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*Tel: [263] [4] 794478 Fax & Messages [263] [4] 793592
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PARLIAMENT OF ZIMBABWE

FIRST REPORT

OF THE BUDGET, FINANCE AND ECONOMIC DEVELOPMENT COMMITTEE

ON THE MID-TERM FISCAL AND MONETARY POLICY REVIEWS OF 2006

SECOND SESSION – SIXTH PARLIAMENT

**PRESENTED TO PARLIAMENT IN
OCTOBER 2006**

[S.C. 24, 2006]

Tuesday 19 July 2005, The Speaker,

ANNOUNCED: That the Committee on Budget, Finance and Economic
Development consists of:

Hon. A. Bhebhe

Hon. Chief Bidi

Hon. T. Biti

Hon. D. Butau – To be Chairman

Hon. Chief Charumbira

Hon. F. kanzama

Hon. T. Khuphe

Hon. C. Majange

Hon. T. Mashakada

Hon. L. Matuke

Hon. E. Mushoriwa

Hon. W. Mzembi

Hon. D.M. Ncube

Tuesday 26 February 2006, The President of the Senate,

ANNOUNCED: That the Committee on Budget, Finance and Economic
Development consists of:

Hon. F. Charumbira

Hon. Sen. B. Chikava

Hon. Sen. Kabayanjiri

Hon. Sen. D. Khumalo

Hon. Sen. J.T. Malinga

Ordered in terms of Standing Order No. 151.

'At the commencement of every session there shall be as many Select Committees to be designated according to portfolios to examine expenditure, administration and policy of government departments and other matters falling under their jurisdictions as the House may by resolution determine and whose members shall be nominated by the Standing Rules and Orders Committee. Such nominations shall take into account the expressed interests, experience or expertise of members and the political and gender composition of the House.

Terms of reference of Portfolio Committees S.O. 152.

'Subject to these Standing Orders a Portfolio Committee shall:

- a) Consider and deal with all Bills and Statutory Instruments which are referred to it by or under a resolution of the House by the Speaker, consider or deal with an appropriation or money bill referred to it by these Standing orders or by or under resolution of this House and,
- b) Monitor, investigate, enquire into and make recommendations relating to any aspect of the legislative programme, budget, policy or any other matter it may consider relevant to the government department falling within the category of affairs assigned to it, and may for that purpose consult and liaise with such a department'.

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EXECUTIVE SUMMARY

The Committee on Budget, Finance and Economic Development analysed the Mid-Term Fiscal and Monetary Policies for 2006, announced by the Minister of Finance and Governor of the Reserve Bank respectively. These policy measures were announced at the end of July. After analysis of the documents, the Committee met with stakeholders, the Minister of Finance and the Governor of the Reserve Bank of Zimbabwe.

The Committee noted that the two policies were announced at a time when the economy is shrinking, with the productive sector not performing to expectation, savings and investment low and the Government deficit astronomic.

Under the Fiscal Policy review, the Committee noted that by end of June, 70% of the budget had been exhausted and that the supplementary budget was thrice the size of the original 2006 budget. Government deficit at 56%, would be mainly financed by Government borrowing which had grown to 927% during the first half of the year. The Committee also noted with concern that revenue proposals were limited and recommends that capital expenditure should not be at less than 30% of the budget. It was noted that the privatisation and commercialisation of public enterprises is slow and that these continue to perform badly and are straining the already constrained national fiscus.

In the Committee's analysis of the Monetary Policy, it was snoted that there are numerous factors, some unavoidable, such as importation of necessary consumables, that contribute to the risk of inflation. However, no clear measures for bringing down the galloping inflation were announced.

The Committee noted Quasi-fiscal operations in the form of direct disbursements to Parastatals and direct importation of Agricultural Inputs and fuel.

The report also alludes to the exchange rate and exchange rate management. The gap noted between the official and parallel exchange rates could lead to leakages of the foreign currency. Leakage of precious minerals may cease in the near future as experts have been engaged to work in that area. Currency reform was welcomed as it eases the burden on financial transactions as well as computer systems.

1. Introduction

The Portfolio Committee on Budget, Finance and Economic Development embarked on the analysis of the Mid Term-Fiscal and Monetary Policies. The analysis of the two is in line with the re-engineered budget process, which requires the review of the performance of the budget and the economy on a quarterly basis. The Committee hopes that the relationship established with the Ministry of Finance and the Reserve Bank of Zimbabwe will be enhanced with time. The Minister and the Reserve Bank Governor were both cooperative with the Committee in their efforts to seek clarification on issues and the Committee is grateful.

