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Budget nightmare for Mthuli Ncube

…Economists call for pro-poor budget … As pressure of fiscal risk builds up

PHILLIMON MHLANGA

FINANCE Minister Mthuli Ncube will today present the 2020 National Budget expected to extricate the ailing economy from rolling electricity shortages, hyperinflation and rampant company closures.

Zimbabwe's frail economy is also being ravaged by high unemployment rate, plunging production levels, healthcare sector crisis, fuel shortages, skyrocketing prices, and acute shortages of foreign currency.

Although nothing matters more than getting the economy back on its feet, today's budget will be judged on how it deals with state entities, which have become symbolic of all government's failures.

Several analysts said the finance minister should change the narrative of state entities and make hard decisions. He should reveal a credible plan to overhaul state enterprises to ensure they become financially self-sustaining.

A repeat of fiscal slippage will worsen public finances, as fiscal deterioration has been caused mostly by the economy's failure to grow. It is expected to contract further by a negative 7% this year.

While the government projects a 4.6% growth in 2020, the IMF and the World Bank say growth will be modest, at slightly more than 2%. The country's situation has been compound by the problems in state enterprises where entities, supposed to support growth, have become a drag on the economy instead. This means the more the government does not take hard choices to solve problems in the state enterprises sector, the more problems build up in the sector.

Those hard choices include policy decisions on how to change the business models of state entities to reflect the fact that the country does not have the resources to sustain the sector in the way it is currently structured, with the state as the sole shareholder.

The idea is to relieve the fiscus from carrying the burden of perennial bailouts because the fiscus is already burdened with debt. This suggests the need to expedite the sale of state entities. But who would want them in their current state?

So far, there is only a noticeable movement at the POSB, where a financial advisor has been engaged to cause its privatisation. In other state enterprises, there has been deafening silence in terms of privatisation implementation.

Economists and other analysts told *Business Times* at the Institute of Chartered Accountants of Zimbabwe (ICAZ) summer school held in the capital last week that headwinds were strong, leaving the country literally on its knees and expecting the Treasury boss to announce sweeping changes in his 2020 National Budget.

They said the budget should be pro-poor, pro-production, with more focus on stimulating demand and economic activity. Another major battle is how to deal with the tax regime, which many believe, fuels inflation.

The 2% tax on electronic transaction, which has been piling misery on citizens, should be scrapped as it is hurting the economy, analysts said, adding that Ncube should pursue a tax reduction drive that would leave more money in the pockets of tax players.

In June, the government re-introduced the country's own currency, ending a 10- year multi-currency system. But the Zim dollar has seen its value plunging to about 20 to the USD on the black market, from the initial 1:2.5 to the USD in February. This has devastated savings, salaries and hope.

The plunge has also threatened the viability of industries due to demand challenges created by the lack of disposable incomes. Thus, Ncube's budget will be judged by how it attracts fresh investments, rejuvenate industries and reinvigorate the ailing economy.

His critics say Ncube's reputation for prudence is now questionable. "We are not what we think we are. If anything, this budget should be a pro-poor economic plan. Any fiction is not going to work," said economist Nigel Chanakira at the ICAZ meeting.

He said a year ago many thought the team comprising Ncube, central bank chief John Mangudya, Treasury permanent secretary George Guvamatanga and Mangudya's deputy Kupukile Mlambo would bring international funding, something the economy failed to do in two decades partly due to the economic sanctions imposed by Western countries.

"Multilateral funding," Chanakira said, "was what Ncube was seeking. But it has not worked. We have gone off the rails in terms of the economic programme Mthuli put in place. The chickens have come home to roost. We seem to have blown that opportunity."

Mthuli Ncube

Chanakira called for modest models, saying Zimbabwe should forget about "mega deals" for a while.

Tafadzwa Bandama, an economist with the Confederation of Zimbabwe Industries, said taxes went up but government expenditure did not decline.

"There is instability in the goods, money forex and labour markets where there is dwindling income. The budget should stabilise these markets," Bandama said. "There is also need for efficient management, policy consistency and credibility. We demand stability in all these markets and public finance management.

She said: "We expect a policy that supports local content in the economy." The government should enhance competitiveness of exports through tax incentives. The current account is contracting because the economy is contracting. There is a need to improve key economic enablers such as electricity and fuel. Right now, the economy is sitting on a time bomb because it is using fuel (due to rolling blackouts) to power production. We want the fiscus to boost aggregate demand. We want a tax policy that boost production, not finance recurrent expenditure.

