THE WORLD BANK
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ZIMBABWE
PUBLIC EXPENDITURE REVIEW
2017

Volume 1: Cross Cutting Issues

Jointly prepared by the Government of Zimbabwe and the World Bank.

GLOSSARY

AfDB	African Development Bank
AFROSAI	African Organization of Supreme Audit Institutions
AMTO	Assisted Medical Treatment Orders
ARDCZ	Association of Rural District Councils of Zimbabwe
BCC	Budget Call Circular
BEAM	Basic Education Assistance Module
BOP	Balance of Payments
BSP	Budget Strategy Paper
BSP-Z	Better Schools Programme-Zimbabwe
CAPEX	Capital Expenditure
CCT	Conditional Cash Transfer
CIT	Corporate Income Tax
CNFA	Cultivating New Frontiers in Agriculture
COFOG	Classification of Functions of Government
CPI	Consumer Price Index
CSC	Civil Service Commission
DEA	Data Envelopment Analysis
DFID	Department for International Development (United Kingdom)
DPO	Development Policy Operation
DRRR	Disaster Response and Risk Reduction
DSA	Debt Sustainability Analysis
DSS	Department of Social Services
ECD	Early Childhood Development
EDF	Education Development Fund
EMIS	Education Management Information System
EMTP	Education Medium Term Plan
ETF	Education Transition Fund
FAO	United Nations Food and Agriculture Organization
FY	Fiscal Year
GDP	Gross Domestic Product
GEC	Girls Education Challenge
GFMIS	Government Financial Management Information System
GFSM	Government Finance Statistics Manual

GNU	Government of National Unity
GoZ	Government of Zimbabwe
GPE	Global Partnership for Education
HIV/AIDS	Human Immunodeficiency Virus Infection and Acquired Immune Deficiency Syndrome
HQ	Headquarters
HSCT	Harmonized Social Cash Transfer System
IBRD	International Bank for Reconstruction and Development
ICT	Information and Communications Technologies
IDA	International Development Association
IDBZ	Infrastructure Development Bank of Zimbabwe
IFIs	International Financial Institutions
IFMIS	Integrated Financial Management Information System
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
INTOSAI	International Organization of Supreme Audit Institutions
I-PRSP	Interim Poverty Reduction Strategy Paper
IPSAS	International Public Sector Accounting Standards
IT	Information Technology
KPA	Key Performance Area
LA	Local Authority
LAPF	Local Authorities Pension Fund
LEAP	Livelihood Empowerment Against Poverty program
LLECE	Latin American Laboratory for Assessment of the Quality of Education
MAMID	Ministry of Agriculture, Mechanisation and Irrigation Development
MASAF	Malawi Social Action Fund
MDA	Ministries, Departments, and Agencies
MIS	Management Information System
MLGPWNH	Ministry of Local Government, Public Works, and National Housing
MoAMID	Ministry of Agriculture, Mechanisation and Irrigation Development
MoFED	Ministry of Finance and Economic Development
MoHCC	Ministry of Health and Child Care
MoPSE	Ministry of Primary and Secondary Education
MPSLSW	Ministry of Public Service, Labor and Social Welfare
MSMECD	Ministry of Small and Medium Enterprises and Cooperative Development
MTEF	Mid-Term Expenditure Framework
MTFF	Mid-Term Fiscal Framework
MWAGCD	Ministry of Women Affairs, Gender and Community Development
MYIEE	Ministry of Youth, Indigenization and Economic Empowerment
NGO	Non-Governmental Association

NPL	Non Performing Loan
NSSA	National Social Security Authority
OAG	Office of the Auditor General
OECD	Organisation for Economic Co-operation and Development
OPC	Office of the President and Cabinet
OSISA	Open Society Initiative for Southern Africa
OVC	Orphans and Vulnerable Children
PAC	Public Accounts Committee
PASEC	Program on the Analysis of Education Systems
PAYG	Pay-As-You-Go
PCW	Public Community Works
PER	Public Expenditure Review
PFM	Public Financial Management
PFMA	Public Finance Management Act
PFMEP	Public Financial Management Enhancement Project
PICES	Poverty, Income, Consumption, Expenditure Survey
PIM	Public Investment Management
PIRLS	Progress in International Reading Literacy Study
PISA	Programme for International Student Assessment
PIT	Personal Income Tax
PLAP	Performance Lag Address Programme
PSNP	Productive Safety Net Programme
PPPs	Public-private Partnerships
PSC	Public Service Commission
PSIP	Public Sector Investment Programme
PSPF	Public Service Pension Fund
RBB	Results-Based Budgeting
RBM	Results-Based Management
RBZ	Reserve Bank of Zimbabwe
SACMEQ	Southern and Eastern Africa Consortium for Monitoring Educational Quality
SACU	Southern African Customs Union
SADC	Southern African Development Community
SAP	Systems Application Products
SDC	School Development Committee
SDG	Sustainable Development Goal
SDR	Special Drawing Rights
SEDCO	Small Enterprises Development Corporation
SEP	State-owned Enterprises and Parastatals
SERA - USAID	Strategic Economic Research and Analysis Program (USAID)
SERA	State Enterprises Reform Agency

SFA	Stochastic Frontier Analysis
SMEDCO	Small and Medium Enterprises Development Corporation
SMP	Staff Monitored Program
SSN	Social Safety Nets
STAP	Seasonal Targeted Assistance Program
TA	Technical Assistance
TCPL	Total Consumption Poverty Line
TDIS	Teacher Development Information System
TIMSS	Trends in International Mathematics and Science Study
TMS	Teacher Minimum Standards
UCAZ	Urban Councils Association of Zimbabwe
UCT	Unconditional Cash Transfer
UIS	Institute for Statistics (UNESCO)
UNDP	United Nations Development Programme
UNESCO	United Nations Educational, Scientific and Cultural Organization
UNICEF	United Nations International Children's Emergency Fund
USAID	United States Agency for International Development
USD	United States Dollar
VAT	Value-Added Tax
WFP	United Nations World Food Program
ZAMCO	Zimbabwe Asset Management Company
ZIA	Zimbabwe Investment Authority
ZIMASSET	Zimbabwe Agenda for Sustainable Socio-Economic Transformation
ZIMRA	Zimbabwe Revenue Authority
ZIMSTAT	Zimbabwe National Statistics Agency
ZIMVAC	Zimbabwe Vulnerability Assessment Committee
ZINARA	Zimbabwe National Roads Administration
ZINWA	Zimbabwe National Water Authority

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ACKNOWLEDGEMENTS

This Public Expenditure Review (PER) was prepared jointly by the Government of Zimbabwe and the World Bank. The report benefited from the support of the Honorable Patrick Chinamasa, Minister for Finance and Economic Development and Mr. W. Manungo, Permanent Secretary of this Ministry. The report further benefited from the guidance from Camille Nuamah, World Bank Country Manager for Zimbabwe; Mark Roland Thomas, Manager, Macroeconomics & Fiscal Management Global Practice and Guang Zhe Chen, World Bank Country Director for Zimbabwe. The joint team was led by Mr. Z.R. Churu, Principal Director, National Budgets at the Ministry of Finance and Economic Development and at the World Bank by co-team leaders, Johannes (Han) Herderschee and Leif Jensen, both Senior Economists, Macroeconomics & Fiscal Management Global Practice supported by Marko Kwaramba, Economist in the same Global Practice. At the Ministry of Finance and Economic Development the team comprised of Fidelis Ngorora, Director, Public Sector Investment Programme; Samuel Phiri, Principal Economist; Marcos Nyaruwanga, Chief Economist and Brian Goredema, Chief Economist. The report was edited by Sean Lothrop, Oscar Parlback and Dean Thompson. Cybil Maradza (Design Consultant) prepared the design and typesetting. Nyasha Munditi (Consultant) updated the figures and tables to 2016, and completed copy editing. Photos presented in the report were taken by Arne Hoel. Farai Sekeramayi-Noble organized the workshops and other communication events and managed all contracts involved. The team is grateful for peer review comments received from Vinaya Swaroop (Lead Economist GMFD2), Blanca Moreno-Dodson (Lead Economist, Global Tax Team) and Edgardo Ruggiero (on behalf of IMF).

In addition to the above mentioned team, selected chapters benefited from specialist contributions. Chapter 1 benefited from contributions by Mr. Eria Hamandische, Director Fiscal Policy and Advisory Services; Jonah Mushayi, Deputy Director Fiscal Policy and Advisory Services; Johannes (Han) Herderschee; Leif Jensen; Marko Kwaramba, all mentioned above; Jason Hayman and Hirut (Mimi) Wolde, both Consultant. Both Chapters 2 and 3 were prepared by Fidelis Ngorora, Marcos Nyaruwanga, Samuel Phiri (all Ministry of Finance and Economic Development) and at the World Bank Leif Jensen; and Hirut (Mimi) Wolde. These chapters benefited from contributions by the MOFED Department Managing the Information Management System led by Director, Mr Sadwel Kanyoza. Chapter 4 benefited from contributions by Daniel Muchemwa, Accountant General and Edwin Vela-Moyo, Director Current Expenditure at the Ministry of Finance and Economic Development and at the World Bank, Leif Jensen; Johannes (Han) Herderschee, Blessing Manyanda, Program Assistant; Norman Jabulani Mukwakwami, consultant; MacDonald Nyazvigo, Senior Finance Assistant; Daniel Domelevo, Senior Public Finance Specialist, and Howard Bariira Centenary, Senior Procurement Specialist.

The report was finalized in October 2016 and macroeconomic indicators for 2016 were updated on March 6, 2017.

Executive Summary

Zimbabwe is at a critical juncture. After dollarization and favorable economic factors fueled a recovery during 2009-12, Zimbabwe today faces slowing growth, a financial crisis, increasingly erratic weather patterns and rising poverty and inequality. To help respond to these issues, the Government of Zimbabwe (GoZ) has sought to examine and ultimately better manage its public expenditures, with a view to ensuring public spending is effective, efficient, equitable, and well-targeted to the needs of its changing population, especially the poor.

A joint product of the GoZ and World Bank, this Public Expenditure Review (PER) aims to inform GoZ's efforts to reform and improve fiscal management. The report, which draws on government revenue and expenditure data from 2011 to 2016, seeks to provide a common evidentiary framework for collaboration between the GoZ and the World Bank, and stimulate debate on the nature and orientation of public spending among representatives of the GoZ, the private sector, and civil society. To be productive, such a debate should consider all public revenues and expenditures – irrespective of agency and how they are managed. To ensure a complete narrative, this PER reviews information on public sector expenditures of the central government, extra-budgetary funds, local authorities, State-owned Enterprises and Parastatals (SEPs), and development partners.

In brief, this report argues that Zimbabwe's ability to formulate and implement effective fiscal policy – a key function of government – is slipping away given the lack of robust controls over public finances, and the deferment of key policy choices on the role and structure of the state. Zimbabwe's comparatively large public sector provides opportunities to boost investment and growth, but, absent strong controls and management, can become a stumbling block for economic development. Total government revenues and expenditures in Zimbabwe exceed 50 percent of GDP, which is comparable with public sectors in high-income European countries, further underscoring the importance of appropriate controls. The initial observations below help to elucidate this premise.

Fiscal policy is a main power of government and more so under Zimbabwe's dollarized economy. Governments apply their fiscal power to raise taxes and revenues, and finance goods and services in the public interest. In areas where public and private interests diverge and the private sector underprovides critical goods and services, governments use fiscal policy to finance and provide public services. Fiscal policy can be leveraged to achieve inclusivity and equity, though achieving such goals sustainably, requires balancing the needs of present and future generations. To promote sustainable growth and protect social welfare, fiscal policy must create an environment where private effort and investment can yield steady incomes for households. In addition, governments use fiscal policy to help stabilize macroeconomic fluctuations from exogenous shocks.

But Zimbabwe's fiscus today is not healthy. Past developments and choices made in difficult circumstances have created a bloated fiscus, which is difficult to maneuver, and may be inadvertently creating – rather than resolving – inequities. As such, Zimbabwe's fiscus is severely limited as an effective tool for Government.

Today, Zimbabwe has very little fiscal space to stimulate the economy amid slowing growth, despite the GoZ's high effectiveness in raising taxes and revenues. Occupying about half of the economy, Zimbabwe's state has become so unwieldly that it may impede rather than support households, families, communities, and firms to improve social welfare. Employment costs for public servants, who represent some two percent of the population, consume more than 20 percent of Gross Domestic Product (GDP), while the state's high domestic borrowing crowds out credit to the private sector, including large and small businesses. Overall public debt, including international arrears, represents 79 percent of gross domestic product. Meanwhile, State-Owned Enterprises (SOEs) and local governments continue to generate contingent liabilities for the sovereign.

Today, Zimbabwe's fiscus has limited flexibility to respond to economic and social challenges. Public wages represent 87 percent of the central government revenue, and 40 percent of local government expenditures and over 20 percent of total SOE expenditure, leaving little for Operations and Maintenance (O&M) and capital investments. The state faces difficulties redirecting public expenditure from government consumption to investments. Each new hire creates a long-term liability, including pensions for government workers, yet Ministries, Departments, and Agencies (MDAs) continue to demand more personnel without effective hiring and HR planning systems. Despite limited flexibility, pressing concerns remain. Though school enrollment has increased, many children still attend schools

without adequate infrastructure and qualified teachers, especially in Early Childhood Education (ECD). Limited O&M for facilities and infrastructure across sectors has required expensive rehabilitation and reconstruction, increasing the costs of public services. Moreover, such inefficiencies limit the quantity and quality of basic services that the fiscus is able to finance for the public.

The state also faces difficulties in protecting the poorest households. The El Nino drought revealed the extent to which social safety nets have deteriorated. In education, the Basic Education Assistance Module (BEAM), which covers school fees for economically disadvantaged children, has all but ceased to operate, and reports suggest that schools periodically turn away vulnerable students. Though families contribute directly to public education through school fees, this financing model may perpetuate rather than reduce inequities, as children from wealthier families consistently reap better education outcomes than those from poorer households. Poor households continue to defer medical care because of rising fees and charges needed to maintain health facilities and services.

Finally, the state may have overstretched through its direct interventions and is no longer supporting private sector development. Zimbabwe's public sector has a long tradition of directly participating in the market economy to support industrial development, as embodied in the long list of Zimbabwean SEPs. Yet some functions of SEPs have not evolved, despite large structural changes in the economy. Many SEPs are now a drag on the fiscus, even as the private sector has filled gaps that SEPs left in the market. In other cases, the GoZ's investment, tariff and subsidy policies are not sufficiently coordinated to achieve desired impacts, while protecting state revenues.

Nevertheless, the Zimbabwe state can leverage its strengths and emerging opportunities to recover a healthy fiscus that can support growth and ensure the public good.

First, the institutional framework for control over central government public spending is comparatively well developed but remains to be comprehensively applied. The 2013 Constitution re-affirmed the principles of good stewardship by the state at all levels. Efforts are underway to modernize and update legal and regulatory instruments for Public Financial Management (PFM), public procurement, and external audit in line with these principles. Authorities will need to extend and implement these principles at the local level and within SEPs.

Second, Zimbabwe's ability to raise taxes and revenues is proven, and citizens and firms are willing to contribute to the exchequer and pay for public services. Yet the GoZ should work to ensure current approaches for mobilizing resources, including private fees, are progressive, and transfers and subsidies support equitable development. In addition, the state must refrain from crowding out the private sector. Fortunately, innovations in financing mechanisms, such as results-based financing (RBF) of rural health clinics and the Harmonized Social Cash Transfer Program (HSCT), have potential to rapidly improve service delivery and outcomes. Zimbabwe's private sector is also willing to partner on financing and providing infrastructure and services, but these arrangements must be scrutinized and transparent to protect the public interest.

Finally, the authorities' plan to fully re-engage with the international financial system should increase access to both development financing and private investment flows. In October 2015, the GoZ submitted a proposal to clear its arrears to the World Bank, the International Monetary Fund (IMF) and the African Development Bank (AfDB), and to reschedule bilateral debts to Paris Club members. In October 2016, the GoZ subsequently cleared IMF arrears. The settlement process is expected to expand Zimbabwe's access to international resources, including funding from the World Bank and the AfDB.

Seizing these opportunities will require the GoZ and the country to confront policy questions that have been deferred for some time. These include questions about: (i) whether and how the size and role of the state might evolve to respond to new economic realities; (ii) the division of labor across all state arms for financing and equitable service delivery; and (iii) the balance between promoting private sector development, preserving benefits of public servants, and protecting the poor. Zimbabwe would benefit most from a fiscus based on deliberate national choices informed by a broad, government-led debate on such questions, rather than one that evolves unevenly responding to fluctuating challenges, shifting interests, and entrenched positions.

As such, this PER reviews the options facing the Zimbabwe fiscus in terms of: (a) challenges; (b) capacities; and (c) choices. Past policy choices have gradually limited the GoZ's control over the fiscus. Renewed control of the public sector will allow the GoZ to effectively implement public policy options. To effectively implement these policy choices, Zimbabwe will need to ensure strong coordination among policy makers, and transparency and accountability.

The Macroeconomic and Fiscal Context

Zimbabwe is suffering from declining growth and serious macroeconomic challenges, including a financial crisis. Zimbabwe adopted a multi-currency regime in early 2009, with the US dollar as reference currency, which effectively dollarized the economy. From 2009 to 2012, Zimbabwe achieved high economic growth, partly due to the stabilization effort, high commodity prices, and an unfettered credit boom. Yet since 2012, economic growth has fallen as the commodity super-cycle ended, the South African Rand depreciated, and credit contracted following a sharp rise in Non-Performing Loans (NPLs) and capital inflows contracted. Zimbabwe has taken steps to improve its business climate, but continues to face low credit for businesses and consumers, acute cash shortages in banks, and a severe drought hurting agriculture production and rural incomes. As a result, per capita GDP has fallen by two percentage points in 2016 and poverty has also increased.

Macroeconomic and fiscal policy options to stimulate the economy have narrowed during the review period. As growth decelerated since 2012, pressures intensified to use macroeconomic and fiscal policies to buttress growth, but the GoZ has increasingly exhausted instruments to implement fiscal policy. During the high-growth years after adopting the multi-currency regime in 2009, Zimbabwe did not adopt a counter cyclical fiscal policy that would have helped the GoZ to manage growth over the long-term, thus few reserves were accumulated.

As Zimbabwe remains in arrears to external creditors, the GoZ has tapped domestic capital markets to finance its budget, which has reduced liquidity and exacerbated cash shortages. During 2016, the GoZ rapidly expanded its use of T-Bills to cover pre-existing arrears to the Reserve Bank of Zimbabwe (RBZ) and other liabilities, which has limited scope for further domestic financing of the budget deficit. In parallel, the GoZ's practice of using commercial banks to finance the public budget has destabilized the banking system and constrained liquidity, as evident in sharp limits on cash withdrawals from bank deposits, and irregular payment of imports.

The financial crisis is linked to the fiscal situation and a successful resolution of the crisis will require very strong fiscal policy credibility. This means addressing the current fiscal imbalances and making the system much more transparent to assure depositors and investors.

Structural impediments, including weak investor protection and uncertain land tenure arrangements, continue to deter capital inflows. The World Bank Doing Business Indicators for 2017 rank Zimbabwe as 161 out of 190 countries, with similar rankings from other classifications. Without capital inflows, Zimbabwe has seen a rapid contraction in imports and a narrowing in the current account deficit.

Zimbabwe faces deeper challenges when considering the consolidated public sector. Since public sector wages consume most central government resources, non-wage expenditures were increasingly paid by user fees and debt of SOEs and local governments. Zimbabwe's public sector deficit expanded even during the period of high growth, so the fiscus now has limited resources to address the deceleration.

KEY CHALLENGES

Government's gross expenditures as a share of GDP, when considering all funding sources, has rapidly grown to the level of some high-income countries. Zimbabwe's central government revenue-to-GDP ratio of 27 percent from 2011 to 2015 was comparable to those of most regional peers, and the country leads peers in collection of Value-added Taxes (VAT).[1] The revenues of central government, including statutory extra-budgetary funds, are complemented by other sources: local government revenues of 5.6 percent of GDP; official development aid estimated at 8.4 percent of GDP; statutory revenues mobilized and spent at source of about six percent of GDP; and SEP revenues – unconsolidated estimates of which are 29 percent of GDP. Zimbabwe's lack of consolidated public accounts makes it difficult to determine the full size of Government, but a conservative estimate suggests the public sector commands resources of about 50 percent of GDP. Such a level is comparable to high-income European countries, which have achieved commensurate levels of government performance, suggesting that Zimbabwe still is under-performing for its size.

While a large state may create many important opportunities, the difficulties to prioritize, monitor, account and coordinate can ultimately limit the government's ability to support economic development and sustain gains in social welfare. States like Zimbabwe must be able to effectively coordinate, prioritize, monitor, and account for all revenue and expenditure, or decisions on policies and programs risk constraining economic development and social welfare. Loss of control over expenditure can translate into accumulation of arrears, debt, and contingent liabilities, and force disorderly adjustments, which may hinder or even reverse the impact of well-intentioned public policies. A state that is too large may also inadvertently crowd out personal and private efforts to create value, and create its own dependency syndrome among households and firms. Such a state may enter a vicious cycle similar to Zimbabwe's experience during 2007-08.

Though Zimbabwe has taken steps to better fiduciary controls and monitor spending, further gains are stymied by inadequate reporting and coverage of the PFM system. Zimbabwe has improved the availability of expenditure reports for decision making by *rebooting* the Integrated Financial Management Information System (IFMIS), which covers central government accounting, but still has limited coverage. For instance, no interfaces are yet in place between the IFMIS and the public service human resource management information system, and the local government and parastatal accounting systems. There are limited controls over the quality of spending and core controls on wages and staffing numbers are insufficient. In addition, Local Authorities have varying capacity to report on their finances: some implement International Public Sector Accounting Standards (IPSAS), while others have difficulties preparing basic monthly and annual financial statements. Zimbabwe has just recently started to estimate information on the fiscal role of SEPs, and regularly collect consolidated financial, performance and debt data. To accurately determine the size of Zimbabwe's consolidated public sector accounts, officials must integrate the PFM systems of central government, local authorities, SEPs, and development partners.

Zimbabwe faces other difficulties in accounting for public expenditures, especially as public services are increasingly funded outside the remit of the Parliament's budget process, where oversight and coordination is weak. Budget transfers, which make up about 20 percent of the central government budget, are allocated outside the overall budget prioritization framework. By dollar value, half of these transfers support recurrent costs in SEPs, universities, and other institutions. But Zimbabwe does not have a clear mechanism for monitoring or controlling explicit budget guarantees to SEPs. In addition, multiple institutions oversee SEPs, but they lack clearly demarcated roles, which has allowed SEPs to build up complex mutual debt, which contributes to systemic fiscal risk. Local governments face increasing deficits partly because central government transfers and local revenues have not kept pace with their greater mandates for service delivery. Splitting the oversight of urban

[1] The increased emphasis on indirect taxation may raise vertical equity concerns in the future.

and rural local authorities into two different ministries requires strong coordination to avoid spending overlaps and duplications, and ensure a consistent policy on fees, charges and tariffs

Zimbabwe's allocation of public sector resources has evolved to be neither effective, efficient, nor equitable. As mentioned, recurrent expenditure, particularly the public sector wage bill, has crowded out expenditures for O&M and capital investments. Despite the GoZ's commitment to channel at least 30 percent of expenditures to capital development, capital expenditure as a percent of budget fell from 15 to eight percent between 2011 and in 2015 – exacerbated by weak budget execution as low as one percent in some categories. Zimbabwe's social protection system once a model in terms of coverage, no longer meets the needs of its population.

Spending on personnel has increased dramatically in recent years, driven by the growing number and remuneration of public employees. The wage bill dominated the growth of public expenditures from 2011 to 2015. Today, Zimbabwe's central government personnel-related expenditures are unsustainable, reaching 22 percent of GDP, 82 percent of total current expenditure, and 87 percent of total domestic revenue in 2015. In key service areas, such as basic education, employment costs represent 98 percent of line ministries' budget, which has left little to fund pressing capital and program-related needs of schools. Within employment costs, allowances such as pensions have grown at rates significantly higher than government salaries. Zimbabwe's pension costs of four percent of GDP outstrip those of African middle income countries, and are driven by comparatively high government subsidization, and very low employee contributions.

Local governments and SEPs face high and rising employment costs, and some SEPs have accumulated arrears for salary payments. In SEPs, employment costs rose from 2011 to 2014 and constituted 22 percent of SEP expenditures in 2014, despite employment numbers declining somewhat. In SEPs, Board costs and remuneration to key management staff increased by 35 percent from 2011 to 2014, though some enterprises accumulated arrears for paying the salaries of rank-and-file staff. In local governments, employment costs rose rapidly to reach 40 percent of total spending in 2015, while administrative, finance and management costs (not directly linked to service delivery) rose to 26 percent.

The high costs of public sector employment raise issues about equity, given the wage gaps between the public and private sectors, and low funding of social services. For example, civil servants make up only 1.6 percent of the population, but consume more than 20 percent of GDP. Even after taking into account that civil servants support their families, their benefits are significantly above average. Real wages have fallen in the private and informal sectors as firms and workers adjust to be competitive in a dollarized economy, but real wages in the public sector have risen (i.e., nominal wages remained flat, but in a deflationary environment). Zimbabwe spends almost five percent of its GDP on social protection, but most expenditures do not benefit the poor. Two-thirds of social protection spending is for civil service pensions. Expenditure on social safety nets to reach the extreme poor, who represent 22 percent of the population, has fallen, reaching only 0.72 percent of GDP in 2015. Skewed deployment of personnel also raises equity questions. For instance, Zimbabwe's ratio of 1.66 in spending per capita between secondary and primary education far exceeds the OECD country average, despite secondary schools' already benefiting from a much lower pupil-to-teacher ratio. Inequities extend across the education sector, as secondary and urban schools tend to be better resourced than primary, ECD, and rural schools.

To compensate for the lack of resources for non-wage expenses, the GoZ has expanded the use of user fees and charges, creating regressive financing of some basic services. MoPSE's own funding for education is progressive (i.e., weighted toward the poor). But the collection of revenue from private fees is skewing resources in a highly regressive manner. As already noted, growing mandates of local governments to provide services have not been accompanied by increases in targeted transfers, which complicates an already difficult situation. Without appropriate mechanisms to equalize financing of basic services, Zimbabwe could find itself reversing recent gains in improving equity.

Zimbabwe's complex government interventions and vague or conflicting policy objectives on user fees, tariffs, subsidies, and transfers across government also raises concerns about equity and sustainability. For instance, the inconsistent decision to impose fees in all schools, while not financing the BEAM, but funding teacher salaries in private schools, left many vulnerable children at risk, and transferred benefits to less poor households. In addition, Zimbabwe supports a highly varied, diffuse mix of social safety nets interventions, bucking the trend of many African countries toward backing single flagship interventions. For SEPs, Zimbabwe's complex mix of below-cost recovery tariffs, debt guarantees and write-offs, central government arrears and transfers, quasi-fiscal activities, and web of inter-SEP debts, make it all but impossible to clearly unravel the benefits of SEPs to households and the economy. Complexity in the SEP realm also reveals fiscal and economic risks. Representing 26 percent of GDP, most SEPs are accumulating losses, losing equity, and accumulating short term debt. Profits (before comprehensive income) were negative from 2011 to 2014, and explicit contingent liabilities represented 13 percent of GDP in 2014. Most enterprises are illiquid, and just under one-fifth are insolvent.

Recommendations

Building on Zimbabwe's institutional heritage and renewal in the 2013 Constitution, this PER presents recommendations in each of its chapters that could be implemented in the short to medium-term to address the challenges noted above. These have been summarized under six consolidated headings below:

Controlling the wage bill

Besides the step already taken by the GoZ, which estimates suggest will save about 1.2 percent of GDP (in full fiscal year impact), the GoZ might undertake the following measures, which could imply short-term savings of an additional one to three percent of GDP:

- Continue the freeze on personnel and wage increases.
- Continue to implement recommendations of the 2015 public employment audit, which call for eliminating staff duplications and redundancies; reviewing leave policies; rationalizing posts; and reducing employment cost obligations to grant-in-aid institutions, and top-ups to teachers in private schools.
- Adjusting personnel allowances (e.g., removing accommodation and transport from the "13th cheque").
- Increasing public employee pension contributions.
- Strengthen wage controls, mandate reviews of promotions, and establish clear rules for contract workers.
- Establish specific short- and medium-term targets for the wage bill and employment numbers, including spending as a share of public expenditures.
- Integrate the personnel management system with the IFMIS, and consolidate the mandate for all personnel-related expenditures for the civil service, including pensions.
- Improve employment planning and budgeting in all MDAs, Local Governments, and SEPs, including undertaking a review of 'service levels' (i.e., the number of staff required to deliver a particular service, or to support the economic and general administrative functions of government).
- Define a remuneration policy for SEPs, and a mechanism for enforcement.
- Systematize and improve performance contracting for SEPs' Boards and CEOs.
- Convert salary arrears to debt and establish a payment plan.

Effective planning and budgeting

- Include all budget and externally-funded activities in the RBB framework and in the budget bill with a view to enhancing Parliamentary oversight.
- Ensure the RBB framework is supported by a thorough review of fragmentation and duplication in program areas.
- Ensure that all new policies and strategies are effectively costed in terms of financial and human resources before approval.
- Strengthen the medium term planning of expenditure levels and composition to inform medium term priorities.
- Establish budget floors for key policy priorities, such as social service delivery and the capital development budget.
- Apply RBB solutions and performance measurement and management systems in local government

Improving PFM practices

- Strengthen central government commitment and expenditure controls by rolling out the budget and commitment modules of the IFMIS, and establishing a robust internal audit function.
- Extend the IFMIS to cover all public revenues and expenditures, in addition to consolidating revenues and expenditure from SOEs, extra-budgetary funds, and development partner financing.
- Strengthen public procurement and cash management planning to improve the execution of capital projects, particularly in social sector ministries.
- Strengthen program-level controls (e.g., audits, operational assessments), and introduce beneficiary-level controls (e.g., grievance redress systems, citizens committees, scorecards) in social protection and safety net programs.
- Harmonize data and information management arrangements into a single social registry for all MPSLSW programs.
- Integrate all debt records into a single registry, and improve transparency of debt contracting and obligations.
- Complete the rollout of the GFMIS in local government, and strengthen key functions: revenue projection and collection, procurement, and asset management.

