ZIMBABWE

2012 BUDGET STRATEGY PAPER

"*Building Consensus on Our Priorities*"

MINISTRY OF FINANCE

August, 2011

Foreword by the Minister of Finance

The pursuit of a modern, stable, healthy, functional and performing developmental state, remains a fundamental imperator for us at the Ministry of Finance. Since 2009 we have carefully pursued this dream with vigor, industry and honesty.

Clearly, given 13 years of sustained decline, devaluation of the economy and macro-economic destabilisation up to 2008, our first task was that of macro-economic stabilisation. This was a task we executed through the guidance of the Short Term Emergency Recovery Programme (STERP). STERP II, which we implemented in 2010, oversaw the consolidation of the economic reconstruction we began in 2009.

Since then, our challenge is to graduate from stabilisation to growth, and from growth to inclusive development. Inclusive development is underpinned by the following assumptions and pre-conditions:—

1. A stable and peaceful political environment;
2. Policy consistency, policy harmony and policy implementation and oversight;
3. Inclusivity and participatory democracy in policy formulation;

4. Macro-economic stability;

5. Constitutionalism and rule of law;

6. Policies around social security and human development;

7. A unifying common vision.

This Budget Strategy Paper (BSP) is a new important element we have developed to underpin participatory democracy, inclusivity and ownership in policy formulation. The Budget is an important fiscal element that must belong to the people and a BSP serves to guarantee a bottom–up participatory approach in budget formulation.

We are, therefore, extremely pleased as Government to present this first BSP for the Republic of Zimbabwe.

We now, therefore, look forward to genuine participation and contributions to the Budget process and content as facilitated by the present and future Budget Strategy Papers.

I thank you.

T. Biti, M.P.

Minister of Finance

TABLE OF CONTENTS

INTRODUCTION

1. The positive economic developments since 2009 and the prevailing stable macro-economic environment provide an opportunity for reverting back to Budget cycles that focus on fiscal planning, consistent with best regional and international budgeting practices.

2. The launch of the Medium Term Plan (MTP) in July, as a follow up on the Short Term Emergency Recovery Programme (STERP), also allows us to take a longer-term perspective to fiscal planning, and improve on budgetary processes, for the attainment of sustainable growth and transformation.

3. Consistent with the above objectives, Government is introducing the Budget Strategy Paper (BSP), which is a budget policy framework for the year 2012 as well as the outlook for 2013-2014.

4. As previously pronounced, it remains Government's unwavering commitment to transform the economy into a developmental state, with the ultimate objective being to improve the standards of living of all Zimbabweans. Hence, this BSP remains anchored on such a transformative agenda.

5. Clearly, and as intimated in our STERP programme, the economic turn-around highly depends on the democratisation of policy making, including formulation of budgets that are gender responsive, and inclusive of all stakeholders,

6. The BSP embeds a strategic **top-down** approach, complemented by a participatory **bottom-up** approach that empowers line Ministries to bid for resources strategically, and in line with the overall expenditure ceilings.

7. Specifically, the BSP identifies issues to be addressed in the 2012 National Budget, derived from previous budget consultations, the Government Work Programme and Sectoral Plans, STERP II, as well as the Medium Term Plan (2011-2015).

8. The BSP reinforces the application of the Public Finance Management Act [*Chapter 22:19*] as well as rebuilding policy management capacity and accountability in the management of public resources.

9. The key principles of the Budget Strategy Paper (BSP) are:—

   (a) Medium-term Macro-Fiscal and Expenditure Framework (MFEF), which contains forecasts of revenues, cooperating partner inflows and debt servicing requirements. This serves as a top-down hard budget constraint.

(b) Fiscal planning, particularly annual budgeting, requires re-focus towards a medium term outlook, whilst at the same time endeavouring to improve effectiveness and efficiency in budgetary processes.

(c) Alignment of spending with national policy priorities and Ministries' strategic plans, following consultations with stakeholders.

(d) Overall spending ceiling, based on sector strategic priorities for the forthcoming year and indicative estimates for a further two years.

10. Accordingly, the BSP is a tool meant to facilitate broader participation and in-depth debate on the national fiscal and other macro-economic policy issues, as a prelude to the 2012 Budget consultative process.

11. This, unlike in previous years, also allows more time for stakeholder participation during the consultative and Budget formulation phases and, hence, enriching the effectiveness of the Budget as a major macro-economic policy tool as it would have been subjected to public debate.

12. The BSP is, accordingly, relevant to a wide range of stakeholders, Parliament, the public, business, labour, and civil society.

13. The introduction of a BSP, as input into the budget formulation process, is also consistent with regional best practices.

14. In the case of other SADC and COMESA countries, South Africa issues a Medium Term Budget Policy Statement; Zambia and Namibia, Medium Term Expenditure Frameworks; while Uganda produces a Budget Framework Paper; and Kenya, a Medium Term Budget Strategy Paper.

THE 2011 FISCAL AND MACRO-ECONOMIC PERFORMANCE

15. The fiscal and macro-economic developments during the first half of 2011 as well as the outlook to the end of the year are covered in the 2011 Mid-Year Fiscal Policy Review Statement presented to Parliament on 26 July 2011.

16. Developments on the macro-economic front during the first half of 2011 indicate that we are on track with regards to overall economic recovery, with inflation within single digit levels and GDP targeted growth of 9.3% within reach.

17. There are, however, downside risks such as financial sector vulnerabilities, volatility in commodity prices, unsustainable current account deficit and wage bill pressures which require to be attended to during the last half of 2011 as well as into 2012.

18. A review of the current economic and Budget performance and projections to year end assist stakeholders to contextualise their inputs to the 2012 Budget as enlisted through this BSP.

THE 2012 MACRO-ECONOMIC OUTLOOK

19. The global economy is projected to grow by 4.5% in 2012. This should impact positively on the domestic economy, particularly in sustaining demand for the country's exports.

20. Similarly, the projected global inflation of 1.7% in 2012 is expected to anchor some level of stability under the multiple currency regime.

21. It is, therefore, critical that our management of the economy enhances industrial competitiveness in both the regional and global market places, in line with Government's medium term objective of consolidating macro-economic stability, that way facilitating increased capacity utilisation, economic growth and development of the country.

