that the legislation grants the entitlement to a deduction in respect of the meals as the expenditure is essential to the business operations. For the avoidance of doubt, we appeal to the Minister to amend the following sections of the Income Tax Act:

1. Section 16 (1) (m) so as to exclude the provision of basic meals to employees from the definition of entertainment.
2. Section 8 (1) (f) so as to exclude the provision of a basic meal to an employee from the definition of a Benefit or Advantage, which has been classified as "entertainment".

We believe that the positive effect on the welfare of the employees, therefore directly translating into increased productivity, outweighs, significantly, the forgone collections by the Minister. In fact, we believe the move will enhance net tax collections from the increased productivity as a result of motivated employees.

Intermediate Money Transfer Tax

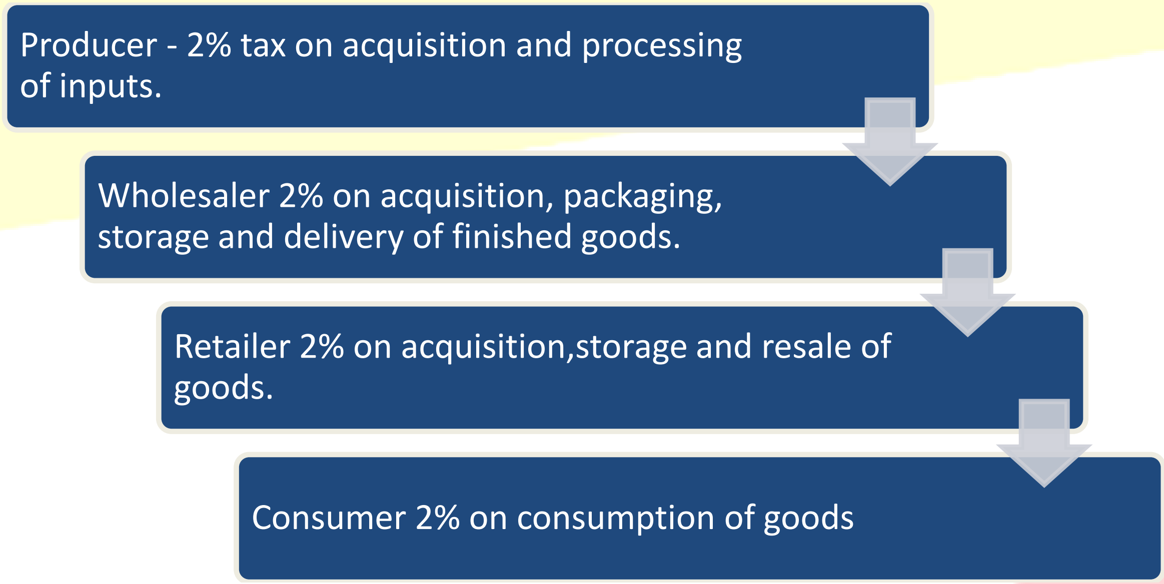
When 2% IMTT was introduced, the spirit of the tax was to bring into taxation the informal sector, which was not in the tax regime. As a result, what it has done is to double tax the formal ta payers, as explained below.

Ordinarily, a tax is charged on revenue rather than on an expense, as such one would not expect the tax calculated on his "*taxable income*" to be included as a deduction in the determination of the "*taxable income*". Currently, section 16(1) (d1) of the Income Tax Act prohibits the claiming of the tax on income as an expense for income tax calculation purposes.

It should be noted, however, that IMTT tax is a tax on an expense and not on revenue. IMTT therefore is in fact more of a cost/expense and such should qualify as a deduction the same way other transaction-based taxes such as customs duties, stamp duties are allowed as a deduction.

Effects of the tax on the cost of production

It cannot be emphasized how the intermediate transaction tax has a compounded effect on the supply chain due to the incremental tax charged from the producer to the consumer, as shown below.



To cushion the supply chain players against the increased cost of production, the cost is passed on to the consumer in the form of price increases across all goods.

The new amendment disallows IMTT for tax purposes, a further cash outflow in the form of tax will be suffered. Effectively an incremental cash outflow will be experienced in the year.