1.2 The economy is not performing as expected; with inflation declared as the “number one enemy” still rising and untamed at a historic high of 1185% in June, a shrinking economy, production is low, foreign currency and fuel scarce. The Budget and Finance Committee was pleased to see the efforts made by both the Ministry of Finance and the Central Bank to address the tribulations afflicting the Zimbabwean economy.

2. Methodology

2.1 On 27th July 2006, the Minister of Finance, Hon. Dr. Murerwa presented the Mid –Term Fiscal Policy Review statement to Parliament and the Governor of the Reserve Bank of Zimbabwe Gideon Gono made a presentation to the nation, the Mid-term Monetary Policy Review Statement. The Budget and Finance Committee reviewed the two documents and this report is a result of the review process.

2.2 The Committee began the process by an analysis of the two statements aided by the technical experts attached to the Committee. This initial analysis was done to aid the Committee to familiarise itself with the issues and processes involved. Numerous economic stakeholders were invited to give their views on the documents as they affected their operations. Some of the various groups who accepted the invitation to give their views to the

Committee were: the Zimbabwe National Chamber of Commerce, Bankers Association of Zimbabwe, Zimbabwe Fertiliser Company, Commercial Farmers Union, Cottco, Chamber of Mines, Delta and Zimbabwe Tobacco Association. Diverse issues were brought up by the different groups, necessitating meetings with the Ministry of Finance and the Reserve Bank of Zimbabwe.

2.3 The Budget, Finance and Economic Development Committee had insightful discourses with the Minister of Finance and the Reserve Bank of Zimbabwe Governor. The meetings helped to put into perspective ambiguous issues and the Committee is grateful to the Minister of Finance, the Minister of Economic Development and the Reserve Bank of Zimbabwe Governor for their indulgence.

2.4 After meeting with stakeholders, the Minister of Finance, and the Central Bank Governor, the Committee compiled some of the issues raised in the various meetings held and came up with this report. This report is a product of the Committee's own analysis of the two statements and interactions with stakeholders and monetary and fiscal authorities.

3. Overview of the Productive Sector

3.1 The agricultural sector has been allocated resources more than any other sector in the last two years, but the returns realised have been lower than expected. According to stakeholders in the sector, most inputs and financing were made available late in the season.

3.2 The mining sector has been affected to a great extent by the exchange rate stagnation and pricing mechanisms, particularly gold related ones. The sector has suffered viability problems because it has failed to contain continually rising production costs.

3.3 The manufacturing sector has struggled with low levels of capacity utilisation due to increased costs of production, shortages of foreign currency

and low demand. Exporters have been faced with the challenge of rising costs of production while prices remain uncompetitive due to the largely stagnant exchange rate.

3.4 Generally the economy's collective production output has been low in the first half of the year. The shrinking economy has put pressure on prices and so inflation continues to soar. The interruptions in electricity supply have slowed down production in all sectors and thereby delaying exports and slowing down inflows of foreign currency.

4. Fiscal Policy Review

4.1 Budget Performance in the first Half of the Year

During the first half of the year, revenue collected amounted to \$76 trillion against a target of 58.2 trillion. Total expenditure amounted to \$90.8 trillion against a target of \$74.3 trillion, with the budget deficit at \$17.8 trillion. Government largely financed this deficit through borrowing from the domestic market. By June, almost 70% of the budget had been exhausted. The Committee was concerned that most of the expenditure was recurrent or consumptive. It is the Committee's view that capital expenditure be not less than 30% if the country is to get out of the economic troubles that it is in.

4.2 Supplementary Budget

The Committee noted with alarm, the Minister's announcement of a supplementary budget which included a Z\$327 trillion, which is much larger than the original estimate for the whole year, of \$123.9 trillion, giving a total expenditure of \$450.2 trillion for 2006. The original revenue target for the whole year was \$110 trillion and an extra \$140 trillion is expected to be raised, resulting in a budget deficit of Z\$200.2 trillion. The supplementary budget exceeds the original budget for the year 2006 by an astounding 164%.

4.3 The pronouncement of the supplementary budget that is thrice the size of the original budget strains the already constrained government expenditure. The Minister of Finance admitted that government deficit financing is the major source of money supply growth and consequently inflation. Government borrowing grew to 927% during the first half of the year.