22. The assumptions of this BSP for the 2012–2014 Macro-economic and Budget Framework are highlighted below.

GDP

23. The economy is expected to grow by 7.8%—9% in 2012, compared to a growth rate of about 9.3% in 2011.

24. Agriculture and mining will remain the major contributors to overall growth, with other sectors such as tourism, manufacturing, transport and communication also increasing their share.

Inflation

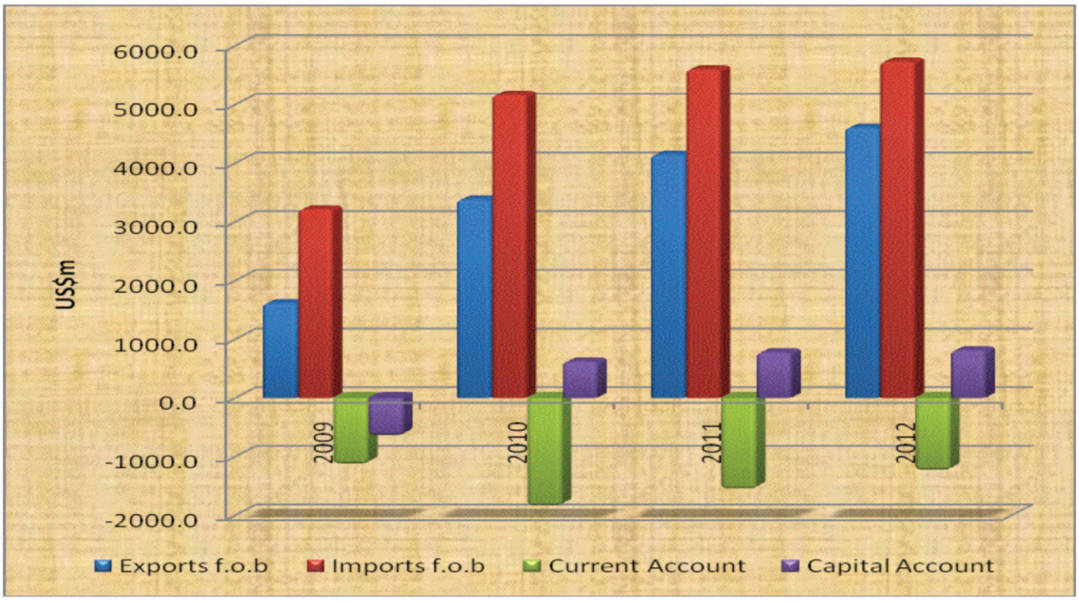
25. Macro-economic stability will be maintained in 2012 through containment of inflation within single digit levels, supported by continued implementation of prudent economic policies which include cash budgeting and use of multiple currencies.

26. Furthermore, domestic capacity utilisation is projected to increase to around 60%, thereby reducing imports, particularly for basic commodities, as well as exposure from fluctuations of the US dollar against the South African rand.

27. Therefore, inflation is expected to average 3.7% and 5% by the end of 2011 and 2012, respectively.

External Sector

28. The balance of payments position is projected to improve, from a deficit of US$789.7 million in 2011 to a lower deficit of US$438.2 million in 2012. The improvement is on the back of anticipated export growth, and marginal positive change on the capital account.



Exports

29. Exports are projected to increase from US$4.1 billion in 2011 to US$4.6 billion in 2012, representing an 11.1% growth.

30. The growth will be underpinned by anticipated favourable international commodity prices and improved output of export commodities in manufacturing, mining and agriculture.

Imports

31. Imports are projected to increase from US$5.6 billion in 2011 to US$5.7 billion in 2012. Food imports are expected to decline by 31.1%, while non-food imports will increase by 5.4%.

32. The decline in food imports is on the back of better performance of the agriculture and manufacturing sectors, while the increase in non-food imports will be mainly on account of increased volumes of fuel imports in support of economic growth.

33. The current account deficit is, therefore, projected to improve from US$1.6 billion in 2011 to US$1.2 billion in 2012.

34. Capital inflows, comprising foreign direct and portfolio investments are projected to increase from US$205 million in 2011 to US$288 million in 2012.

35. Key factors militating against improved foreign direct investment (FDI) and portfolio investment inflows into the country include risk perceptions on the country.

Financing

36. The above BOP performance reflects a gap of US$438.2 million. Government remains concerned over this projected mismatch between exports and imports.

37. Overall, it is imperative that the country develops policy measures and strategies to improve the Balance of Payments position. A key issue is the speed at which we can address the external debt overhang.

38. In the medium term, it is critical that the country targets to build 3 months import cover and avoidance of further accumulation of arrears and running down of external reserves on unproductive imports.

39. Such cover enables the country to cater for exigencies such as drought induced food shortages, commodity price shocks, among others.

MACRO-ECONOMIC & BUDGET FRAMEWORK FOR 2012–2014

40. Based on the above assumptions and macro-economic outlook, the 2012-2014 Macro-economic and Budget Framework is detailed below.