Strengthening transparency and accountability

- Publish consolidated public sector accounts to enable better expenditure planning and accountability.
- Ensure timely publication of publicly financed activities, and timely follow up on questionable activities.
- Streamline and strengthen oversight of SEPs, and establish and disclose a comprehensive central database on SEP performance and ensure compliance with National Corporate Governance Code.
- Strengthen the national student assessment system, and join international assessment programs to help monitor better education outcomes.

- Improve the governance of school fees, better track the costs of delivering education, and support disclosure of EMIS data to help in monitoring education spending, efficiency, and outcomes.
- Broaden service level benchmarking from water supply to other functions of local government, and monitor unit costs of service delivery.
- Work towards a common platform, targeting mechanisms, and harmonized administrative processes for all social protection programs to reduce fragmentation and inefficiencies.

Modernize resource mobilization

- Review the progressiveness and regressiveness of the current tax system, and monitor the impact of foregone revenue on tax expenditure and tax incentives.
- Roll-out a new debt management strategy that integrates domestic and foreign debt, and includes short-term measures to link debt management to the Government's cash position, and medium-term measures on the risk maturity profile of debt.
- Set clear policy on borrowing by and between SEPs, and by local governments.
- Improve the governance of school fees and levies, and address spiraling inflation in education services.
- Cap the share of extra-budgetary funds, including related user fees, in core areas of public service delivery.
- Review the types of approvals required for local government rates and budgets, to ensure the principle of cost recovery is respected.
- Improve the fiscal capacity of local governments by establishing a predictable and equitable transfer system, strengthening their ability to raise and collect sustainable sources of revenue, and achieve cost recovery tariffs for local services.
- Consolidate transfers to better serve core service areas, such as health, education, and social protection.
- Engage development partners around a short- and medium-term strategy for financing and expanding coverage of social protection and safety net programs.

Longer-term choices

In addition to the recommendations above, this PER explores longer-term solutions to Zimbabwe's challenges. Zimbabwe must confront key policy questions to move forward. In certain areas, the 2013 Constitution provides guidance, but choices on implementation remain. In other areas, matters remain open for policy-making. The questions below speak to Zimbabwe's key longer-term policy choices, which should ideally be informed by a broad-based, Government-led dialogue.

Public sector revenues exceed 50 percent of GDP, a level that raises concerns about the role of the state in the economy. ***Is the current level optimal in terms of effectiveness, efficiency and equitability? If not, what size of state would most appropriately meet Zimbabwe's challenges?***

The high public sector wage bill creates rigidity in the budget, and undermines the role of fiscal policy in economic development. It also perpetuates some inequities between public and private sector workers. ***Should conditions of service for the public sector, including SEPs and local governments, be adjusted in line with macroeconomic and fiscal performance?***

Current macroeconomic developments have led to unequal access to public services. In particular, access to education and some social services is financed by fees and charges that limit access by low

income families. ***In cases where household contributions finance a significant share of service delivery, could equalization mechanisms effectively offset the regressive impact of private contributions, without disincentivizing those contributions? Or should the focus be on ensuring that public spending is progressive enough to offset the equity impacts over time?***

The 2013 Constitution calls for more decentralization of service delivery, but revenue mobilization by local government remains constrained. Unfunded mandates generally lead to gaps in service delivery and undermine accountability and trust in government at the local level. ***How should resources be shared between central and local levels of government to support effective, efficient and equitable service delivery?***

State-owned enterprises are falling short of expectations in their contributions to the economy, and becoming a burden on the fiscus, while the private sector is actively meeting demands in the market. ***Should the state maintain commercial enterprises in areas where private sector can meet demand? In cases where SEPs provide purely public goods, what oversight arrangements would best protect the public interest in Zimbabwe while ensuring sustainable service delivery?***

Zimbabwe recently approved an ambitious new national social protection strategy. However, a large number of social protection and safety net programs do not effectively reach the extreme poor. The country also has many other pro-poor programs that aim to help poor households raise incomes, but funding is spread thinly and fluctuates a great deal, rendering many programs unsustainable and ineffective. ***How should Zimbabwe prioritize across these programs over the short-to-medium term, in the face of limited resources?***

INTRODUCTION

Zimbabwe today is facing macroeconomic and fiscal challenges and a regional drought, which is expected to disproportionately harm the poor. As explained elsewhere in this PER, Zimbabwe's relative economic boom from 2009 to 2012 has been trailed by falling growth, high debt, and cash and credit shortages, exacerbated by the El Nino drought, which crippled agriculture and caused widespread food insecurity. About 1.6 million people – or 12 percent of the population – were unable to meet their minimum food requirements in 2015. According to World Bank estimates, poverty declined in 2012 and 2013, but has increased since 2015. Poor farmers in rural areas will likely fare the worst under the drought, noting that the poverty rate in rural areas in 2011/12 reached 80 percent, surpassing the 72.3 percent rate for the whole population.

The GoZ is taking steps to address these challenges, including making arrangements to clear its IFI arrears and address its high debt overhang. In October 2015, the GoZ submitted a proposal to clear its arrears to the World Bank, the International Monetary Fund (IMF), and the African Development Bank (AfDB), and to reschedule bilateral debts to Paris Club members. The Government cleared the IMF arrears in October 2016. The settlement process is expected to expand Zimbabwe's access to international resources, including funding from the World Bank and the AfDB.

Authorities are also examining scope for reforming fiscal policies and better managing revenues and expenditures to turn the tide on key challenges. Given Zimbabwe's dollarized economy and weak financial sector, the GoZ has limited options for using fiscal policy and stimulus to jumpstart growth or increase investments in the social programs. Further, fiscal policy was not countercyclical during the post-dollarization boom of 2009-2012. In this context, key overarching issues that the GoZ faces are:

- A large public sector, with a large share funded above general government revenues, which raises concerns about the sustainability of public finances;
- High recurrent expenditures on the public sector wage bill, which makes the budget less flexible in responding to shocks, and crowds out expenditures for development;
- A significant public debt burden, coupled with an absence of a debt management policy; and
- Limited oversight of SEPs, local authorities and extrabudgetary funds, which makes it difficult to control costs, budget effectively over the medium-term, and measure the effectiveness and efficiency of spending.

This Public Expenditure Review (PER) presents a series of policy chapters to explore these and other challenges, and identify possible options for consideration by authorities and stakeholders. The PER presents core chapters on Zimbabwe's macroeconomic context, public expenditure trends, public finance management, and public sector wage bill – the latter of particular importance to the sustainability of public finances. The PER then presents sector-specific analyses on local governments, State-Owned Enterprises (SEPs), Education, and Social Protection.

The PER focuses on developments during 2011-2015, and documents the political and institutional environment that influenced fiscal policy. Detailed high quality data covering the central government's revenues and expenditures are available between 2011 and 2015.[1] In some cases, this report refers to earlier years when this helps to understand current arrangements. For example, institutional arrangements for collecting user fees for services are grounded in an institutional reform

[1] The analysis presented in this report was largely completed in 2016 covering the period 2011-15. The data in the macroeconomic chapter were updated to 2016.

enacted in 1999. Similarly, some of the public sector wage bill dynamics can be understood only in terms of political arrangements agreed at the start of the Government of National Unity (GNU), which was in office from 2009 and 2013. The presentation is selective, and does not provide a comprehensive overview of political or institutional developments in Zimbabwe.

The PER seeks to provide a common evidentiary framework for collaboration between the World Bank and Zimbabwe, and help policymakers understand their country's expenditure priorities and execution patterns. The PER attempts to identify emerging challenges to effective public expenditure management, and situate those challenges within international experience. The PER's ultimately seeks to contribute to a debate on the nature and orientation of public spending, both within the government and between public officials, the private sector, and civil society. The GoZ and its partners might use the PER to inform polices and strategies for development and poverty reduction. For example, the PER might inform debate on the National Poverty Reduction Strategy moderated by the MoFED. Similarly, the PER might inform the reengagement strategy with IFIs coordinated by the RBZ, or the review of the Zimbabwe Agenda for Sustainable Socio-Economic Transformation (Zim Asset), coordinated by the Office of the President and Cabinet (OPC).

The PER was prepared through a joint effort by the Government of Zimbabwe, particularly the Ministry of Finance and Economic Development along with sector ministries, and World Bank staff. This PER is Zimbabwe's first since 1995.[2] This innovative approach reflects the sensitivity of the engagement process and the importance of ensuring domestic ownership of the analytical foundation. The World Bank's participation in the PER reinforces the credibility of the analysis to nongovernmental stakeholders, while the Government's involvement ensures local relevance and helps build political consensus to address key challenges.

[2] World Bank (2004), Zimbabwe Country Assistance Evaluation, Report No. 29058, May 21, Washington, DC.

CHAPTER

ONE

Macroeconomic Context

EXECUTIVE SUMMARY

This chapter frames Zimbabwe's fiscal challenges in the context of its macroeconomic developments. Zimbabwe adopted a multi-currency regime in early 2009, with the US dollar as a reference currency, which effectively dollarized the economy. Dollarization stimulated economic growth from 2009 to 2012, but macro challenges have since deepened and growth has declined. Fiscal policy was pro-cyclical during 2011-12, leaving little room for counter-cyclical policy when growth rates subsided. Similarly, bank lending boosted growth, but subsequently contracted as banks were confronted with Non-Performing Loans (NPLs). Declines in domestic bank lending were accompanied by increases in foreign capital inflows, widening the current account deficit, but inflows thereafter contracted as debt service became unsustainable. A public sector of this size is unusual at this income level and it is arguably unsustainable and acts to limit economic growth. More recently, Zimbabwe has made efforts to improve its business climate. However, fiscal policy remains important to addressing development challenges and safeguarding social gains made since 2009.

This chapter sets the stage for later chapters discussing macroeconomic and fiscal policy challenges. The key challenges and policy options discussed in this chapter are summarized below.

CHALLENGES

1. Economic growth has fallen significantly, and remained negative in per capita income terms in 2016 due to the financial crisis. Such challenges call for fiscal reform.
2. Fiscal pressures increased between 2011 and 2016. The rapidly rising costs of employing public workers drove significant growth in expenditures, and crowded out non-salary expenditures.
3. The public sector in Zimbabwe consumes around half of all domestic resources. A public sector of this size is unusual at this income level and it is arguably unsustainable and acts to limit economic growth.
4. The effectiveness of fiscal policy has been constrained by significant and volatile extra-budgetary expenditures (particularly for SEPs). Only central government revenues and expenditures are subject to oversight in Zimbabwe. Other expenditures are audited, but reports are available with long time lags, limiting efforts to ensure the accountability of major expenditures.
5. Though generally effective and efficient, central government tax policy is inequitable, and indirect taxes make up an increasing share of tax revenues. Zimbabwe has limited room to improve tax buoyancy on a sustainable basis.
6. Zimbabwe has limited access to external financing and has lacked an effective debt management strategy. The lack of a debt strategy contributed to the arrears of the Reserve Bank of Zimbabwe (RBZ), and the more costly financing of SEPs over the short-term (rather than through phased, longer-term financing with better terms). The resulting lack of liquidity in the financial sector was a major cause of the financial crisis.

POLICY OPTIONS

Officials might consider the following reforms to improve the sustainability, accountability, and equity of Zimbabwe's fiscal framework:

Short-Term

- Review and revise the fiscal framework, in support of the needed fiscal reforms. The unsustainability of public finances, in particularly the level and composition of public expenditures, needs to be addressed by better mechanisms for shaping fiscal policy-making. This includes spending reviews, higher efficiency of taxation, and fiscal rules to cap central government expenditure levels to central government revenues against GDP. Furthermore, the fiscal framework on the size and composition of service delivery funded extra-budgetary needs to be clarified.

- Improve management of the public sector wage bill, with a view to strengthening Zimbabwe's fiscal position and alleviating the liquidity crisis. Authorities might consider reducing the size of the public sector workforce, and decreasing salaries and benefits.

- Begin implementation of a debt management strategy, focused on:
  - Repaying IFI arrears, followed by a rescheduling of official external debt.
  - Linking debt management to the Government's fiscal cash position.

Medium-Term

- Continue to rollout the debt management strategy, focused on:
  - Improving transparency, particularly of financial securities.
  - Adopting a risk-maturity profile of debt.
  - Integrating all public sector debt records within a single debt registry managed by a debt management office.

- Better manage and track extra-budgetary sources, SEPs, and local authorities in the overall budget, particularly by:
  - Adopting an integrated accounting system incorporating all accounts operated independently by Ministries, Departments and Agencies, and those of local authorities and development partners.
  - Restructuring SEPs to improve service delivery and reduce costs. To-date, 27 of 107 SEPs have been identified for restructuring.

- Implement reforms to improve the equity of revenue collection and expenditure and revenue reforms. (Equitability)
  - Undertaking a comprehensive review of the equity of revenue mobilization and expenditure policies.
  - Examining measures to expand the income tax base and make the tax structure more equitable.
  - Better coordinating public spending with social safety nets, and private sector spending (user fees).

1 MACROECONOMIC DEVELOPMENTS

Zimbabwe's adoption in early 2009 of a multi-currency regime – effectively dollarization – enabled stabilization of domestic prices, but also limited control over macro-economic instruments and outcomes. Nevertheless, the dollarization of the economy, coupled with a commodity super cycle and appreciation of the South African Rand versus the US dollar, fueled a sustained boom and double digit economic growth through 2012.

After peaking in 2012, economic growth steadily decelerated. From 2012, the dollarization boom started to taper off. Economic growth retreated due to the end of the commodity supercycle, a depreciating South African Rand, and a decrease in bank lending. Declines in growth were partly offset

by a sharp recovery in agriculture in 2014. Yet as agriculture faltered due to the drought, economic growth fell to 1.1 percent in 2015 and declined further in 2016 (Box 1.1). In parallel, per capita income declined and inequality increased. The services sector was the main contributor to growth between 2011 and 2016 (see Figure 1.1). Zimbabwe's exports of goods and non-factor services declined between 2012 and 2016 as the country lost external competitiveness.

Box 1.1: Recent Economic Developments

Economic activity weakened in 2016, partly due to the continued drought and financial crisis. Economic growth in 2016 is estimated at 0.7 percent. The El Niño induced drought coupled with a decline in agricultural productivity caused the agricultural sector to shrink by 3.7 percent in 2016. Meanwhile, the impact of the financial crisis decreased growth in the service sector to 1 percent after steady growth of over three percent annually from 2011 to 2015. Growth of the industrial sector remained subdued. The contraction in the economy reduced investment by 8 percent in 2016 from about US$2.4 billion in 2015, and private consumption by 0.3 percent. Deflation continued but at a slower pace in 2016. Annual deflation averaged -1.6% in 2016 from -2.4% in 2015.

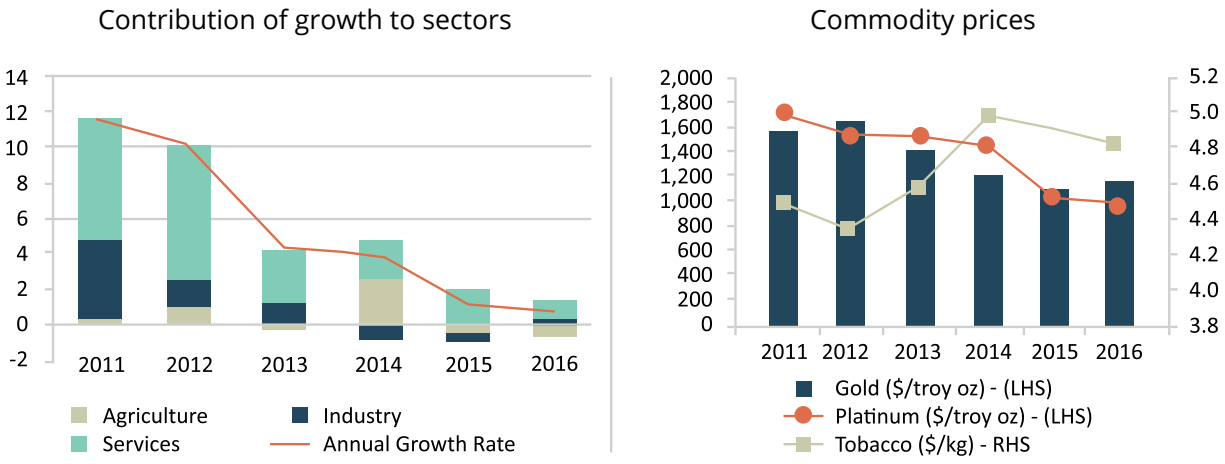
The financial crisis continues to dampen economic prospects. The crisis stems from a large increase in Government borrowing from March 2015 to June 2016 from the banking sector, primarily to pay the Reserve Bank of Zimbabwe (RBZ) and select State-Owned Enterprises (SEPs) arrears. The Government borrowed about US$1.4 billion, or about 10 percent of GDP, mostly by issuing treasury bills. Sold at a discount to banks, the treasury bills boosted bank profitability. However, the scale of borrowing led to severe liquidity shortages in the financial sector. As a result, daily limits were placed on cash withdrawals, and the RBZ issued bond notes beginning in November 2016. The total amount of bond notes in circulation increased by 21% to US$88 million in February from US$73 million as of 31 December 2016. These measures resulted in further outflows of dollars from the formal sector. Moreover, while the domestic -interbank payment system continues to function, cash payments receive a discount compared to payment in interbank dollars.

As a consequence, Zimbabwe's external position adjusted significantly. The current account deficit narrowed further in 2016. Imports are estimated at US$5,163 million in 2016 down from US$5,980 million in 2015 – about 14 percent lower – due to the rising cost of capital and the temporary restrictions on imports of good competing with local production, which were imposed by the Government in June 2016. On the other hand, exports increased by 2.3 percent to US$3,707 million in 2016, in spite of a lack of credit and continued drought.

The financial crisis has led to a significant deterioration in the GoZ's fiscal position. The Central Government deficit increased to 10 percent of GDP in 2016 from 3 percent of GDP in 2015, driven by contracting revenues and increasing expenditures. Fiscal revenues declined by about six percent, driven mainly by a drop in import-based fiscal revenues, such as customs duties and the value added tax. As government borrowing from banks and non-bank financial institutions has reached its limit, emergency short-term measures are needed to ensure the Government can balance the budget. Meanwhile, the lack of credit has adversely impacted private debt. In particular, private external arrears have increased due to irregular payments for imports.

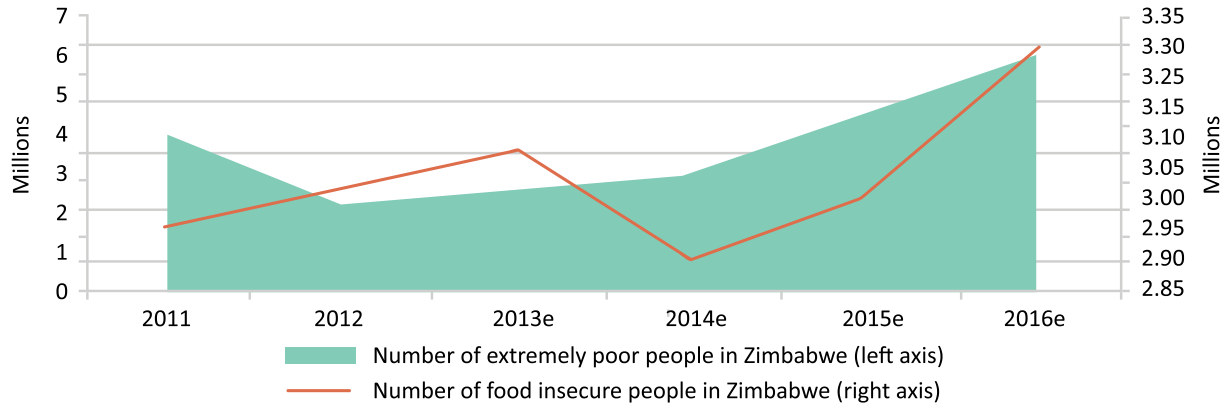
The drop in agricultural output linked to the drought increased poverty. The number of extremely poor people is estimated to have increased to 3.36 million in 2016, up from 3.22 million in 2015 (Figure 1.2). The number of people with food insecurity will increase to over 4.4 million people by 2017 (ZimVac).

Figure 1.1: Sector Growth and Commodity Prices, 2011-16



Source: Ministry of Economic Development and World Bank- Global Economic Monitor.

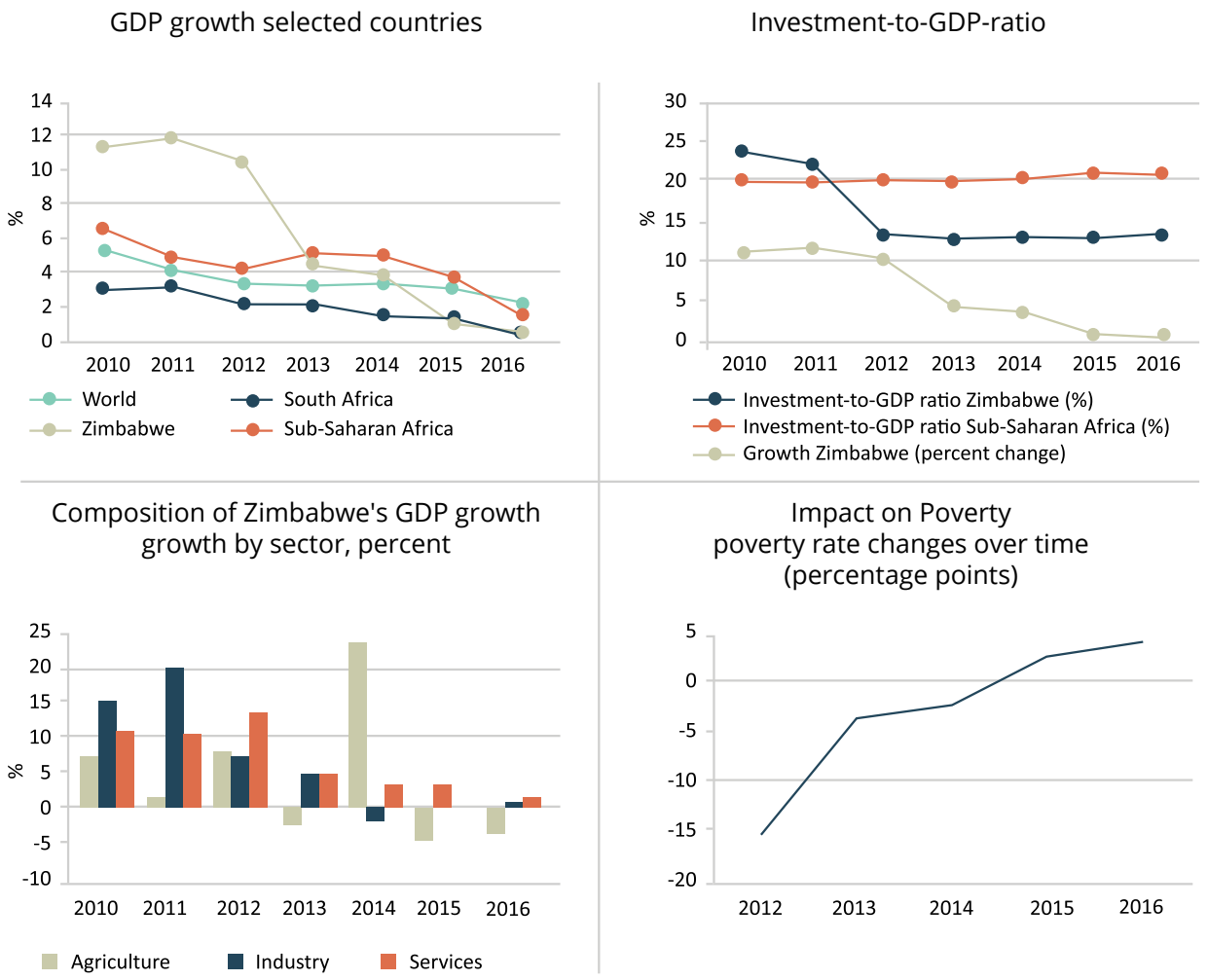
Figure 1.2: Poverty Rates Increased After Falling in 2014



Source: World Bank Macro Poverty Outlook, October 2016, Washington.
e: World Bank Staff Estimates

The decline in economic growth in 2013 mirrored a sharp preceding fall in investment, as shown in Figure 1.3. In 2010 and 2011, Zimbabwe's investment-to-GDP ratio exceeded the average for Sub-Saharan Africa, but has been about a third lower than this average since 2012. A lack of investment – particularly in irrigation and utilities – may have increased the volatility of GDP. Agricultural output was particularly unstable as it relied on favorable weather conditions, while services growth remained stable.

Figure 1.3: GDP Growth, Investment and Poverty, Selected Countries 2010-16



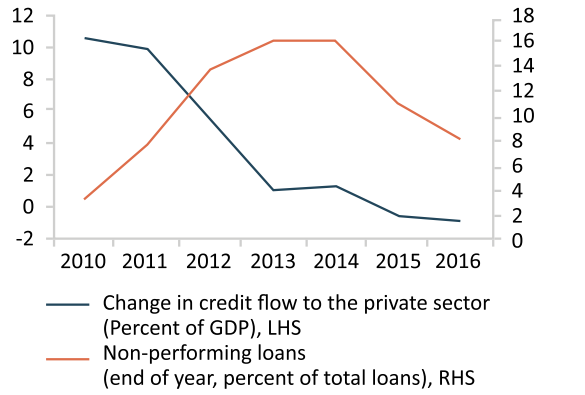
Source: Author's calculations from MoFED and RBZ data.

The decline in the investment-to-GDP ratio corresponded with a significant reduction in domestic bank credit (Figure 1.4). Domestic bank lending strongly recovered after dollarization in early 2009, but NPLs started to increase sharply in 2011 and 2012 as debtors were unable to service liabilities. Banks subsequently tightened lending standards and raised lending rates, which drove a drop in the flow of bank credit-to-GDP ratio from almost 10 percent in 2010 and 2011 to less than one percent in 2013 – before starting to recover in 2015. As domestic bank credit declined, cross border lending increased dramatically in 2013 and 2014. The availability of foreign loans kept the current account deficit high despite a decline in investments in 2012. The recovery in bank lending in 2014 and 2015 coincided with a decline in net cross-border borrowing, and a narrowing in the current account deficit. The shift from financing domestic production to imports, and back to domestic production, affected the tax base and tax collections.

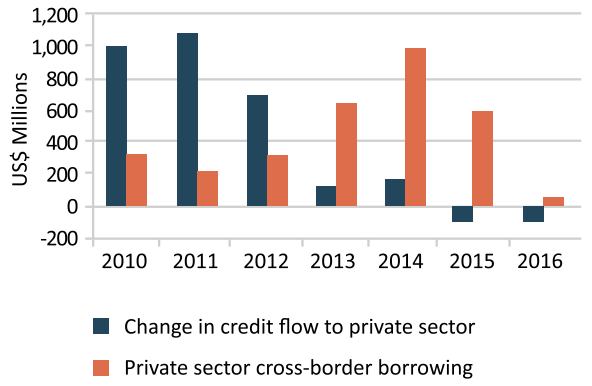
The banking sector has shown signs of stress since early 2016. Depositors have been unable to fully access their money from banks while bank lending remains fragile. The cash crisis may be explained partly by excessive government borrowing from the banking sector, poor bank asset quality, and balance of payment (BOP) pressures. Poor lending may be due to high interest rates. Taken together, such factors negatively affect growth prospects.

Figure 1.4: Bank Lending and Current Account Indicators, 2010-16

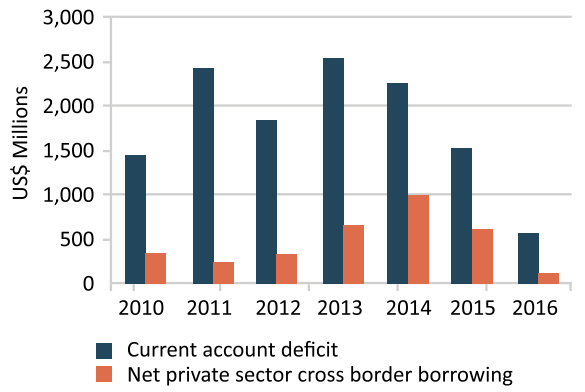
After a sharp fall during 2011-13 when NPLs increased, banking lending continues to stagnate



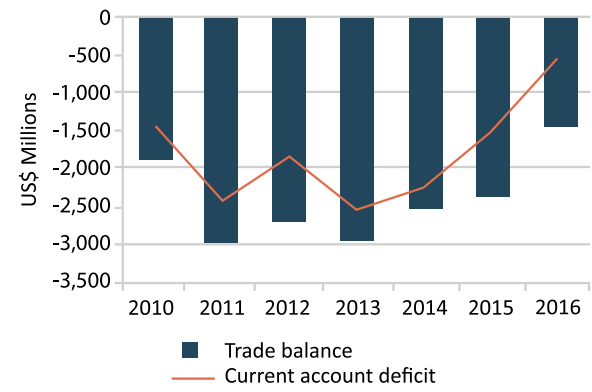
The fall in bank lending may have contributed to borrowing abroad during 2013-15



Borrowing abroad may have boosted imports, widening the current account deficit



The trade balance is the driving force behind the current account deficit



Source: Ministry of Finance and Economic Development and Reserve Bank of Zimbabwe.

Purchases of NPLs by an asset management company, which were backed by a fiscal guarantee, contributed to the decline in NPLs and – indirectly – bank lending. In 2014 and 2015, the Reserve Bank of Zimbabwe (RBZ) tightened banking supervision standards, closed six banks that did not meet new standards, and established the Zimbabwe Asset Management Company (ZAMCO) to purchase NPLs from commercial banks. ZAMCO is owned by the RBZ, which guarantees its liabilities.[1] Besides bolstering bank balance sheets by purchasing NPLs through ZAMCO, the RBZ used moral suasion to get banks to reduce lending rates.

From end-2014, government purchases of bank debt more than doubled domestic debt. Most of this was held by commercial banks, crowding out lending to the private sector (Figure 1.5). At present, 80 percent of the government's domestic debt is held by commercial banks, which report at face value even when purchasing debt at a discount. Government debt to the banking system increased rapidly since March 2015, accounting for over 40 percent of all bank deposits. However, with limited access to foreign capital markets, Zimbabwe's banking sector was required to absorb government debt stocks of some 15 percent of GDP. The resulting lack of liquidity led to a financial crisis, which severely restricted bank lending to the private sector.