Prices of commodities will increase further, pushing up the average cost of the basic consumer basket, resulting in reduced revenues and quality of goods and loss of welfare within the economy, leaving both the consumer and producers worse off.

Other effects of the tax to be taken into consideration include:

The double-taxation effect the 2% tax has by imposing a tax on tax. When an entity acquires goods that are subject to Value Added Tax (VAT), the 2% tax is calculated on the amount inclusive of the VAT amount. The 2% tax basically does not take into consideration the rules of double taxation but taxes the players in the supply chain on amounts including VAT. Every registered taxpayer is an agent of Zimra who charges and collects VAT on behalf of the government. As such, taxpayers are being taxed on the payment of taxes through agencies. This further increases the cost of production.

Transfer Pricing Regulations in Relation To Management Fees as per Section 16 of the Income Tax Act

In a normal group set-up, each component of the group is set up to specialize in a particular line of service for the provision of goods and services to the public. It is inevitable that the services provided by a certain component of the group would be required by another member of the group. It, therefore, makes business sense for the component to promote the group member and engage them.

In other cases, it will be economical to have certain services which are not required on a daily basis by each component of the group centralized and shared amongst the group.

With effect from 1 January 2016, Zimbabwe introduced Transfer pricing legislation. Section 98B, as read with the 35th schedule of the Income Tax Act, provides that a company that has transactions with associates needs to be trading at arm's length.

Before the introduction of the transfer pricing legislation, section 16 (1) (r)[1] of the Income Tax Act was the main regulator of charges between related parties and restricted the claim of general administration fees charged between branches and subsidiaries of companies. In 2017 the restriction was extended to transactions between associates. The excess fees are deemed to be a dividend in the case of cross-boarder payments.

Section 16 continues to be in place regardless of compliance with transfer pricing documentation which supports that transactions between associates are at arm's length.

The TP legislation requires the related parties to transact at arm's length. The party that receives the income is taxed in full. However, Section 16(1) (r) imposes a restriction on the payer regardless of the payee being taxed in full. Furthermore, third parties transacting under similar and comparable conditions are allowed a full deduction.

There seems to be two pieces of legislation that address the same issues. We believe that the transfer pricing legislation was meant to cover situations addressed in section 16(1)(r) therefore the section should be repealed. Why would one go through the process of identifying an arm's length price which the

[1] : save as is otherwise expressly provided in this act, no deduction shall be made in respect of any of the following matters—
(r) in the case of expenditure incurred on fees, administration and management in
favour of a company of which the taxpayer is an associated enterprise, or (where the company is a foreign company) the local branch—
(ii) incurred after the commencement of trade or the production of income, any amount in excess of 1% of the amount obtained by applying the above formula.

Revenue Authority will disallow for tax purposes? Taxes provisions should be fair and in this case it is favouring third party transactions and disadvantaging group set ups creating unfair competition in the market.
We believe this has an effect on investments, as investors are discouraged from expanding and diversifying their investments. This tax legislation appears to be discouraging group set ups.

We appeal to the Minister to have related party transactions supported by a TP document excluded from the provisions of section 16(1) (r).

Revision of Tax Thresholds – Pegging Tax Thresholds in USD

Tax Threshold

We note that Finance Act No. 3 of 2019 Appendix 1 increased tax thresholds by a factor of 8. However, the exchange rate now sits at US$1: ZWL$85. To ensure taxpayers get reasonable deductions during inflationary periods, we propose that all tax thresholds be fixed in USD.

Tax Tables Revision

With reference to the appendix to the Finance Act No 2 of 2019, most of the Tax legislation monetary values were revised by a factor of 8. However, we note that the change in the tax tables was not in alignment, as a factor of 2 was used, and this has left employees disadvantaged and resulted in almost every employee being subjected to tax.

A comparison of taxes paid by employees earning in RTGS and those in USD shows that employees paid in RTGS are being taxed much more than those who earn in USD. Disposable incomes are worse off, coupled with the difficult economic conditions, the welfare of the general workers has been eroded. This includes farm workers and cleaners.

We appeal to the Minister to consider revising the tables and have them aligned with the economic environment or fixing the employment tax tables in USD.

