THE SOUTHERN AFRICAN PARLIAMENTARY SUPPORT TRUST (SAPST)

BRIEF ANALYSIS OF THE 2012 MID-TERM FISCAL POLICY REVIEW STATEMENT

PRESENTED TO PARLIAMENT BY THE MINISTER OF FINANCE

HON. TENDAI BITI

ON

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1. Introduction and Background

The Honourable Minister of Finance, Tendai Biti, presented the 2012 Mid – Term Fiscal Policy Review Statement to Parliament on the 18th of July, 2012. The Fiscal Policy was issued against a background of deteriorating domestic conditions, characterised by weak agriculture production, below par revenue collections, (on account of underperformance in the diamond sector), as well as weakening global economic conditions. The economy is therefore project to slow down by **40% from an optimistic 2012 Budget projection of 9.4% to 5.4%.**

The minister has thus recast his 2012 Budget theme from ***"Sustaining Efficient and Inclusive Growth with jobs",*** to a more modest and compromise tone, that is ***"From Crisis to Austerity: Getting back to Basics".*** This tone follows a no holds barred engagement of Cabinet on the 14th of June, 2012 at a Special Cabinet Meeting called specifically to deal with the economic situation in the country.

2. The following are the key highlights of the Statement: -

HIGHLIGHTS OF THE FISCALPOLICY REVIEW

- Economy to slow down by 42% from earlier optimistic projections of 9.4% to 5.4%;
- Agriculture to drastically slow down from a 2010 bullish high growth rate of 33.9% to -5.8% heightening fears of food insecurity;,
- Budget revised downward by 9% to US$3.64 billion from an optimistic 2012 Budget projection of US$4 billion, necessitating re – prioritisation of Votes;,
- Revenue projections recast from US$4billion to US$3.64 to match expenditure, owing to weak collections;,
- Half year revenue collections of US$1.565 billion against budget target of US$1.838 billion, yielding a variance of US$244.2 million.
- Diamond revenue remittances at US$49 million, account for 93.8% (US$229.3 million), of revenue variance.
- Budget cut back forces Treasury to re – prioritise expenditures, sacrificing capital and operational budgets.
- Non wage related Recurrent Expenditure (operational and maintenance) at US$217.9 million against budget target of US$919 million, implying an under - expenditure of 47%, **yet wage bill stands out at 70% of budget against target of 53%.**
- Target disbursements to Social sectors at US$36 million against budget target of US$122.7 million, yet foreign travel chewed up US$156 million.
- Excise duty on diesel and petrol increased from 16cents/per litre and 20 cents/litre respectively to 20cents/ litre and 25cents/ per litre.
- Public Finance Management Act Regulations to be gazetted;,
- Constitution ready and Treasury commits to fund Stakeholder Workshop and Referendum.

3. COMMENTARY ON FISCAL POLICY STATEMENT

3.1.1. Macroeconomic and Fiscal Framework

Macroeconomic Parameter	2012 Budget Target	2012 Revised Projection
GDP	**9.4%**	**5.4%**
Inflation	**5%**	**5%**
Revenue	**$4 billion**	**$3.64 billion**
Diamond	**$0.6 billion**	**-**
Exports	**$5.16 billion**	**$5.09 billion**
Imports	**$8.3 billion**	**$$8.215 billion**
Real Sector Parameters		
Agriculture	**11.6%**	**-5.8%**
Manufacturing	**6%**	**6%**
Mining	**15.9%**	**16.7%**

The Minister of Finance has had to revise the GDP growth figures given the glaring weak economic recovery prospects owing to a major slump in agriculture. On the back of a drought scenario, agriculture production has been cut back from 11.6% growth to a subdued -5.8% growth. This will have a significant impact on overall economic performance given the sector's strategic role and backward and forward linkages with the rest of the economy, and in particular manufacturing sector. Total maize production has been recast from 1.35 metric tonnes to 968 0000 tonnes, pointing to a significant slump in food security in excess of 1.3 metric tonnes. This indicates a likely humanitarian crisis.