The 2009-2014 Macro-Economic Framework

	2009 Act	2010 Est.	2011 Proj	2012 Proj	2013 Proj.	2014 Proj.
Real Sector and Inflation (US$ m and %)						
Nominal GDP level in US$ m	**5623**	**6716**	**8998**	**9959**	**11297**	**12711**
Real GDP growth (%)	**5.4**	**8.1**	**9.3**	**7.8**	**6.6**	**6.4**
Annual Inflation (average %)	-7.7	3	4.5	5	**5.5**	**5.7**
Central Government (US$ m)						
Total Revenue and Budget Grants	**974.4**	**2339.1**	**2744.9**	**3400**	**3841**	**4321**
Revenue (Tax and Non Tax)	933.1	2339.1	2744.9	3400	3841	4321
Budget Grants	41.3	0	0	0	0	0
Off Budget Grants	93	500	500	500	0	0
Total Expenditure Central Government	**920.9**	**2106.9**	**2744.9**	**3400**	**3841**	**4321**
Current expenditure	**804.0**	**1603.3**	**2140.2**	**2495.5**	**2734.7**	**2975.2**
OW: Employment costs	*550.3*	*1098.5*	*1800.0*	*2040.0*	*2112.5*	*2160.9*
Other recurrent expenditures	*182.0*	*504.8*	*340.2*	*340.2*	*455.5*	*622.2*
Capital expenditure	45.2	415.3	550.0	850.0	1056.3	1296.5
External Sector (US$ m)						
Exports (fob)	1613.3	3380.1	4143.7	4604.1	5164.4	5684.6
Imports (fob)	3213.1	5161.8	5599.6	5731.5	6015.5	6355
Current Account Balance	-1140.3	-1852.5	-1565	-1247.6	-1034.3	-894.6
Capital Account	-656.5	617.5	775.4	809.5	849.8	847.7
Overall Balance of Payments	-1867	-412.1	-789.7	-438.2	-184.5	-46.9
Memorandum Items *As a % of GDP*						
Revenues	**16.6%**	**34.8%**	**30.5%**	**34.0%**	**34.0%**	**34.0%**
Expenditure and Net Lending	**16.4%**	**31.4%**	**30.5%**	**34.1%**	**34.0%**	**34.0%**
Current expenditure	*14.3%*	*23.9%*	*23.8%*	*25.1%*	*24.2%*	*23.4%*
OW: Employment costs	*9.8%*	*16.4%*	*20.0%*	*20.5%*	*18.7%*	*17.0%*
Other recurrent expenditures	*3.2%*	*7.5%*	*3.8%*	*3.4%*	*4.0%*	*4.9%*
Capital expenditure	*0.8%*	*6.2%*	*6.1%*	*8.5%*	*9.4%*	*10.2%*
External Sector						
Exports fob	*28.7%*	*50.3%*	*46.1%*	*46.2%*	*45.7%*	*44.7%*
Imports fob	*57.1%*	*76.9%*	*62.2%*	*57.6%*	*53.2%*	*50.0%*
As % of Total Expenditures						
Current expenditure	*87.3%*	*76.1%*	*78.0%*	*73.4%*	*71.2%*	*68.9%*
OW: Employment costs	*59.8%*	*52.1%*	*65.6%*	*60.0%*	*55.0%*	*50.0%*
Other recurrent expenditures	*19.8%*	*24.0%*	*12.4%*	*10.0%*	*11.9%*	*14.4%*
Capital expenditure	*4.9%*	*19.7%*	*20.0%*	*25.0%*	*27.5%*	*30.0%*

Source: MTP, MOF, RBZ

2012 BUDGET FRAMEWORK

REVENUE

41. The Revenue to GDP ratio is expected to grow from 30% to about 34%, on account of ongoing tax reforms focusing on ZIMRA restructuring, compliance initiatives and increased automation of the tax collection system, among others.

42. Taking account of this, Government revenues are estimated at US$3.4 billion in 2012.

43. The contributions of VAT and PAYE to total revenues are expected to remain largely unchanged, with improvements in the share of Customs and Excise Duties as well as non-tax revenue anticipated.

44. No significant growth in support from co-operating partners is also anticipated during the overall outlook period.

45. In previous Budget Statements, Government appealed for more external development support in order to augment domestic revenues in financing priority programmes and projects.

46. Inflows from development partners during 2011 are projected to amount to around US$593.7 million, with projections for 2012 amounting to US$500 million.

47. Focal support areas remain those in health, agriculture, social protection, governance, water & sanitation and education, with the support being channelled outside the Budget Framework through UN Agencies, NGOs, private sector, and other non-state actors.

48. The 2010 and 2011 Budget Estimates excluded development partners' assistance on account of these resources being channelled outside the Government systems. It remains Government's desire for such noble interventions by cooperating partners to be integrated into the National Budget.

49. In addition, the level of pledged support remains low when compared to receipts by other countries in the region, while actual disbursements tend to fall below the pledges.

50. Unlocking higher levels of development partners' support hinges on the execution and implementation of our debt strategy, among other factors.

EXPENDITURES

51. In the past, Treasury would rationalise the various expenditure proposals from line Ministries to fit within the resource envelope. The introduction of the BSP provides upfront, an indication of resource capacity that enables Ministries and Departments to align their spending requirements for 2012 to this resource envelope.

52. In line with projected revenues, total expenditures in 2012 are projected at US$3.4 billion.

53. From the above resource envelope, an amount of US$2 billion is already committed towards employment costs, translating to 60% of total expenditure or 20.5% of GDP. It is envisaged that the proportion of employment costs will progressively decline to reach 50% by 2014.

54. Capital expenditures' share in the total budget is expected to improve to about 25% in 2012, translating to US$850 million. This, however, is still lower than the desired target of 30% of total expenditures which threshold is envisaged for 2014.

55. The resource envelope remaining for Government operations and maintenance for 2012 will, therefore, be around US$510 million.

Development Budget Proposals

56. The MTP identifies robust infrastructure as a key enabler for economic recovery, growth and transformation. The key objective of the Plan is restoration of basic services and provision of efficient and reliable infrastructure network in order to facilitate smooth business and social operations, stimulate economic growth, social transformation and economic development.

57. In its report on Infrastructure and Growth in Zimbabwe, published in March 2011, the African Development Bank (ADB) evaluated the state of our infrastructure and identified key challenges as follows:—

   (i) Sustained deterioration in the quality of infrastructure assets due to inadequate funding for maintenance;

   (ii) Private sector financed road, transport and communications sector services are more expensive than in neighbouring countries;

(iii) Mismatch between cost of providing a service and tariff levels, coupled with inefficiencies have tended to result in parastatals making losses and hence deterioration in service provision;

(iv) Lack of progress in building institutional capacities for management and regulation of the basic services;

(v) The deterioration in basic infrastructure has had a negative impact on the other productive sectors of the economy;

(vi) Minimal investment by the private sector in basic infrastructure.

58. The ADB report proposes an Action Plan for Infrastructure for (2011-2020) with a total requirement of US$14.2 billion, with the following key features:—

(i) Rehabilitation of the national power grid, road network and railways network;

(ii) Upgrading of airports and air traffic communications and safety, consistent with international standards;

(iii) Investment in dam construction and water conveyance, to meet demands for agriculture, industry and households;

(iv) Rehabilitation of existing water supply and sanitation infrastructure;

(v) Development of the national communications grid, for ICT based on fibre optics;

(vi) Increased emphasis on routine maintenance of infrastructure assets, in order to avoid repetition of cycles of deterioration;

(vii) Institutional reform and capacity strengthening in implementation and management of existing, as well as new infrastructure investments.

59. The Public Sector Investment Programme is one of the financing options for the action plan, complemented by own resources of local authorities and parastatals, the private sector through Public Private Partnerships (PPPs) arrangements, as well as cooperating partners.