Fuel Import Duty

There is a need to scrap the Road Haulage Fuel Import Duty of US$0.05/Litre so as to reduce the cost of fuel in the economy and allow the importation of fuel by licensed petroleum retailers while also reducing Fuel Import Duty to about US$0.20. Zimbabwe now has the most expensive fuel in SADC, and it does not do the country any favours on AfCFTA or export competitiveness. Taxes and Duties on fuel now constitute US$0.50 on every litre sold, which is too high.

Relief Facility for Business

Our members did not access the ZW$18b stimulus package. The credit guarantee arrangement with Government is not offering enough comfort to banks to lend to the Private Sector. Hence there is a need to set up a fund for draw-down by businesses. An option could be allocating 50% of Special Drawing Rights (SDR) towards industry capacitation in preparation for increased competition under the African Continental Free Trade Area (AfCFTA), with the remaining 50% going towards exchange rate support, with a special focus on those players who are not eligible for the foreign currency auction market.

Special Economic Zones

The lack of information and unconvincing incentives have seen low uptake of the SEZ initiative by players. Special economic zones should not be the preserve of the government. It is our recommendation that private special economic zones be considered and given way.

The Health Sector

The Budget seems to turn a blind eye to the much-undercapitalized health sector. The COVID-19 pandemic has exposed the sorry state of affairs in this very critical sector, worse still, with a 4th wave expected to hit us before year-end. A game plan is required to introduce Universal Health Coverage, also targeting informal players. The over-reliance on donor support puts the country in a precarious position and is a source of concern.

COVID-19 Vaccination

The Minister of Finance indicated that US$93.2 million had been spent on procuring 11.8 million vaccines doses and 7.2 million syringes out of the US$100 million set aside by Government. While he mentions the need for additional resources, there is no indication of specific sources of finance. Failure to secure the requisite financial resources threatens the achievement of the targeted 60% herd immunity. Also, any financing option should take into consideration the debt burden.

Progress on Infrastructure Projects

Critical growth enabling infrastructure projects seem to be lagging behind, with negative implications on the cost and ease of doing business and trade facilitation, bearing in mind the advent of the African Continental Free Trade Area (AfCFTA). While the adverse effects of COVID-19 on progress are understandable, it is crucial to ensure that the pandemic is not used as a scapegoat for inefficiency and incompetency.

a. Roads: Beitbridge-Harare-Chirundu Highway

The project is behind schedule, with 180.45km of the 2020 target of 200km, now open to traffic. The failure to achieve the 2020 target casts doubt on the achievement of the 2021 200km target. The Mid-Term Budget Review did not indicate specific interventions meant to expedite the completion of this very important corridor, especially in light of the absence of the railway alternative.

While cognizant of the adverse effects of the pandemic on progress, subdued traffic due to lockdowns also present an opportunity for the acceleration of works, and contractors should take advantage thereof. Congestion during normal times disrupts progress.

There is a need for Government to create performance contracts for the contractors with clear deliverables. Under the current arrangement, each of the five (5) contractors is given a 20km stretch to work at a time, being given another 20km stretch once they finish the previous one. We recommend that if a contractor fails to meet targets for two consecutive stretches owing to inefficiency and incompetency, they must lose their contract to capable higher performers already engaged for the project. Getting an outsider might be costly and time-consuming, assuming that the contractors are recruited after a thorough vetting process. However, if new contractors become necessary, due process should be followed as they engaged.

b. Hwange 7 & 8 Expansion Project

The project is said to be at 65% completion, with only US$378 million out of the US$998 million China Eximbank having been drawn down. The draw-down does not seem to tally with the 65% completion unless the remaining works are the most expensive. This project is also behind schedule, with commissioning rescheduled to 2022. While we may celebrate improved generation at Kariba due to the good rains, climate change remains a resident threat to hydroelectricity power generation. In this light, high priority needs to be given to the completion of the Hwange projects, given the coal stocks that we have.

Furthermore, more efforts need to be put towards roping in Independent Power Producers (IPPs) to complement public sector initiatives. Appropriate incentives which ensure a win-win situation should be explored.