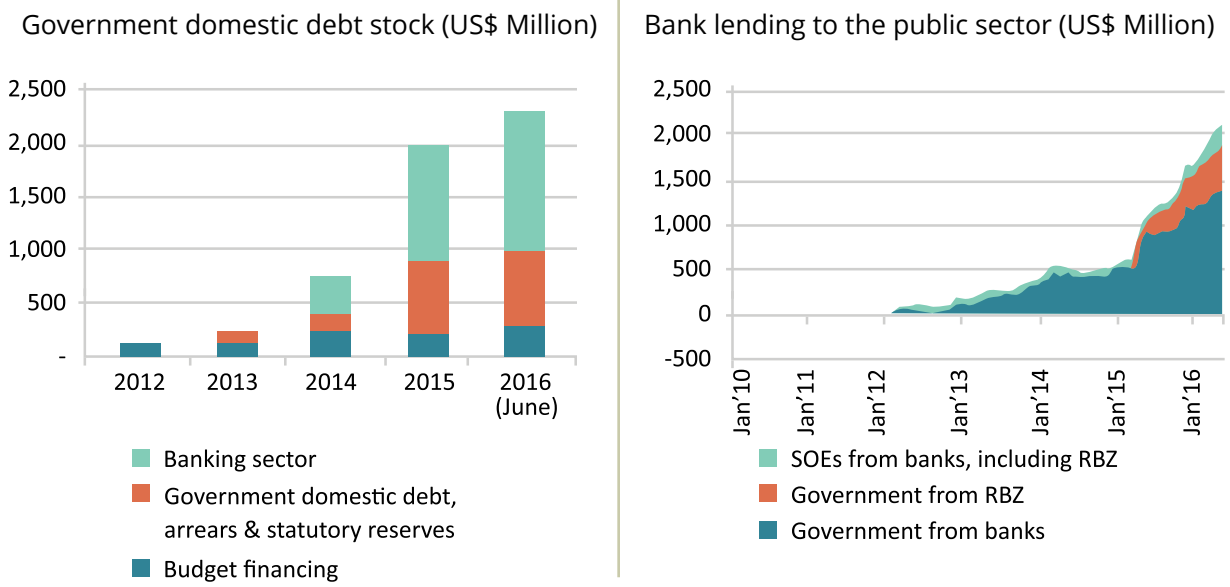
Weak bank lending has contributed to falling demand and deflation. Since, 2013, declining bank credit has caused demand and inflation to fall, starting a deflationary period (see Figure 1.5 and Figure 1.6).

[1] Indirectly, these liabilities are guaranteed by the Ministry of Finance and Economic Development (MoFED), which in 2015 assumed the RBZ's legacy debt. Explicitly guaranteed debt is recorded in the debt database at the MoFED, however, implicit guarantees are not.

Figure 1.5: Government Domestic Debt and Banking Lending to the Public Sector, 2010-June 2016

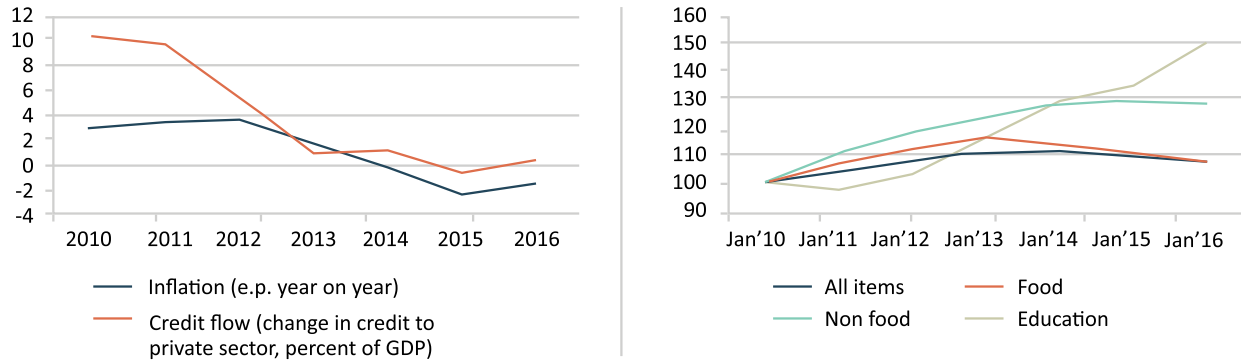
Government domestic debt increased as it recapitalized and funded the arrears of the RBZ, and funded ZAMCO

But most government debt was held by the banking sector, crowding out private sector lending



Source: Author's calculations from MoFED and RBZ data.

Figure 1.6: Inflation and Credit, 2010-16



Source: Ministry of Finance and Economic Development, ZIMSTAT and RBZ.

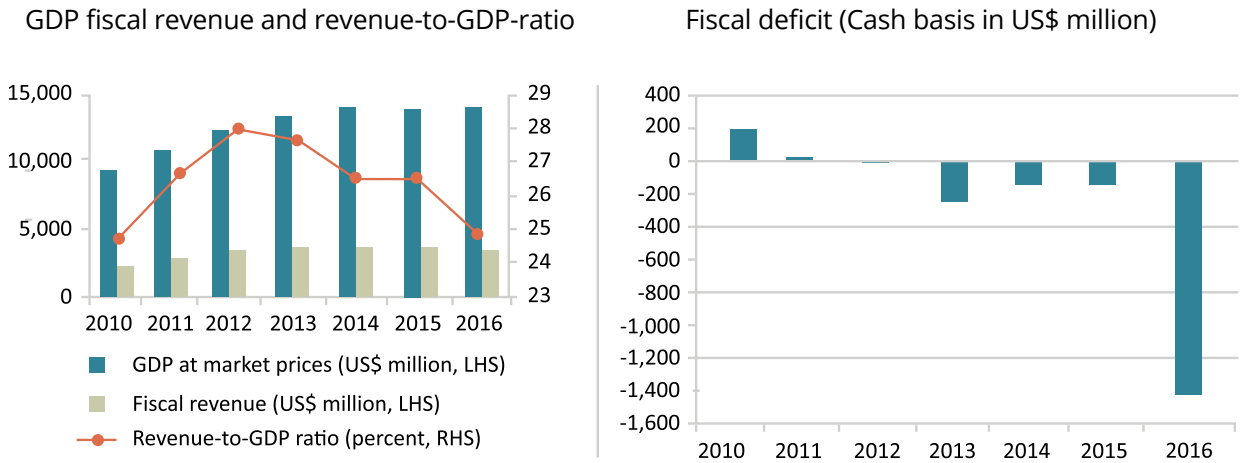
2 REVENUE MOBILIZATION

This section assesses revenue mobilization from three perspectives: effectiveness, efficiency, and equity. Zimbabwe is efficient in mobilizing fiscal revenues, and has one of the highest revenue-to-GDP ratios in Africa. However, increasing reliance on indirect taxes raises equity concerns. In principle, the size of the public sector raises concerns about economic growth, as a large public sector tends to crowd out private sector economic activities. However, this chapter does not offer a quantitative assessment of the crowding out effect of the public sector.

The level and composition of revenues and expenditures remain important fiscal policy instruments, given the country's limited borrowing options. After dollarization in 2010 and 2011, Zimbabwe opted for a modest countercyclical fiscal policy, leaving its policy options constrained by limited access to national and international capital markets. Though Zimbabwe's overall fiscal policy was set, authorities had significant options for changing the composition of revenue and expenditure.

Zimbabwe's revenue collection recovered significantly between 2011 and 2015. Fiscal revenues, as reported by the central government, and excluding extra-budgetary funds, rose from 24.8 percent of GDP in 2010 to 28 percent in 2013 – before stabilizing at about 26 percent of GDP between 2014 and 2016 (Figure 1.7).

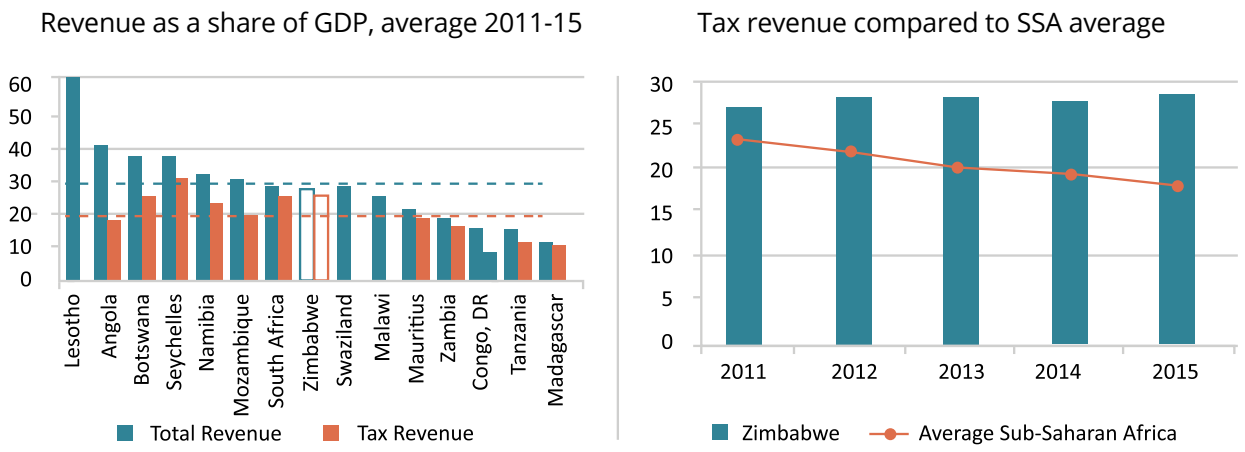
Figure 1.7: Fiscal indicators, 2010-16



Source: Ministry of Finance and Economic Development.

Zimbabwe's revenue-to-GDP-ratio is comparable to most regional peers, averaging around 25-28 percent of GDP between 2011 and 2016. Most countries in the Southern Africa Development Community (SADC) that performed better than Zimbabwe are in the Southern African Customs Union (SACU) – Lesotho, Botswana, Namibia, and South Africa. However, Zimbabwe's revenues understate actual revenue, since revenues excludes extra-budgetary funds and revenues for local governments (Section 1.4).

Figure 1.8: Revenue, Total and Tax Revenue to GDP Ratio

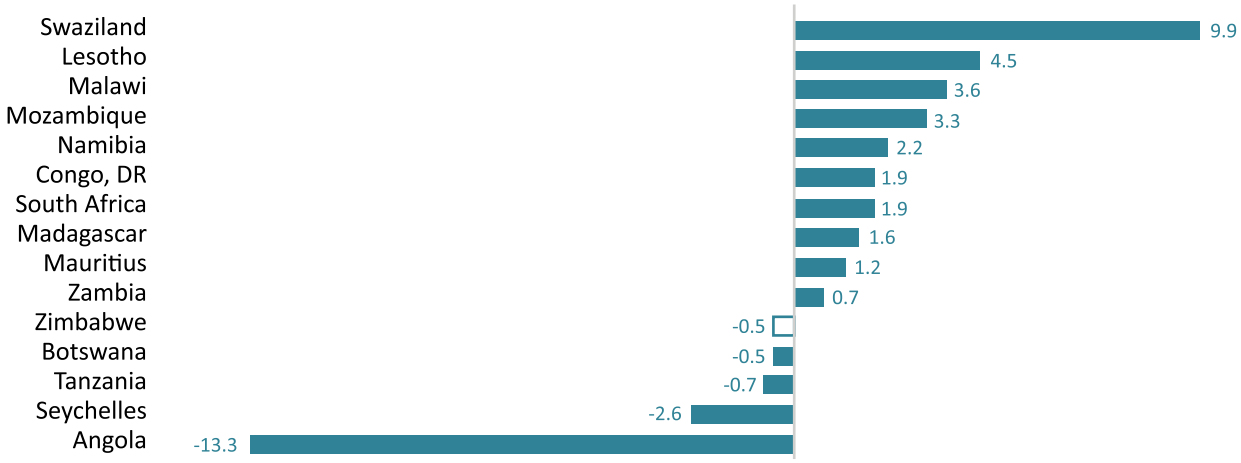


Note: Total Revenue average for five years including estimates.

Source: Ministry of Economic Development and World Bank.

In terms of revenue growth in SADC, five countries, including Zimbabwe, registered negative revenue growth in the five year period under review. Revenue collection as a percentage of GDP declined, on average, by 0.5 percentage points in Zimbabwe (Figure 1.9). Angola was the worst performer, registering an average decline of 13 percent. Swaziland was the best performer, recording an average increase of about 10 percent.

Figure 1.9: Revenue Growth, in Percentage Points, 2011-15



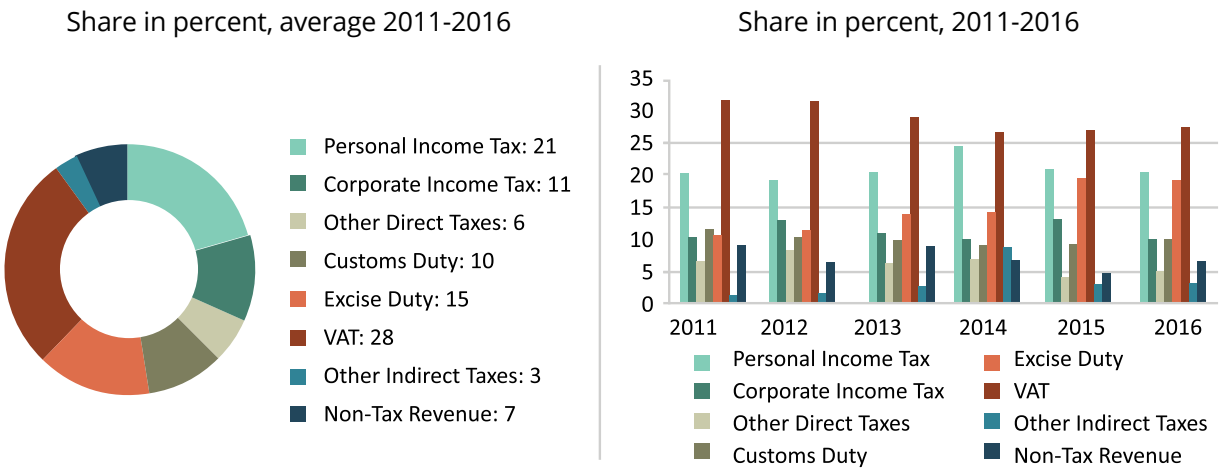
Source: IMF WEO database.

Tax revenue collection in Zimbabwe, as a percentage of GDP, was the second highest among SADC countries between 2011 and 2015. Zimbabwe's collection was relatively high at 25 percent of GDP, second only to the Seychelles, while the SADC's average was 19 percent in the same period (Figure 1.8).

Indirect taxes, mainly VAT and custom duties, have come to dominate tax revenue. Indirect taxes have significantly increased since 2011, excluding a temporary slump in 2014. More specifically, trade taxes have benefited from a recent raise in import duties to support local production.

The VAT was the largest source of tax revenues for the GoZ, averaging 28 percent of total revenue from 2011 to 2016 (Figure 1.10). The VAT is collected from imports and domestic sales. However, a slowing economy resulted in falling growth in VAT revenues. Between 2014 and 2015, the VAT increased only slightly, mainly from an increase in revenue collected on higher imports. The second and third largest contributors to total revenue were the personal income tax (PIT) and excise duty, which averaged 21 and 15 percent of revenue, respectively. The growth of excise tax revenue from 2013 is partly due to an increase in excise duty rates for petrol and diesel, and a high rate of general consumption of fuel products. The share of non-tax revenue remained low – averaging only seven percent of total revenue between 2011 and 2016.

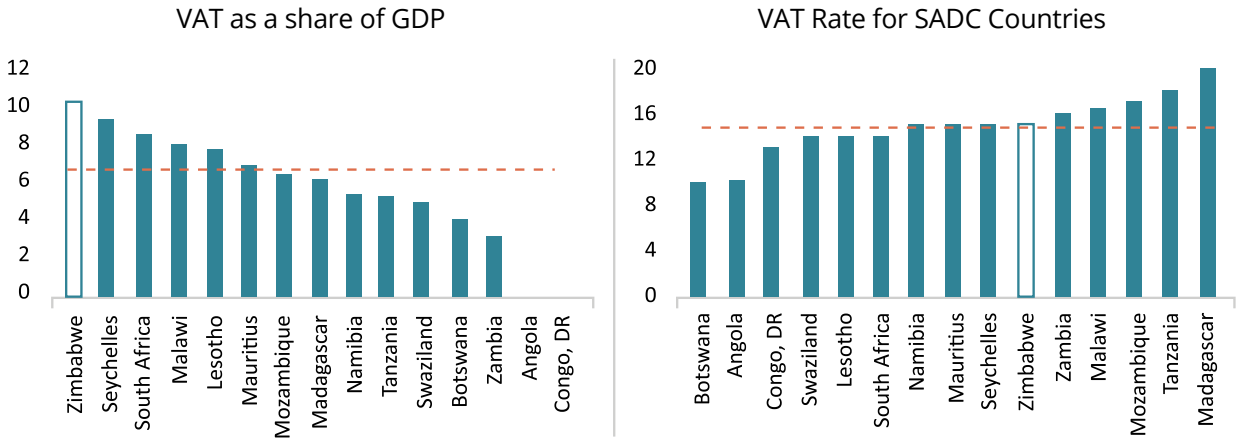
Figure 1.10: Composition of Revenue



Source: MoFED.

Zimbabwe leads SADC countries in VAT collection as a share of GDP. Averaging about seven percent of GDP, Zimbabwe's collection is more than 50 percent above the SADC average and close to double Zambia and Botswana's collection. In terms of VAT rates, SADC countries range from a low of 12 percent in Botswana to a high of 20 percent in Madagascar (Figure 1.11). Zimbabwe's VAT rate is among the top six at 15 percent – the required rate under SADC macroeconomic convergence criteria. Fewer exemptions and better compliance have made Zimbabwe the leader in VAT collection as a share of GDP.

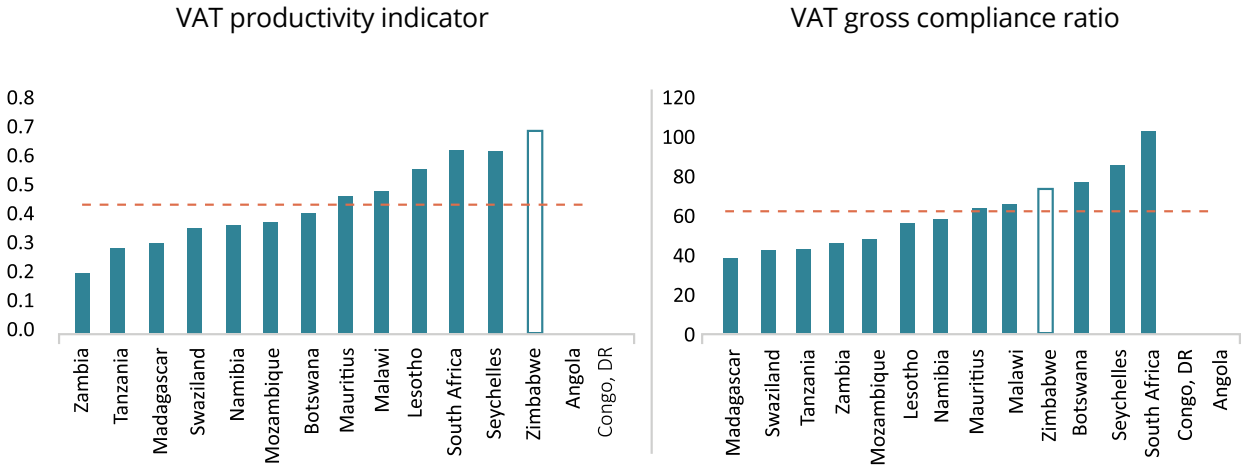
Figure 1.11: VAT SADC Countries



Source: USAID Collecting Taxes Database, 2012-13.

Zimbabwe also ranks high as measured by the VAT productivity indicator.[2] In the VAT gross compliance ratio,[3] which measures the gap between potential and actual collection of revenues, Zimbabwe ranks among the top four SADC countries (See Figure 1.12).

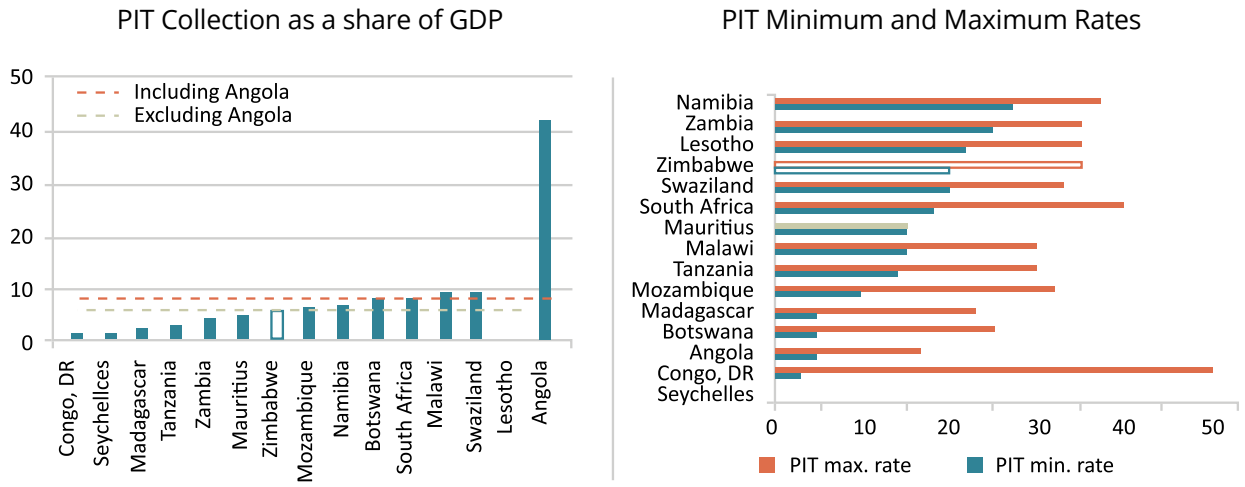
Figure 1.12: VAT Productivity



Source: USAID Collecting Taxes Database, 2012-13. No data available for Congo DR and Angola.

PIT is the second largest contributor to tax revenue in Zimbabwe, averaging about 21 percent of such revenue. PIT revenue surged from $588 million in 2011 to US$770 million in 2015. However, Zimbabwe's PIT collection as a share of GDP is slightly below the SADC average (Figure 1.13). PIT revenues have been negatively affected by retrenchments and reductions in remuneration packages over the years. Though Zimbabwe has PIT minimum and maximum rates higher than the averages in SADC, this is offset by lower PIT productivity. The latter suggests a poor capture of the PIT tax base, because of relatively generous exemptions and reliefs, and/or taxpayers in certain sectors, such as independent professional service providers, not fully integrated into the tax system.

Figure 1.13: PIT Collection



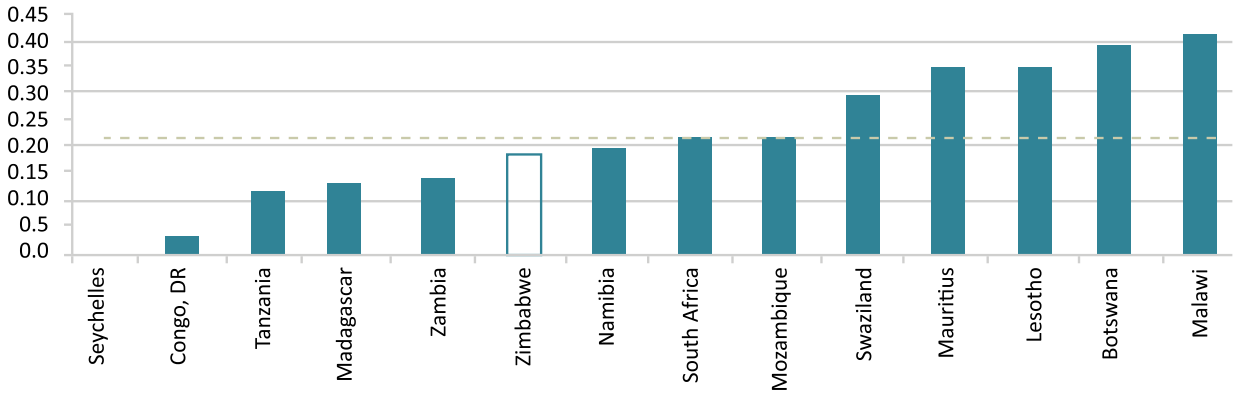
Source: USAID Collecting Taxes Database, 2012-13.

[2] VAT productivity: This is a tax revenue performance indicator. It represents how well the VAT produces revenue given the prevailing tax rate. It is calculated by taking VAT receipts as percentage of GDP and dividing it by the standard VAT rate.

[3] VAT Gross Compliance Rate measures of how well the VAT produces revenue for the government. It is more refined than VAT productivity, since it takes into account the fact that VAT is mostly only applied to final consumption by households and individuals. It is calculated by dividing the ratio of VAT revenues to G by the product of total private consumption and the VAT rate.

In line with the findings in Figure 1.14, Zimbabwe's PIT productivity[4] is below average compared to SADC countries.

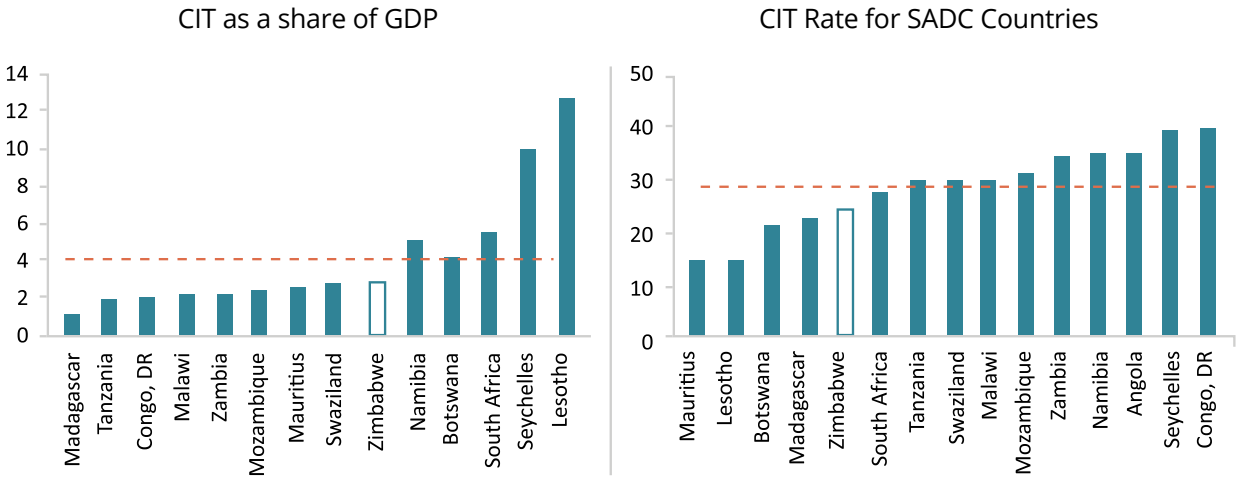
Figure 1.14: PIT Productivity for Select SADC Countries



Source: USAID Collecting Taxes Database, 2012-13. No data available on Angola.

The Corporate Income Tax (CIT) constitutes about 11 percent of collected tax revenue. In recent years, the CIT has grown substantially from a low of about US$296 million in 2011 to US$479 million in 2015. Nevertheless, the CIT productivity[5] and as a share of GDP is relatively low compared with SADC countries (Figures 1.15 and 1.16). Reasons for this include lower corporate tax rates than SADC averages, low corporate profitability, and the closure of some companies during this period. Though foreign investments and their contribution to CIT remain relatively low, tax incentives for foreign capital investments and other allowances for corporations may have lowered CIT revenue. In recent years, however, the Government has standardized CIT rates and repealed preferential rates for various classes of corporate income taxpayers, which no longer reflect policy priorities.

Figure 1.15: CIT Collection

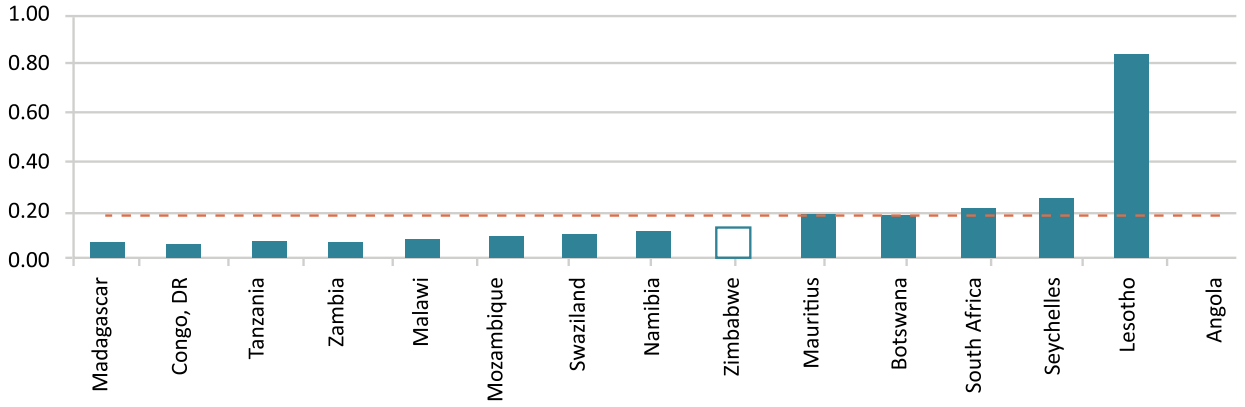


Source: USAID Collecting Taxes Database, 2012-13.

[4] PIT productivity: This is a tax revenue performance indicator. It provides an estimate of how well the personal income tax is doing in terms of producing revenue given the personal income tax rate structure. It is calculated by dividing the actual personal income tax revenue as a percent of GDP by the average PIT rate. The average PIT rate is a weighted average of the lowest and highest marginal personal income tax rates, with weights equal to the levels at which these rates begin to apply.

[5] CIT productivity: This is a tax revenue performance indicator. It represents how well the corporate income tax produces revenue given the prevailing tax rate. It is calculated by dividing the ratio of total corporate income tax revenues to GDP by the general corporate income tax rate.

Figure 1.16: CIT Productivity for Select SADC Countries



Source: USAID Collecting Taxes Database, 2012-13 (No data available on Angola).

The increased emphasis on indirect taxation may raise vertical equity concerns. Over recent years, authorities have tried to mitigate this impact by adopting progressive income taxes and zero rating for some products (Box 1.2). However, the government only uses tax expenditures to a limited extent. A further assessment of equity under current taxation, and the needs for any adjustments, may also be included in the in-depth analysis as suggested in earlier paragraph.