60. Some of the infrastructure projects Government has identified for implementation in the short to medium term are indicated in paragraphs 61—105.

Energy

61. Availability of power is by far the biggest challenge facing the economy.

62. Measures aimed at completion of rehabilitation programmes at existing power generation facilities, expansion of existing generation capacity, demand side management, improvement in financial performance of ZESA and creation of an enabling environment to attract private investment in the power sector are all critical in ensuring reliable and consistent supply of electricity.

Power Generation

63. Installed generation capacity stands at 1 920MW, against demand of 2 200MW. Average output from available plants, most of which are operating at sub-optimal levels is around 1 200MW, against the 2011 and 2012 targets of 1 600MW and 1 900MW, respectively.

64. In order to achieve the above targets, an amount of US$80 million is required for the rehabilitation of power plants, including small thermal power stations.

65. Therefore, the 2012 Budget would have to set aside resources to complement the Zimbabwe Power Company's (ZPC) own contribution towards the above requirement.

66. Construction of new generation plants at Hwange 7 & 8, and expansion of Kariba South, which require US$1 billion and US$400 million, respectively, is expected to generate an additional 900MW. These projects lend themselves to financing through Public Private Partnerships following expression of interest already received.

Transmission & Distribution

67. The transmission and distribution infrastructure requires rehabilitation and upgrading, following years of inadequate maintenance and vandalism, whilst new settlements and rural areas require connection to the national grid.

68. In order to ensure reliability of the systems in wheeling power, about US$400 million is required in the short term for rehabilitation and upgrading. The Zimbabwe Electricity Transmission and Distribution Company (ZETDC) will have to intensify efforts to fully collect billed amounts from consumers currently standing at US$450 million, thereby increasing capacity for reinvesting in the infrastructure.

69. In addition, the utility, with support of the relevant State agencies, will have to enhance measures for curbing vandalism of infrastructure.

Demand Side Management

70. Measures to ensure more efficient use of power by consumers and, hence, create savings that can be channelled to the productive sectors also need to be pursued.

71. Such measures could include replacement of incandescent lights with energy saving bulbs, resuscitation of the ripple control system and installation of prepayment meters at a cost of US$8 million, to be availed by ZETDC from own resources.

Water & Sanitation

72. Most urban local authorities are failing to provide adequate and clean water, whilst sewerage systems are experiencing blockages and most distribution systems are in disrepair. There will be need to expand capacity of water sources in order to meet increased demand.

73. In the rural areas, the main challenge relates to an increased number of non-functional boreholes and water points and the absence of a proper maintenance and expansion programme.

74. With regards to sanitation in the rural areas, focus has been mainly on construction of toilets through a subsidy to

beneficiaries. However, beneficiaries need to contribute more towards sanitation as experience has shown that usage of sanitation facilities is highest where there is realisation by communities of the consequences of prevailing practices. This should reduce public health risks that have seen the emergence of preventable diseases, such as cholera.

75. Key intervention areas relate to rehabilitation of both urban and rural water and sanitation facilities, in order to improve access, strengthening coordination and implementation of sanitation programmes as well as expansion of hygiene education programmes.

76. Requirements for water and sanitation amount to US$3.9 billion, comprising construction of new water sources, conveyancing and treatment as well as sanitation.

77. Expansion of settlements, lack of maintenance and low revenue generation capacity by local authorities on account of unreliable billing and collection systems are also major challenges.

78. In light of the above, the 2012 Budget would have to set aside resources for dam construction, water and sewer infrastructure

rehabilitation as well as water supply for rural communities. Cooperating partners are also encouraged to continue with the support of the water and sanitation projects, especially for the rural and disadvantaged communities.

79. In the same vein, local authorities are expected to reinvest income from service charges towards rehabilitation programmes as well as building new capacities.

Transport

80. The rehabilitation and maintenance of roads has to continue in support of efficient movement of traffic and people and improved linkages with other neighbouring countries.

81. The overall financial requirement of US$2.6 billion covers primary, secondary and tertiary road networks (US$985.9 million); dualisation of some trunk roads (US$924 million) as well as; rehabilitation of the urban road network (US$715 million). In addition, there is need to strengthen financial and institutional capacities for regular maintenance by the various road authorities.

82. With regards to the dualisation of trunk roads, implementation will be done through Public Private Partnership arrangements, whilst the Budget and ZINARA will continue to mainly make provisions for the rehabilitation and maintenance programmes.

83. Upgrading of the rail network, focusing on the rehabilitation of track, signalling and telecommunication infrastructure, as well as procurement of locomotives and wagons will require a total amount of US$1.1 billion. The unbundling of the NRZ into strategic business units, and creation of a regulatory authority, should provide an environment that facilitates private sector investment.

84. Such reforms would also improve operational efficiency and lower transport costs. Given the limited support from the fiscus, the bulk of the financing for the rail rehabilitation programme will necessitate the participation of private capital through PPPs and joint venture initiatives.

85. Ensuring that Zimbabwe becomes a destination of choice for tourists requires that our airports infrastructure is upgraded to international standards at an estimated cost of US$350 million. This covers outstanding works for JM Nkomo airport

(US$10 million), upgrading of Victoria Falls, Buffalo Range and Kariba airports (US$340 million).

86. Reconsideration of the implementation of the Aviation Infrastructure Development Levy, complemented by private capital should unlock sufficient finance for all airports infrastructure rehabilitation and upgrading programmes.

Information Communication Technology

87. Notwithstanding investments by both Government and the private sector in ICT infrastructure in the past few years, Zimbabwe still faces ICT challenges in both data and voice arenas, which are manifested by congestions and slow connectivity.

88. Usage of ICTs is also beyond the reach of many ordinary Zimbabweans, with low and costly broadband penetration.

89. Upgrading of existing technology provides opportunities to expedite communication and decision making by economic actors, enhance the quality of learning, cascade ICT technology to the rural areas through the establishment of one-stop information centres and the way Government delivers services to the people.

90. The upgrading of television and transmission infrastructure, installation of the fibre optic network, information centres as well as E-Government is expected to cost about US$82 million.

91. The equipment for both Zimbabwe Broadcasting Holdings (ZBH) and Transmedia will be financed through licensing fees and contributions from Government. The fibre optic network will be financed from private investors, whilst the requirements for E-Government and communication information centres will be met in full from Government resources.

Housing

92. The urban housing backlog, currently estimated at over one million new units, has remained high due to the lack of new housing development projects over the years.