The solar alternative at the household and company levels needs to be promoted through scrapping import duties on solar equipment and offering tax incentives for companies who migrate to solar energy. The micro-solar projects being initiated by the Rural Electrification Authority (REA) should be upscaled to reduce demand on the national grid.

c. **Modernisation of Beitbridge Border Post**

The Budget was silent on progress on the Beitbridge Border Post Modernisation Project. This is one of the most critical national projects, given the envisaged positive impact on trade facilitation in the SADC region. The project complements the Beitbridge-Harare-Chirundu highway initiative and also the drive towards a One-Stop-Border Post at Beitbridge.

Border Management

The snail's pace of progress in implementing the One-Stop-Border Post at Beitbridge is worrying, more so, that the Minister is silent about it. Being the busiest border post in SADC, there is a need to ensure that Beitbridge does not stand in the way of trade facilitation with the envisaged increase in trade under the African Continental Free Trade Area (AfCFTA).

There is a need for the digitization of ZIMRA operations, moving towards paperless operations. The ASCUDA system needs constant and timely upgrades to ensure that downtime, which causes congestion, is minimized.

Security systems and infrastructure need upgrading to plug rampant smuggling and corruption. The porosity of our borders is a constant cause for concern. State of the art CCTVs, drones, scanners should be procured to enhance the detection of the vices. The use of drones in border surveillance can enhance efficiency while cutting down costs and corruption related to human patrols.

Increased efficiency arising from the above initiatives will help lessen the negative effect of the Kazungula Project on the Beitbridge Border Post.

Grain Procurement

As of 26 July 2021, grain deliveries to GMB depots stood at 636 884 tons valued at ZWL$20.9 billion, of which 566 751 tons were for maize, 58 212 tons small grains, 11 260 tons soya beans and 661 tons wheat. Anticipated deliveries are estimated at 1.9 million tons and valued at ZWL$62 billion. The Grain Marketing Board has been designated as the sole buyer, and Government expects to mobilize financial resources through grain sales, AMA Bills Facility and fiscal revenues.

Of concern is the practicality of this arrangement, with the GMB already owing farmers ZWL$9.3 billion for current deliveries worth $23.1 billion. The likelihood of perennial grain payment delays is very high. Any delays in farmer payments and grain deliveries will expose cash-strapped farmers to cash-rich clandestine buyers who will procure the grain for a pittance and deliver it to the GMB at a profit. Some of these middlemen will also engage in corruption activities with GMB officials for faster payment processing. The creation of such arbitrage activities should be avoided at all costs as it kills the goose that lays the golden eggs. Furthermore, an audit of the refurbishment works on GMB storage facilities is needed to avoid yester-year grain spoilages (post-harvest losses).

In the absence of adequate financial resources for grain procurement, Government could consider repealing Statutory Instrument 145 of 2019, which makes the Grain Marketing Board (GMB) the sole buyer of maize and include it among commodities tradable on the Zimbabwe Mercantile Exchange (ZMX). The commodity exchange is expected to start trading in the second half of the year.

ZNCC REACTION TO THE MID-TERM MONETARY POLICY STATEMENT

Inflation

There was a significant decline in annual inflation from 837.5% in July 2020 to 56.37% in July 2021. On the other hand, month-on-month inflation has been increasing from a 2-year low of 1.6% in April 2021 to 2.5% in May and 3.9% in June, then receding to 2.56% in July. In the outlook period, month-on-month inflation is expected to stabilize below 3%, while annual inflation is expected to further decline to the 22% - 35% range by December 2021. Although annual inflation is falling, the double-digit figure of 56.37% is still high and has a profound negative effect on the economy's already low wages and purchasing power. Also, as long as we have high double-digit inflation, macroeconomic convergence will remain elusive. According to the SADC Harmonised Consumer Price Indices (HCPI) May 2021, Zimbabwe had the highest inflation figures for 2021, with annual and month-on-month and annual inflation above the regional averages. Table 1 shows the wide disparity between the month-on-month (MOM) and year-on-year (YOY) for Zimbabwe and its major trading partner, South Africa. It is our hope that efforts to contain money supply growth, the major inflation driver, will be sustained.