4.4 The Minister of Finance informed the Committee that the government through the National Economic Development Priority Programme (NEDPP) is taking strides to implement as many “quick win” projects as possible and government is also trying to raise resources through privatisation and commercialisation. The Committee will request information from the Minister of Economic Development on what the “quick win” projects are.

4.5 Government Deficit

Government is now expected to raise Z\$200.2 trillion to cover its total budget obligations. The total budget deficit stands at 56% and the Committee hopes that the “quick win” projects will raise enough resources to cover this. The Committee also noted with unease that the external debt to various multilateral institutions stood at US\$ 3, 968 million as at the end of June. The balance of payments current account deficit was projected at US\$ 434 million in 2006. The Committee also noted that the country still owes US\$ 119 million to IMF under the Poverty Reduction and Growth Facility (PRGF).

4.6 Revenue Proposals

The Committee was concerned that revenue proposals were limited.

Apart from the “quick win” projects, commercialisation and privatisation of public enterprises there do not seem to be many tangible plans for revenue collection. The Minister of Finance also announced in his Mid-Term fiscal review statement, a corporate quarterly tax return. This policy requires that corporate taxpayers give estimates of taxable income based on annual estimated income on a quarterly basis. The submission of a return will be to

facilitate verification of the basis of estimation, which allows for easier follow up of non-compliant taxpayers.

4.7 Tax free threshold adjustments

Pay as you earn (PAYE) tax threshold increased from \$7 million to \$20 million. The Committee appreciated this move as it will provide some relief to the tax payers, although there is room for improvement. The tax burden will probably remain a concern for as long as government expenditure remains disproportionate to the GDP. The Committee encourages government to move away from PAYE as a major source of revenue. It is the Committee's concern that the fiscal and monetary policies should create an environment that will increase production to meaningful levels.

4.8 Public Enterprises

The Committee was concerned to note that some Public enterprises have continued to perform poorly and have not been able to service their internal and external debts, guaranteed by government. The Minister of Finance allocated Z\$553.2 billion to meet some of the called up loans. The Committee expressed concern at the slow progress in commercialisation and privatisation of Public Enterprises as they continue to be a drain on the national fiscus.

5. Monetary Policy Review

The Committee also analysed the Mid-Term Monetary policy. This report has selected some issues, which were viewed as being of paramount importance.

5.1 Inflation

The Committee noted with concern the rapidly rising inflation, which was at 585.8% in December 2005, to 1193% in May and then it slightly dipped to 1185% in June 2006. For a long time now, both the Minister of Finance and the Governor have termed inflation, "the country's number one enemy". The highly inflationary environment has made planning complex for all sectors of the economy, including government. A number of factors have been

attributed by different sources to high inflation, such as shortage of foreign currency, lack of bi- and multi- lateral sources of borrowing, corruption, government borrowing, increases in oil prices in the international arena and speculative behaviour. The Committee believes that the high inflation is probably due to all these and more importantly low productivity in the economy. Numerous traders and retailers have also tended to kindle the rise in inflation by their pricing mechanisms.

5.2 Importation of critical necessities such as maize, fuel and power has had an inflationary impact on the economy, because earnings in terms of exports are much less. The Committee was greatly concerned that neither the fiscal nor the monetary policy statements address the issue of bringing down inflation. Stakeholders also expressed dismay that no specific targets were set for inflation in the second half of the year.

5.3 Some stakeholders indicated dismay that the two policies just narrated the woes besetting the country, with inflation being 'the number one enemy' without proffering solutions. Neither policy set a target that is being worked towards. In his comment on this, the RBZ Governor responded that it was every Zimbabwean citizen's responsibility to make an effort towards bringing down inflation.

5.4 During the meeting with the Committee, some stakeholders said they were expecting measures that would reduce inflation, such as reduction in government expenditure, increase in productivity and elimination of speculative behaviour. They also expected the following; introduction of measures to enhance foreign exchange generation and policy consistency by both government and the Central bank for confidence building in the investing public. The Committee discussed at length, with both the Minister of Finance and the RBZ governor issues pertaining to enhancing productivity in the economy.

5.5 Interest rates

The Committee noted that interest rates were reduced as follows; overnight accommodation rates from 850% to 300%, unsecured lending rates from 900% to 350%. The Committee is of the opinion that this is a welcome move as it gives banks latitude to further reduce lending rates, hopefully to the productive sectors. It is envisaged that both the public and private sector will now be able to borrow money at low interest rates. The RBZ Governor called upon banks to reciprocate by redeploying to productive sector funds.

