7 January 2019-ESR analysis on critical economic challenges facing Zimbabweans today.

Post the 30th July 2018 harmonized elections, one of the most important questions that Zimbabweans have had to deal with is how the new government will resolve the deep and complex economic problems Zimbabwe is grappling with. Economic commentators have expressed mixed views and proposed a number of solutions to Zimbabwe economic woes. This analysis seeks to provide a certain perspective on Zimbabwe's economy and unpack some of the complexities that Zimbabwe faces as the development trajectory unfolds.

2% tax: The Poor man's dilemma

Zimbabwe is done with elections at least for the next five years. Apparently after elections all citizens look forward to economic growth, development and expansion.

Over the remaining four and half years citizens are hoping for initiatives and indicators to resuscitate the economy. Undoubtedly the most important indicators in any economy that set the tone for economic activity and recovery are the monetary and the fiscal policy statements. Clearly given Zimbabwe's economic background and political situation there is a need for the captains of this ship to steer it in a different direction- the right direction.

Facts:

- According to International Monetary Fund (IMF), Zimbabwe has the second largest informal sector in the world after Bolivia, thus Zimbabwe has the largest informal sector or bottom of the pyramid entrepreneurs in Africa.
- After the bank crisis in Zimbabwe at the turn of the millennium majority of the citizen lost trust in financial services providers, accordingly they became financially excluded.
- Mobile Money slowly brought back the confidence in financial services providers, the bank was only a thumb away and in one's pocket.

Given the above facts it was our hope that the Minister of Finance and the Governor would come up with a pro-poor budget and monetary policy statements. In any case it is the Governor who led the development of the National Financial Inclusion Strategy. The main agenda of the document is to provide financial services to poor, to provide access to transacting accounts, access to micro-savings, micro-credit, micro-insurance and to micro-pensions.

The standard the world over, and as it is stated in the national agenda, financial inclusion should not be forced on anyone. It is not an obligation, people should choose to be financially included not forced into inclusion.

The Zimbabwean case is unique as it turned financial inclusion from a choice to a need. One must be financially included in order to transact making use of mobile money and the various low income bank packages that banks have introduced to ensure that everyone is banked.

The Minister's dilemma

Economic fundamentals are pointing in the wrong direction, Official Development Assistance (ODA) has continuously been going down, and the tax base has been shrinking despite the vibrant informal sector. The only solution that the country has is Domestic Resource Mobilisation (DRM). USAID defines DRM as *"the process through which countries raise and spend their own funds to provide for their people – is the long-term path to sustainable development finance"*. DRM not only provides governments with the funds needed to alleviate poverty and deliver public services, but is also a critical step on the path out of aid dependence.

It is however important to note that DRM does not necessarily mean **new taxes or higher tax rates**. These two have the effect of harming the poor and consequently leads to financial exclusion. USAID researches and observations have shown that "*governments often see their revenues rise though improved audits or simplified filing processes,*" like encouraging government to accept mobile money payments for government and local government fees and taxes.

So why introduce the 2% tax if it harms the poor? Why not use the other ways to enhance DRM?

Uganda is a larger economy than Zimbabwe and they fought in parliament for the reduction of the mobile money tax from 1% to 0.5%. Sadly the debate became emotional as a member of parliament was chased away from the burial ceremony of a supporter in his constituency over his support for the 1% Mobile Money tax. They argued the MP lied that he was representing their views. Ironically Zimbabwe had the same debate in recent weeks, Members of Parliament on one corner fighting for reduction of the tax to 0.5%, whilst others believed the 2% is good for the poor and good for the economy. Fortunately or unfortunately politics is a game of numbers. Our hope as Zimbabwe is that economic issues should not be voted for or against on party lines but based on the will of the people.

The reasons behind the taxes vary, and would all make sense or not depending on which side you are, politically or economically.

The need for revenue: - As highlighted earlier, Zimbabwe has the second largest informal sector economy in the world after Bolivia. This sector has shunned the banks since the financial crisis. Thus, a lot of transactions are happening in that sector that are presumably not being taxed enough. No Pay As You Earn (P.A.Y.E), Sales tax, Value Added Tax (VAT), capital gains tax, corporate tax amongst other tax brackets.

Should the government aim at increasing the tax or the government should aim at broadening and widening the tax base whilst maintain the same tax rates?

Those who are for the 2% would argue that for a government to be able to provide for its citizens things like free health, and good roads and many others, we need to increase revenues and this comes through tax increases.

Those against the 2% would argue, yes the need is there for service provision but government can enhance revenues through other means other than tax increases. Government revenue is a function of economic performance and efficient collection systems. However even with the best performing economy, without an efficient collection system, revenues may not improve at the rate that is sustainable. Therefore, those against will argue that our collection systems are not efficient.

The social need - The social needs of any economy means there should be enough disposable income in the hands of the citizens. This alone has a multiplier effect on the economy and macro-economic fundamentals will stabilize in the long run. Therefore, there is no need to tax the poor.