Table 1: Comparison of Zimbabwean and South African Inflation

	Aug'20	Sept	Oct	Nov	Dec	Jan'21	Feb	Mar	Apr	May'21
ZIM - MOM Inflation	8.2	3	4	2.6	4.2	5.4	4.3	1.9	1.8	2.7
SA - MOM Inflation	0.3	0.2	0.5	-0.3	0.4	0.6	0.6	0.9	0.8	0.2
ZIM - YOY Inflation	782.4	676.4	438.5	371.3	332.9	364.3	333.7	255.4	201.8	164.9
SA - YOY Inflation	4.6	4.5	4.9	4.3	4.4	4.5	3.8	4.1	5.8	6.5

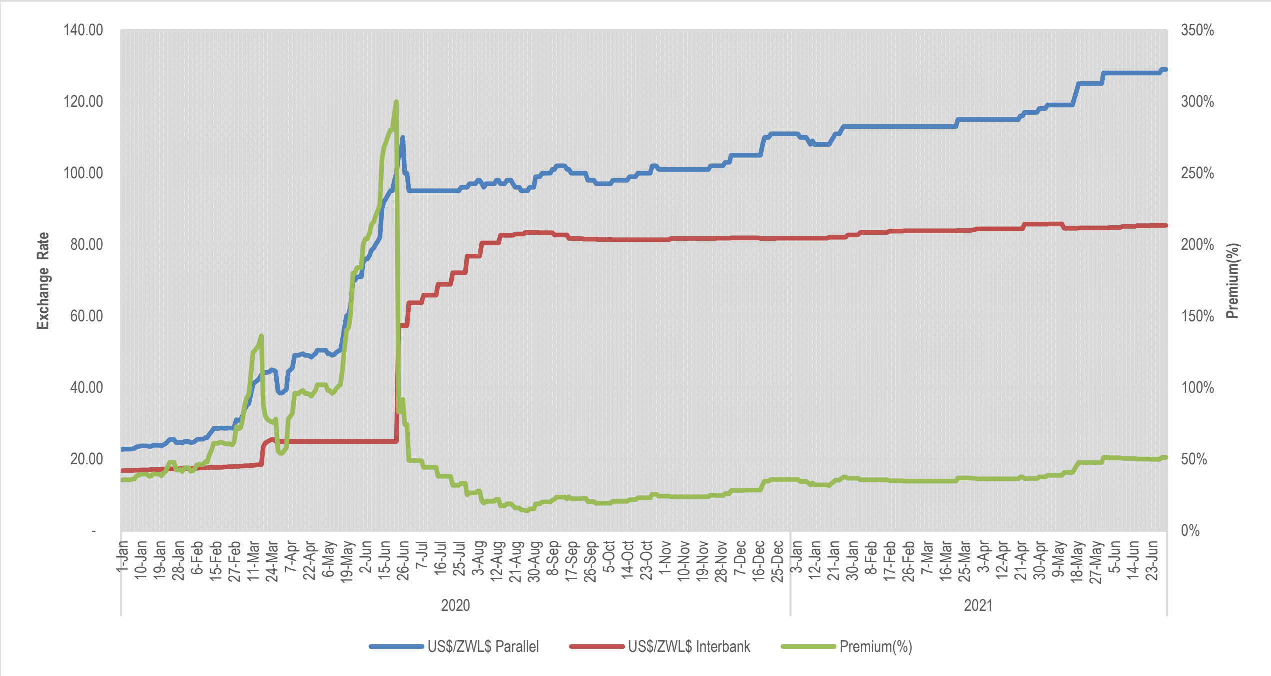
Source: SADC Harmonised Consumer Price Indices (HCPI) Issue No. 113

Money Supply

The Monetary Policy Statement is not speaking into broad money supply (M3), but just high powered money, that is, reserve money (M0). That blackout of such information is worrisome, given that Zimbabwe's money supply growth is among the highest in the world, probably only second to Venezuela. The Central bank must religiously and timeously release both reserve and broad money supply statistics for transparency, facilitating a comprehensive view of progress regarding money supply management.

The Exchange Rate

The central bank says that the foreign exchange auction market has brought stability to the exchange rate. However, the persistent and widening spread between the foreign exchange auction rate and the parallel market rate (Figure 1) seems to tell a completely different story. This trajectory will continue as long as the majority of economic agents are accessing their forex from the parallel market. The increasing parallel market premium remains a formidable threat to monetary stability as it can potentially reverse the gains from the containment of money supply growth, hence undoing progress on the disinflation drive. The status quo also casts doubt on the extent to which the auction market reflects the actual market conditions.