In conclusion, indirect taxes have a higher tax performance and productivity than direct taxes, and account for most tax revenues in Zimbabwe. Going forward, further analyses and review of income taxation – personal, corporate and eventually also property – might help ensure a sustained, high tax-to-GDP revenue generation. Based on secondary sources, this PER prepared an initial assessment, which points to separate, in-depth analyses of taxation in Zimbabwe. With reference to the relatively low yield ratios, such analyses could assess ways to improve tax buoyancy, to ensure economic development is reflected directly in improved tax revenue. The analysis could also focus on broadening the tax base as tax rates are already high by regional standards. The country's tax rate structure has remained relatively stable, witnessed by the fact that the VAT rate has stayed at 15 percent since 2009, and corporate rates have remained at 25 percent since 2010. In terms of a need for rebalancing the structure between direct and indirect tax revenues, the revenue from indirect taxes on imports may come under pressure from future requests for trade liberalization. This has been observed in SADC countries, where efforts to liberalize trade through reduced and harmonized duty rates have led to shrinking revenues from import taxes. Furthermore, the review may include an assessment of equity under current taxation, and needs for any adjustments.

Box 1.2: Progressive Income Taxation

The Government has gradually adjusted the tax-free threshold from US$100 in early 2009 to US$300 in 2015, accounting for the cost of living and general welfare of the population. A key motive has been to improve taxpayers' disposable incomes. In complement, authorities have substantively flattened tax bands.

The threshold for the highest personal income tax rate has also been adjusted upwards. The highest rate of 50 percent is now applied to those earning above US$20,000.

Moreover, to protect extremely poor households, the government has exempted many basic commodities from the VAT, such as mealie-meal, meat, vegetables, and sugar.

Yet by applying a flat, relatively low VAT rate, and zero-rating basic commodities, the GoZ may be foregoing substantial revenue. The higher the level of income, the higher the revenue foregone,

and hence the higher the absolute subsidization of these income groups. Though modifications in the VAT rates and base may be less efficient in redistributing wealth, such modifications remain entry points as long as the GoZ faces difficulties and constraints in implementing targeted spending instruments (e.g., conditional cash transfers).

3 PUBLIC DEBT

Zimbabwe's large public debt burden is a significant constraint on economic growth. By severely restricting and elevating the costs of accessing international capital markets, it limits fiscal policy options. The large public debt burden means the private sector faces a higher cost of capital, particularly as Zimbabwe does not have access to risk mitigating instruments. Meanwhile, the public sector's exclusion from most international capital markets makes it vulnerable to fiscal shocks as domestic capital markets are small—as was witnessed in 2016.

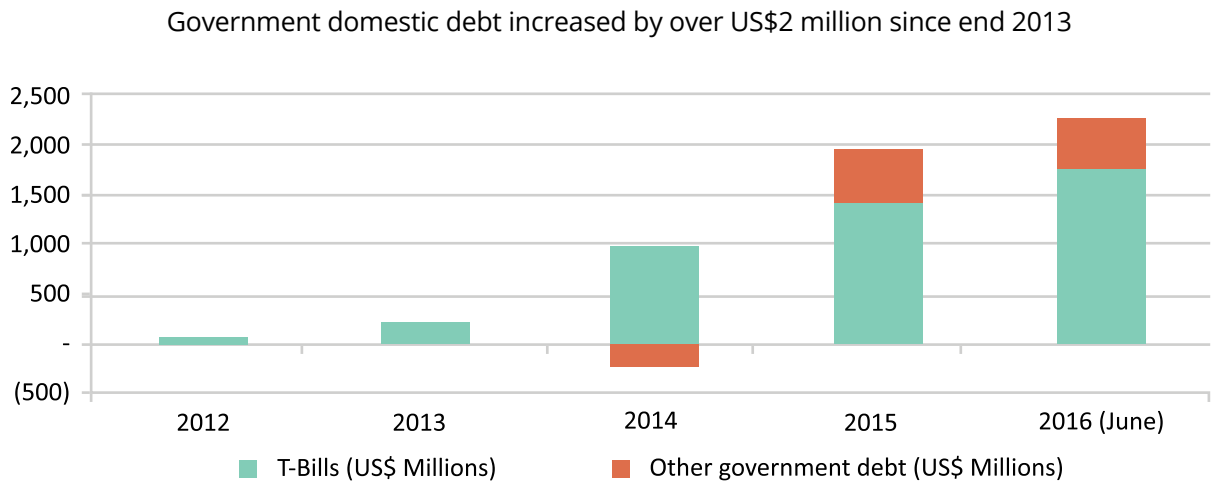
At present, Zimbabwe is servicing its domestic debt, but continues to accumulate arrears on most of its external debt. As of October 31, 2016, Zimbabwe's public and publicly guaranteed debt totaled US$11.2 billion, or around 79 percent of GDP. External and domestic public debt, as a share of total public debt, constituted 67 and 33 percent respectively (Table 1.1).

A large share of domestic public debt represents government legacy obligations. These obligations included the recapitalization of the RBZ, financing of ZAMCO, and assumption of RBZ non-core debt. Under the RBZ Debt Assumption Act, which was enacted on August 7, 2015, the government assumed an estimated US$690.5 million in domestic liabilities incurred by the RBZ before 2008. The claims were subject to validation, and then settled through issuance of long-term government securities.[6] The government also issued treasury bills in the domestic market through private placements on an ongoing basis, for resource mobilization and budget financing purposes.

The rapidly rising stock of T-Bills has deepened financial markets, but also drawn attention to the steep yield curve for government paper. There has been a significant rise in T-Bills—80 percent of which are held by commercial banks. Previously, the RBZ and other public sector arrears were not tradeable. However, the requirement to finance public arrears led the Government to pay arrears with T-Bills. Though the increase in T-Bills has deepened financial markets, its early stage of development means the market is opaque and volatile. Trading in T-Bills is legal, but pricing can be imprecise and not centrally recorded. T-Bills that come due may be financed by government borrowing from the banking system, and are reported as "other government debt". Going forward, the authorities are committed to supporting the development of transparent markets for T-Bills, which will provide benchmark interest rates for both the public and the private sector.

[6] Such as those offered by the official export credit companies, and the Multilateral International Guarantee Agency (MIGA).

Figure 1.17: Central Government Domestic Debt, Stock, End of Period, 2012-June 2016



Source: Ministry of Finance and Economic Development.

External debt accounts for the bulk of total public debt. Over half of external debt obligations (58 percent) is owed to bilateral creditors, as shown in Table 1.1. External debt currently stands at around US$7.5 billion, of which US$5.2 billion (70 percent) constitutes principal and interest arrears, including penalty interest.[7] These figures are similar to those published by the IMF.[8] Specifically, obligations to multilateral creditors stood at US$2.5 billion (34 percent of external public debt) as of October 2016. Of this amount, about 46 percent (US$1.16 billion) is owed to the World Bank; 24 percent (US$0.6 billion) to the African Development Bank (AfDB) and 8 percent (US$0.2 billion) to the European Investment Bank (EIB). Thus, the World Bank is Zimbabwe's principal external creditor, followed by China and Germany (Table 1.1).

Table 1.1: Public and Publicly Guaranteed Debt - October 2016 (US$ Millions)

	DEBT	ARREARS	TOTAL
Domestic Debt	3,716		3,716
External Debt	2,252	5,232	7,484
Bilateral Creditors	1,260	3,160	4,366
Paris Club	258	2,965	3,223
Non-Paris Club	1,002	141	1,143
Multilateral Creditors	526	2,019	2,546
RBZ-External	466	107	573
Total	**5,968**	**5,232**	**11,200**

Source: 2016 Budget Statement, MoFED.

[6] Such as those offered by the official export credit companies, and the Multilateral International Guarantee Agency (MIGA).
[7] A joint IMF and World Bank mission visited Harare, Zimbabwe in 2014 to conduct a loan-by-loan debt reconciliation exercise, and managed to reconcile the multilateral debt, and more than 80 percent of bilateral and commercial external debt dating back to December of 2013. However, a small percentage portion of the arrears, mainly penalty interest, remains subject to reconciliation.
[8] At the end September of 2015, approximately 40 percent of the $690.5 million of debt assumed had been validated and settled through the issuance of long-term (5 year) Treasury bonds (T-bonds) (IMF, 2nd Review of the SMP).

The 2016 joint World Bank-IMF Debt Sustainability Analysis (DSA) confirms that Zimbabwe's public debt is unsustainable. It continues to be in debt distress, which is consistent with the results of past DSAs. All external debt indicators breach their indicative thresholds under the baseline scenario, and many of them stay above the thresholds for more than ten years. As noted above, PPG external debt was at 79 percent of GDP as of 31 October 2016 – two and a half times the 30 percent threshold for weak policy performers. The IMF projects the debt to stay above 30 percent of GDP for the large part of the projection period (2016-2036). Further, the debt-to-exports ratio and the debt-to-revenue ratio were well above their respective thresholds in 2016. The alternative scenarios, which entail arrears clearance with international financial institutions, will see marginal improvements of these indicators.

Efforts to reengage and normalize relations with creditors and the international community have been intensified. Monthly payments of US$150,000 to the IMF have been complemented by pari passu payments to the World Bank and the AfDB, and a strategy for clearing arrears to other international financial institutions (IFIs) has been articulated. The strategy envisions simultaneous clearance of arrears with the IFIs using: (a) a bridge loan to facilitate payments to the AfDB and the International Development Association (IDA) and (b) a long-term loan from a bilateral lender to repay the International Bank for Reconstruction and Development (IBRD). On October 20, 2016, Zimbabwe cleared the IMF arrears. Clearance of World Bank and AfDB arrears remain to be implemented and the authorities plan to pursue traditional debt rescheduling under the umbrella of the Paris Club.

As part of their efforts to engage external creditors, the authorities are strengthening their debt management capabilities. Zimbabwe has recently enacted a new debt management law, the Public Debt Management Act, which was approved on September 11, 2015. The law provides a comprehensive framework for debt management, including a mandate to issue debt and guarantees, and requirements for developing a debt management strategy and reporting. The law also transforms the existing debt management office, outlining clear responsibilities around debt service, recording and validation. Since the law was enacted recently, implementation is pending in several areas, including the development of a debt strategy and the publication of a debt statistical bulletin. There will be an annual external financial and compliance audit. The internal audit process is at an early stage of development and is expected to commence in 2017.

4 FISCAL RISKS

This section reviews the main entities in Zimbabwe's government public finance management and outlines key fiscal risks. Zimbabwe has a sizeable public sector. However, the country publishes neither a consolidated balance sheet of its public assets and liabilities, nor a consolidated budget and expenditure statement. Though the Central Government produces annual accounts, a significant part of government finances are handled by subnational governments, and/or organized in extra-budgetary units.[9] Such entities do not produce financial reports regularly. Consequently, it is difficult to analyze and estimate financial performance of the entire public sector in Zimbabwe, and to compare Zimbabwe with SADC countries. Nonetheless, this section attempts to estimate financial flows for these individual entities and consider relevant fiscal risks.

[9] The 2014 Government Finance Statistics Manual (GFSM) provides the framework for a consistent classification of public sector activities and finances. For a definition of extrabudgetary units, including what their main purposes are, please refer to "Coverage and Sectorization of the Public Sector" GFSM Companion Guides, 2001, and "Definitions of Government in IMF-Supported Programs". Technical Notes and Manuals, IMF Statistics Department, 2013.

Risks Related to the Fiscal Accountability Framework

General government gross expenditures are particularly important to ensure the accountability and transparency of government services and other core functions. Public sector activities and management in Zimbabwe are split into two main categories: general government and public corporations. Public sector corporations are entities controlled or owned by a government, with assets held in corporate form, and operating in a business environment, such that most – if not all – revenues come from the sale of goods and services. The accountability and transparency of such entities are laid out in the corporate governance framework, as discussed in Chapter 6. The general government has a different accountability and transparency framework, where:

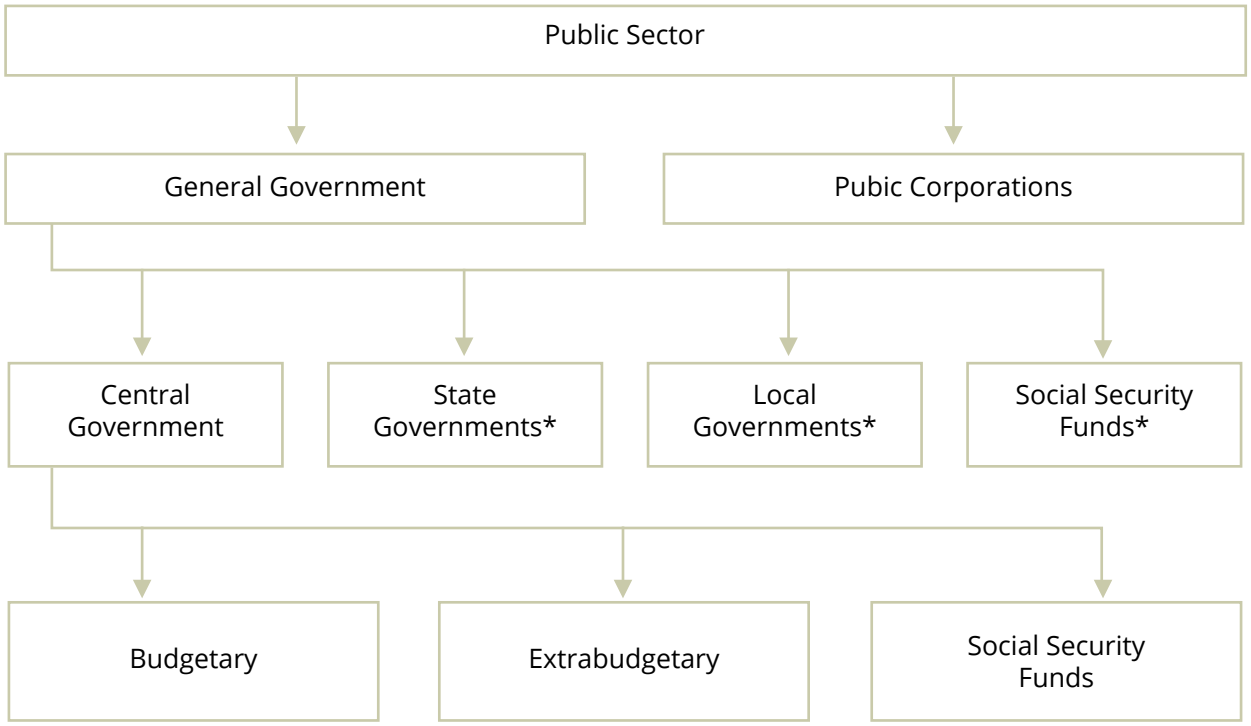
- The objectives, mandates and standards for public service delivery and other functions are regulated by law, and hence overseen by the Parliament and the public at large;
- The gross expenditures related to central government services, and the supporting gross revenues and funding sources, are adopted in the annual budget, and approved by the Parliament or local political councils; and
- Funding for public services is preferably global, and not ear-marked to specific sectors or services. Tax revenues, for example, are collected and made available for public service delivery prioritization, as the Cabinet, and ultimately the Parliament, see fit.

In such situations as Zimbabwe's, where the framework on general government services and related funding deviates from these principles, establishing a sound and robust accountability and transparency framework is difficult – if not impossible. Zimbabwe's practice of mobilizing significant parts of funding for services outside of the formal budget impairs efforts to ensure accountability of services. The Parliament's role, as well as the role of the public, is diminished when financing for public services is fragmented and lacks visibility. As discussed in this PER, serious concerns remain on the quality and robustness of public finance management in Zimbabwe. Challenges include the limited value of revenue and expenditure forecasts; inefficiencies in budget and financial management from fund fragmentation; and fiscal risks given uncertainty in gross expenditures and available financing.

Chart 1.1 outlines the makeup of Zimbabwe's public sector, including units not captured by the normal budgetary process. Zimabawe public sector includes: (a) Central Government; (b) Statutory extrabudgetary funds;[10] (c) Local Authorities; (d) State-owned enterprises; (e) Development partners; and, (f) Other extrabudgetary funds.

[10] As regards funding by development partners, unfortunately data did not document these funds in full

Chart 1.1: Composition of Public Sector



Source: excerpt from IMF (2014), *Government Finance Statistics Manual 2014,* op. cit.
* Budgetary units, extrabudgetary units and social security funds may also exist in state, provincial, and local governments.

This report discusses the public sector under the headings below and available information on public sector revenues is reported in Table 1.2:

- Central Government revenues and expenditures are discussed in chapters 2 and 3;
- Statutory Extrabudgetary Funds are discussed in chapter 2;
- Local Authorities are discussed in Volume 2;
- State-Owned Enterprises in Volume 3;
- Development Partners (DP) are not covered in detail in this report. DP report planned expenditures on a voluntary basis to the MOFED, which summarizes these expenditures in the budget. Financing from DPs of key services are based on their own priorities and often do not reflect the Government of Zimbabwe's priorities. This risks over-concentrating resources or creating gaps in services due to changes in DP priorities; and
- Other Statutory Funds cover mostly health and education. Education is discussed in detail in Volume 4.

Table 1.2: Public Sector Revenues, 2011-15, (US$ Million, Unless Otherwise Indicated)

	2011 Act.	2012 Act.	2013 Act.	2014 Act.	2015 Est.
Revenues (i)	6,657	8,017	7,679	7,933	n.a.
Central Government (ii)	2,921	3,496	3,741	3,770	3,738
Statutory Extra Budgetary Fund (iii)	n.a.	n.a.	n.a.	n.a.	542
Local authorities (iv)	570	608	693	804	n.a.
State-owned enterprises (v)	3,462	4,067	4,325	4,194	n.a.
Commercial	2,616	2,922	3,043	2,806	n.a.
Parastatal	846	1,145	1,282	1,388	n.a.
Development partner (vi)	1,228	1,682	1,034	1,104	1,181
Resources mobilized and spent at source (vii)	675	746	811	772	807
Health	201	206	210	208	207
Education	474	540	601	564	600
	Percent of GDP				
Pro Memoire: Unconsolidated public sector revenues, excluding government transfers (i)	60.8	64.3	56.9	55.9	n.a.

Notes: (i) Excludes transfers from central government and assuming half of SEP and parastatal revenues are mobilized from the public sector;
(ii) Estimates of revenues and expenditures by the Central Government are available from the Public Finance Management Information System. Trends in these revenues and expenditures are discussed in chapters 3. The systems that are used are covered in Chapter 5;
(iii) The figure in 2014 reflects a reclassification rather than a budgetary exercise. Starting in Fiscal Year 2015, revenues and expenditures by Statutory Funds are included in the budget estimates reported to Parliament. Trends on these expenditures are included in Chapter 3;
(iv) Local Authorities mobilize and spend resources and are audited annually. Information is available up to 2014 due to delays in preparing audit reports. A detailed assessment of these revenues and expenditures is presented in Chapter 6;
(v) There are two categories of public enterprises: commercial state-owned enterprises and parastatals that deliver public services. Both charge for services and are audited annually. Information is available up to 2014 due to delays in preparing audit reports. A detailed assessment of these revenues and expenditures is presented in Chapter 6;
(vi) Development partners' flows are reported as humanitarian assistance and official transfers in the Balance of Payments prepared by the Reserve Bank of Zimbabwe;
(vii) Revenues and expenditures mobilized and spent at source are estimated on the basis of the share of health and education expenditures in private consumption. Actual data are available for 2012. This data is extrapolated for 2011 and 2013-15 on the basis of price developments on these expenditures as reported in the CPI. Revenues and expenditures in the primary and secondary education sector are discussed in Chapter 8.

Source: Ministry of Finance and Economic Developments, Reserve Bank of Zimbabwe and author's calculations.

Though available data allow reporting aggregate public sector revenues, consolidated revenues are expected to be significantly lower, except for the public sector wage bill.[12] Central Government accounts for under half of revenues. However, there has been a large increase in revenues generated by state-owned enterprises and local authorities. Aggregate public sector revenues are more than 60 percent of GDP (Table 1.2). However, estimates suggest that the share of the consolidated public sector fell slightly from over 60 percent in 2011 to just under 56 percent in 2014. Of this, it is estimated that the aggregate public sector wage bill reached over 28 percent of GDP in 2014 (see Table 1.3).[13] the latest year for which data are available.

Table 1.3: Public Sector Wage Bill Estimates, 2011-14 (US$ Millions)

	2011	2012	2013	2014
Central Government	1,834	2,504	2,767	3,040
Local authorities	232	286	430	505
State-owned enterprises	382	443	481	492
Commercial	328	374	404	405
Parastatal	54	69	77	87
Public sector wage bill (US$ million)	2,448	3,233	3,678	4,037
Pro-memoire (percent of GDP)	22.3	25.9	27.3	28.4

Source: Ministry of Finance and Economic Development and author's calculations.

Fiscal Risks

Limitations on data constrain a full estimation of fiscal risks, but available information allows us to identify key issues. Certain risks emanate from the fact that management of public resources is dissipated over different agencies with limited coordination and/or information sharing. This gives rise to issues of sustainability, accountability, transparency, and equitability.

Sustainability

The data suggest that the public sector in Zimbabwe consumes around half of all domestic resources. A public sector of this size is exceptional at this income level. Certain developed countries have public sectors of this size, but these tend to have open trade policies, transparent public entities, strong oversight, and often more external competition. As Zimbabwe does not fully share such characteristics, the country's public sector is arguably unsustainable and acts to limit economic growth.

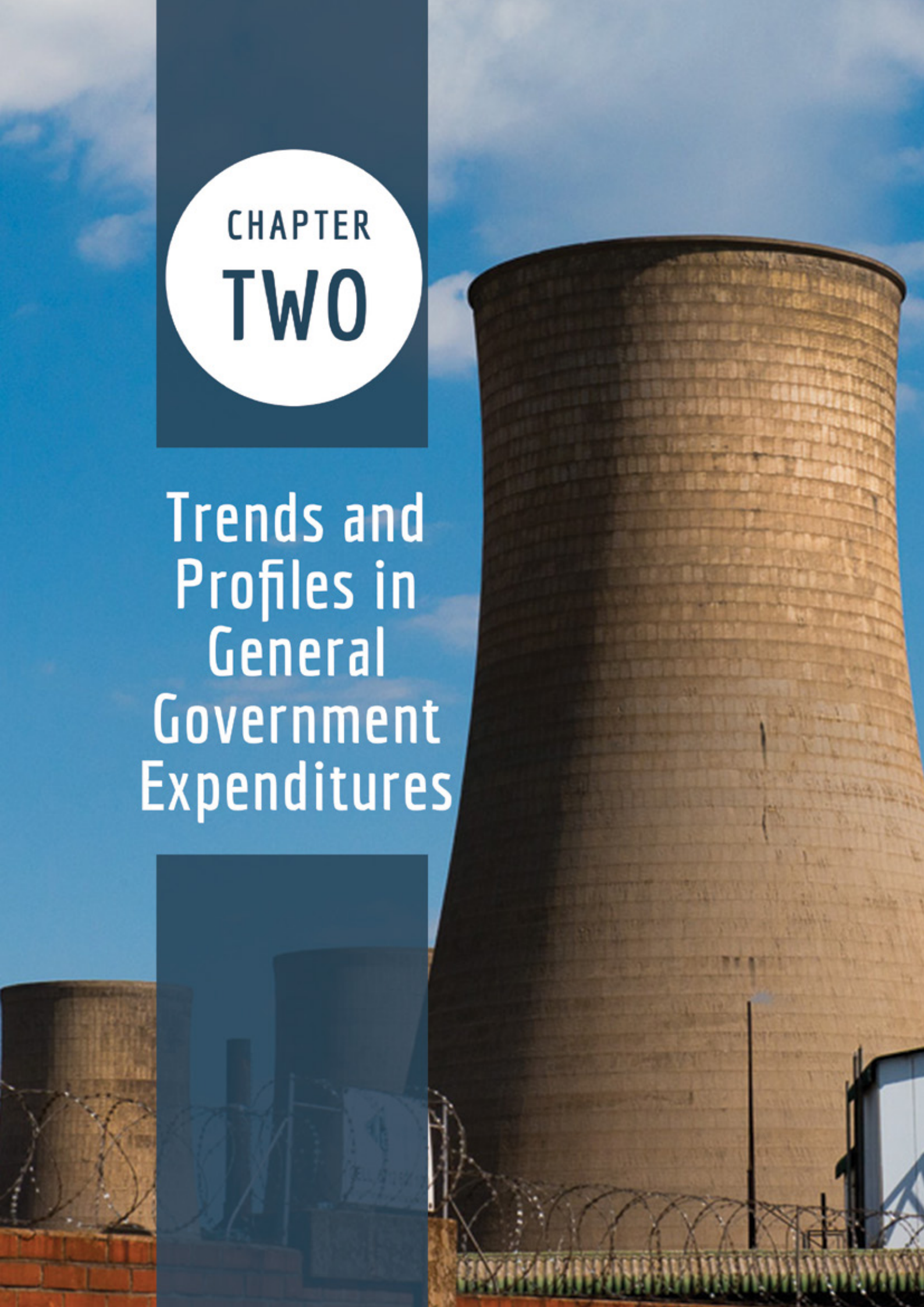
Specifically, the size of the public sector primarily reflects a large public sector wage bill. The share of public wages as a share of spending is not compatible with a sustainable fiscal position in the medium-term, nor with providing public goods and services. At present, public sector wages have been sustained by selling public assets. This is discussed in chapters 5 and 6 in further detail.

[12] The following assumptions are made to arrive at these estimates, namely: aggregates exclude central government transfers to parastatals and SEPs, but include revenue flows among SEPs; half of SEP and parastatals sales are to other public sector agencies.
[13] Recent wage bill data is available for the central government wage bill, as discussed in chapter 4, but not for the local government and SEP/parastatal wage bill, which is based on audited data, as discussed in chapters 6 and 7.

Transparency
Though Central Government accounts are published regularly, accounts of extra-budgetary funds, local authorities and state-owned enterprises/parastatals are not published in a timely manner. Further, such accounts are not readily available within government. Developing integrated government accounting and financial reports would be helpful and would facilitate addressing fiscal sustainability challenges.

Accountability
The limited information on public bodies/ funds outside of Central Government means it is difficult for Central Government to assess and remedy poor performance. Moreover, stakeholders such as the general public face difficulties in assessing government performance. is problematic.

Equitability
The increased use of user fees to finance delivery of public services (such as in education and health), disproportionately impacts low income households, reflecting its regressive nature.



CHAPTER

TWO

Trends and Profiles in General Government Expenditures

EXECUTIVE SUMMARY

Any effort to improve the efficiency and effectiveness of public expenditure requires a solid understanding of expenditure profiles and trends – where central and local governments spend revenues, how expenditures are spent across levels of government, and how well governments and agencies execute their budgets. This Chapter provides an overview of profiles and trends of general government expenditures from 2011 to 2015, and a foundation for the detailed discussion of these questions in other chapters of this report. The Chapter first outlines key challenges related to Zimbabwe's expenditure management and policy options for government to ensure the effective prioritization and execution of expenditures. It then examines profiles and trends by spending areas (i.e., ministry, sector, and economic classification) and the composition of government transfers. Finally, the profiles and trends of budget execution are examined based on the same spending area classifications.

At the outset, it is useful to note that Zimbabwe's general government expenditures compare favorably with its neighbors. Between 2011 and 2015, Zimbabwe's average expenditure for general government, which includes both central and local governments, was 28 percent of GPD. This rate is comparable to neighboring countries, though lower than the average of 32 percent in the Southern Africa Development Community (SADC).

KEY CHALLENGES

1. **Zimbabwe's high share of central government expenditure on recurrent spending has crowded out investments in capital projects as well as operations and maintenance, notably for infrastructure, boding ill for economic growth.** On average, 90 percent of Zimbabwe's central government expenditure is on recurrent expenditure, particularly wage-bill related expenditures. Despite the Government's commitment to channel at least 30 percent of expenditures to capital development, capital expenditure as a percent of GDP fell from 15 percent in 2011 to eight percent in 2015. The dominance of recurrent spending, coupled with low execution of capital expenditures, has negatively affected the implementation of infrastructure projects important to Zimbabwe's growth, particularly those requiring multi-year funding.

2. **The share of local government expenditure, out of total government, has increased in recent years, but local authorities have concerns about fiscal sustainability** given the high share of recurrent spending at the local level, growing mandates for social services, and decreases in transfers from central government. Local governments have resorted to fees to make up the spending gap, which puts pressure on local populations, notably the poor.

3. **For central and local governments, the wage bill is the driver of recurrent expenditure and culprit in crowding out other spending, fueling a dependence on external funding.** Personal emoluments as a share of total expenditure rose from 64 percent in 2011 to 81 percent in 2015 – amid a drop in spending on capital and operations and maintenance. As explained in section 3.4, high wage bill expenditures has led to a dependency on external funding for program-related costs, including capital development. Given the growth in the wage bill at the central and local levels, Zimbabwe also faces growing costs of public sector pensions, which now constitute the most expensive program area in the social protection sector.

4. **Budget transfers make up around 20 percent of the central government budget, with approximately half of the transfer amount made in support of recurrent costs (wage bill) in parastatals, universities and other institutions.** The budget allocations

on recurrent transfers have trended upwards in recent years, which means that about 20 percent of the budget cannot be accounted for in the RBB, or other accountability framework on central government.

5. **Budget execution rates for capital spending are relatively low and volatile, but high for personal emoluments, which degrades Zimbabwe's capacity to generate the base for future economic growth.** The low capital expenditure execution rate is due to the crowding out effect of spending on personnel. Without improvements in execution rates, further budget increases are likely to prove superficial and ineffective.

6. **The implementation of modern expenditure management approaches and tools is hampered by Zimbabwe's high recurrent spending, particularly on wage bill costs, and reliance on external sources for funding recurrent and capital spending.** This expenditure structure renders budget planning and reprioritization more difficult, decreases the certainty of transfers to local governments, and hinges investments in modernizing social services and infrastructure on less predictable external sources. In addition, authorities may have difficulties applying traditional mechanisms for fiscal accountability as external and other financing may be outside of control of Parliament.

7. **In terms of budget allocations by sector, the budget share for the social sectors, including education and health, was increased by approximately 33 percent over the period.** Since budget allocations are significantly skewed towards recurrent expenditures, particularly employment costs, concerns are evident on how to sustain program expenditures on service delivery and social protection, including robust and predictable funding. These matters are further discussed in chapters 5-6.

POLICY OPTIONS

With a view to ensure the efficiency and effectiveness of government service delivery, the Government needs to address a series of imbalances in the overall allocation and prioritization of central and local government expenditures. These include:

- **To ensure government expenditures favor growth and sustained service delivery, recurrent expenditures, especially wage bill costs, need to be reduced significantly.** The chapter on the wage bill lays out a series of specific proposals.