Christopher Mugaga, the CEO of the Zimbabwe National Chamber of Commerce, said there was no independence of institutions. "You can't run an economy like that. There is too much government hand," he said. "The truth of the matter is we are re-dollarising, we are only delaying it. We are printing money and it has to stop. Another is the debt management sins the government has committed. There is need to sort this one out," Mugaga added.

There is also intense pressure bubbling up from a number of government services, including health care after years of underfunding.

The budget will be the first since the economy ditched the multicurrency system in June this year.

On the monetary front, analysts said the re-introduced Zimbabwe dollar was not working because people don't know what the price will be tomorrow.

Chartered accountant, Duduzile Nyirongo, said "no matter how much money the government prints, people will run away from it."

This means Ncube should unveil a raft of incentives to stimulate investment and unlock employment opportunities. "Our economy remains under siege," said Itai Chirume, an executive director at MMC Capital. "There is need to decisively make a commitment to legacy debts. As long as we have an unresolved situation regarding legacy debts, we will not be able to get new investment."

He called for the removal of restrictions on fungible shares. "An issue of property rights emerges," Chirume said. "It deprives them the right to dispose. These are some of the sins committed by the authorities but they are not prepared to carry the cross. The environment does not reward the assumption of risk. We are now aiming to minimise the carnage by being satisfied with a return to zero. The budget must deal with the investment environment," Chirume added.

The government is currently battling underfunding, and Ncube recently appealed to the IMF to "have some flexibility" to fund the government. Zimbabwe has cleared its IMF debt arrears but still owes other multilateral and bilateral financiers. The country's fiscal space remains severely constrained due to poor performance of revenue inflows against the background of rising recurrent expenditure and a shrinking tax base. The economy is saddled with a high debt overhang with an estimated debt stock of US$18bn as at June 2019.

Ncube is standing at the crossroads. Which way will he take?

Weak fiscal, budgetary institutions fuel domestic arrears-IMF

The Q&A

The International Monetary Fund (IMF) recently launched the Regional Economic Outlook, with a focus on the domestic arrears' situation in sub-Saharan Africa. According to the report, domestic arrears accumulation reflects weak fiscal and budgetary institutions, particularly weak Public Finance Management Systems (PFM). The report said the impact of fiscal shocks on arrears is larger for countries with weak PFM (when PFM systems are weak arrears accumulate faster in bad times) and countries under a fixed exchange rate regime. *Business Times* (BT) sat down with IMF Resident Representative to Zimbabwe Patrick Imam (PI) on the arrears situation in Southern Africa and the recommendation on how the arrears can be extinguished. Find excerpts below.

BT: What are arrears, and can you tell us the size of domestic arrears in sub-Saharan Africa?

PI: An arrear is essentially debt that is overdue. It forces a creditor to extend the loan without prior agreement. To put it simply, it means your payment is late on a contractual obligation, such as a loan.

Getting a good grip on the problem in sub-Saharan Africa is difficult, as the data is not easily available. The IMF just did a study on the problematic arrears, and at the end of 2018, 24 out of 30 sub-Saharan African countries for which data was available had arrears. We found that the average stock of arrears was about 3.3 percent of GDP. They have increased recently, mainly in commodity exporting countries. But it's important to highlight that in addition to those recorded arrears, most if not all sub-Saharan countries often also have unrecorded arrears, which can be sizeable, adding to the burden of debt once they are audited and verified.

BT: Why should domestic arrears be a concern for African countries?

PI: Domestic arrears have multi-faceted effects on the economy. They are particularly damaging to the private sector and banks, with negative ramifications for growth. The IMF analysis suggests that a 1 percentage point of GDP increase in the accumulation of arrears could result in reducing real per capita GDP growth rate by 0.3 percentage point. In addition to lowering growth, domestic arrears can undermine trust in government and generate corruption, hamper domestic revenue mobilisation efforts and public service delivery. Domestic arrears accumulation also reduces the effectiveness of fiscal policy in stimulating the economy during downturns. This is because expansionary fiscal policy becomes less effective when spending is financed through arrears.

BT: Why do countries accumulate arrears?