93. The shortage of housing finance instruments and high mortgage interest rates have contributed to the huge housing backlog in most urban areas. This has been compounded by the legal framework, which does not allow for commencement of construction until all the offsite infrastructure is in place.

94. Many local authorities also lack financial capacity to provide offsite and onsite infrastructure, as well as implement urban renewal programmes that are necessary for the provision of decent shelter to residents.

95. Provision of incentives for private sector participation is critical in promoting housing development in the country. This could take the form of concessioning, where the private developer provides offsite infrastructure and collects rates for a specified timeframe that allows them to recoup their investment costs.

Social Services Infrastructure

96. The development budget also targets social infrastructure, focusing on education and health as a means to fight poverty and improve human development. The targeted approach embraced since 2009, has made great strides in restoring social service delivery in these sectors.

97. Coverage, however, has been limited due to resource and capacity constraints.

98. Focus will be on rehabilitation and maintenance of existing infrastructure, procurement of equipment as well as expansion in some areas in order to improve accessibility to services.

99. Whilst in the main, requirements for restoring social service delivery are met by Government, there is a potential for private investment.

Public Private Partnerships (PPP)

100. Promotion and implementation of infrastructure projects in the country through Public Private Partnerships has so far been slow, notwithstanding the immense potential this financing option has in the provision of public infrastructure services, such as water storage and transport, power generation, concessions for railways and airport services.

101. The absence of an institutional, legal and policy framework as well as governance and pricing issues for parastatals such as NRZ, ZESA, ZINWA, CAAZ and Local Authorities have also been major impediments to private sector participation.

102. There is urgent need, therefore, to finalise the regulatory framework for PPPs and the creation of a well staffed PPPs Unit as there are already a number of expressions of interest in some of the sectors by prospective partners.

Rural Development

103. The economic challenges we faced during the past decade have had devastating effects on rural communities, with most public services infrastructure such as transport, water and sanitation and communication in a state of disrepair.

104. The economic recovery we have enjoyed over the past few years is still to significantly trickle down to rural communities as options for income generation remain limited to agriculture.

105. Sustainable rural development is a viable strategy for fighting poverty in the rural areas. Infrastructure rehabilitation, maintenance and expansion in areas such as roads, ICT, and most of all, rural electrification are all necessary catalysts for rural development.

Financial Inclusion

106. The decade long macro-economic challenges led to severe financial dis-intermediation and exclusion of the greater proportion of the Zimbabwean population. It is, therefore, critical that measures are put in place to facilitate greater participation of the lower income groups into the economic mainstream, and

thus contribute towards poverty alleviation and promotion of overall economic development.

107. The promotion of financial inclusion requires the creation of specialised financial institutions, including more microfinance banks and leasing companies.

108. Credit Bureaus will also be required as supporting infrastructure.

109. Furthermore, increased accessibility of institutions should broaden serving of financial needs of the population.

Distressed and Marginalised Areas Fund (DiMAF)

110. Notwithstanding the general rebound in economic activity, it is a fact that there are some sectors, as well as economic entities, whose partcipation lags behind and still remain distressed. In this regard, previous consultations undertaken call for interventions that facilitate recovery of companies and industries with a view to improving overall productive capacity utilisation as well as job creation.

111. It is in this context that there are ongoing consultations regarding revival of industries such as those in Bulawayo, Gweru and other parts of the country.

112. Instruments for intervention aimed at addressing capital challenges faced by distressed and marginalised industries, include the Distressed and Marginalised Areas Fund (DiMAF) unveiled in the 2011 Mid Year Fiscal Policy Review Statement, in collaboration with local financial institutions and external investors.

113. The 2012 Budget will, therefore, have to set aside resources to further grow the Government contribution. Stakeholders are, therefore, expected to make their contributions regarding how the scheme can be enhanced in terms of additional sources of financing, terms of lending, as well as overall management.

Recurrent Expenditure Proposals

114. Public service delivery remains below par in a number of areas, resulting in Zimbabweans failing to access quality services from Government Ministries and Departments. Furthermore, concerns remain over the levels of remuneration in the public sector, in comparison to the cost of living.

115. These concerns remain, notwithstanding the Budget Framework wherein over the years, Recurrent Expenditures have accounted for a disproportionate share of the budget.

116. The high non-discretionary component of the expenditures is crowding out funding for critical development and other programmes which are necessary for economic recovery, growth and poverty reduction.

117. Realignment of our recurrent expenditures is, therefore, critical, while addressing the operational and service delivery requirements and the imperator for improvements in conditions of service for public servants.

Imperator of Pay Increase within Budget Constraints

118. In previous budgets, Government has reiterated its concern over pay levels for civil servants and made a commitment to improve working conditions. For the year 2011, remuneration reviews were undertaken in January and July.

119. While the two reviews could not attain cost of living consistencies, it is pertinent to note that the proportion of employment costs to total expenditure and GDP is now considerably high. Our employment costs, projected at US$1.8 billion by year end, account for 20.5% of GDP or 66% of revenue.

120. Following the 2011 remuneration reviews, the annualised employment cost bill amounts to US$2 billion. This budget level accounts for 60% of the projected 2012 revenues of US$3.4 billion, leaving a balance of US$1.4 billion for the rest of the other budget items.

121. Consideration of a remuneration review in 2012 will increase the annualised bill beyond the US$2 billion, thereby further reducing resources available for operations and maintenance, as well as development expenditures.

122. It is, therefore, imperative that there be a deliberate and collective agreement on how to manage public service remuneration reviews in a manner that frees resources for other Government requirements. International best practices recommend containment of employment costs to around 30% of the total budget or 10% of GDP.

123. It becomes critical that measures aimed at controlling the wage bill are adopted and enforced, including implementation of the results of the Payroll and Skills Audit, freeze on non-critical vacant posts and overall establishment rationalisation.

124. As will be recalled, Government undertook a Payroll and Skills

Audit exercise between 2009 and 2010, to evaluate staff levels and the effectiveness of the Civil Service.

125. His Excellency the President, on the occasion of the opening of Parliament on 6 September 2011, confirmed that the Public Service Commission is in the process of verifying the areas of presumed irregularities and taking corrective action.

126. In this regard, progress over the validation and the necessary corrective measures by the Public Service Commission should be tabled before the end of the year, which report will provide details of confirmed as well as potential savings on Ministries' establishments, where applicable. Accounting Officers and all heads of stations, together with all Government employees, are expected to give maximum co-operation for the success of the exercise.