- **To support effective and sustained service delivery, the allocation to "transfers" needs to be revised and most likely down-sized,** with funding to be allocated to core service delivery areas, such as on-budget activities on health, education and social protection.

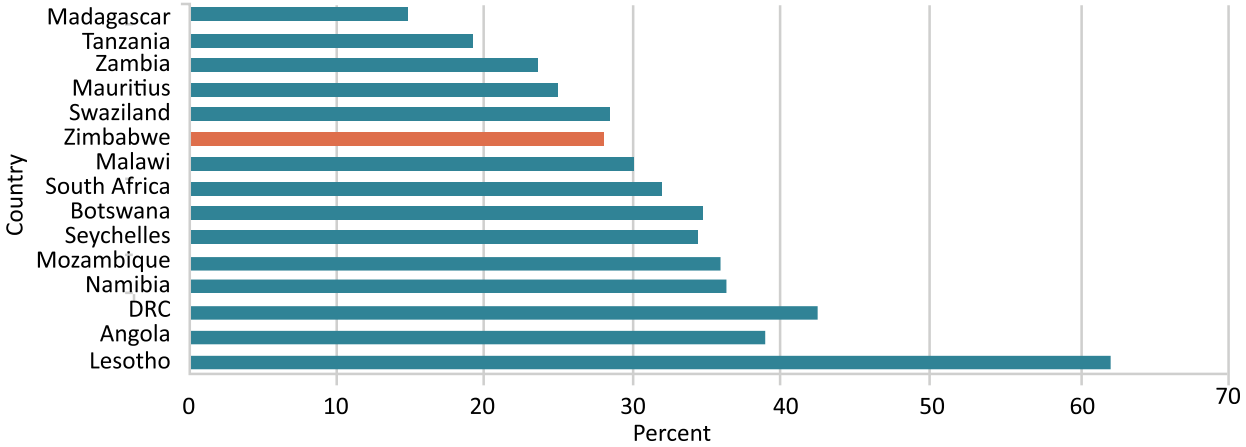
- **There is a need to achieve "value-for-money", including justification for budget allocations to various areas.** The linkages between program objectives, activities, and related expenditure needs are only partial, and do not provide a sufficiently robust platform for assessing efficiency in spending towards results. All activities of the budget should be included in the RBB, together with a thorough review of fragmentation and duplication in program areas.

- **The outstanding central government commitment to fund local service delivery needs to be addressed,** either by increasing the 'own-tax' sources of local government, or by prioritizing transfers to local government in the central government budget. If the transfer solution is preferred, RBB solutions across levels of government should be established, to ensure local accountability and efficiency in the spending at local government levels.

1 GENERAL GOVERNMENT EXPENDITURES – MAJOR TRENDS ACROSS CENTRAL & LOCAL GOVERNMENTS

The size of Zimbabwe's general government budget is below the average of its Southern African neighbors. As a percentage of GDP, Zimbabwe's public expenditures increased from 26 percent in 2011 to 28 and 29 percent in 2012 and 2013, respectively – before stagnating at 27 percent in 2014 and 2015. Zimbabwe's average public expenditure of 28 percent of GDP between 2011 and 2015 was lower than the average of 32 percent of GDP for countries in the SADC. Although higher than comparable countries, such as Zambia and Tanzania, Zimbabwe ranked 6th within the SADC Region (see Figure 2.1).

Figure 2.1: Total Public Expenditure as Percentage of GDP in SADC Region



Source: IMF eLibrary, http://www.elibrary.imf.org, March 2016.

As indicated in Chapter 1, general government expenditures comprise expenditures from central government and local government – and eventually social security contributions. The rest of this chapter focuses mainly on the trends in and composition of central government expenditures, while Chapter 5 examines local government expenditures in greater detail. However, highlights of trends of both central and local government include:

- **Local government expenditures make up an increasing share of Zimbabwe's overall expenditures.** Local government expenditures rose from six percent to ten percent of GDP from 2011 to 2014, while trends in general government as a whole was flat, around 26-27 percent of GDP.

- **On a proportional basis, the central government spends much more on wages than local authorities.** The central government's share of expenditures on wages is approximately twice that of local governments, noting that differences in classification prevents setting the ratio more precisely. However, as a proportion of the overall budget, local governments spend more on capital expenditures.

- **The central government and local authorities have complementary, sometimes overlapping roles in funding sector services.** Most local expenditures are made up of core local government services: housing; water and sanitation; local roads and works; and policy and emergency services. The budget for core local government services grew from 2012 to 2015. Although the central government funds education and health as core areas, local authorities allocate a minor budget to

these sectors. Both the central government and local authorities increased allocations to education and health. Yet the rate of local authorities' budget execution on health and education declined from 2012 to 2015.

- **Budget execution rates are higher in central government, though local authorities have improved their rates in recent years.** The difference is partly because each government level has a different composition of expenditure. For the central government, budget execution is fixed, and wage bill-related costs make up more than 90 percent of expenditures. Budget execution among local authorities is more volatile given their larger share of operational expenditures. Fiscal constraints further explain the low execution rates (see next bullet).

- **The vertical fiscal burden sharing has changed, causing local authorities to have concerns about fiscal sustainability.** General transfers from central to local governments were reduced (as a fund share) over the period – a difficult development amid an expanding local government sector. The central government's ear-marked transfers on health and education were mostly flat over the period. As detailed in Chapter 5, local governments are building up fiscal deficits and wage- and payment arrears. They are sub-executing their budgets, and facing a revenue structure heavily dependent on non-tax sources, including 'fees for services' and fines. Local authorities have difficulties budgeting for such non-tax revenues, and are concerned that fees may not sufficiently cover costs to provide services. The only tax source available for funding of non-fee related services and tasks is property taxes, which constrains options for local authorities.

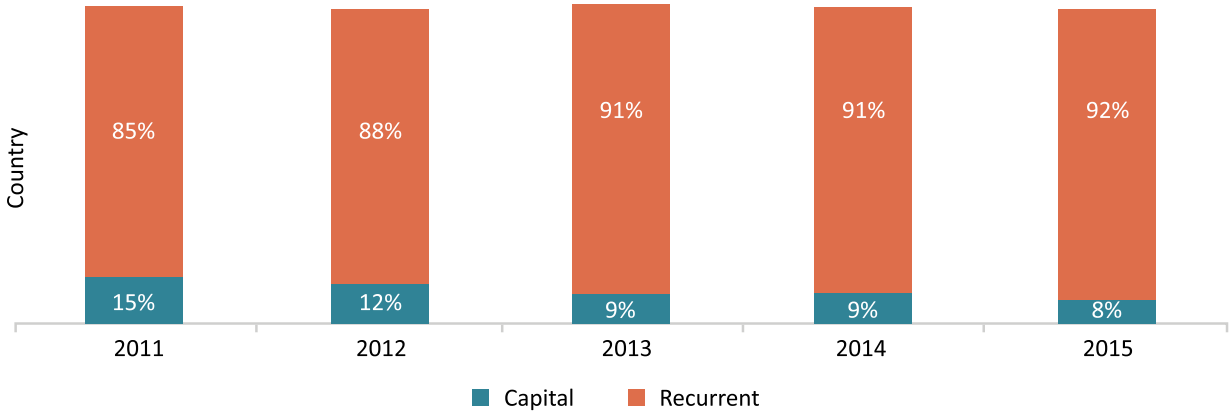
In summary, local governments appear to cover areas that do not overlap efficiently with central government expenditure programs, raising concerns about fiscal sustainability.

2 PROFILES & TRENDS OF CENTRAL GOVERNMENT EXPENDITURES

A. RECURRENT VERSUS CAPITAL: RECURRENT EXPENDITURES COVER MORE THAN 90% OF BUDGET

Recurrent expenditures continue to dominate central government expenditures in Zimbabwe's public finances. The growth of public expenditures has been skewed towards recurrent spending, which made up more than 90 percent, on average, of total public spending between 2011 and 2015. This left less than 10 percent, on average, of public budget for capital spending, as shown in Figure 2.2. Essentially, capital expenditures fell by approximately a half – from 15 percent of the central government budget in 2011 to eight percent in 2015.

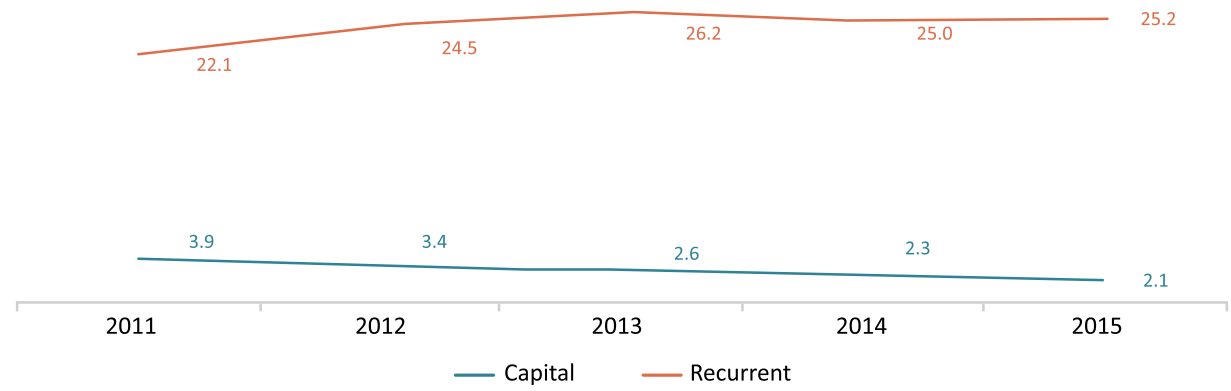
Figure 2.2: Expenditure Composition, 2011-15



Source: Ministry of Finance and Economic Development.

The Government has committed to increase capital spending, though little progress has been made. Despite the Government's commitment to channel at least 30 percent of its expenditures towards capital development, as indicated in Chapter 1, only 2.9 percent, on average, was achieved between 2011 and 2015. Recurrent expenditures, mainly the wage bill, have crowded out capital spending, widening the gap between recurrent and capital spending from 18.2 percent of GDP in 2011 to 23.1 percent in 2015, as shown in Figure 2.3.

Figure 2.3: Expenditure Share of GDP (Percent)



Source: Ministry of Finance and Economic Development.

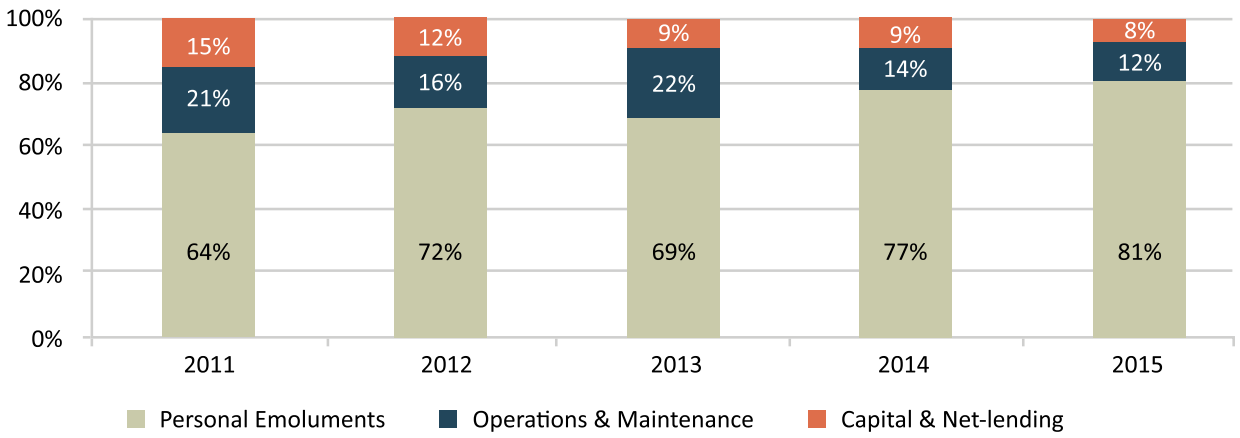
B. EXPENSE ITEMS - WAGE BILL CROWDING OUT OTHER EXPENSES

The role of wage expenditures in the public budget limits the Government's fiscal policy options. An analysis of the three main components of public spending classified by the Government of Zimbabwe – personal emoluments; capital budget and net lending; and operations and maintenance – indicates that the wage bill rose from 17 percent of GDP in 2011 to about 22 percent of GDP in 2015. During the same period, operations and maintenance, and capital and net lending fell, on average, by nine and seven percent respectively, as shown in Figure 2.4. The buildup of wage-related expenditures over the years has limited policy options for the Government, by undermining the role of the budget as a fiscal policy instrument for ensuring better public services.

The constrained fiscal environment has also impeded or delayed infrastructure projects, particularly those requiring multi-year funding. Though infrastructure investments increased in 2011 and 2012, reduced capital budget and net lending expenditure in 2013 and 2014 constrained funding for on-going multi-year infrastructure projects, which inevitably affected their viability and timelines.

The growth in the wage bill partly reflected greater support for social services. For example, the Government increased staff in education and health – measured in both headcount and per unit cost. However, the benefits of this increase was undermined by reduced support for operations and maintenance and capital assets, such that employees were unable to access the requisite tools to perform their duties. Moreover, the data indicate that *personal emoluments* have generally crowded out *operations and maintenance* and *capital and net lending,* with capital the most affected.

Figure 2.4: Share of Expenditure by Expense Areas, 2011-15[1]

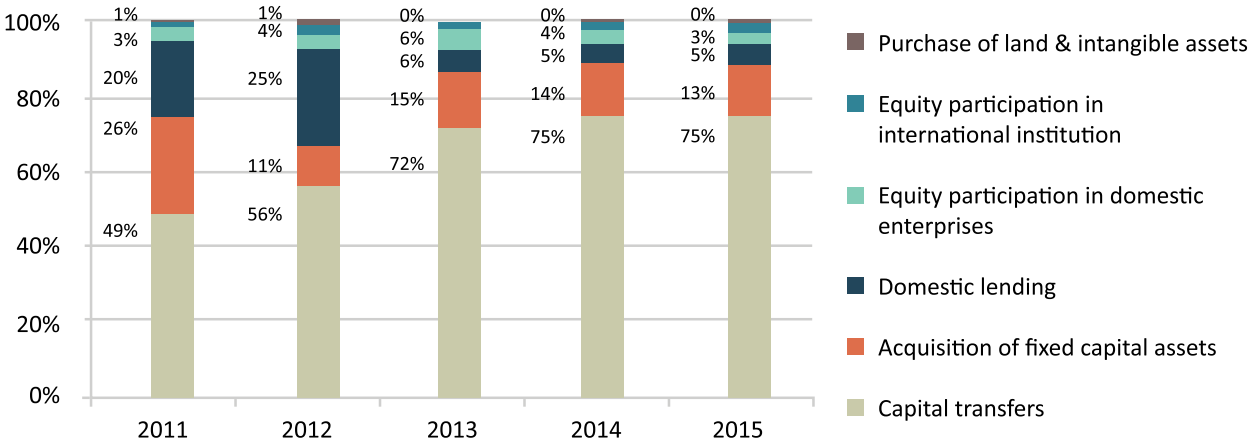


Source: Ministry of Finance and Economic Development.

The main categories of expenditure for capital and net lending include *capital transfers, acquisition of fixed capital assets,* and *domestic lending.* *Capital transfers* make up a significant share of capital expenditures, averaging 66 percent between 2011 and 2015, as shown in Figure 2.5. These transfers are funds earmarked for the procurement of capital goods for parastatals and grant-aided institutions, and for other capital programs. *Acquisitions of fixed capital assets,* on the other hand, relate to the procurement of capital goods for central government ministries and departments. These increased from 20 percent in 2011 to 35 percent in 2014, before falling to 13 percent in 2015. However, most public infrastructure services, such as for transport, energy, and water and sanitation, are delivered through parastatals and local authorities with support from the central government through *domestic lending.* However, *domestic lending* was cut to these public entities, from 16 percent of overall capital expenditures in 2011 to only 5 percent in 2015, mainly due to the limited fiscal space.

[1] The database has been supplemented with other government sources to reclassify current transfer salaries from operations and maintenance to personal emoluments for the period 2011-2013.

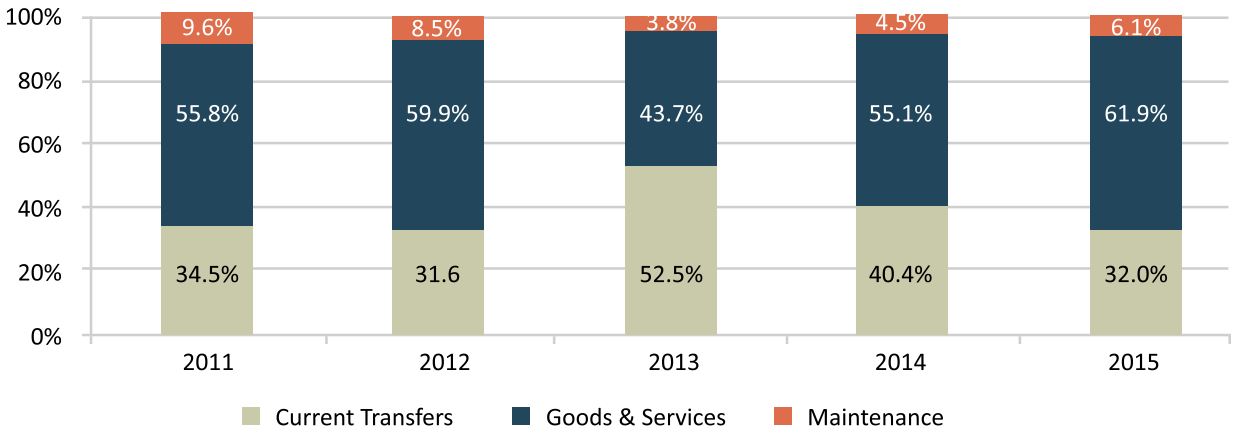
Figure 2.5: Composition of Capital Expenditure, 2011-15



Source: Ministry of Finance and Economic Development.

Goods and services, current transfers,* and *maintenance* are the major components of *operations and maintenance. Of these, *goods and services,* on average, accounted for about 55 percent of the expenditures between 2011 and 2015. As shown in Figure 2.6, the trend is relatively consistent throughout the period, except in 2013 when the share of *current transfers* significantly increased from its average of 33 percent to 53 percent, mainly due to increased spending during the 2013 Harmonized Elections. Maintenance expenditure, which provides for maintenance of infrastructure assets, received the lowest share of funding, and constituted only 6.5 percent, on average, of spending on *operations and maintenance* between 2011 and 2015. Although rising slightly by 1.6 percent between 2014 and 2015, the continued low share of funding for *maintenance* risks worsening service delivery and increasing costs as a result of an accelerated deterioration of assets.

Figure 2.6: Composition of Operations and Maintenance, 2011-15



Source: Ministry of Finance and Economic Development.

C. ADMINISTRATIVE CLASSIFICATION: EXPENDITURE GROWTH BY MINISTRY

The trend of public expenditures under administrative votes reflected a varied performance over the period 2011 to 2015. Some ministries experienced increases in line with overall expenditure growth. However, for some votes, the growth in expenditures reflected a reconfiguration of administrative structures as a result of the creation, abolishment, merging, and demerging of some functions. In addition, variations in resource allocations for capital projects reflect changes in the number of projects within a particular year as well as stage of project implementation.

The ministries with the largest expenditure growth accounted for almost two thirds of all public expenditures. The largest increase in public expenditures was registered at the Ministries of Primary and Secondary Education; Home Affairs, Public Service, Labour and Social Welfare; Defence; and Environment and Natural Resources Management as a result of overall expenditure growth. These constituted the top five expenditure units within the Government, accounting for 63 percent of total expenditures in 2015 (Table 2.1).

The ministries that experienced a decline in expenditures were those that relied on capital spending. Ministries of Transport and Infrastructural Development; Foreign Affairs; Energy and Power Development; and Small and Medium Enterprises and Cooperative Development recorded sustained cutbacks in expenditures between 2011 and 2015. Except for the Ministry of Foreign Affairs, the decline was due to the crowding out of capital expenditures by current expenditures.

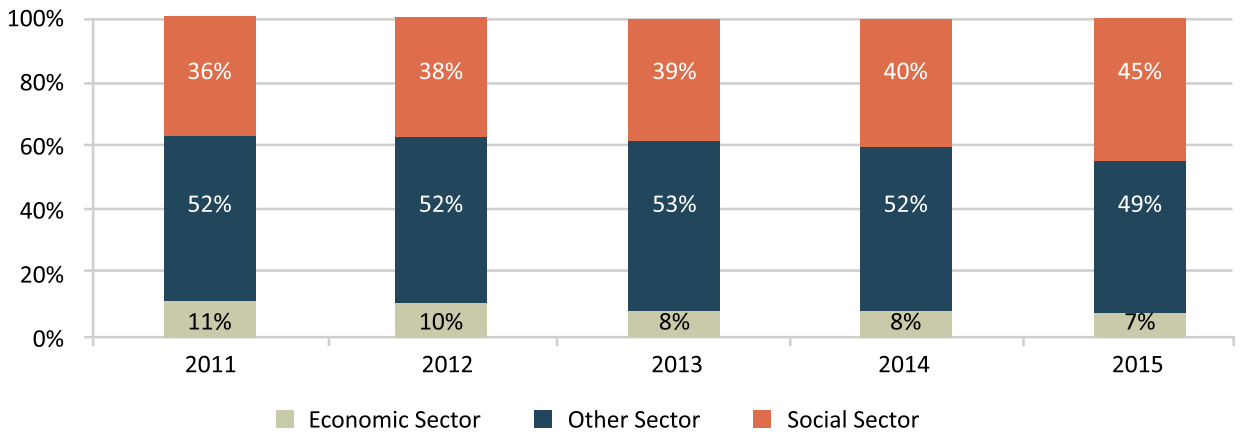
Table 2.1: Top 10 Ministries by Share of Actual Expenditure 2011-2015

2011	2012	2013	2014	2015
Primary & Secondary Education: 18%	Primary & Secondary Education: 19%	Primary & Secondary Education: 19%	Primary & Secondary Education: 21%	Primary & Secondary Education: 24%
Public Service: 13%	Public Service: 15%	Public Service: 13%	Public Service Commission: 13%	Public Service Commission: 12%
Defence: 9%	Defence: 10%	Defence: 9%	Defence: 10%	Defence: 9%
Home Affairs: 9%	Home Affairs: 9%	Home Affairs: 10%	Home Affairs: 11%	Home Affairs: 10%
Health & Child Welfare: 8%	Health & Child Welfare: 8%	Health & Child Welfare: 7%	Health & Child Welfare: 7%	Health & Child Welfare: 8%
Higher Education & Tertiary Education: 7%	Higher Education & Tertiary Education: 7%	Higher Education & Tertiary Education: 7%	Higher Education & Tertiary Education: 7%	Higher Education & Tertiary Education: 7%
Finance: 6%	Finance: 6%	Finance: 5%	Finance: 5%	Finance: 4%
Office of the President & Cabinet: 5%	Office of the President & Cabinet: 5%	Office of the President & Cabinet: 5%	Office of the President & Cabinet: 5%	Office of the President & Cabinet: 6%
Agriculture, Mechanisation & Irrigation Development: 5%	Agriculture, Mechanisation & Irrigation Development: 6%	Agriculture, Mechanisation & Irrigation Development: 5%	Agriculture, Mechanisation & Irrigation Development: 6%	Agriculture, Mechanisation & Irrigation Development: 5%
Justice & Legal Affairs: 3%	Justice & Legal Affairs: 2%	Justice & Legal Affairs: 7%	Labour & Social Services: 3%	Labour & Social Services: 3%

D. SECTOR CLASSIFICATION[2]: SOCIAL SECTORS EXPENDITURES' INCREASE BY 33 PERCENT

Only the *social sector* experienced expenditure growth between 2011 and 2015. During this period, expenditure on the *social sector* increased from 36 percent of total expenditure to 45 percent, while expenditure fell in the *economic sector* and *other sector.* The growth in the *social sector* was driven mainly by increases in the health and education sub-sectors, possibly reflecting a deliberate attempt by the Government to resuscitate and improve social service delivery. For example, the Government in 2013 lifted the freeze on employment of nurses to improve the nurse-to-patient ratio.

Figure 2.7: Expenditure by Sector Classification, 2011 - 2015



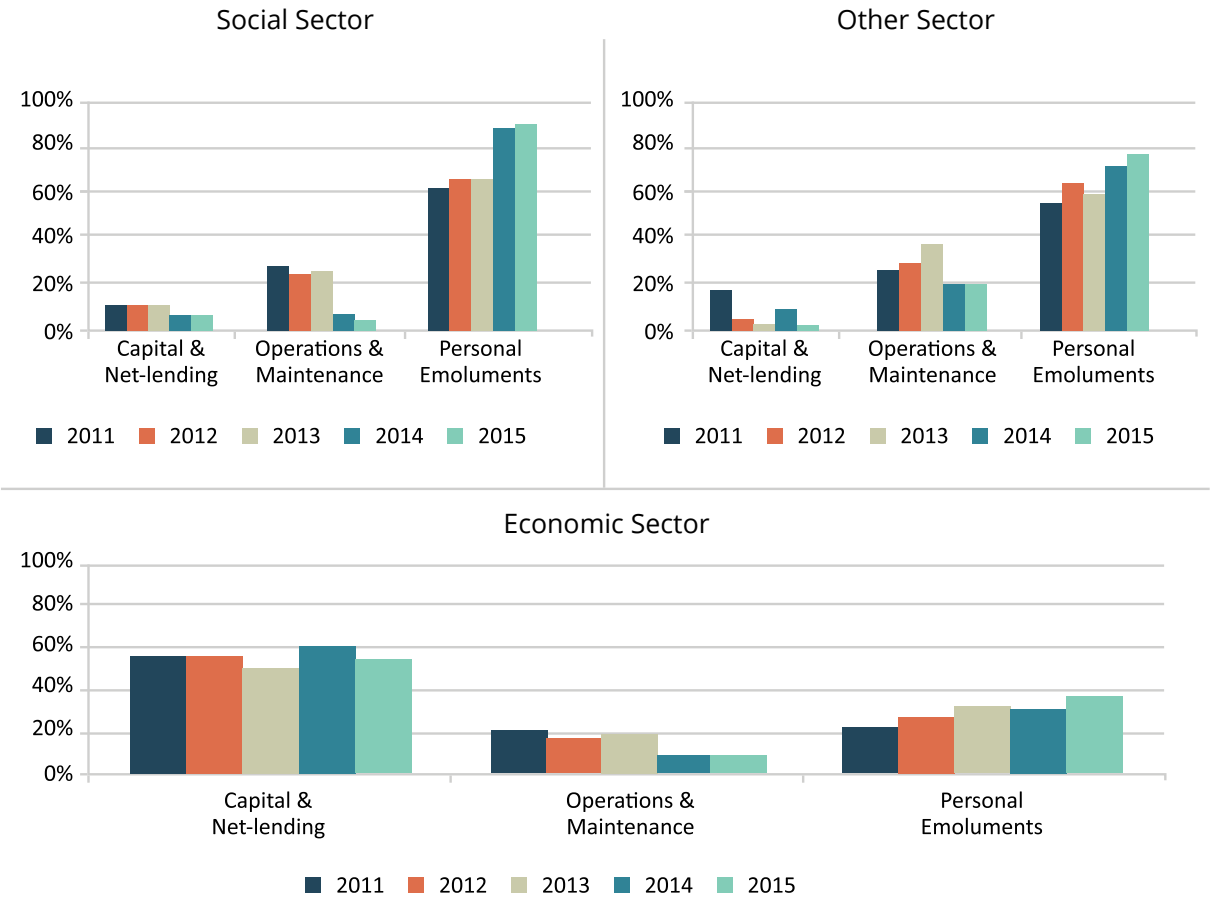
Source: Ministry of Finance and Economic Development, Author Calculations.

Wage expenditures represented 75 percent of all spending in the *social sector.* *Personal emoluments* constituted a significant share of total expenditures in the *social sector,* accounting for about 75 percent, on average. Conversely, the shares of *capital and net lending,* and *operation and maintenance* expenditures, which are both critical for service delivery, declined over the same period as shown in Figure 2.8. Specifically, spending on *operations and maintenance* decreased dramatically in 2014 and 2015. A continuation of this trend could result in staff redundancy and erosion of public infrastructure.

The *economic sector* and *other sector* witnessed their shares of total expenditures decline between 2011 and 2015, due mainly to cuts in *capital and net lending.* *Capital and net lending* make up, on average, 50 percent of the *economic sector,* and are vulnerable to expenditure cuts during financial difficulties or crises. The marginal decline in the *other sector* between 2011 and 2015 was mainly due to a decrease in *capital and net lending* as well as *operations and maintenance,* which in 2014 and 2015 also constituted a small percentage share of total sector spending (see Figure 2.8).

[2] The Government of Zimbabwe has not yet formally adopted a uniform budget classification by function or sector cluster. The nature in which the administrative votes have been structured reflects their functions; hence, an attempt has been made for this analysis to classify the Administrative votes into functional classification guided by the Classification of Functions of Government (COFOG) using the IMF 2001 Manual. The functional classification was transformed into three broad sectors: Economic, Social, and Other sectors. However, ministries with such overlaps where allocated to classes that accounts for the largest part of their total outlay.

Figure 2.8: Share of Sector Expenditure by Economic Classification, 2011-2015



Source: Ministry of Finance and Economic Development, and authors' calculations.