The economy faces major downside risks given a high wage bill currently chewing up 70% of the recurrent budget, and projected to close the year at 73% of budget. The other factors blamed for the economic down turn include: -

- Revenue underperformance;,
- Policy inconsistencies – dampening foreign investor sentiment, particularly the **Indigenisation Act;,**
- Lack of capital;,
- Slow implementation of reforms;, and
- Global economic slowdown, compounded by the Euro Zone crisis.

Given the above challenges the economic recovery prospects have been further compromised by the persistent slump in electricity energy production, a key enabler. Electricity energy production for the year to June 30th 2012 stands at 960 MW, which is 50% below the optimal demand levels of 2.100 MW, when the economy is running at optimal levels. This will continue to put a check on any meaningful recovery in GDP in the near term, as it has negative economy-wide impacts on productivity in key economic sectors (mining, manufacturing, agriculture, and commerce).

The Indigenisation Act and more specifically the recent regulations on banking sector is the last nail further denting investor confidence. This will negatively affect any prospects to unlock foreign investment, and foreign lines of credit, and hence compound the current liquidity crunch. Most distressed banks have been trying to mobilise foreign capital to comply with the RBZ capital requirements, and hence this will be directly affected by this policy development. Industry capacity pitched at 60% now, is likely to get a significant **knock to 50% or worse**, given the likely squeeze to both domestic and foreign capital on the back of this policy.

Inflation Outlook

Though Inflation projections have not been changed from 5% for the year, it is doubtful how this is sustainable given the developments on the Global economy. The Euro zone crisis has not yet dissipated, and will have a bearing on the direction of the South African Rand in the near term. This will have a negative impact on the inflation outlook during the second half of 2012.

Also of note is the likely impact of the upward adjustment in the excise duty on diesel and petrol, from 16cents/ litre and 20cents/ litre to 20cents/per litre and 25centes per litre, respectively. This will load the transport component of the CPI as well as the transport cost component of the industrial production function.

3.1.2. Public Finance Reshuffle

Government has had to cut back on total expenditures by 10% from US$4 billion to US$3.64 billion on the back of weak revenue collections. This has resulted in Treasury issuing a re-prioritised Expenditure/ Votes/ Appropriations bill to ratify these fiscal constraints. However, the re – prioritization has been in favour of maintaining the current salary structured up to year end, whilst suppressing key funding for social and physical infrastructure. This will no doubt compromise the current fragile economic situation, and hence further dent economic growth.

Budget Credibility at Stake: This mid stream change in budget assumptions on macro fiscal framework is a major threat to budget credibility. One would have thought the Ministry could stick up with the projected budget, for now whilst focusing on measures to fully account for the under-performance of the revenue side. More so given that diamond revenues are not coming to book, yet mining sector growth is rather bullish. The issue here is that of corporate governance in the mining sector.

Minister to Intensify Engagement of Multilateral Agencies: Donor flows have accounted for US$184.9 million year to date against a budget projection of US$500 million for 2012. Of this, bilateral donors have accounted for the bulk with US$179.2 million, whilst multilateral have released US$5.7 million. Government has since worked out on a debt strategy, which is the Zimbabwe Accelerated Arrears Clearance Debt and Development Strategy (ZAADDS), to address the US$7.4 billion external debt, which is 118% of GDP.

This is a positive development which is likely to lead to an improvement in the country's relationship with Multilateral Institutions that had over the last 13 years been confined to technical assistance, and hence lay the basis for a Staff Monitored Programme. This will in medium to long term help in re – igniting access to stable long term foreign lines of credit and balance of payments support (BOP).