127. Redress of all identified irregularities, complemented by various on-going capacity building interventions in the public service with support from countries such as China and India, as well as other co-operating partners such as the ADB, the World Bank, DFID, MEFMI and others, should strengthen the quest for a more efficient public service.

128. Overall, it is necessary that Government, in consultation with Staff Associations, establishes a wage policy which provides parameters that guide wage reviews as well as consideration of non-monetary incentives.

Pension Reform

129. The current Pay as You Go Pension System is unsustainable as contributions from current members are insufficient to meet pension payments, resulting in Government having to meet the shortfall from tax revenue.

130. Additionally, budgetary constraints have made it difficult to make meaningful pension reviews which would enhance benefits for retired public servants.

131. In this regard, Government is undertaking Pension Reforms which should lead to the creation of a Pension Fund, taking into consideration fiscal sustainability and transferability of pensions, as well as pension benefits consistent with contributions.

Social Services

132. A strong human capital base is a pre-requisite for sustainable socio-economic growth and development.

133. The skills flight that has occurred over the past decade had resulted in a huge skills gap in the country which is now constraining service delivery. This calls for intensive training and incentives to attract and retain skills, particularly in the health and education sectors.

Education

134. Notwithstanding other increasing support to the sector, educational outcomes had continued to decline as evidenced by low examination pass rates. These had seen the Grade Seven pass rate declining from 62.4% in 2005 to 39.4% in 2009, whilst the Ordinary level pass rate declined from 21.5% in 2005 to 19.7% in 2009.

135. Capacity constraints to effectively monitor and supervise teaching and learning practices at all levels of learning remains a challenge due to inadequate manning levels and mobility.

136. Educational assistance programmes, such as BEAM, have so far recorded low coverage leading to high drop-out levels, particularly for the girl child. Failure to afford fees and levies has also acted as a barrier to accessing education by those from vulnerable households.

137. It is, therefore, critical to restore the quality of teaching and learning, coupled with facilitating access to education to the vulnerable groups.

138. Going forward, special attention has to be given to strengthening the education supervision system.

139. With regards to tertiary education, there remains serious challenges at all levels, including limited availability of Government financial support for students, unconducive and inadequate student accommodation, teaching and learning materials and facilities. Institutions of higher education are also further constrained by incomplete buildings, and challenges over full restoration of optimum teaching and research staff levels.

140. The 2012 Budget, therefore, has to accommodate funding for completion of infrastructure as well as scaling up resources for operational requirements for colleges and universities. It will also be critical that Government, working in partnership with financial institutions, operationalises a Student's Grant and Loan Scheme as intimated under the 2011 Budget.

Health

141. Our overall Health Policy objective is to improve the health status

of the Nation in order to contribute positively to socio-economic development. The National Health Strategy (2009-2013) provides a framework for achievement of this policy objective.

142. The thrust of the strategy is to promote and improve the quality of health services and equity in service delivery, with emphasis on the Primary Health Care System, community based approach and a strong referral system.

143. The plan targets to increase per capita health expenditure from US$9 to US$34 or 15% of expenditure in line with the Abuja Declaration.

144. The current support to the health sector is mainly directed towards tertiary health services, thereby, compromising service delivery at primary level, particularly in the rural areas where 70% of the population resides.

145. Shortage of medical and managerial health professionals, essential drugs and medical supplies, inadequate provision and maintenance of equipment and infrastructure, dilapidated transportation and telecommunication systems are militating against achievement of the MDG goals.

146. The current drug levels range between 29% and 58% for Vital against a target of 100%, and between 22% and 36 % for all categories on the essential drugs list against a target of between 75% and 80%.

147. Enhanced Government support, complemented by development partners should lead to an improvement in the quality of health care delivery.

Social Protection

148. Social protection programmes remain a major intervention to protect and alleviate extreme poverty among the vulnerable groups.

149. The new five year National Action Plan (NAP) II for Orphans and Vulnerable groups was developed with a view to strengthening social protection mechanisms and scaling up support towards social protection services.

150. These interventions target reduction in household poverty, increased access to child protection and basic education services.

Food Security

151. Agriculture is the mainstay of this economy, with strong linkages to other sectors and employs a greater part of the population.

152. It remains a major concern that productivity in most of the crop sub-sectors remains low, leading to poor returns to our farmers. Accordingly, it is critical that the following issues are addressed:-

(i) increasing productivity and production of agricultural food crops and livestock,

(ii) promotion of investment in agriculture, including in irrigation infrastructure, and research and development, and

(iii) development of markets.

153. Furthermore, sustainable marketing arrangements through among others, efficient operationalisation of the Zimbabwe Commodity Exchange will be critical in dealing with the challenges in the current marketing framework.

Gender and Youth Empowerment

154. It remains Goverment's priority that the participation of women and youths in the productive sectors of agricuture, mining,

tourism, manufacturing, construction, among other businesses be meaningfully advanced.

155. Stakeholders, therefore, need to make inputs for the 2012 Budget with regard to programmes targeted at empowering gender responsive empowerment programmes as well as those that support the participation of our youths in mainstream economic activities.

156. In this regard, it is imperative that the Budget process continues to make provisions for the recapitalisation of Funds under the Ministries responsible for Youths, Gender and Small and Medium Enterprises.

OTHER INTERVENTIONS

157. As indicated in the 2011 Mid Year Fiscal Policy Review Statement presented to Parliament on 26 July 2011, our economy faces other challenges and bottlenecks.

158. Whilst some measures are being instituted during the last half of 2011, elements of these remain on the agenda for the 2012 Budget.

159. Accordingly, this Budget Strategy Paper for the period 2012 and 2013-14, also appraises such challenges, calling for more debate and input by stakeholders.

Support to Productive Sectors

160. Achieving and sustaining projected economic growth rates of 9.3% in 2011 and 7.8% – 9% in 2012 requires addressing major challenges facing industry. This includes lack of capital, antiquated machinery, high labour costs and old technologies which have rendered most industries uncompetitive.

161. The hardest hit sub-sectors are clothing and textiles, leather and leather products, pharmaceuticals, agro processing, sugar industries, milling, dairy sector, fertiliser and chemicals, timber and wood processing, metals and electricals, rubber and tyre industries among others.