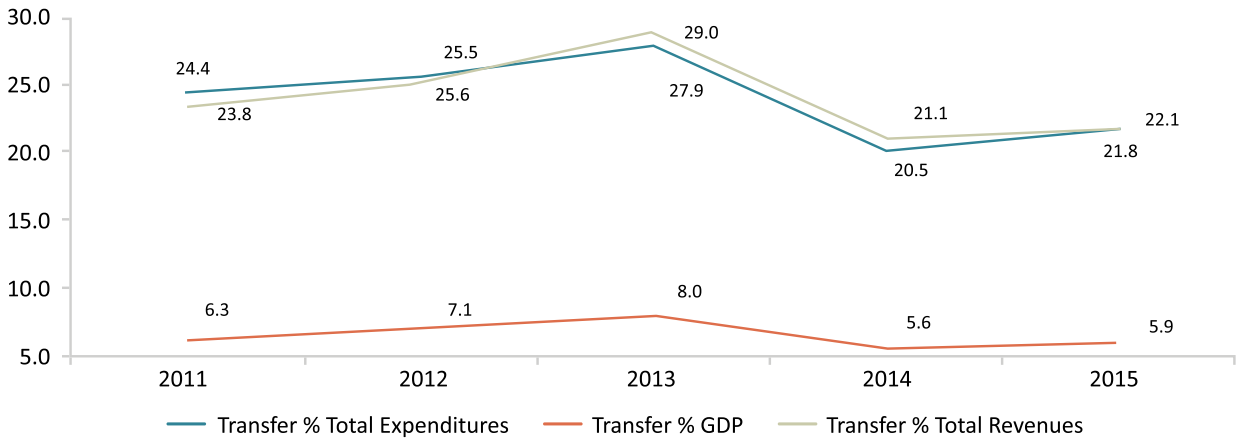
3 TRANSFERS[3]: IN DECLINE AND DOMINATED BY WAGE BILL COSTS

Transfers are used to help certain types of government institutions fund a variety of activities. A significant share of the budget is transferred to grant-aided institutions comprising parastatals, state universities and public institutions, which carry out a significant portion of infrastructure development. Transfers come in two forms: *current and capital.* Transfers are used for infrastructure development and capitalization of public enterprises and other strategic services provided on behalf of the Government. The bulk of transfers are for current expenditures, such as paying salaries, and funding operations and maintenance at grant-aided institutions. Capital transfers are either transferred as capital grants or as lending.

Though representing more than 20 percent of expenditures, transfers declined between 2011 and 2015, dropping significantly from 2013 to 2014. In 2015, transfers made up 22 percent of total expenditures, 22 percent of total revenues, and six percent of GDP (Figure 2.9).

[3] The analysis under this section will exclude pension as a transfer since it is dealt with in the chapter on the Wage Bill.

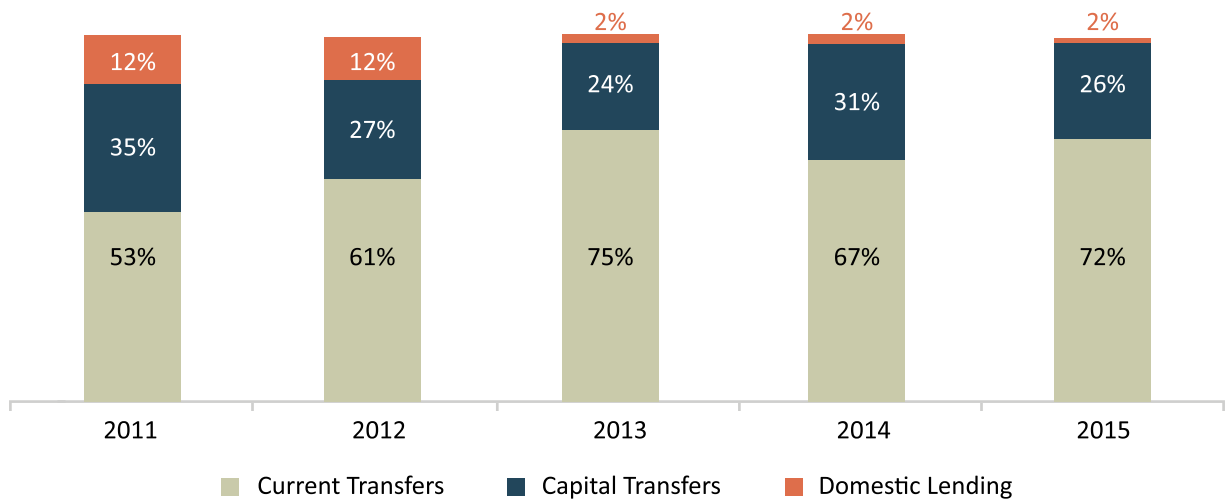
Figure 2.9: Transfer Expenditure Ratios, 2011-15 (Percent)



Source: Ministry of Finance and Economic Development.

As overall transfers declined, *current transfers* increased to cover more than 70 percent of total transfers budget. Between 2011 and 2015, *current transfers* averaged 66 percent of total transfers – reaching 72 percent in 2015. This adds to overall trend of wage bill expenditures crowding out capital expenditures, reducing funding for infrastructure development. The high share for *current transfers* in 2015 is expected to fall as the government takes measures to roll back salary subsidies to institutions that should finance their own operations. Meanwhile, *capital transfers,* which include lending, made up an average of only 29 percent of total transfers between 2011 and 2015.

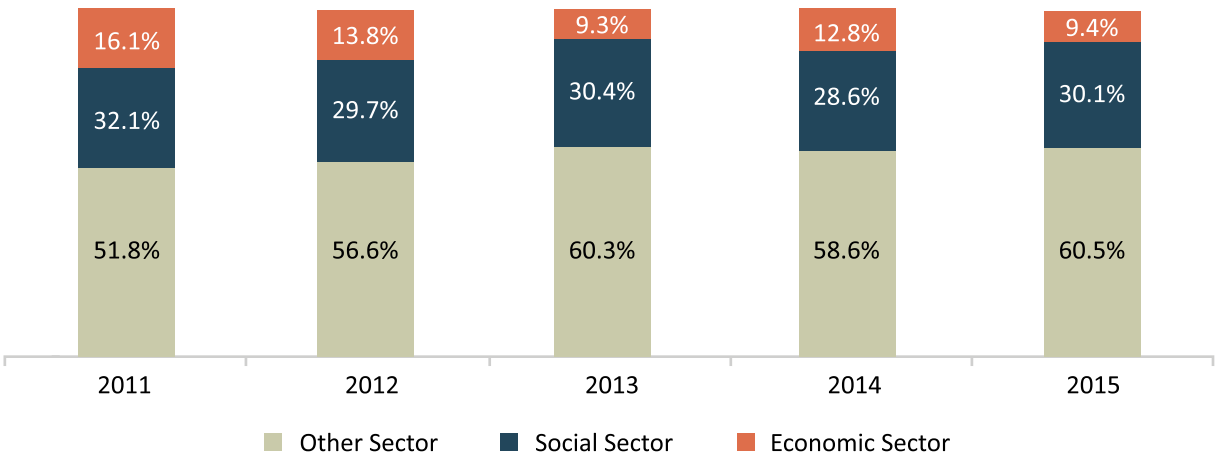
Figure 2.10: Composition of Transfer Expenditure, in Percent, 2011-2015



Source: Ministry of Finance and Economic Development.

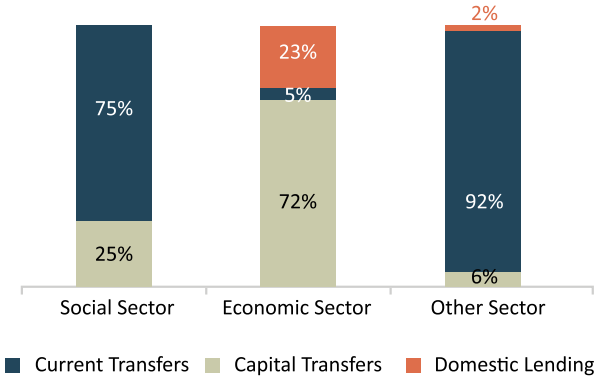
Most transfers are distributed to the *other sector,* which accounted for more than 60 percent of transfer in 2015. Between 2011 and 2015, the average percent of total transfers to the *social sector* was 30 percent, the *economic sector* 12 percent, and the *other sector* 58 percent. Though transfers to the *other sector* grew by about eight percent between 2011 and 2015, transfers to the *social sector* and *economic sectors* declined by six and 42 percent, respectively (Figure 2.11).

Figure 2.11: Composition of Transfers by Sector, in Percent, 2011-2015



Source: Ministry of Finance and Economic Development and authors' Calculations.

Figure 2.12: Composition of Sector Spending by Economic Classification, in percent, 2011-15



Source: Ministry of Finance and Economic Development and authors' Calculations.

The distribution of transfers by capital and current expenditure varies by sector. 75 percent of transfers to the *social sector* were current and 25 percent capital. The near inverse is true in *economic sector,* where 72 percent of transfers were capital and 28 percent current (Figure 2.12). Infrastructure projects drove the higher share of capital transfers in the *economic sector.* In the *other sector,* nearly all transfers (92 percent) were for current expenditures.

Given that the *other sector* receives 60 percent of all transfers, and that transfers make up about 22 percent of Zimbabwe's budget, about 10 percent of the overall central government budget is allocated to 'budget support' for current costs, mainly salary related costs, in parastatals, state universities and other institutions.

4 BUDGET EXECUTION

This section examines the extent of budget execution for fiscal years 2011-2015 by analyzing execution rates of adjusted budgets against actual expenditures, using the same set of expenditures lenses as in section 2.[4]

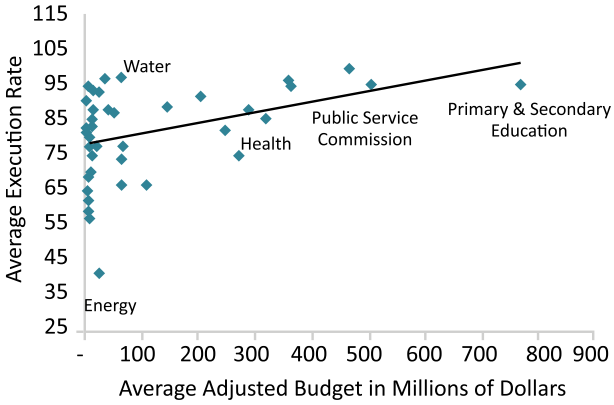
[4] Execution rates are calculated by dividing actual expenditure by the adjusted budget. This formula is used also for aggregates, adding components and calculating the execution rate on the aggregated amount.

A. ADMINISTRATIVE CLASSIFICATION: FEWER MINISTRIES WITH EXECUTION RATES ABOVE 75%

Non-discretionary expenditures, especially wages and pensions, drive overall execution rates in Zimbabwe. The execution rate on overall expenditures averaged about 88 percent between 2011 and 2015. The rate reached 94 percent in 2012, fell gradually to 84 percent in 2013 and 2014, but rebounded to 87 percent in 2015. Overall, 30 ministries had average execution rates above 75 percent. The Ministry of Public Service led among ministries with a 99 percent rate for the three years it was in existence. In general, high execution rates were attained in ministries where non-discretionary expenditures, such as wage and pension bills, made up a high share of total expenditures.

There is a positive correlation between the size of the adjusted budget and the execution rate, as shown in Figure 2.13. This is consistent with the composition of budgets, where non-discretionary expenditures are given priority for cash disbursements, resulting in higher execution rates. For the highest executing votes, such as the Ministry of Primary and Secondary Education and the Public Service Commission, wages made up most of their expenses.

Figure 2.13: Average Adjusted Budget and Execution Rate by Votes, 2011-15

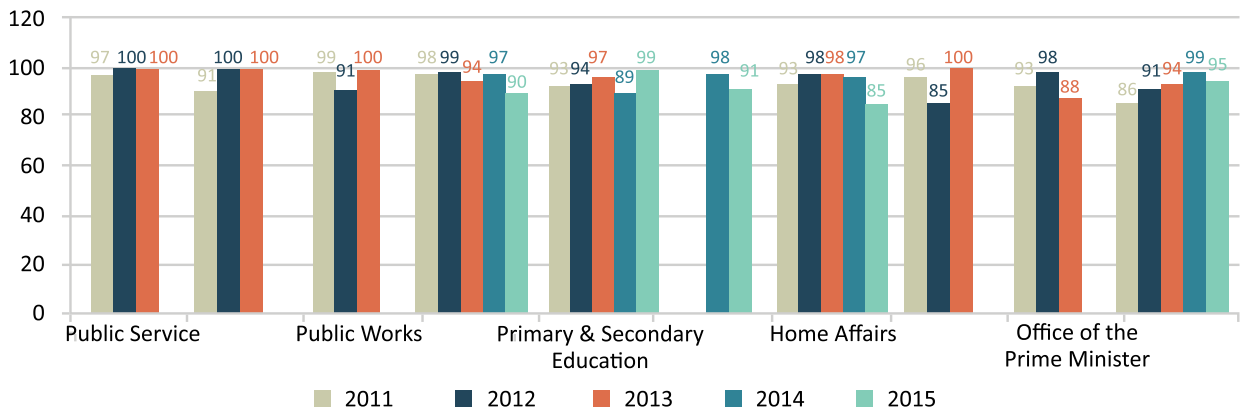


Source: Ministry of Finance and Economic Development and Author's Calculations.

The overall execution rates of ministries varied over the years. In 2011, the overall execution rate for Zimbabwe's 37 ministries was 91 percent – with the top five averaging 98 percent. In 2012, the overall execution rate increased to 94 percent, and the top four ministries had 100 percent rates. In 2013, the overall execution rate dipped to 84 percent, but the Ministry of Energy and Power Development (MEPD) achieved only a 10 percent rate. Between 2012 and 2013, the Ministry of Primary and Secondary Education increased its rate from 94 percent to 97 percent, but the Ministry of Health and Childcare's rate fell from 92 percent to 70 percent. In 2014, the overall execution rate was 84 percent, though the MEPD continued a dismal (five percent) rate. In 2015, the overall execution rate was 89 percent, and the MEPD's rate ten percent. The Ministry of Primary and Secondary Education and the Ministry of Health and Child Care recorded strong rates of 99 and 91 percent respectively.

In terms of a threshold, 58 percent of ministries achieved more than a 75 percent budget execution rate in 2015, which was less than the 86 percent of ministries in 2011 and 2012. In 2011, 32 of 37 existing ministries registered rates above 75 percent. Of 36 ministries in 2012, 32 recorded rates above 75 percent. The Ministry of Small and Medium Enterprises Development registered the lowest 52 percent rate in 2012. In 2013, only 23 of 37 ministries had rates above 75 percent, but six ministries recorded 100 percent. 15 of 28 ministries had rates above 75 percent in 2014. In 2015, 18 of 31 ministries had execution rates above 75 percent.

Figure 2.14: Budget Execution by Administrative Classification (Top 10 Admin Units) (Percent)

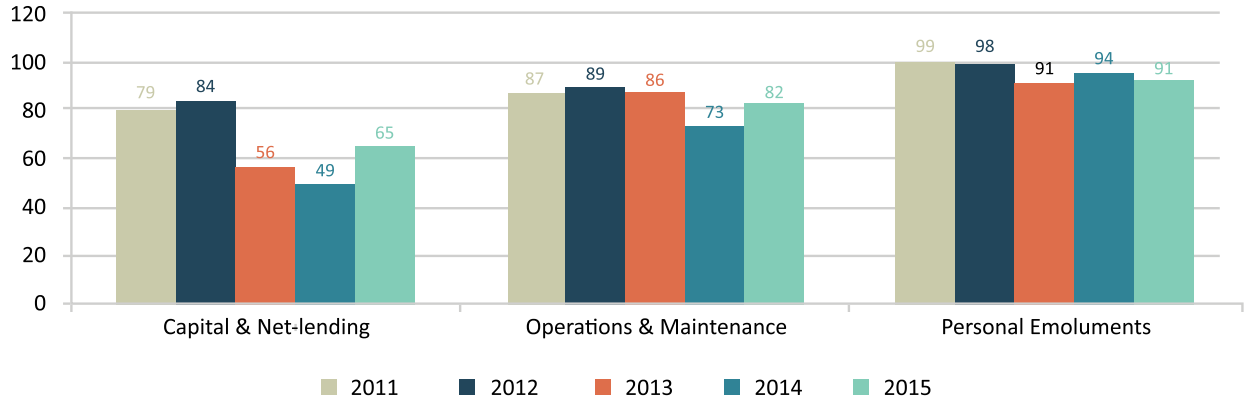


Source: Ministry of Finance and Economic Development.

B. EXPENSE ITEMS: SCOPE TO IMPROVE EXECUTION IN CAPITAL AND OPERATIONS SPENDING

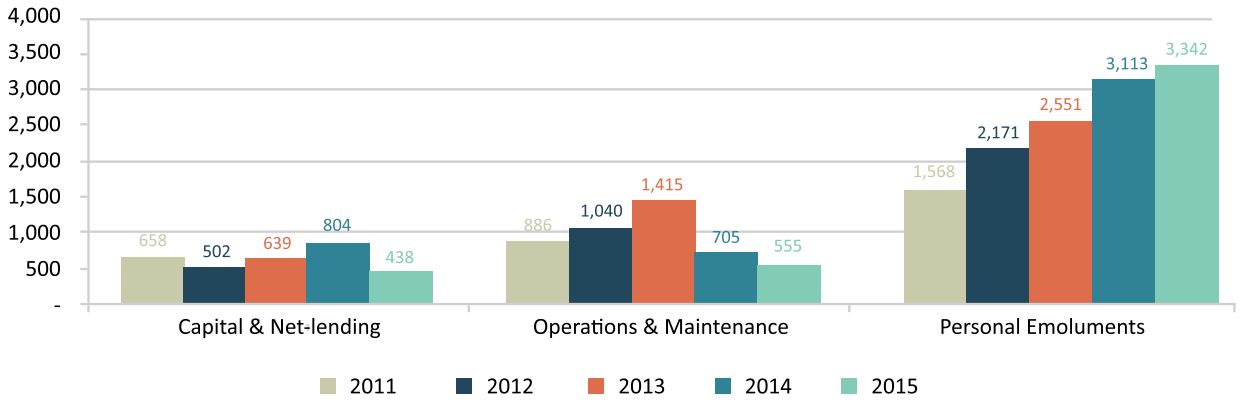
Budget implementation remained a challenge for *capital and net lending,* but also for *operations and maintenance* (current), as evidenced by the relatively low execution rates compared to *personal emoluments.* As shown in Figure 2.15, execution rates trended downward between 2011 and 2014, but rebounded in 2015, except for *personal emoluments,* which fell marginally from 94 percent in 2014 to 91 percent 2015. Higher execution rates in 2011 and 2012 were partly due to the ability of the Government to support budgeted expenditure in line with incoming revenue flows and prioritization of budget items for execution (cash budgeting principle). Yet in 2013 and 2014, cash flow challenges and upward adjustments in non-discretionary expenditures supported a decline in execution rates for *capital and net lending* as well as *operations and maintenance.* As depicted in Figure 2.16, authorities adopted a more conservative budgeting principle in 2015 after accounting for the cash squeeze facing central government, which led to an improvement in budget execution.

Figure 2.15: Execution Rates by Economic Classification, 2011-2015 (Percent)



Source: Ministry of Finance and Economic Development.

Figure 2.16: Adjusted Budget by Economic Classification, in Millions of USD, 2011-15



Source: Ministry of Finance and Economic Development.

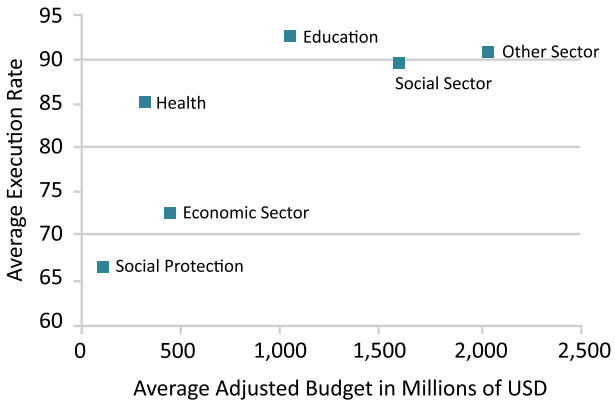
The low burn rates for *operations and maintenance,* and capital spending reflected tightening budgets, which will have implications for operational support required for providing services. Between 2011 and 2015, budget execution rates for *operations and maintenance* averaged 83 percent, ranging from 89 percent in 2012 to 73 percent in 2014. In the same period, the execution rate for the capital budget averaged below 67 percent, dropping from a high of 84 percent in 2012 to a low of 49 percent in 2014, to a large extent due to wage bill costs crowding out capital expenditures. However, there was a significant improvement in 2015, which recorded 65 a percent rate. Unless budget execution improves, increases in allocations will remain cosmetic, and lead to redundancy in the civil service.

Not surprisingly, *personal emoluments* have enjoyed the highest budget execution rates – averaging 95 percent between 2011 and 2015. The highest rates were 99 percent and 98 percent in, respectively, 2011 and 2012, while the lowest rate of 91 percent was realized in both 2013 and 2015. High execution rates for *personal emoluments* is attributable to the rigidity and non-discretionary nature of expenditures for employment.

C. SECTORAL CLASSIFICATION: SOCIAL- AND "OTHER" SECTORS ARE SEEING HIGH BUDGET EXECUTIONS

Between 2011 and 2015, the *other sector* achieved the highest budget execution at 91 percent, followed by the *social sector* and *economic sector* at 89 and 73 percent, respectively (Figure 2.17). For all three sectors, execution rates for *personal emoluments* were consistently high due to the non-discretionary nature of these expenditures.

Figure 2.17: Average Adjusted Budget and Execution Rate by Sector Classification, 2011-15



Source: Ministry of Finance and Economic Development and authors' Calculations.

The execution rates in social sub-sectors were relatively high. Between 2011 and 2015, execution rates across social sub-sectors for *personal emoluments* were high – averaging 97 percent and reaching 100 percent in 2011. For other expenses in the *social sector,* the budget execution was somewhat lower: an 81 percent rate for *operations and maintenance,* and a 60 percent rate for capital expenditures. Between 2011 and 2015, the health sub-sector recorded an execution rate of 85 percent, with a low of 70 percent in 2014. The education sub-sector averaged 93 percent. Of note, low execution rates on operation support in education are likely due to a heavy reliance on off-budget funding sources, such as school fees and levies, which are retained by schools and other education institutions (see Volume 4).

5 EXPENDITURE MANAGEMENT CHALLENGES

As indicated above, more than 90 percent of Zimbabwe's budget expenditures are allocated to current expenditures, predominantly the wage bill. In such context, operational and capital expenditures suffer from low budget execution, partly because these expense areas rely on less predictable and volatile external funding sources. In this expenditure structure, authorities have less scope to apply modern expenditure- and fiscal management approaches. For example:

- Budget reprioritization efforts, including efforts to create fiscal space, become difficult, since most expenditure items, such as for the wage bill, are rigid. Budget planning suffers from stop-and-go interruptions as levels of overall gross expenditures are determined outside the budget.

- Similarly, medium-term expenditure management tools, such as expenditure ceilings to cap overall spending, are difficult to apply, as authorities may be constrained to use external funding for discretionary expenditures based on fund availability, rather than thoughtful planning.

- Results- based budgeting is also less efficient in such a context, as resources cannot be predictably scoped, budgeted, and (re)prioritized according to impact or results. However, the results-based budgeting approach can still improve transparency on where revenues are spent and for which results.

- Since the budget covers mainly core-staff expenditures, and capital and operational expenditures rely on less predictable external sources, authorities face difficulties in strengthening and modernizing infrastructure and public service delivery. Volumes 4 and 5 provides examples of education and social protection programs that might benefit from restructuring or simplification, but have been impeded by such expenditure constraints.

- Mechanisms to ensure fiscal accountability tend to be less efficient in such a context. When public services are largely funded by external parties or sources outside the control of the Parliament or the Government, traditional accountability tools may no longer applicable.

Finally, expenditure management across levels of government is negatively impacted. Transfers to local government are constrained and vulnerable under a rigid budget environment, and to-date local governments have been obliged to seek alternative funding sources to balance their budgets. Chapter 5 explores this topic in greater detail.

Table 2.2: Consolidated Central Government Budget, 2015 and 2016

EXPENDITURE HEAD	APPROPRIATION		STATUTORY FUNDS		OTHER RESOURCES		TOTAL	
YEAR	2015	2016	2015	2016	2015	2016	2015	2016
Personal Emoluments	3,317	3,191	12	5	-	-	3,329	3,196
Operation & Maintenance	385	384	400	317	56	56	841	757
Capital Lending	341	315	129	296	796	739	1,266	1,350
Total	4,043	3,890	542	618	852	795	5,437	5,303

A. STATUTORY FUNDS

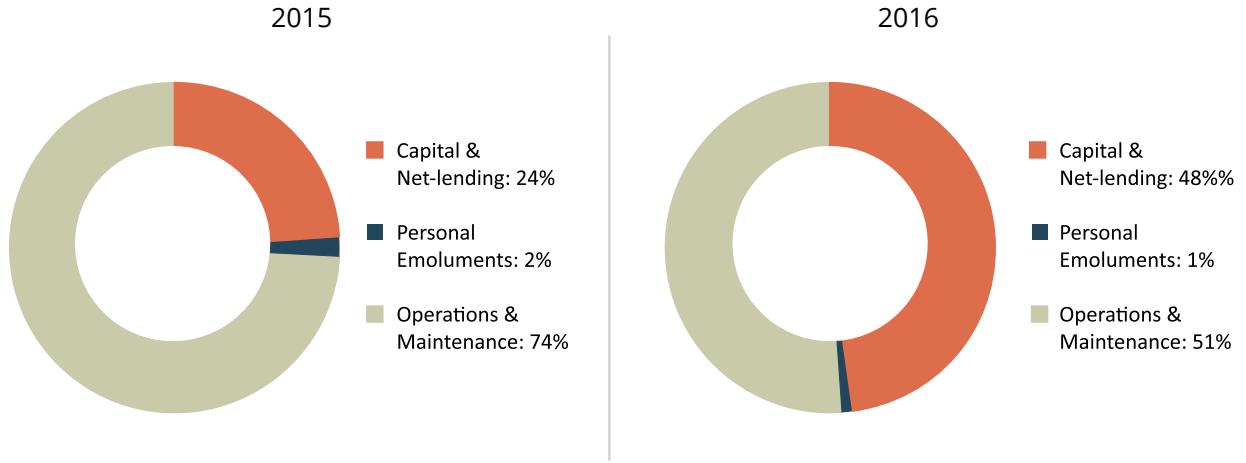
Zimbabwe started tracking revenue collected from different sources, such as statutory funds, in 2015, which can increase transparency and improve budget management. Statutory funds are established from an act of parliament or statute other than the Public Finance Management Act (PFMA). Apart from the statutory funds, there are other funds established as a result of section 18 of the PFMA. These funds collect revenue from user fees and charges, which are either retained or transferred to the Consolidated Revenue Fund depending on the nature of the fund and are subject to the approval by the treasury. Retained revenues are spent on all expenditure heads or activities as determined by the appropriate act or constitution of the fund. Although the revenue and expenditures incurred under this arrangement should be a part of central government finances, the Government of Zimbabwe has not been consolidating these in its financial records in the past. However, since the 2015 budget, the Bluebook incorporates revenues and expenditures from different funds.[5] Even though these are not appropriated by parliament, they have been included in the Bluebook for transparency purposes and can lead to positive reforms in budget management.

In 2016, statutory funds accounted for about 12 percent of total budgeted resources, up from 10 percent in 2015. An analysis of the 2015 data reveals that 76 percent of resources raised from statutory funds were earmarked for recurrent expenditures, consisting of personal emoluments at 2.2 percent and operations and maintenance at 74 percent, with the balance of 24 percent going towards capital spending. For 2016, the share of capital spending from statutory funds has improved to 48 percent, reflecting a more developmental oriented spending of these funds. The share of personal emoluments declined further in 2016 to only representing 0.8 percent along with a further decline in operations and maintenance to 51 percent, as shown in Figure 2.18.

The use of statutory funds brings challenges to public administration. Fees and expenditures financed from statutory funds are not entirely subject to standard rules and procedures of revenue and expenditure management. There is also limited appreciation by the public on the way these resources are utilized and accounted for and there are opportunities for improved transparency and accountability. However, these revenues have bolstered government capacity to finance service delivery, and have been helpful in ensuring improved service delivery in targeted areas.

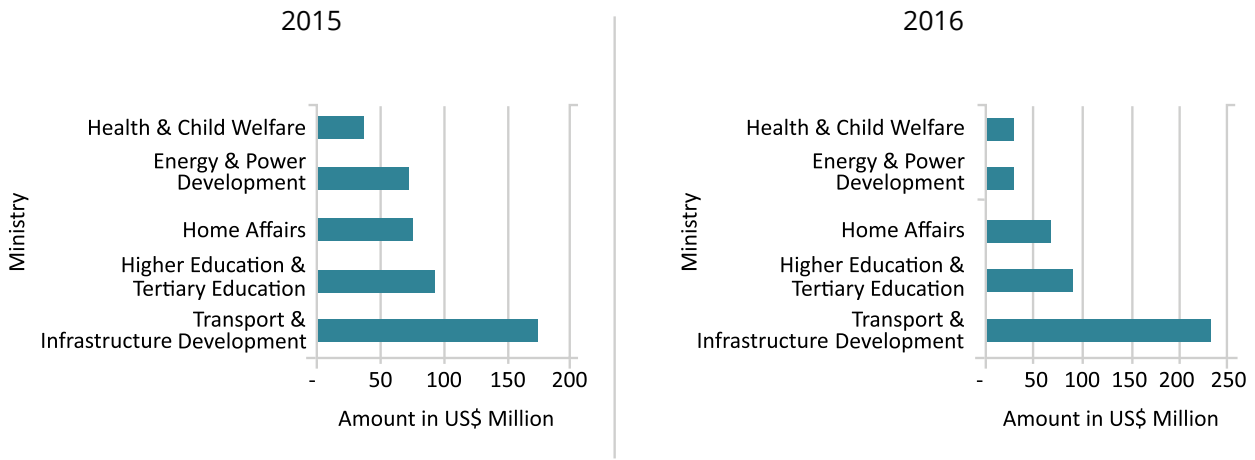
[5] The Blue book contains the estimates of revenues and expenditures presented to parliament.

Figure 2.18: Statutory Funds Budget, 2015 - 2016



Ministries' use of statutory funds has increased and have been predominantly used in transportation and infrastructure development. Twenty ministries were recorded as having statutory funds in 2015, and that number increased to 24 in 2016. The Ministry of Transport and Infrastructural Development topped the ranking, reflecting the collections made from the Road Fund. This fund is managed by Zimbabwe's National Roads Administration (ZINARA) and collects toll fees, road access fees, and vehicle licensing fees. Along with ZINARA, the Ministry of Higher and Tertiary Education, and the Ministry of Home Affairs were consistently in the Top 5 statutory funds spenders, as shown in Figure 2.19.

Figure 2.19: Top 5 Statutory Funds Budget, 2015 - 2016



The economic sector accounted for more than half of the statutory funds used in 2015 and in 2016 (see Table 2.3). The reason for the dominance of the economic sector is that services funded with user fees and levies, which come from statutory funds, are in the economic sector. The social sector ranked second averaging at 29 percent. As a consequence, this raises equity and accessibility challenges, particularly in the health and education subsectors.