3.1.3. *Revenue Outturn*

Revenue collections to June have totalled US$1.565 billion against a target of US$1.838 billion implying a variance of US$244.2 million. The bulk of this variance is accounted for by an under performance in diamond revenue of $229.3 billion (93% of the variance). This is quite ironic particularly given that mining sector growth has been revised upwards from 15.9% to 16.7% in 2012, given the solid recovery in commodity prices post the global financial economic crisis. This climb started off mid 2010, and the sector has continued to benefit to date**.** Surely the buoyancy in the sector must be supported by robust revenue remittances from the sector.

3.1.4. *Sacrificing Social Infrastructure*

The Expenditure outturn points to a highly unsustainable expenditure structure that is skewed towards recurrent expenses, with wages and salaries dominant. **Foreign travel alone has chewed up US$156 million cumulatively to date (from 2009 to 2012 YTD); yet no meaningful return is being unlocked**. It would appear that government workers are using foreign travel to subside their welfare at the expense of supporting key social sectors. This is highly unsustainable, and a major drain on the fiscus.

Government wage related expenses have accounted for a budget overrun of $94 million, and chewed 70% of Budget, yet we are only half way through the year. The total spent on wages has been US$1.167 billion against a budget target of US$1.073 billion. In fact the expenditure on wages was far off the budget target of 53%.

Government has had to sacrifice key sectors: Non wage recurrent expenses that covers operational and maintenance received US$217.9 million, against a targeted budget position of US$919 million. Social sectors were sacrificed, getting releases of US$36 million against a target of US$122.7 million. This will have a negative bearing on the country's capacity to meet the 2015 MDGs targets. Even disbursements to line ministries have had a major knock at US$395.59 million that is 24% of the US$1.614 billion budget target. In essence the Table below shows the worrisome scenario on the spending pattern of Government.

Government Spending to June 30th, 2012

Spending Parameter	Target as % of Budget	Year to date % spent
Employment costs	**53%**	**73%**
Capital Expenditure	**20%**	**11%**
Government Operations	**23%**	**15.4%**
Civil Service	**-**	**62.4% of Budget**

Capital Budget has also been under threat, getting a significant knock as it only received disbursements of US$204 million against a target of US$ 386.9 million. These developments will put a check on GDP. This expenditure pattern will also compromise government service delivery capacity, and hence dent the contribution of the government sector to overall GDP.

3.1.5. Proposed Tax measures

Duty on Wheat flour

The government has increased the duty on wheat flour from 5% to 20% to protect local production. Blending wheat flour will still be imported at 5% in batches of 3000tonnes monthly by millers. Minister contends that this will not increase the price of bread, which is very unlikely. Bakeries are likely to pass on the cost to local consumers, and hence negatively affect the inflation outlook in the short to medium term.

Excise duty

Government has increased the duty on diesel and petrol from US$0.16cents/litre and $0.20cents per litre respectively to US$0.20 cents per litre to US$0.25 per litres. The Minister hopes to collect US$20 million from this source. The challenge with this increase in duty is that it will be passed on to consumers, and hence translate into higher pump prices. Given that transport constitutes 16.7% of the Consumer price index, (CPI), this will have a negative impact on the inflation outlook in the short to medium term.

4. Medium to Long Term Economic Outlook and Conclusion

The Fiscal Policy review honestly traces the challenges the economy is facing. The reshuffling of expenditures is a cautionary position Treasury has taken to safeguard credibility in numbers. However, we believe the Ministry should have remained solid on pushing for full accountability on diamond revenue remittances, rather than sacrifice the entire public sector delivery capacity, and hence used the 3rd quarter revenue performance to smoothen the cash flows.

The slowdown in GDP is on account of a weak agricultural sector performance. In the medium to long term, the country needs to look up to other sectors and deploy energies towards restoring economic enablers, liquidity, and measures to enhance industrial competitiveness. The inflation outlook is gloomy given the high duties on fuel, wheat flour, and negative developments globally particularly the Euro Zone crisis, and sluggish global economy.