PI: Arrears are, with the printing of money, one of the worst forms of financing the state as the consequences on the economy are so negative. Concretely, two issues matter most in the countries the IMF looked at. They are typically found in countries that have structural difficulties in controlling arrears, or that are going through difficult economic times.

Concretely, domestic arrears accumulation can result from structural factors such as weak public financial management systems. There are for instance shortcomings in the formulation of unrealistic budgets, or an inability to control spending. In addition, you have examples of poor cash management or delays in processing payments. In all these cases, the government can through strengthening fiscal institution improve mechanisms to track and monitor the accumulation of arrears, including with the adoption of new technologies.

In addition, arrears can result from abrupt growth slowdowns, commodity price shocks, or conflict and are often marked by sharp falls in fiscal revenues. Therefore, building fiscal buffers in good times can also help minimise the risks of arrears accumulation. External financing can of course also help.

And lastly, the political cycle matters in some countries. Data have also shown that some countries in sub-Saharan Africa undergoing either presidential or parliamentary elections tend to experience a small spike in arrears.

BT: Can there be circumstances when accumulating arrears is inevitable?

PI: Arrears are not inevitable, but it takes a lot of sophistication to avoid them completely. Governments should obviously put in every effort to avoid arrears accumulation, given their damaging effects on the economy. But one can imagine examples where a large fiscal shock may exceed a country's ability for fiscal adjustment, as was the case in many oil producing countries in the region when the prices of oil collapsed five years back. If additional financing is not available, resorting to forced borrowing by accumulating temporary arrears may be an unfortunate but inevitable outcome. Having said that, public financial management reforms which I just mentioned, that build strong fiscal institutions, are critical to minimise the risks of accumulating arrears, and are the most effective remedy against them.

BT: Why does the IMF tolerate the accumulation of domestic arrears but not external arrears?

PI: The Fund's primary mandate is to ensure the stability of the international monetary and financial system. In this context, external arrears, which reflect a rupturing of a sovereign's relations with its external creditors, undermine the system. Therefore, we pay very close attention to them.

However, the Fund's concern about domestic arrears are clear, as they undermine domestic stability and are therefore critical, are hence within the Fund's mandate. The Fund works with country authorities through targeted conditionality in Fund programs with the aim of regularising them and converting arrears into normalized debt if you like.

BT: What is the IMF recommendation to countries willing to clear their stock of arrears but don't have enough resources?

PI: That's a very pertinent question. First of all, countries must take stock and verify the full amount of arrears. Second, they must stop the accumulation of further arrears. When this is done, they must assess their capacity for repayment. If repayments must be sequenced because of a lack of resources, prioritisation should be based on a clear set of criteria guided by the impact on macroeconomic stability and inclusive growth. But clearance strategies are obviously country specific, and there is no "one size fits all". As an example, a small company is less likely to withstand an arrear than a larger one and could therefore be prioritised in the debt clearance process.

BT: What are your views on Zimbabwe's arrears situation?

PI: Zimbabwe's recent history is interesting. Zimbabwe has had protracted arrears on external debt for the past two decades, which has cut off access to official financing. The country has large arrears to international financial institutions like the World Bank, African Development Bank and European Investment Bank. The country has, however, also bilateral arrears to countries like Germany and China for instance. There is, however, currently no consensus on an agreed path forward to clear these arrears.

On the domestic front, the situation is a bit different. All domestic arrears were essentially wiped out by the hyperinflation a decade ago. So unlike most other countries in the region, Zimbabwe started with a clean slate. But despite this initial advantageous starting point, Zimbabwe is now in a similar position as other countries in Africa when it comes to domestic arrears, and for similar reasons. Some of the spending that took place was not authorised by parliament, but still went ahead regardless. This inability to impose a hard budget constraint on say parastatals, or quasi-fiscal activities that are not budgeted for are major reasons for arrears. The accumulation of arrears is also pertinent at the local and central government level.

Going forward, the authorities have recognised that there is a need to better control spending across government departments and ministries to avoid the accumulation of new arrears. Under the Staff Monitored Programme, the authorities have committed to not accumulate arrears noting that economic stabilisation can be impaired by government arrears to its private-sector suppliers. Strengthening the Public Finance Management System including strengthening budget control and sanctions entities is something the authorities are also working on. The authorities have also committed to complete a comprehensive stock-take of domestic expenditure arrears across the central government including publishing a report on it. Thus, the public will see for itself the arrears situation.