Table 2.3: Sectoral share of Statutory Funds in percentages

SECTOR	2015	2016
Economic Sector	51	53
Other Sector	18	21
Social Sector	31	26
Grand Total	**100**	**100**

B. OTHER RESOURCES

Other sources of government financing include donor funding, loan financing, and public entities' own resources. Support from these sources amounted to US$852 million and US$795M in 2015 and 2016 respectively, which represented 15 and 16 percent of total available resources for those time periods as shown in Table 2.4. Available data for the same time period shows that more than 90 percent of these resources was earmarked for capital spending as shown in Table 2.5. The significant share of capital spending dedicated to other resources is consistent with its major compositions of loans from development partners and parastatals' own resources, which are mainly used for development expenditure.

Table 2.4: Other Resources in USD, 2015 - 2016

EXPENDITURE HEAD	2015	2016
Capital & Net-lending	796.3	739.0
Operations & Maintenance	56.0	56.2
Personal Emoluments	-	-
Grand Total	**852.4**	**795.2**

These other resources of financing are accounted differently in the Government books. Historically, donor support was recorded and reported through the Vote of Credit, while for the period 2009 – 2013 these figures were not recorded in the Government books. Currently, the Ministry of Finance and Economic Development aggregates information on the projects and programs financed by donors using an agreed format between the donors and the Government. The respective beneficiary Ministries monitor project implementation process. The support from development partners, though now being aggregated in the Estimates book of Expenditure is not appropriated by Parliament given that it does not use the Government Public Finance Management Process. Nevertheless, the data reported through this aggregation helps to reach a more detailed view of the composition of public expenditure. Public entities own resources include those funds directed towards financing of Government programs and project by public entities such as parastatals and local authorities. These resources are normally generated from user charges and fees collected by these entities. Also included in the budget are Government borrowed and guaranteed loans earmarked for financing public programs and projects and usually these are delivered through channeled through public entities.

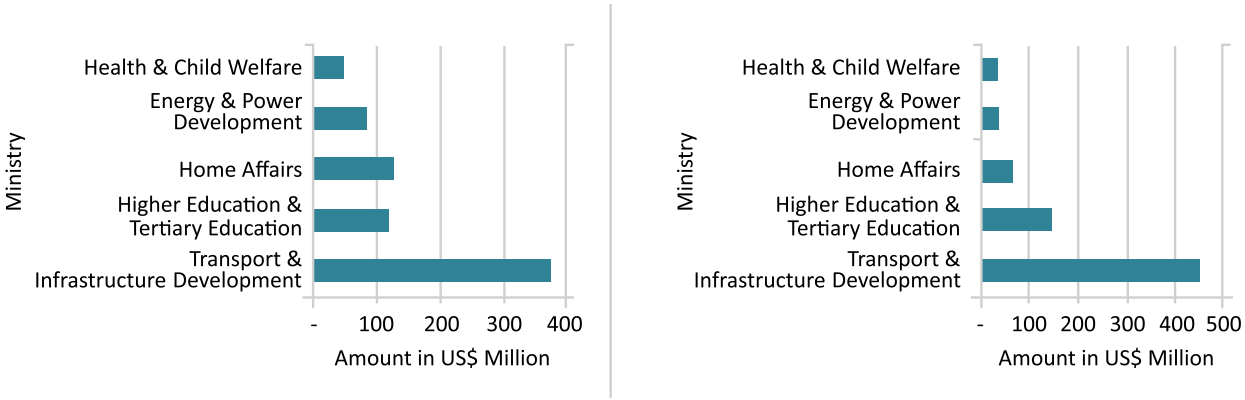
About 90 percent of the other resources are earmarked for capital spending. The significant share of the capital spending of Other Resources is consistent with its major compositions of loans, development partners support and parastatal own resources which are in the main used for development expenditure.

Table 2.5: Percentage share of Other Resources Spending by Budget Type

EXPENDITURE HEAD	2015	2016
Capital & Net-lending	93.4	92.9
Operations & Maintenance	6.6	7.1
Personal Emoluments	-	-
Grand Total	**100**	**100**

The number of ministries having expenditures and financing from Other Resources deceased to 10 in 2016 from 12 in 2015, however maintaining the same top five ministry spenders. For the two years, the Ministry of Energy and Power Development tops the ranking in terms of quantum of resources reflecting the loan funded projects namely Kariba South Hydro Power Station Extension, Hwange Deka Pump Station and Bulawayo Small Thermal Power Station. In addition, there has been consistency for the two years with regards to four Ministries in the Top 5 Other Resources spenders, comprising of the Ministry of Transport and Infrastructural Development, Ministry of Information Communication Technology, Postal and Courier Services, Ministry of Health and Child Care in addition to the Ministry of Energy and Power Development.

Figure 2.20: Top 5 Other Resources Spenders, 2015 - 2016



Support from other resources predominately went to the economic sector, accounting for 75 percent, on average, in 2015 and 2016, as shown in Table 2.6. This was mainly due to the loans component which makes the largest share of other resources channeled through parastatals, which carry out most of the infrastructure development work.

Table 2.6: Percentage share of Other Resources by Sector, 2015 - 2016

EXPENDITURE HEAD	2015	2016
Economic Sector	73	86
Other Sector	3	2
Social Sector	24	12
Grand Total	**100**	**100**

CHAPTER

THREE

Managingthe Public Sector Wage Bill

EXECUTIVE SUMMARY

This chapter discusses the role of the wage bill in Zimbabwe's public finances, which is among the largest in Southern Africa. Spending on personnel has increased dramatically in recent years, driven by the expanding size of the public workforce, and the rising average remuneration for public employees. The wage bill dominated the growth of public expenditures from 2011 to 2015. Moreover, the relative rigidity of wage expenditures tended to squeeze out expenditures in other categories, such as capital investment and operations and maintenance, which negatively affected expenditure quality.

The wage bill increased by an average of 15 percent during 2011 to 2015 – peaking in 2012 at a remarkable 42 percent increase year-on-year, before slowing to nine percent in 2013, and just one percent in 2015.

KEY CHALLENGES

1. Zimbabwe's wage-related expenditures account for an unsustainably high share of overall government spending, reaching 22 percent of GDP, 82 percent of total current expenditure, and 87 percent of total domestic revenue in 2015.

2. A high wage bill implies rigidity in the budget, and undermines the role of fiscal policy in economic development. The rigidity is expressed in two ways. First, wage bill costs are fixed in the short-term, such that variable costs tend to be squeezed out in constrained budget situations. Second, even carefully planned efforts to downsize the wage bill typically will not yield a full fiscal-year impact in any budget.

3. Employment allowances have experienced significantly higher annual growth than government salaries, which suggests further discretion and less transparency in the overall management of wage bill expenditures. Such allowances include pension costs, which the Government highly subsidizes as employee contributions are too low.

4. The implementation of a firm and robust plan for downsizing the number of personnel and overall wage bill-related costs has become even more difficult to achieve, as the wage bill has not been managed effectively in recent years. Additional staff have been hired, and the overall unit costs per staff (salary, allowances) have increased.

POLICY OPTIONS

The Government has taken steps to contain the growth of the wage bill, as evidenced by the diminished growth of costs from 2011 to 2015. With a view to generating savings of US$170 million per year, the most significant interventions announced in the 2016 Budget Statement included:

- *A freeze on personnel numbers, originally introduced in 2011.* Yet this freeze has not been successful in containing the growth of the civil service, due to insufficient implementation control.

- *No wage increases since 2014.* Though not an explicit and stated policy of the Government, salaries have not been adjusted since 2014. Performance-related salary increments have also not been implemented, thus there has been no nominal salary progression for civil servants.

- *Implementation of reforms linked to a civil service audit in 2015.* Based on this audit's recommendations, the Government has started to eliminate staff duplications and redundancies. In addition, the 2016 National Budget Statement includes a commitment to reduce the wage bill by rationalizing posts, reviewing leave policies in education, reducing employment cost obligations to grant-aided institutions, and cutting government top-ups to teachers in private schools.

Once fully implemented, these and other interventions are expected to generate savings of US$170 million, or about 1.2 percent of GDP, in full fiscal year impact. Yet in the mid-year Budget Statement of September 2016, the Government estimates that only $118 million of the projected savings will be realized this fiscal year, which is equal to an achievement ratio of about 70 percent. Though disappointing, this result is not surprising, as total employment costs in first six months of 2016 represented almost 97 percent of total revenues.

The following measures could imply short-term savings of additional 1-3 percent of GDP, in support of the Government's policy objectives on growth and social service delivery:

- Short term measures may include establishing a clear wage bill target and developing consistent policies. In this context, the Government might consider indexing public sector wages to inflation. Specifically, the MoFED could establish specific and short-term targets for controlling the wage bill, as a share of government expenditures. The Government's target to have total employment costs at 60 percent of total revenue by 2019 was not followed by a firm and explicit implementation plan. For example, the commitment to have "no wage increase since 2014" was not implemented. The total wage bill increased significantly in 2015, as did real wages at around 10 percent.

- Furthermore, the Government might reconsider allowance costs, such as removing accommodation and transport from the "13th cheque". The Government could also address insufficient employee contributions towards pension costs, which have resulted in additional monthly expenditures of US$39.8 million, or close to US$480 million for all of 2015.

- The Government could adopt specific plans for down-sizing staff and wage bill costs over the short- and medium term. This includes defining 'service levels': the number of staff requested to deliver social services and support the economic and general administrative functions of government. The resulting staffing plan is the starting point for assessing wage bill costs, and the means for specific right-sizing of staff size, and thus down-sizing of wage bill expenditures.

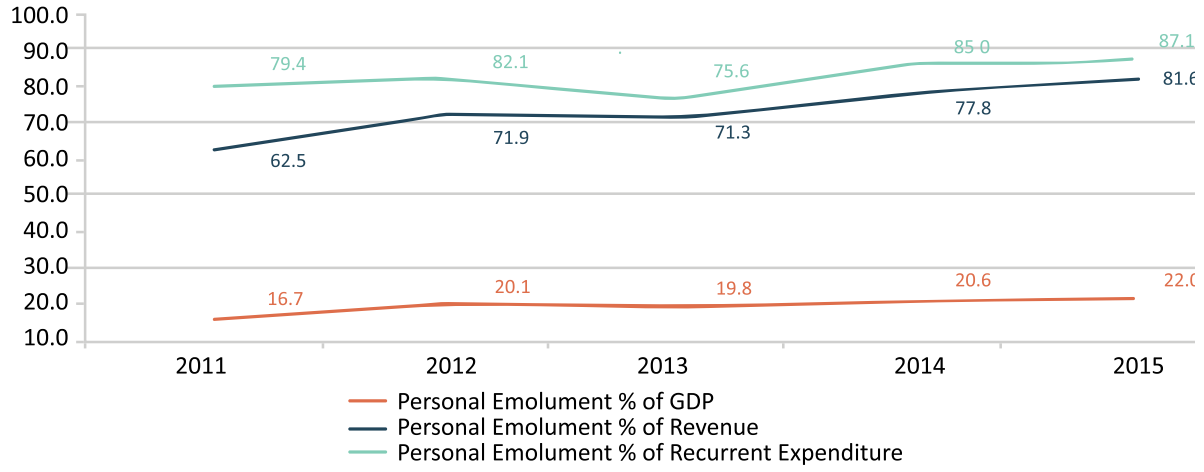
- In the medium term, the Government should consider reviewing and strengthening the Medium Term Expenditure Framework, and widening the adoption of program-based budgeting. A sound program budgeting process could link the level and composition of wage bill expenditures directly to the objectives and outputs of public service delivery, which would make prioritizing budget items, including wage-related costs, more explicit and transparent.

The 2016 IMF Staff Report for the Zimbabwe Article IV Consultation provides further details and recommendations on potential steps in wage bill reform.

1 INTRODUCTION

Zimbabwe's wage-related expenditures account for a substantial portion of overall government spending. The country's wage bill grew from 2011 to 2015 at an average year-on-year growth rate of 15 percent. The growth of the wage bill peaked in 2012 at 42 percent, before slowing to nine percent in 2013 and ten percent in 2014, and to one percent in 2015. In 2015, spending on wage-related expenses was 22 percent of GDP, 82 percent of total recurrent expenditure, and 87 percent of total domestic revenue. Hence, between 2011 and 2015, Zimbabwe's wage bill dominated public spending and grew consistently, except for the slight dip in 2013, as shown in Figure 3.1.

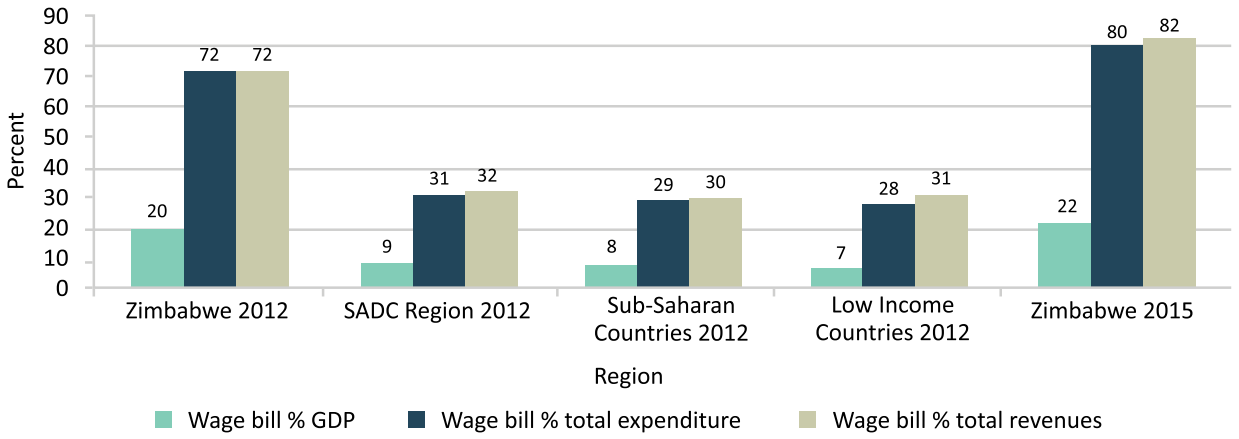
Figure 3.1: Wage Bill Expenditures Ratios (Percent)



Source: The Ministry of Finance and Economic Development.

Zimbabwe's wage bill is among the highest in Africa. In 2012, wage-related expenditures were 72 percent of total public spending and 20 percent of GDP. As a share of GDP, Zimbabwe's rate exceeded the SADC average by 11 percent, the Sub-Saharan African average by 12 percent, and the average of low-income countries by 13 percent. Measured as a share of total expenditures or revenues, Zimbabwe's wage bill is more than double the shares in SADC, Sub-Saharan Africa and low income countries (see Figure 3.2).

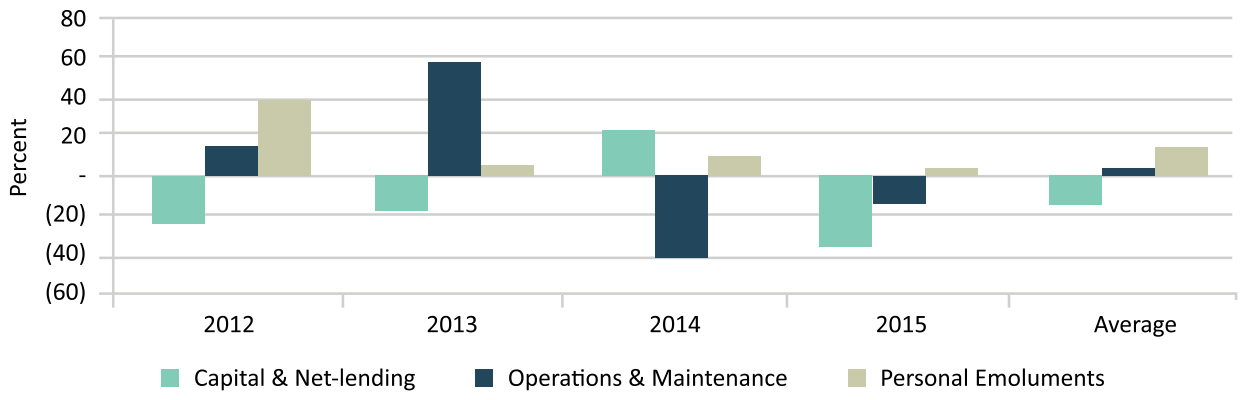
Figure 3.2: Wage Bill Indicators: Zimbabwe and Average Ratios for Comparative Groups



Source: The Ministry of Finance and Economic Development.

A high wage bill causes rigidity in the budget, undermining the role of fiscal policy in economic development. As illustrated in Figure 3.3, *personal emoluments* were the only expenditures with year-on-year growth between 2012 and 2015. Less rigid expenditure areas, such as average spending on *capital and net lending,* contracted year-on-year, while spending on *operations and maintenance* expanded slightly. These spending trends leave Zimbabwe with little room for fiscal maneuvering in financing infrastructure as well as operations and maintenance.

Figure 3.3: Year on Year Growth by Main Expenditure Categories, 2011-2015



Source: The Ministry of Finance and Economic Development and Authors' Calculations.

2 WAGE BILL BY ECONOMY CATEGORY[1]

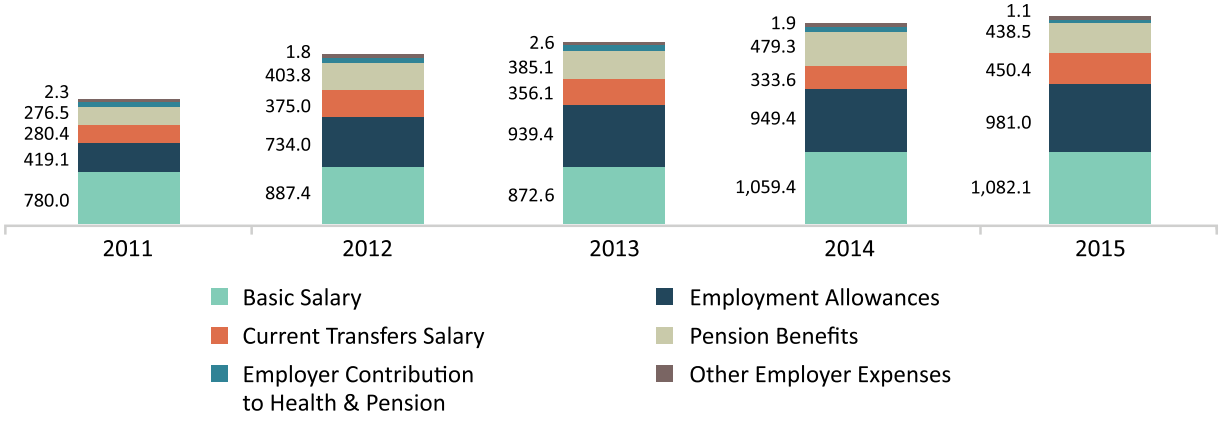
The wage bill in Zimbabwe can be classified into the following economic categories:

- **Basic Salary** – pensionable salaries to government employees.
- **Current Transfer Salary Payments** – salaries and employment allowances paid to staff employed by grant-aided institutions.
- **Employer Contribution to Health & Pension** – co-payments made by the Government to public employees' health insurance and pension contributions.
- **Employment Allowances** – contractual payments paid to government employees, such as housing and transport allowances.
- **Other Employer Expenses** – miscellaneous employment-related expenses paid by the Government to its employees.
- **Pension Benefits** – pensions for former central government employees.

All categories of the wage bill increased between 2011 and 2015 in nominal terms, as shown in Figure 3.4. *Basic salary,* on average, constituted the largest share of the wage bill, followed by *employment allowances and pension benefits.* Though representing an average of 36 percent of the wage bill, the share of basic salary fell from 43 percent in 2011 to 36 percent in 2015. On the other hand, the share of *employment allowances* rose from 23 percent in 2011 to 32 percent in 2015.

[1] For purposes of this analysis, adjustments were made to the external data as reported by the authorities, since the data for 2011 – 2013 that came from the Public Finance Management Information System could not disaggregate wage bill and operations and maintenance from current transfers.

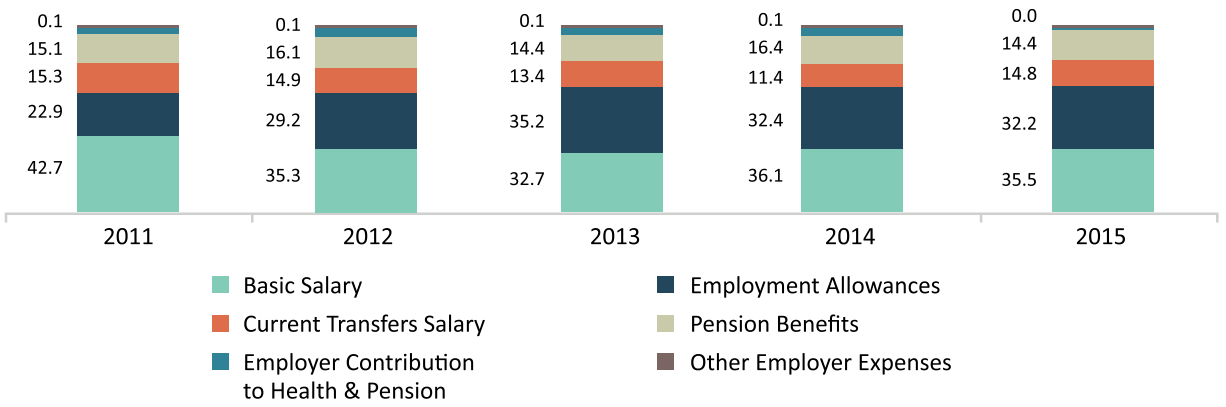
Figure 3.4: Composition of the Wage Bill Expenditure in Millions of USD, 2011-15



Source: The Ministry of Finance and Economic Development.

The growth in *employment allowances* is largely due to needs to adjust remuneration to the cost of living (see Figure 3.4). Bias towards reviewing and increasing allowances rather than *basic salary* is linked to the non-taxable status of *employment allowances* in the civil service, while *basic salary* constitutes taxable income. Raising allowances instead of the basic salary has been the simplest way to appease the work force's pressure on the Government when upwards adjustments are made to the non-taxable income bracket. The share of *pension benefits* remained relatively stable at around 15 percent (see Figure 3.5).

Figure 3.5: Composition of the Wage Bill Expenditure, in percent, 2011-15



Source: The Ministry of Finance and Economic Development.

The Public Service Pension Fund (PSPF) is in charge of administering pension benefits. As detailed in the Public Service (Pensions) Regulations, 2992, the PSPF is designed as an unfunded Defined Benefit pension arrangement, which is commonly known as 'Pay-As-You-Go' (PAYG). The PAYG arrangement uses pension contributions from current employees to meet the benefits of those who have retired, withdrawn from service, or died. Despite this design, the GoZ has funded the PSPF entirely since 2009, as employee contributions have not been solicited amid worsening economic conditions. Since June 2009, all members in the Public Service have received a standard 'allowance', initially pegged at US$100 per month, but reviewed and increased regularly. This expected PAYG pension arrangement suffers from a huge mismatch between employee contributions and payments for pension benefits, which is undermining the PSPF's sustainability. In 2015, the Government estimated that it incurs a monthly additional expenditure of US$39.8 million without adequate employee contributions.

Real wages in Zimbabwe increased about 55 percent from 2011 to 2015, averaging more than ten percent per year. As noted in Table 3.1, real wages grew by 26 percent from 2011 to 2012, though more slowly in recent years. Since 2014, the annual growth in real wages of about eight to ten percent surpassed growth in nominal wages, due to negative inflation rate.

Table 3.1: Development in Real Wage (2011-2015)

SECTOR	2011	2012	2013	2014	2015
Nominal Wages (millions USD)	1,758	2,402	2,556	2,824	2,953
Head count (Numbers)	219,847	229,070	231,549	237,106	229,610
Average nominal wages	7,998	10,486	11,038	11,909	12,861
Average real wages, in 2011 prices	7,998	10,109	10,470	11,321	12,528
Nominal average wages, growth		**31.1**	**5.3**	**7.9**	**8.0**
Real average wages, growth		**26.4**	**3.6**	**8.1**	**10.7**

Note: Real Wages = Nominal wage*2011 price index/current price index
Source: Figures 3.4 and 3.8

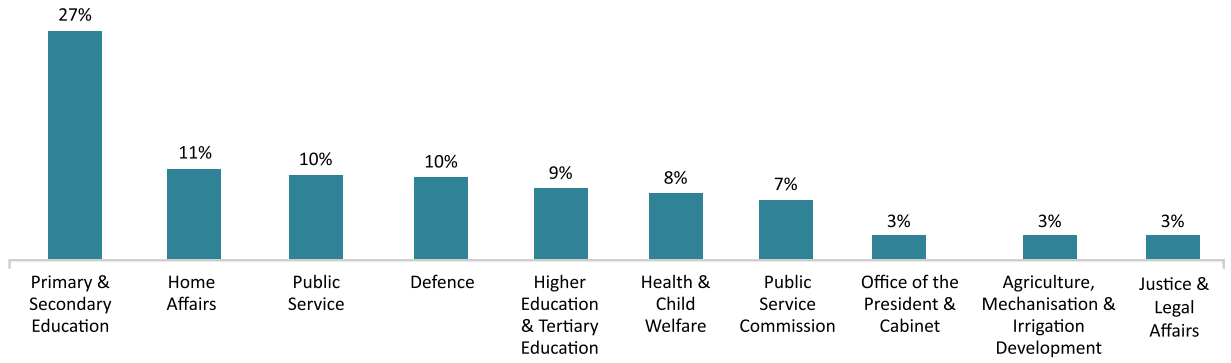
3 WAGE BILL BY ADMINISTRATIVE AREA

Most votes have registered sustained growth in the wage bill, which averaged 15 percent across all ministries from 2011 to 2015. The following public entities consistently accounted for 90 percent of total wage-related expenditures, as a share of their total budget:

- Primary and Secondary Education
- Home Affairs
- Public Service
- Defence
- Higher Education and Tertiary Education
- Health and Child Welfare
- Public Service Commission
- Office of the President and Cabinet
- Agriculture, Mechanisation and Irrigation Development
- Justice and Legal Affairs.

The Ministry of Primary and Secondary Education accounted for the largest share of expenditure on account of employment costs for teachers, as shown in Figure 3.6. Of the top 10 spenders, only the Ministry of Home Affairs and the Office of the President and Cabinet experienced sustained growth in wage bill expenditures.

Figure 3.6: Share of Wage Bill Expenditures by Vote, Average 2011-15



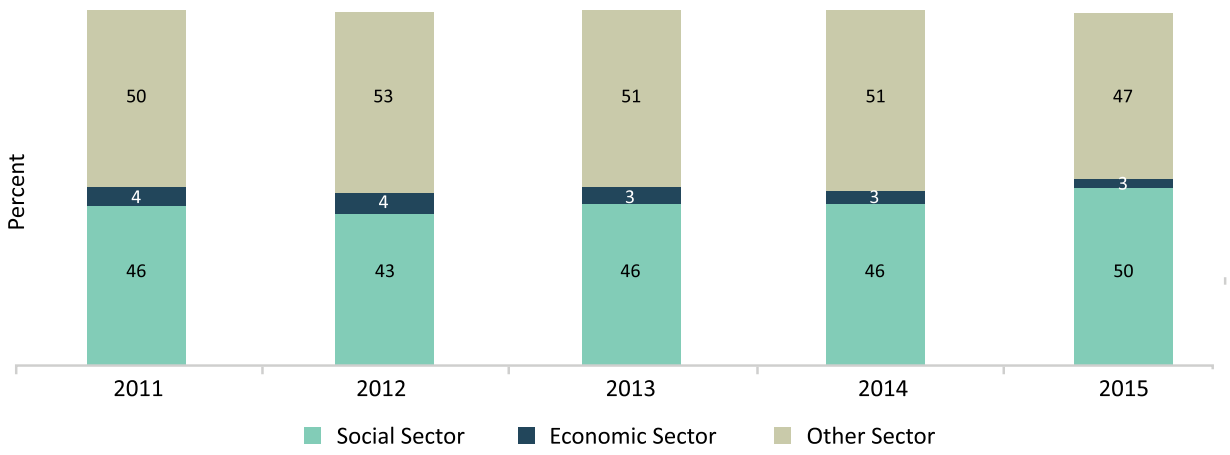
Source: The Ministry of Finance and Economic Development.

There were slight shifts in the list of top ten spenders on the wage bill. In 2012, the Ministry of Foreign Affairs dropped out of the top ten. The Public Service Commission joined the list in 2014 and 2015, after assuming responsibilities for funding pensions, which had previously been paid by the Ministry of Public Service, Labour and Social Welfare.. In recent years, the Ministry of Finance and Economic Development has joined the top ten reflecting employment costs under the Zimbabwe Revenue Authority (ZIMRA).

4 WAGE BILL BY SECTORS

The *other sector* and the *social sector* represented more than 95 percent, on average, of wage-related expenditures between 2011 and 2015. Conversely, the *economic sector* made up an insignificant share, or less than 4 percent, of the total wage bill. During this period, the *social sector* grew by 88 percent and the *other sector* 61 percent, but the *economic sector* grew by only 22 percent (see Figure 3.7).

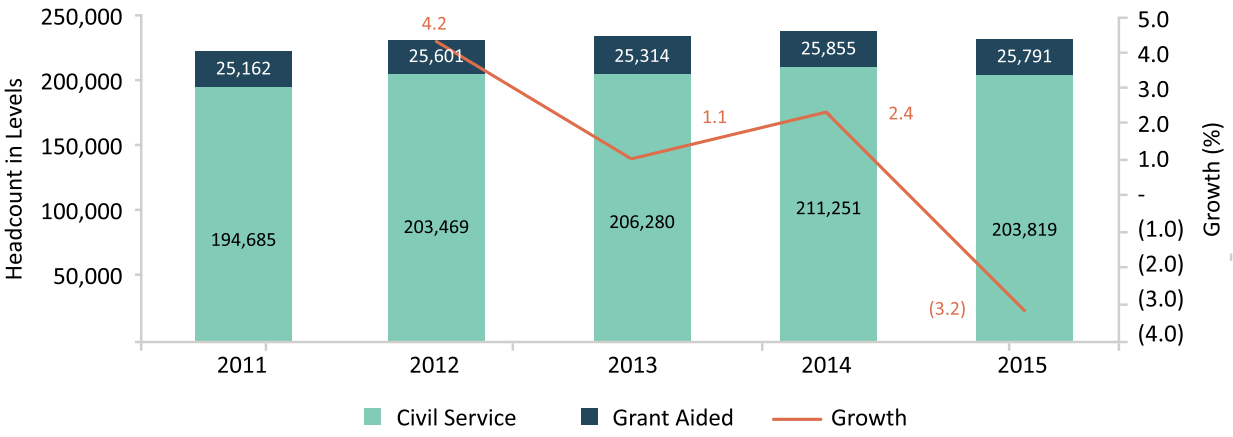
Figure 3.7: Composition of the Wage Bill by Sectors, 2011-2015



5 WAGE BILL DRIVERS

The growth in the wage bill was driven by increases in the average public sector salary, and expansion of the civil service. The number of government employees rose by 9,763 between 2011 and 2015. The government headcount increased from 219,847 in 2011 to 229,610 in 2015 – or 4.4 percent year-on-year . The average growth of the public service headcount was 1.1 percent, peaking in 2012 at 4.2 percent year-on-year, as shown in Figure 3.8.