The financial inclusion dilemma – the more the poor are taxed the more they become financially excluded. No poor person would want to buy micro-insurance, open a micro-savings account or invest in micro-pension schemes if they perceive the investments/savings to be expensive due to high transaction cost. A poor person who is going to borrow from any MFI for agriculture finance would have to incur the administrative cost of borrowing, the interest, the tax when they buy inputs plus an additional cost in terms of the tax to the MFI that is shipped to the customer.

Zimbabwe is a peculiar economy and no policy pronouncement will delight everybody. Thus the need for a balance when we review policy. However, for a person who has read the National Financial Inclusion Strategy, the 2% fiscal measure will look like it’s going in the other direction. As an organisation that believe and advocate for financial inclusion we are obviously inclined to side with this view.

After the introduction of the 1% tax in Uganda, the country started recording falling numbers on digital finance users. At least they have cash as an alternative which we do not have.

Consider the poor people who survive on less than $2 a day and those who survive on social benevolence. How about those that receive micro remittances just to survive a day should they be paying the 2%. How about those that are on social welfare who get monthly payments from NGOs should we collect 2% from them when they transact?

Economic analyst have proposed to the Minister of Finance to revert to the old 5 cents per transaction. Politicians have proposed the reduction of the tax rate to 0.5%, the Uganda way. If that is not a possibility, the minister should introduce a monthly threshold where those that transact below the poverty datum line will not be taxed until they reach the poverty line limit -anything outside that will be taxed. The 2% on a person who survives on less than $2 a day is high, consequently they will shun mobile money and prefer cash which unfortunately is not available. Imagine the vegetable vendor who was already accepting mobile money as a means of payment. They are most likely to pass on the tax amount to the buyer or they will go cash.

The biggest challenge however of a threshold is the financial inclusion illusion how do we deal with multiple account ownership in order to enforce the poverty datum line threshold.

The foreign currency crisis

Zimbabwe like most frontiers and emerging economies often face the foreign currency challenge. This basically means the country has insufficient stocks of foreign exchange reserves and that makes it difficult to trade internationally. The failure to trade evidently has an impact on Zimbabwe, an economy that relies on foreign products and services. The scope of this paper is not to discuss the causes but to evaluate the possible solutions and the likely impact on the poor and the bottom of the pyramid.

The government has already started putting in place measures/restrictions to address these, the Minister of Finance has stated that *"in the interim, steps are being taken to establish a Foreign Currency Allocation Committee to promote efficient management of our foreign currency inflows"* and presumably outflows as well. The committee will help allocate the foreign currency reserves available to industries and purposes deemed a macroeconomic priority by the committee. However, restricting currency flows in and outside a Zimbabwe has adverse effects on several industries.

If the pharmacies and hospitals can't get an allocation what is the impact on the health services delivery. What is the impact on welfare of the poor man and the community as a whole? If Delta and Mutare Bottling do not get their allocation, to pay for their license fees and concentrates, what is the impact on the poor store owner or bottle store owner downstream? If the foreign currency crisis is caused by Zimbabweans importing more than they are exporting then there is a huge possibility that Zimbabweans are creating jobs in neighbouring countries than they are creating in their own economy.

The peasant farmer who survives on chemical fertilisers may be at risk of poor harvest as there is no foreign currency to buy critical chemicals and fertilisers. Alternatively companies may be allowed to import using their own foreign currency reserves or lines of credit, but the product will be priced in hard currencies or at the going rate – out of reach for the ordinary peasant farmer.

Zimbabwe seems to be operating a fixed exchange rate policy but still allowing industry to use the parallel market rate to "bond" value their products. Is this legal?

The hidden subsidy

The perceived bond to USD value has created market distortions and dual pricing. Special consideration should be given to the ordinary Zimbabwean who was earning enough to cover the standard consumer basket. S/He still earns the same bond value but in real terms the same basket has tripled in value. Thus the same person now earns two thirds less.

Here is an interesting scenario that is obviously benefiting the ordinary citizens but hurting the economy. The poor man is buying fuel with bond at the perceived 1:1 valuation, yet to replenish the fuel stocks the country has to pay in foreign currency. Using the real value and reality on the ground, if petrol is $1.40 bond, in real terms it is US$0.40 which is exactly the same price as Iran and Qatar. To the poor man it is a bonus to the pocket, but it comes with a cost of having to wait in the queue for long time and loosing productive time.

Indications on the ground are that a number of stations are now selling fuel in foreign currency and the number is growing by the day. It's not a surprise that citizens will soon be asked to pay for their public transport fares in foreign currency yet they are only earning in bond and they are not allowed to trade the bonds on the parallel market for US$. Talk of January disease.