162. It has been estimated that resources required to address the capacity constraints facing industry amount to at least US$4 billion, with the requirement for 2012 placed at about US$1 billion.

163. In order to attract the required investment in the productive sector, there is need to build business confidence, as well as

address issues impacting on productivity. It is, therefore, critical to promote good corporate governance, sustain macro-economic stability, develop infrastructure, ensure protection of property rights and flexibility of labour laws.

Lines of Credit

164. Given the capital requirements of industry and low domestic credit capacity, the target is to mobilise lines of credit from other countries, including the regional and international financial institutions.

165. Government will, therefore, remain engaged with various international institutions in this regard.

Tariffs on Basic Commodities

166. The introduction of low tariffs on selected basic commodities has led to stiff competition for local companies. It will, therefore, be necessary to evaluate this policy, mindful of the need to maintain adequate supply of goods and services in the country.

167. The BSP, therefore, envisages input of policy review proposals from the relevant stakeholders for incorporation into the Budget,

mindful of the need to avoid tariff structures that nurture development of uncompetitive monopoly pricing.

168. Furthermore, stakeholder proposals would also need to take account of our obligations to SADC, COMESA, WTO and other relevant bodies.

Taxation of Inputs

169. Government shares the concern that inputs into production, such as raw materials and capital goods, should not be subjected to taxation that undermines start up of industrial operations.

170. Consequently, Government has progressively effected tariff reductions that have seen duty levels drop to 0–5% on raw materials and capital goods, a development that has resulted in Government forgoing revenues in order to assist companies to procure inputs at competitive prices.

171. The process of migrating to the new Harmonised System 2012 Tariff Handbook, consistent with the regional integration agenda is in progress.

172. Industry is, thus, called upon to submit their proposals for additional removal of duty on raw materials and capital goods for consideration in the 2012 Budget and inclusion in the new Tariff Handbook.

173. The above migration, in relation to duty on raw materials and capital goods, is consistent with the objective of increasing our productive capacity.

Taxation of the Mining Sector

174. Zimbabwe is endowed with mineral resources, hence, the expectation of citizens is that the mining sector should contribute meaningfully to the fiscus, thereby availing resources to fund critical developmental and social service delivery expenditures.

175. Furthermore, the finite nature of extractive resources, necessitate that communities also benefit from the exploitation of such resources.

176. The contribution of the mining sector to the fiscus remains subdued in spite of the firming of mineral prices.

177. To maximise the contribution of the mining sector to the fiscus, the BSP proposes the undertaking of a study on the inventory

of minerals in the country with a view to assess the potential throughput and value.

178. This will assist in the evaluation of revenue contribution to the fiscus, thereby improving issues of transparency and accountability in the mining sector.

Buy Zimbabwe, Build Zimbabwe Initiative

179. It is of concern that around 70% of the retail shelf space is stocked with imported goods, despite local production of such goods, leaving Zimbabwe largely a Nation of peddlers of imported products.

180. Over-dependence on consumption of imported goods does not benefit the local economy in terms of employment generation, sustainable revenue flows to the fiscus, and leads to deterioration in the balance of payments as well as de-industrialisation. The closure of 75 companies over the past two years in Bulawayo alone is one sad example.

181. Participation in the Buy Zimbabwe, Build Zimbabwe initiative by business and consumers, goes beyond simply an assertion of pride in local products.

182. Competitiveness in terms of price, quality and packaging all remain central, if we are to guarantee domestic industrial production and employment.

Value Addition

183. Zimbabwe has pre-dominantly exported unprocessed primary products over the years, despite the benefits to be derived from increased export earnings and employment following value addition.

184. The low level of value addition activities, particularly on the mining and agriculture products has resulted in the country being unable to realise meaningful benefits from its endowments and, hence, compromising employment creation, foreign exchange earnings and economic growth, among others.

185. It will, therefore, be necessary to institute further measures to discourage exportation of raw products that have potential for beneficiation and value addition in the country.

186. Lessons on treatment of raw chrome exports will be useful in this engagement. Indications are that where a tonne of raw chrome

brings in under US$200, with beneficiation the realisations increase by more than six fold to US$1 200 per tonne.

187. Stakeholders are, therefore, invited to submit proposals on measures that promote value addition on products such as cotton, diamonds and chrome, among others, for consideration during Budget formulation.

Labour Law Reforms

188. Industry continues to reel under high overhead costs, with labour costs being one of the main areas of concern. Many sectors are experiencing labour disputes over wage levels. Some of the awards by arbitrators have tended to have no bearing on capacity to pay, labour productivity and promotion of industry's regional competitiveness.

189. Another issue for consideration is the provision of flexibilities within our labour laws so as to allow equal treatment for day and night workers in order to maximise utilisation of our limited energy resource and other utilities.

190. It has been suggested that a fair balance between work during the day and working during the night could enable industry to

benefit from redundant energy and lower telecommunication tariffs, increase in employment and production levels.

191. It is, therefore, critical that stakeholders come up with clear inputs and proposals regarding amendments to the labour laws taking into account the above and related concerns.

External Arrears Clearance

192. Zimbabwe's external debt, currently estimated at over US$7 billion and accumulating interest of about US$300 million annually, remains a major impediment to normalisation of relations with creditors and financial institutions. In this regard, the country is unable to leverage new financing from International Financial Institutions (IFIs) and bilateral institutions.

193. Government has already agreed on Zimbabwe's Accelerated Arrears Debt Clearance and Development Strategy (ZAADS) as a strategy for resolving Zimbabwe's debt challenges. The strategy focuses on re-engagement and normalising relations with creditors and the international community in order to secure maximum debt relief. This should provide scope for the country to access new financing to augment domestic resources for sustainable economic growth and development.

194. Its implementation requires a good track record in policy consistency, credibility and predictability and effective engagement with the International Financial Institutions.

195. On its part, Government has gone a long way in meeting conditions that warrant debt relief, which include tightening External Loans Coordination Committee (ELCC) criteria such that our borrowings are more concessional.

196. Government has also made significant strides towards establishing macro-economic stability as well as improving the management of public finances, including reforms at the Reserve Bank.

197. In this regard, cooperating partners, both multilateral and bilateral, should now come on board with commitments for debt relief and other forms of support.

Budget Management

198. Consistent with the cash budgeting system, Government expenditure has been limited to the resource envelope.

199. However, the accumulation of arrears to service providers as well as crowding out of critical expenditures by selected items such

as employment costs and foreign travel presents a challenge to effective budget management.