5.6 There was an outcry, however, from some sectors that the interest rates are way below inflation rates and therefore do not encourage savings. The Committee also heard concerns that while reduction in interest rates is targeted at stimulating productivity, credit that is underpinned by consumptive and speculative borrowing is highly inflationary.

5.7 The Committee is hopeful that the lowered interest rates, which were punitively high will now stimulate companies to borrow money to finance capital projects and thereby increase production in the country. The Governor in his discourse with the Committee alluded to the fact that the fiscus will also benefit greatly from lowered interest rates because of increased productivity.

6.0 Productive Sector Concessionary Funding

Agricultural Sector Productivity Enhancement Facility (ASPEF)

The Committee noted with gratitude that the beneficiaries of ASPEF were given a reprieve in terms of loan repayment. Under the new-based performance ASPEF rollover framework, the farmers will be able to roll over part of their existing loans for another cropping season, with a maximum threshold of one year. Stakeholders in the agricultural sector registered relief that the ASPEF loans would now be rolled over the next twelve months. This performance based rollover support, will work as an incentive to the farmers. The Committee was particularly pleased by this move, as it will encourage

discipline in the utilisation of borrowed funds and the servicing of loans. This facility is a positive incentive for the farmers. The Committee is hopeful that this will result in increased agricultural productivity.

6.1 Concern was raised by some in the agricultural sector that ASPEF funds are only being accessed by big established farmers and though the facility is still at a concessionary rate of 50%, it is still inaccessible to A1 farmers. They expressed concern that there are no “cheaper” funds for the small-scale farmer. In his meeting with the Committee, the RBZ Governor informed the Committee that RBZ interventions were largely issued for large-scale production that would increase agricultural produce to feed the nation as well as for export.

6.2 Small and Medium Enterprises (SMEs) Development Fund

The Committee noted the provision of the \$16 billion concessionary SMEs fund at 70% interest. The Committee also noted that this move is likely to increase production. However, concern was raised by representatives from the sector that the fund was inaccessible to SMEs, but was being accessed by big companies. The Committee urged the Central Bank to put into place measures that would ensure that the fund is accessed by intended beneficiaries. The Committee expressed hope that umbrella bodies in the sector would work with RBZ and the SMEs to ensure that the fund accomplishes its purpose. However, the Committee is concerned about the monetary authorities moving into the fiscal sphere.

6.3 Tobacco Performance, Research and Development Facility

The Central Bank introduced the Tobacco Performance, Research and Development Facility, where growers will get additional support of 65% of sale value of actual deliveries sold onto the auction floors, evaluated at the old exchange rate of US\$1 to Z\$101 000, retrospectively from the start of the auctioning season to the end of August, 2006. Stakeholders in the sector applauded this move, as it was felt that it would improve viability of farmers,

particularly if producer prices for the various crops are adjusted timeously, and critical imports are readily available.

6.4 The stakeholders in the sector welcomed the 65% bonus and they felt that it would translate to increased demand for seedbed, tobacco fertilisers and crop chemicals. The Governor assured the Committee that all efforts were being made to make interventions timeously; to this end the RBZ had provided funding for the importation of chemicals and fertiliser to the tune of 15 to 20 000 tonnes of fertilizer. He added that funds were also released for the importation of equipment.

7. Agricultural Issues

Some stakeholders expressed concern that the issue of BIPPAs was not comprehensively addressed by either policy and felt that this could compromise Zimbabwe as an investment destination. There was also discontentment communicated to the Committee on the issue of farmers who are dispossessed of their movable assets without compensation as provided for in the constitution. The stakeholders further protested that there was no security of tenure on the farms, which leaves farmers with no collateral for borrowing money from the banks. The Governor assured the Committee that the Central Bank had provided funds for 99-year leases, which will give stability and security to farming.

8. Foreign Exchange and Exchange Rate Management

Foreign exchange shortages have persisted, in spite of matching the exchange rate to that of the parallel market at the last Monetary Policy review. The rate has increased from \$101 000 to \$250 to the USD. However, the parallel market rate had since sky rocketed to \$500 by the end of June 2006. A number of stakeholders were concerned at the huge gap between the parallel and the official rate, which has been a major source of discomfort for the exporters. The big gap may cause huge leaks of the much-needed foreign currency. However, when the Committee questioned the RBZ

Governor on the setting of the exchange rate, he said the RBZ would determine the exchange rates until Zimbabwe gets out of the economic difficulties.