Source: 2021 Mid-Term Budget and Economic Review

Figure 1: Interbank and Parallel Market Exchange Rates

Foreign Exchange Auction Market

Total allotments as at 30 June 2021 stood at US$1,544.98 million. Average weekly allotments as at June 2021 of US$32.57 million for the main auction and US$7 million for the SMEs auction imply a 4:1 ratio between the two auctions. Large firms seem to be prioritized at the risk of the underfunding of the small firms. This may indicate concentration risk given that Zimbabwe now boasts of very few big players regardless of how active they are in the priority ladder or spectrum.

Of concern also is the apparent bias towards the manufacturing sector in the forex allocations. Manufacturing companies account for 17 out of the top 20 auction beneficiaries. Is this not at the expense of other sectors? For example, mining sector players have been lamenting the decline of some of their forex applications as they are considered net exporters. This is quite unfair, given that the mining sector is the one sustaining the forex auction market. While we are cognizant of higher trickle-down effects from big players and other sectors, there is a need to ensure fairness in foreign currency allocations.

The issues of inefficiencies and allotment backlogs continue to weigh down on the price discovery function of the auction system. These are expected and will persist as long as the exchange rate is not market determined. Demand for forex will always exceed supply given the huge spread between the auction rate (US$1:ZWL$85) and the parallel market rate (US$1:ZWL140). However, for now, the central bank must consider a downward revision of the weekly auction allocations from the current US$45 million to about US$30 million. Continual allocations of non-existing funds only worsens the balcklog situation. Alternatively, it would be better for the RBZ to postpone trading and clear backlogs than continue trading and accumulating backlogs. Sustainable clearance of the backlog requires an improved approach to exchange rate determination, as this is the only market-friendly way instead of allocating funds towards the backlog.

Multiple bidding, among other illegal practices, has been blamed for the delayed allotments. It is our view that tougher punitive measures be put in place for forex abusers. The civil penalties specified in SI 127 of 2021 are not deterrent enough. According to SI 127 of 2021, '***Using foreign currency obtained from a RBZ foreign exchange auction for a purpose different from the one specified in the application to take part in the auction***' attracts '***a fixed penalty of ZW$1 million or an amount equal to the value of foreign currency obtained, whichever is greater, plus an additional 5 per cent of the fixed penalty for each day it is unpaid, up to a maximum of 90 days***'. Some errant auction market players may actually be prepared to pay based on the cost-benefit analysis of their illegal actions. Other players might be merely using their access to the auction to protect their accumulated reserves. They may not have much to lose. While we are cognisant of the need to balance punishment with ensuring entities continue to operate for the sake of the economy, combining the civil penalties with blacklisting/suspension from the auction for a specified period is recommended.

The central bank has put in place measures to address the forex auction allotments backlog. What is not clear is whether the measures are only meant to clear the existing backlog or to both clear and then prevent any future backlogs in the system. Interventions should mainly focus on the latter, that is, ensure that there are no backlogs going forward to restore confidence in the auction system while enhancing its price discovery function. Treasury has reportedly said the auction backlog would be cleared in 45 days-time with no detail of the source of funds.

While it is difficult to judge the feasibility, it is our hope that the source of funds will be sustainable and will not trigger unintended consequences in other spheres.

We continue calling for the ‘decentralization’ of the forex auction. Banks must be the major players on the auction system while the central bank confines itself to monitoring and regulation. With the market inefficiencies experienced at the auction, the central bank should be intervening to deal with attendant risks. Unfortunately, the tone of the Monetary Policy Statement leans more towards over-praising the auction and promising to remain resolute in utilizing it as opposed to soliciting views on its future.

The Chamber also reiterates the need for the auction system to graduate from being a forex allocation mechanism to a price discovery mechanism. By the end of the year, the auction should move away from the priority list, which promotes elitism and threatens the market mechanism.