200. The strengthening of both the structure and quality of expenditures within the context of a balanced budget becomes an imperative.

Targeted Approach

201. The targeted approach to the implementation of projects, where funding available in any given period is directed and concentrated towards critical requirements for the completion of a few targeted projects before moving on to others, will continue to be pursued in 2012.

Support from Development Partners

202. Government has since 2009, been revamping the Public Finance Management System (PFMS) with a view to enhance the management and accountability of resources.

203. Despite these efforts, aid remains largely outside the Budget, contrary to the 2005 Paris Declaration on Aid Effectiveness and Accountability which encourages use of recipient country systems to deliver aid.

204. Issues that require urgent attention with regard to cooperation with our development partners include:

- improving the **predictability** of external resources;
- increasing **volume of aid flows** meant to complement the Government Budget;
- entrenching **Government leadership** of the policy process and rationalising processes; and
- improving **national capacities** in aid co-ordination and external resource management.

Implementation Capacity

205. There is a large stock of incomplete projects which are dotted throughout the country. There may be need to re-establish the underlying rationale and economic basis to the projects so that only good quality projects are selected, funded and implemented in a way which avails their service potential to the populace.

206. Insufficient absorptive capacity of implementing agencies with regard to the utilisation of disbursed funds on capital projects is of great concern. In particular, project implementation is constrained by planning, procurement, human, organisational and institutional capacity challenges even when financial resources are available.

207. The country lost critical skills during the lull in economic activity. As a result, Government is facing challenges regarding the implementation of capital investments.

208. Contractors have displayed a lack of capacity to execute, fix and supply contracts, whilst service providers are hardly able to offer a service without an upfront payment.

209. A trend has also been noticed where suppliers deliberately undervalue the contract amounts in order to win tenders and immediately ask for cost escalations.

Strengthening Public Finance Management

210. Given the slow recovery in our revenues and lack of external support, strengthening of central government financial management systems becomes critical in order to ensure efficient and effective use of resources. In this regard, implementation of the Public Financial Management Act (PFM Act) regulations, guidelines and capacity building frameworks needs to be expedited.

211. Furthermore, the upgrading, maintenance and replacement of obsolete hardware requires both technical and financial support.

212. There is also need to strengthen the level of system support and funding for maintenance and configuration of the PFMS in order to meet emerging needs including training of users in Ministries and infrastructure improvements.

Public Enterprises and Local Authorities

213. Parastatals and local authorities provide critical services to the public and economy such as energy, water and sanitation, transport and communication services.

214. Research has shown that most of these institutions are awarding huge salaries for their staff, most of which is unsustainable, as they have failed to remit statutory obligations, such as PAYE, VAT and pension contribution payments.

215. There is, therefore, need to institute performance benchmarks aimed at reducing their reliance on the fiscus for funding, improving performance, as well as attracting new investment. Such reforms will include commercialisation, privatisation and restructuring.

216. In addition to the above, it should be a requirement that any parastatal requesting financial support from Government through the budget submits audited financial statements, as well as commitment to meet statutory obligations.

217. This will require an expansion on the scope of fiscal surveillance in order to reduce the attendant fiscal risks given that most of them are running deficits and have accumulated a large stock of debt, most of which has become contingent liability to Government.

Financial Sector Reforms

218. Measures aimed at further deepening of the financial sector reforms will need to be pursued in order to build confidence and eliminate inherent vulnerabilities.

219. Areas in need of attention include under-capitalisation of some institutions, increasing ratio of non-performing loans and strengthening the function of lender of last resort, among others.

220. Furthermore, resolving the Reserve Bank debt of over US$1.2 billion as well as restructuring of the bank's balance sheet should also be concluded.

221. In view of the dynamic nature of financial systems, there is need to regularly review the effectiveness of regulatory frameworks to keep pace with changes taking place in the market place with particular emphasis on conglomerates whose financial activities span across the banking, insurance and securities markets.

Securities Commission

222. Measures to computerise activities of the ZSE are essential in line with the SADC objective of interconnectivity of SADC exchanges and Central Securities Depository.

Currency Reforms

223. Continuation of the multiple currency regime is essential in order to consolidate the prevailing macro-economic stability and confidence necessary for the ongoing economic recovery efforts.

National Statistics

224. Availability of quality and timely national statistics continue to constrain better and efficient planning for most organisations. This is as a result of capacity challenges at ZIMSTAT as well as lack of cooperation by stakeholders.

2012 Population Census

225. The last census was carried out in 2002 with the next one pencilled for 2012.

226. The preparations and conduct of the census will involve various activities at different stages of implementation, hence, a significant amount of funding will be required.

227. Government is, therefore, calling upon all organisations and individuals to cooperate in support of the census exercise.

Regional Integration

228. Regional integration remains a major imperator for Zimbabwe's future economic growth. However, the process of integrating the region has been very slow given that the formation of a SADC Monetary Union was pushed further backward to 2018.

229. Zimbabwe must ensure that among other things, its macro-economic framework is improved if it is to fully benefit from regional integration initiatives.

STAKEHOLDERS FEEDBACK TO BSP

230. As alluded to earlier in this document, the purpose of the BSP is to provide a platform for the Nation to debate and build consensus on the priorities for the forthcoming year thereby assisting Government in improving the quality of the 2012 Budget.

231. In order to facilitate gathering of inputs from stakeholders, the following feedback framework is being put in place:

- Ministry of Finance traditional provincial consultations;
- Pre-budget seminars involving Parliament and Government;

- Written submissions by stakeholders;
- Posting inputs on Treasury website (www.zimtreasury.gov.zw);
- Ministry of Finance traditional meetings with stakeholders;
- The normal Government Budget process.

CONCLUSION

232. This Budget Strategy Paper is Government's effort to ensure effective linkage between policies, planning and budgeting as further reflected in the National Budget calendar attached as Annexure 1 to this document.

233. The macro-economic and fiscal forecasts and targets included in this document are indicative only and maybe revised as necessary during the 2012 Budget preparation to reflect any changes in economic and financial conditions.

234. This document is being made available to the public for full participation by stakeholders in order to build consensus on the priorities that should guide the preparation of the 2012 Budget.

235. The document should also guide Ministries and public sector institutions in the formulation of their 2012 Budget Proposals.