8.1 The RBZ Governor announced the introduction of the Foreign Exchange Assessment Board, made up of a broad based group of people, chaired by the RBZ Governor to determine exchange rates. The Committee is optimistic that this board will manage the exchange rate effectively so as to attract greater inflows of foreign currency.

8.2 The Monetary Policy also announced that gold companies could now retain 75% of their gold earnings in the Foreign Currency Accounts (FCAs) from the previous 40%. Representatives from the mining sector were concerned that the policy would benefit the bigger mining companies, while leakages from the small scale miners would continue. Earnings from small-scale mining would continue to diminish.

8.3 Both the Minister of Finance and the RBZ Governor, expressed concern at leakages in precious minerals, but the Central bank Governor assured the Committee that Mining and Minerals experts from abroad have been engaged to visit gold mines and other precious minerals mines to evaluate the types of minerals and their worth. These efforts are aimed at discontinuing leakages of precious minerals.

8.4 Currency Reform

The RBZ Governor announced currency reform, which meant that the old bearer cheques would be obsolete by 21st August 2006 and a new set of bearer cheques have since been introduced. Three zeroes were removed from the bearer cheques. Deposits of old bearer cheques exceeding \$100 million for individuals and \$5 billion for corporates had to be accompanied by a ZIMRA clearance certificate and a letter of explanation. Attempts at depositing old bearer cheques after the deadline would result in the forfeiting

of the value of the holdings. There was also a stipulation that around the country's main ports of entry, no local currency would be allowed into the country if it exceeded the stipulated allowable cash.

8.5 The Committee applauded the removal of three zeroes as it has improved convenience in transacting business. Stakeholders also expressed gratitude at the slashing of the zeroes, as the numerous figures were becoming impossible for computer systems to accommodate and cash transactions were becoming cumbersome because of the amount of notes carried. The Committee expressed concern that some innocent people were harassed in roadblocks during the changeover, period from old currency to the new. Both the Minister of Finance and the Governor assured the Committee that the move was intended for renegades and apologised for any inconvenience to innocent people affected.

9. Conclusion

Both the Monetary and fiscal policies seem to gloss over the real challenges facing the economy. There is an urgent need to rebuild the country's productive sector by investing correctly in the two main pillars of the economy, that is agriculture and mining, which have a longer development period, but produce a sustainable income. There is need for government to live within its means and put in place measures to advance development through production.

10. Recommendations

10.1 Fiscal Restraint should be exercised as much as possible, to minimise government borrowing. Ministries should confine themselves to spending what was budgeted for and not carry out tasks that will necessitate government borrowing because this inevitably fuels inflation.

10.2 Government Borrowing should be managed in such a manner that it encourages capital expenditure, to ensure development and attract

investment. This must be supported by a deliberate policy by both fiscal and monetary authorities for strengthening the productive sector.

10.3 The Committee is aware that a policy directive was made for parastatals to charge economic prices, but this has not been implemented. Parastatals and local Authorities should be allowed to charge commercial rates, which should be gradually spread over a year so that the public are not levied with high rates at one go. It is recommended that government be unequivocal on the way forward so that these entities do not continue to be dependent on the fiscus.

10.4 The Ministry of Finance, in conjunction with the Ministry of Agriculture should develop an appropriate funding instrument for crop production, sensitive to incubation and gestation periods. An inputs Committee should be established that will focus its energies on ensuring that all agricultural inputs are properly planned for and timeously procured.

10.5 The Ministry of Agriculture should develop long-term investment in horticulture production and refocus its marketing channels.

10.6 Having taken note of Zimbabwe's international obligations to international development partners, it is the Committee's considered view that the Reserve Bank of Zimbabwe be assisted in managing foreign currency resources by a payments Committee, constituted by user ministries and chaired by the Ministry of Finance.

10.7 The Committee recommends that the Minister of Finance forms a quasi-fiscal operations coordinating Committee guided by a speedy decision making mechanism. Such Committee would enhance a more harmonious working relationship between the parent Ministry of Finance and the Reserve Bank of Zimbabwe. It is the Committee's view that the Reserve Bank of Zimbabwe

should operate under the umbrella of this Committee in order to protect the legality of quasi-fiscal operations.

10.8 The Budget proposals should take into account all quasi-fiscal funding by the Reserve Bank Zimbabwe, so that all public funds are accounted for, further supporting the recommendation for a Quasi-fiscal operations Committee.