Remittances

The continued decline in ODA in Zimbabwe has made remittances an important aspect of Zimbabwean economics. They are a critical part of DRM. However, remittances flowing through the formal channel seems to be going down due to the perceived 1: 1 exchange rate between the bond and the dollar. Analyst are convinced the quantum of remittances has not changed, there is a possibility that remittances may actually have increased, but the channel has changed. Over the past year Zimbabwe has seen the birth of grocery remittance businesses. Instead of the diasporans sending money home they are petrified that their loved ones may not have access to the funds. If they do, they may not be able to buy the same groceries with the same remittances in Zimbabwe as they would do in neighbouring countries. Thus, instead of enhancing Zimbabwe's domestic resources through remittances Zimbabweans are creating jobs in other countries through retail purchases.

Remitting to Zimbabwe has become increasingly expensive due to the unavailability of foreign currency at the last mile. As such remittance companies have to import the hard cash for the Zimbabwe market. That cash guarantee cost is obviously passed on to the customer, for that reason many diasporans are now using informal channels to remit to Zimbabwe. Unfortunately these funds are not recorded, Zimbabwe has no data on them thus policy makers cannot plan based/depending on them. It is clear that these are the funds that are feeding the parallel market and hence economic dualization.

Whilst economists appreciate demonetisation may not be the best option since the country does not have enough foreign currency resources to fund the process of replacing bond value 1 for 1 with the US dollar. There may be need to officially recognise the bond as quasi currency that can be traded on the foreign exchange market. The poor at the bottom of the pyramid continue to suffer from dual pricing, bond note inflation, unemployment and excessive taxes. Sweden has the lowest number of paper notes and coins circulating in the economy, it is going cashless. Similarly, in Zimbabwe cash is no longer the King, Digital Money is. Zimbabwe can recall all the bond notes in the market and become the first cashless economy in Africa. That will be a better substitute title than a country facing liquidity crisis.

Promoting a culture of savings

Browsing through the budget one realises that there is not much that has been said about savings other than the savings bonds that are used for mopping up excess liquidity in the market. The poor rarely participate in these bond markets as such one would conclude that the poor are not saving and the Minister might have reached the same conclusion. Wrong! Evidence on the ground suggest otherwise.

We are still a low savings country and a lot has to be done to improve savings. Zimbabwe needs to start including the BoP in savings mobilisation. Economics has taught us that a country that does not save will not grow. In the absence of foreign direct investments (FDI) and falling ODA, DRM through innovative products like digital finance can improve

Zimbabwe’s position. It is wrong to assume that the people at the BoP do not save, it is equally wrong to exclusively concentrate on corporate savings in a country that has the largest informal sector in Africa.

The BoP needs are exactly the same as the needs of those at top of the pyramid and the government must realise that and promote channels and products that serve the poor. The poor need insurance and the poor are saving albeit informally. How much will the country benefit and what in the multiplier effect of an inclusive formal savings. Every year end there are a lot of savings groups that share groceries to break a cycle - that is 12 month deposit that was sitting in a box without being used. Such deposit –nano deposits - can be formalised and loaned out to the same BoP communities that are depositing the funds. Consequently community development from the source.

The government need to look at private public partnerships in linking and formalising relationships between savings groups and formal financial services providers. From where Zimbabwe is coming, government must do away with credit only microfinance institutions especially in BoP communities. Credit based microfinance has some negative impact on the community especially when customers fail to honour their commitments. Our MFI should now transform into fully fledged MFIs offering micro deposit function, these can be done digitally no need to visit the branch – we are a cash lite economy. MFIs should offer insurance as well as credit. Rwanda has started a compulsory pension scheme for all its citizens. How much will the insurance sector collect from the informal sector if Zimbabwe launches a pro-BoP obligatory or non-obligatory insurance product that works?

Privatisation of Public enterprises

It appears the government is now ready to jump on to the privatization bandwagon again. Citizens are not sure if this is a matter of political and economic ideology or is it a means to raise revenue. Whatever the reason, if this shift happens the government has told us that this will produce a significant improvement in service to the customer thus boosting efficiency and quality of remaining government units. Clearly privatisation shrinks the size of government which is what we all need.

Privatisation provides a platform for growth, but if growth is exclusive then the poor man at the BoP will not enjoy the benefits. Privatisation has to be inclusive for there to be economic development and for the poor man to benefit. C.K Prahalad in his book “The Fortune at the Bottom of the Pyramid” argues that “*We have to learn from the successes and failures of the past; the promises made and not fulfilled. Doing more of the same, by refining the solutions of the past— developmental aid, subsidies, governmental support, localized nongovernmental organization (NGO)–based solutions, exclusive reliance on deregulation and* *privatization of public assets—is important and has a role to play, but has not redressed the problem of poverty".*

Zimbabwe has had the Structural adjustment programs where privatisation was key. Have the programs helped in alleviating poverty? In as much as privatisation is key the hope for every Zimbabwean is to lead to "inclusive capitalism".//Ends

About the ESR

The Election Situation Room provides a platform for effective citizen monitoring and domestic observation of electoral and national processes, where key stakeholders and the general public can feed information and receive timely updates on key national and electoral processes. To achieve this, more than 40 organizations drawn from across the country and from different sectors have come together under the banner of the Election Situation Room. It has a Steering Committee that provide guidance and leadership to the ESR.

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