The Minister of Finance reported that owing to the auction system, 65 to 70% of the products in the retail sector are now locally produced. While this is applauded, it is essential to note that this is from a volume perspective only. The real impact of that development on the current account, and hence the balance of payment, hinges on the value aspect. The relative proportion of retail products in our import basket, especially in value, will give a better picture of the impact of the auction system on our external position.

20% Compulsory Conversion of Nostro Balances

The 20% compulsory conversion of Nostro balances should be done away with as it reduces confidence in the banking sector, resulting I n reduced foreign currency deposits. It is also a soft property rights issue that scares away investors.

Bank Policy Rate

The central bank maintained the bank policy rate at 40%, in line with its forward guidance policy on the interest rate. However, a downward revision of the policy rate was expected, in line with the inflation outlook. Given the central bank's tight leash on money supply growth, a moderate downward revision on the policy rate will not be significantly inflationary but bring some relief to the private sector.

10% Interest Rate Cap on the Medium-term Lending Facility

The central bank put an interest rate cap of 10% on the Medium-term Lending Facility. This moves sends negative signals to the market, while setting a bad precedence of tampering with the interest rate, which is tantamount to financial repression.

Sectoral Distribution of Loans

Although the dominance of the productive sector in terms of loans which stands at 84.75%, is applauded, the sectoral distribution of the loans needs to be interrogated. Currently, agriculture is dominating, accounting for 31.22% of loan advances, much higher than manufacturing (10.92%) and mining (7%). This is in addition to other ZIMRA support in the form of scrapping of duty on agricultural equipment and inputs. Cognisant of the importance of the agricultural sector through its forward and backward linkages with manufacturing and other sectors, there is a need to ensure that biased support to the sector does not suffocate other complementary sectors as this will compromise value chains and overall growth. As such, similar commitments must be made towards manufacturing, mining and other sectors. A holistic value chain approach is needed in sectoral resource allocation to rebalance the economy.

ZW$500 million MSMEs Facility

The central is applauded for the ZW$500 million Micro-Small and Medium Scale Enterprises (MSMEs) funding facility to be accessed through the banking system at an annual interest not exceeding 40%. The facility translates to approximately US$5.9 million (at the official exchange rate) or US$3.8 million at the parallel rate of ZWL$130. The 40% interest rate seems to be in line with the inflation projections, which will ensure that though the real interest rate will be initially negative, given the annual rate of inflation standing at 56.37% for July, if the projected 25% - 35% range is achieved by December 2021, the real interest rate will be in the positive range, ensuring the sustainability of the facility. This implies that the loans will become costly if inflation maintains its downward trajectory, which might affect the MSMEs appetite for the facility, likely leading to low uptake. So, the major task of the central bank is to strike a balance between the economic sustainability of the facility and attractiveness to the MSMEs.

Payment of Interest on Savings Accounts and Fixed-term Deposits

The interest rate policy sould take into consideration the the need to balance the cost-build up of banking institutions and the cost of capital to the private sector amidst pressures arising from the global pandemic. The contral bank should also be wary that Statutory Instrument 65A of 2020 on the payment of interest on savings accounts may potentially flout competition laws, given that setting savings rates to be honoured by banks is synonymous with collusion.

US$150 million Letter of Credit (LC)

While the facility is welcome, there is a need to give preference to those not accessing the foreign exchange auction system. Double-dipping will crowd out other economic agents. Furthermore, there is a need to strengthen the foreign exchange management system as a way of boosting suppliers' confidence in the letters of credit.

Fintech Developments - Regulatory Sandbox

The Regulatory Sandbox is a welcome development that fosters innovation necessary to promote the digitization of financial services in line with global trends. It also promotes homegrown applications, thus reducing reliance on foreign providers with the associated Balance of Payments implications.

Partial Privatization of Fidelity Printers and Refineries

This commendable move may see formal gold deliveries improving, given that producers have a stake in the gold refinery. However, it is very critical that due diligence and due process be observed to safeguard national interests. Clarity is needed on the inclusion of both large-scale and small-scale gold producers and the proportion of shareholding.

Acquisition of Shareholding in ZimSwitch

This strategic move gives the central bank more control in the National Payments System, especially the mobile money sector, while also advancing the interoperability agenda, bringing convenience to the transacting public.

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