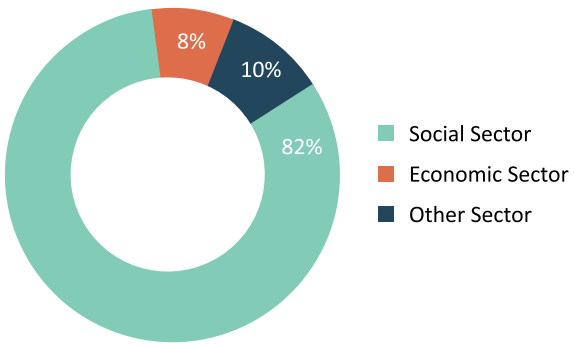
Figure 3.8: Public Service Headcount Numbers and Year-on-year Growth, 2011-15



Source: The Ministry of Finance and Economic Development.

The Ministry of Primary and Secondary Education (MoPSE) led public entities in growth of headcounts. The top ten government organizations in raw headcounts from 2011 and 2015 were the Ministry of Health and Child Care (MoHCC); Ministry of Agriculture, Ministry of Mechanisation and Irrigation Development (MoAMID); Ministry of Higher Education and Tertiary Education; Ministry of Youth, Indigenisation and Empowerment; Ministry of Local Government, Public Works, and National Housing; Office of the President and Cabinet; Ministry of Home Affairs, Labour and Social Services; and the Judicial Services Commission.

Figure 3.9: Employment Head Counts by Sector Classification, Average 2011-2015



Source: The Ministry of Finance and Economic Development, Author Calculations.

The reasons for high headcounts varied: the MoPSE employs a high number of teachers; the MoHCC employs nurses and doctors in central and local Governments and faith-based health institutions; and the MoAMID, which ranked third, supports extension officers at the ward level to support farmers. Though the top ten employing ministries registered an average drop of 1.4 percent in new headcounts, many government organizations recorded growth in employment, both in establishing and filling posts.

From 2011 to 2015, the *social sector* accounted for 82 percent of the total workforce in Zimbabwe's civil service and grant-aided institutions. In contrast, the share of the *economic*

sector and *other sector* trailed at eight and ten percent, respectively, as shown in Figure 3.9. The *social sector* employed an average of 187,506 workers – 89 percent of whom were part of the civil service, while the rest was employed by grant-aided institutions. Of the 24,129 employed in the *other sector,* 83 percent were in the civil service. The economic sector employed only 17,975, of whom 99 percent were in the civil service.

The highest growth in public service headcounts took place in the *social sector.* Employment in the *social sector* grew by five percent from 2011 and 2015, representing more than 9,000 new staff members (Table 3.2). Employment in the *other sector* grew by three percent, while employment fell by one percent in the *economic sector.* Over this period, the Government pursued a deliberate policy to improve social service delivery, which explains why growth in social sector employment exceeds the overall growth in public service employment of 2.3 percent.

Table 3.2: Sectoral Headcount (2011 -2015)

SECTOR	2011	2012	2013	2014	2015
Social	178,376	187,976	191,535	195,915	187,506
Economic	18,122	18,044	17,527	17,469	17,975
Other	23,349	23,050	22,532	23,722	24,129
Total	**219,847**	**229,070**	**231,594**	**237,106**	**229,610**

Source: The Ministry of Finance and Economic Development and authors' Calculations.

A. UNIT COST

The rise of salaries and allowances also contributed to an expanding wage bill from 2011 to 2015, as growth in headcounts cannot completely explain the rapid growth in wage expenditures. Salary increases and promotions, which grew by 72 percent from 2011 to 2015, resulted in upward adjustments to salaries and allowances, helping to propel the rapid growth of wage expenditure.

Adjustments to the pay scale were fairly equitable for grades A - E from 2011 to 2015. On average, salaries where adjusted upwards by 40 percent. Grades A and B received the highest increases of 49 and 44 percent, respectively. The higher grade of E received a 33 percent increase during the same period (see Table 3.3).

Table 3.3: Evolution of Pay Scales and Pay-Grade[2]

Evolution of Pay Scale and Pay Grade (In Percent)					
BAND	2011	2012	2013	2014	2015
E3	100	114	121	133	133
D3	100	115	122	136	136
C3	100	115	123	138	138
B3	100	116	123	144	144
A3	100	117	125	149	149

Source: The Ministry of Finance and Economic Development.

Table 3.4: Average Salary by Sector, 2011-2015

SECTOR	2011	2012	2013	2014	2015	AVERAGE
Social	4,536	5,802	6,513	7,038	8,124	6,403
Economic	4,235	5,741	5,885	5,362	5,216	5,288
Other	9,135	14,981	14,888	11,210	11,312	12,305

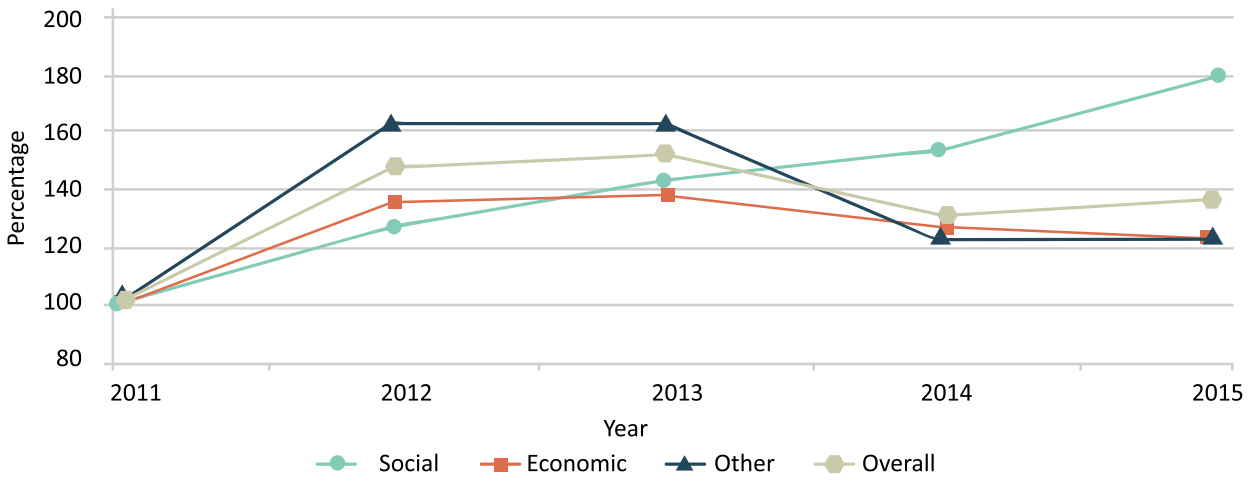
Source: The Ministry of Finance and Economic Development, Author Calculations.

Salaries were the highest in the *other sector,* but grew the fastest in the *social sector.*[3] In nominal terms, employees in the other sector earned the most, averaging salaries double those in the *economic sector* and *social sector,* as shown in Table 3.4. Yet salaries in the *social sector* grew by 79 percent from 2011 to 2015 – much faster than the 23 and 24 percent growth rates for the *economic sector* and *other sector,* respectively (see Figure 3.10). The growth in the social sector unit cost was driven mainly by salary adjustments in the education sub-sector, particularly salaries for university staff.

[2] The figures under this section use 2011 salary levels as their base. The reason is that the Government transitioned that year from paying government employees a flat US$100 allowance to paying salaries on a differential scale following the adoption of the multi-currency regime.

[3] In analyzing sectoral unit cost, we approximate the unit cost using a simple average by dividing total employment cost by the headcount.

Figure 3.10: Average Salary Trend



Source: The Ministry of Finance and Economic Development, Author Calculations.

B. ALLOWANCES

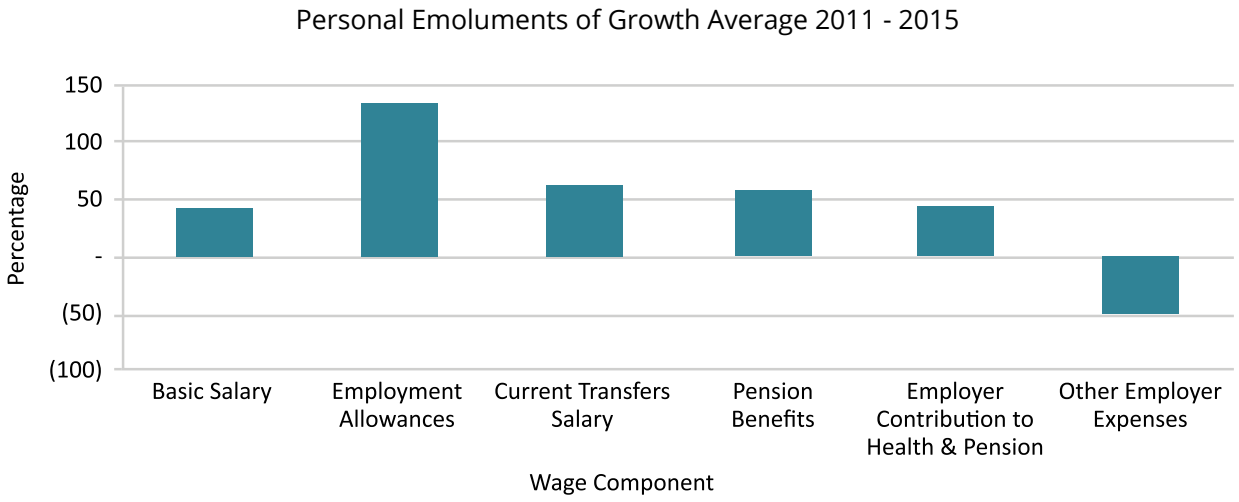
***Employment allowances* made up a significant component of the wage bill, hovering around 30 percent of total wage-related expenditures.** Though representing slightly lower than the 36 percent share for *basic salary, employment allowances* more than doubled between 2011 and 2015, as shown in Table 3.5 and Figure 3.11. *Employment allowances* increased by 134 percent, greatly surpassing the average growth in all categories of 67 percent. Such allowances were a major driver of growth in per unit cost.

Table 3.5: Personal Emolument Expenditure, Year-on-year growth Trends (2011 -2015)

ITEM	2011	2012	2013	2014	2015
Basic Salary	100	114	112	136	139
Employment Allowances	100	175	224	227	234
Current Transfers Salary	100	134	127	119	161
Pension Benefits	100	146	139	173	159
Employer Contribution to Health & Pension	100	161	161	157	142
Other Employer Expenses	100	79	115	85	48
Total	**100**	**138**	**146**	**160**	**167**

Source: The Ministry of Finance and Economic Development.

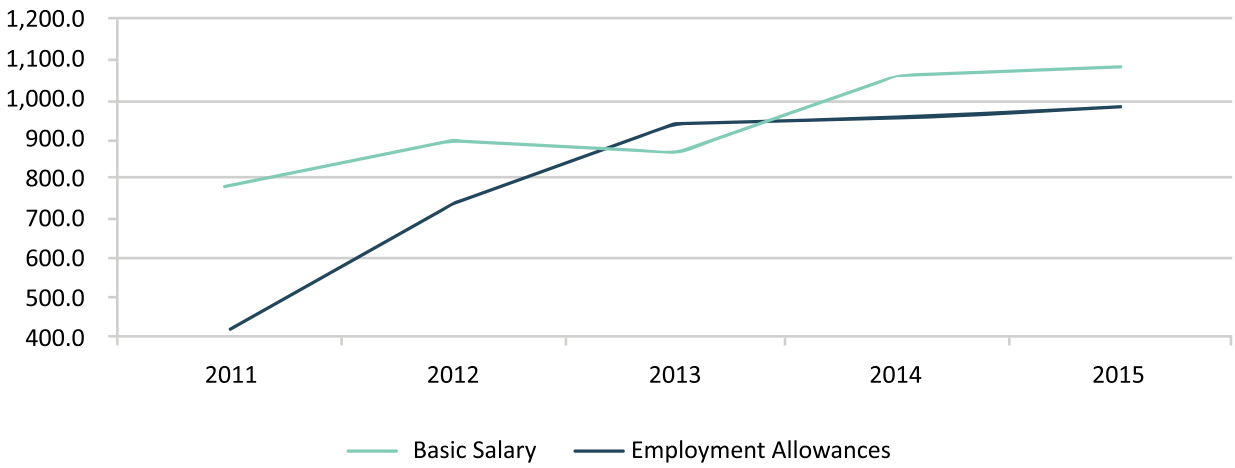
Figure 3.11: Composition of Personal Emolument Expenditure Trend



Source: The Ministry of Finance and Economic Development.

Wage-related data points to a positive correlation between basic salaries and *employment allowances,* which further stresses the importance of comprehensive government reform efforts. The correlation remained from 2011 to 2015, and indicates an indexation to some extent, and in which case adds additional burden on the authorities when attempting to contain the wage bill. This is also exacerbated by the faster growth in *employment allowances* than basic salaries, as shown in Figure 3.12.

Figure 3.12: Basic Salary and Employment Allowances Expenditure, 2011-15



Source: Ministry of Finance and Economic Development.

CHAPTER

FOUR

Strengthening Public Finance Management to Improve Service Delivery

EXECUTIVE SUMMARY

A transparent and accountable public financial management system is critical to fostering trust between citizens and the government, and ensuring the effective delivery of public services. PFM is commonly defined as the set of laws, rules, systems, and processes that countries use to allocate public funds, undertake public spending, account for funds, and audit results. This chapter examines challenges facing Zimbabwe's PFM system, and the Government's recent and ongoing efforts to improve the transparency and accountability of public expenditures.

Zimbabwe faces unique characteristic and hurdles affecting its PFM system. Given its large public sector, Zimbabwe must manage substantial public expenditures including central government expenditures representing 27 percent of GDP, which exceeds an average of 20 percent among comparable countries. Zimbabwe's PFM system, including its Integrated Financial Management Information System (IFMIS), do not fully capture funding from all fund sources, especially local governments, extra-budgetary funds, state-owned enterprises (SEPs), and external partners. Commitment controls are inadequate, which permits unbudgeted growth in the civil service and burdensome wage bill. In other areas, Zimbabwe has historically faced a misaligned budget process, a near-sighted budget perspective, weak transparency in financial reporting, and insufficient capacity to implement internal and external audits.

The Government has committed to a reform program to address these and other PFM challenges. Since adopting a multi-currency regime in 2009, authorities focused on re-establishing a well-functioning budget process and improving fiscal planning, budget execution, the integrity of public accounting, and the generation and dissemination of sound management information, to support public expenditure allocation and execution. Authorities expanded the coverage of the IFMIS to all ministries and provincial capitals, with a view to further expansion. In accordance with a new PFM Act approved in 2009, the Ministry of Finance and Economic Development (MoFED) and the Office of the Auditor General (OAG) now report regularly to Parliament, and monthly and quarterly consolidated financial statements are produced and regularly published in the Gazette. In addition, MoFED took steps to develop and roll-out a framework results-based budgeting (RBB), which support efficient and transparent budget allocation and budget execution.

Yet to succeed on this reform program, the GoZ seeks to deepen its efforts to address specific challenges impacting the accountability and performance of Zimbabwe's PFM system.

KEY CHALLENGES

1. Though the 2009 PFM Act establishes requirements for revenue and expenditure estimates and rules governing funds, the Act lacks specific provisions normally included in a budget system law, such as a detailed plan for the stages of budget preparation, as well as provisions for virement, which are necessary to ensure funds are used for their appropriated purposes.

2. Though Zimbabwe has prioritized adopting a medium-term budget perspective and RBB, officials face hurdles in implementing these approaches. Authorities have difficulties mapping budget allocations to medium-term RBB frameworks, given inadequate links between department and agencies budgets.

3. The PFM system continues to suffer from limited coverage of the IFMIS and inadequate commitment controls, which impair efforts to control costs, including on the wage bill. Not all agencies use the IFMIS to commit funds and manage expenditures and receipts, which has led to commitments to hire civil service employees without confirmed funding, and thus payment arrears. The insufficient procedures for handling arrears had an impact on

cashflow management. Payment of arrears also contributed to issuing T-bills in 2015, and a budget deficit in the first half of 2016.

4. Despite recent gains in coverage, the PFM system still does not formally capture and track funding from local governments, SEPs, and external donors. For example, the Appropriation Act does not cover all financing sources, such as some statutory funds and donor funds, despite certain funds appearing in budget statements.

5. Though Zimbabwe has increased the regularity of audits, the Office of Auditor General (OAG) and ministries lack adequate financial and human resources to implement external and internal audits. The OAG, for instance, lacks the resources to perform IT audits, special audits, forensic audits, and value-for-money audits. The audits outside of Harare face particular resource constraints.

POLICY OPTIONS

The Government should continue efforts to revise Zimbabwe's budget system, by introducing a more detailed law codifying budgetary procedures and provisions for virement in the treasury instruction as well as the Public Financial Management System, and by aligning the calendar for budget preparation with international standards.

The Government should continue work to improve results-based budgeting, which is being piloted in Zimbabwe. Since RBB systems link budget allocations to measurable outputs, it is crucial to integrate reforms into the national strategic framework, including medium-term development plans, such as Zim-Asset. Budget classifications (or "programs") should reflect the mandates, and the current and planned activities of ministries and other spending agencies. More complex programs can be broken into sub-programs to create specific objectives and targets, and enable precise monitoring of outputs. Programs and sub-programs are expenditure categories linked to specific objectives, and do not necessarily correspond to particular administrative units. In some cases, multiple agencies might receive allocations under the same program and contribute to the same policy goals.

The Government is advised to continue efforts to improve the transparency and effectiveness of the budget process, including by establishing a medium-term budget perspective. Authorities might consider:

1. increasing information and capture of extrabudgetary funds planned in the gross expenditure outlays of ministries and agencies;

2. strengthening the medium-term focus on expenditure levels and composition (i.e., Medium Term Expenditure Framework (MTEF) and MTFF); and

3. further applying revenue and expenditure forecasting tools and models to inform medium-term fiscal prioritization considerations, such as budget drivers and pressures related to structural costs of pensions and other entitlement programs. The expenditure and revenue forecasting tools should preferably be based on estimates of revenue from all financing sources, including user fees and charges.

Zimbabwe's government budget lists new tax incentives provided to the private sector, but does not report in the budget the cost of these incentives. International good practices[1] suggest that countries prepare a complete list of tax expenditures in the context of the annual budget preparation, and report the revenues foregone/tax expenditures in the budget, using the same format as corresponding expenditures supporting the same policy objective as the tax expenditures. Zimbabwe is currently not aligned with this practice, but the RBB framework provides a helpful point of departure for budgeting and reporting on these tax expenditures. The Zimbabwe Revenue Authority (ZIMRA) has been tasked with assessing tax expenditures, but its assessment methodology and results have not

[1] IMF, "Manual on Fiscal Transparency". 2014

been made public. ZIMRA and the Zimbabwe Investment Authority (ZIA) might jointly prepare cost-benefit analyses of tax expenditures related to attracting foreign direct investments, to help ensure the relevance and efficiency of tax exemptions in this important area.

The Government should work to expand the coverage of the PFM system in the IFMIS, by integrating local authorities, SEPs, extra-budgetary funds, and donor financing.

Zimbabwe could consider reforms to control its payroll commitments and costs, including by migrating its civil service software onto the Ministry of Finance and Economic Development information system Systems Application Products (SAP). Besides merging and centralizing payroll management system, a new IFMIS module would support commitment control better than the current system.

The Government could take complementary actions to strengthen employment and wage controls. These include enforcing limits on hiring, mandating administrative review of promotions, and establishing rules for using contract workers. In the longer-term, the Treasury could be more active in controlling the growth of the public workforce, and tightening oversight of irregularities in payroll management. For example, posts unfilled for a long time, or for which relevant agencies cannot provide a reasonable justification, could be abolished.

The Government might consider allocating more resources to support external and internal auditing. As the scope of the OAG's mandate expands, the Government must increase funding. In principle, the Government should always match resources with the growth of the OAG's responsibilities, such that its capacity to audit is not constrained.

1 BUDGET PREPARATION AND ADOPTION

Zimbabwe is making progress on preparing its budget in accordance with international standards. The country's national budget is now prepared according to international public sector accounting standards. However, efforts are underway to implement program budgeting, including producing results-based information. Authorities aim to create a more comprehensive budget by including expenditures by local authorities, extrabudgetary funds, and contributions by the country's development partners.

A. BUDGET STRUCTURE AND COVERAGE

The legal framework covering the country's PFM system has not been updated since 2010. The Public Finance Management Act (PFM Act) of April 2010 was the most recent PFM legislation that dealt with the national budget. The Act establishes the formal requirements and schedule for producing annual revenue and expenditure estimates, and submitting them to Parliament. The Act includes rules governing the authority to advance funds, circumstances under which appropriated funds may be withheld, and the duration of appropriations and warrants. However, the PFM Act lacks some specific provisions normally included in a budget system law.[2] For instance, the Act does not provide a detailed plan for the various stages of the budget preparation, approval and execution process. Nor does it have provisions for virements (transfer between votes) during budget implementation, which are necessary to ensure that funds are used for their appropriated purposes. Zimbabwe's budget system

[2] Budget system laws are also commonly referred to as organic budget laws. The IMF describes a budget system law as *"the formal expression of rules that govern budgetary decisions made by the legislature and the executive. The objectives of the formal rules are to specify what budgetary processes are prescribed in law, who is responsible, and when key budgetary steps should be taken."* This definition is found in: Lienert, I & Fainborn, I. 2010. Reforming Budget Systems Laws. IMF

is now being revised, and the introduction of a more detailed law codifying budgetary procedures will be a major step in the evolution of its fiscal policy process.[3]

The Government's Estimates of Expenditure Book (the "Blue Book") provides a limited description of each ministry's operations and priorities. The 2010 Blue Book introduced a single page listing for each ministry, detailing its mandate, key functions, overarching policy goals, operational objectives, and priority outputs in infrastructure and service delivery, which are being upgraded to include in the Book more performance information. However, as the Blue Book provides little practical information on a ministry's program or operational activities, the resources allocated during the budget process cannot be directly linked to specific public services. The budget covers different types of financing, including "votes"[4] statutory funds[5] and donor funds. However, statutory funds are shown in the budget statement, but do not appear in the Appropriation Act. Donor-funded projects were first included in the 2015 budget; they appear in the budget statement, but not in the Appropriation Act, as current donor funding is not now channeled through the government budget system. Budget documents clearly present revenues and expenditures of central government, but not of local authorities.

B. BUDGET PREPARATION - FORMAT AND TIMETABLE

Budget preparation begins in either April or May, when the MoFED initiates consultations with line ministries, the private sector, civil society, and Parliament. Based on these consultations and guided by national plans, the MoFED develops strategic priorities for the forthcoming budget year. At the same time, the MoFED prepares the Mid-Term Fiscal Review Policy (MTFRP), which is presented to Parliament in July.[6] In August and September, the MoFED formulates the macro-fiscal framework, which includes GDP growth and public revenue projections for the next fiscal year. Tentative expenditure targets are then developed based on the macro-fiscal framework. A Budget Strategy Paper (BSP), highlighting priority areas for the next fiscal year, is also presented to the Cabinet.[7]

A national budget is submitted to Parliament after a budget framework has been created and the Cabinet has provided its input. The budget process starts with the Budget Call Circular (BCC) informing line ministries of the expenditure ceilings for the next fiscal year, which will constitute the base for their proposed spending plans.[8] This is followed by the MoFED holding detailed budget discussions with line ministries to examine their policy priorities and expenditure plans to create performance agreements and formal budget proposals (see Table 4.1). Integrated budget and performance proposals are then prepared and used by the MoFED to create a consolidated budget framework, which is submitted to the Cabinet by mid-November. The Cabinet's input is incorporated in the final document, and the budget is presented to Parliament.[9]

Though it is consultative and relatively transparent, Zimbabwe's budget process deviates from international best practices in several important ways. For example, the legislature should be

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[3] Bird, A. Strengthening Institutions for the Preparation of Government Budgets.

[4] Defined in Section 1 of the PFM Act as follows: "A 'vote' is one of the main segments into which an appropriation Act is divided and which specifies the total amount which is usually appropriated per department in an appropriation Act; and is separately approved by parliament or a provincial legislature, as may be appropriate, before it approves the relevant draft appropriation Act.

[5] A statutory fund is any fund established by or in terms of any legislative act in Zimbabwe other than the PFM Act, but does not include a fund established by or for the purpose of a statutory body.

[6] The primary focus is on the fiscal performance in the current fiscal year, and on identifying necessary changes and adjustments to the annual budget. In practice, the review also contains a more forward looking update of the macroeconomic and budget framework and an analysis of policy and budget priorities. Like the budget statement, the review is presented to Parliament as a ministerial speech.

[7] The Budget Strategy Paper was introduced by the 2011 Mid-Year Fiscal Review Policy and commenced in 2012 to guide budgeting, while providing indicative fiscal priorities for 2013 and 2014.

[8] From 2009, the BCC has included expenditure targets (specific resource envelopes) for each department or agency within line ministries. The BCC covers current and capital expenditure.

[9] This comprises: (i) the Minister's Budget Statement, which is presented as a speech and sets out the underlying macroeconomic and policy framework for the budget, and outlines its expenditure priorities and revenue measures; and (ii) the Blue Book, which includes the detailed estimates of expenditure broken down by administrative ministry vote, departmental sub-vote and economic item.

allowed at least two months to review the draft budget proposals . However, the draft budget is usually debated in parliament in December, which may not allow sufficient time for detailed analysis. If approved, the budget proposal is sent to the president who signs it into law as an appropriation act.[9] The other good practices suggest that the initial consideration on the budget in Year t is based on the estimate of expenditure needs and composition as established in the budget process in $Year_{t-1}$. In Zimbabwe, the focus on the medium-term perspectives on expenditure levels and composition (MTEF and MTFF) is not strong.

Table 4.1: Budget Cycle

Year	MoFED Consultation with Line Ministries	Mid-Year Fiscal Policy Review Statement	Macro-Fiscal Framework	Budget Strategy Paper Presentation	Issuance of Budget Call Circular	Detailed Budget Discussions	Line Ministries Submit Spending Proposals	Budget Hearings with Line Ministries	Consolidated Budget Framework	Budget Presentation
2010		14 July 2010	Oct 2009	Not Yet Introduced	23 Sept 2009		16 Oct 2009			25 Nov 2009
2011		26 July 2011	Oct 2010	August 2010	10 Sept 2010	Sept - Oct 2010	1 Oct 2010	Oct 2010		25 Nov 2010
2012		18 July 2012	Oct 2011	30 Sept 2011	17 Oct 2011	Oct -5 Nov 2011	28 Oct 2011	Oct - 5 Nov 2011		17 Nov 2011
2013		18 July 2013	Oct 2012	Sept 2012	27 Sept 2012					15 Nov 2012
2014		11 Sept 2014	Oct 2013	Not Presented to Cabinet	17 Oct 2013		31 Oct 2013			27 Nov 2013
2015	20 Oct - 21 Nov 2014	30 July 2015	Oct 2014	Oct 2014	17 Oct 2014	3 Oct - 9 Nov 2014	31 Oct 2014	3 - 9 Nov 2014		26 Nov 2014
2016	1 Oct - Nov 2015		Oct 2015	Oct 2015	21 Sept 2015	1 Oct - Nov 2015	16 Oct 2015	19 Oct - 6 Nov 2015		26 Nov 2015

[10] The need for improving the budget cycle, in terms of transparency and allocation of time for the Parliament to review, is also highlighted in the recent TA report by the IMF, "Zimbabwe Public Financial Management Reform Strategy". April 2015

[11] The 2010 PFM Act specifies that the draft budget should be submitted to parliament "not earlier than thirty days before and not later than thirty days after the start of the forthcoming financial year". The draft budget is customarily presented during the first week of December.

The costs related to tax expenditures should be integrated in the budget preparation, to inform budget allocations and priorities. Currently, Zimbabwe's government budget lists new tax incentives provided to the private sector, but does not report in the budget the cost of these incentives. International good practices[12] suggest that countries prepare a complete list of tax expenditures in the context of the annual budget preparation, and report the revenues foregone/tax expenditures in the budget, using the same format as corresponding expenditures supporting the same policy objective as the tax expenditures. Zimbabwe is currently not aligned with this practice, but the RBB framework provides a helpful point of departure for budgeting and reporting on these tax expenditures. The Zimbabwe Revenue Authority (ZIMRA) has been tasked with assessing tax expenditures, but its assessment methodology and results have not been made public. ZIMRA and the Zimbabwe Investment Authority (ZIA) might jointly prepare cost-benefit analyses of tax expenditures related to attracting foreign direct investments, in support of ensuring relevance and efficiency of the tax exemptions on this important area.

C. INTRODUCTION OF PROGRAM- AND RESULTS-BASED BUDGETING

Zimbabwe has begun to transition from line-item budgeting to a results-based budgeting (RBB) system. RBB systems classify budget allocations according to measurable outputs clearly linked to program areas, policy objectives, and performance criteria (see Figure 4.1). RBB was formally adopted in 2006 as one component of a broader results-based management (RBM) reform program coordinated by the Office of the President and Cabinet (OPC). The MoFED introduced a set of intermediate reforms in 2010 based on international experience with RBB. The Government's objective is for *"program budgets [to] present more useful information on service delivery and allow for transparency and accountability in service delivery...*[assisting policymakers in] *determining whether allocations reflect priorities; planning the delivery of services; monitoring the use of resources within each program; [and] identifying areas where savings can be made or where more funds are needed."*[13]

RBB plays a key role in the Government's fiscal strategy. The country's medium-term development plan ("Zim-Asset") recognizes that since Zimbabwe *"will continue to experience fiscal space challenges going into the near future, there is great need to optimize utilization of the scarce revenue streams that flow into Treasury. This Plan, as reiterated, will be greatly guided by the Results Based Management System and Results Based Budgeting (RBB) which emphasizes achievement of tangible and high quality results from limited resources."*[14]

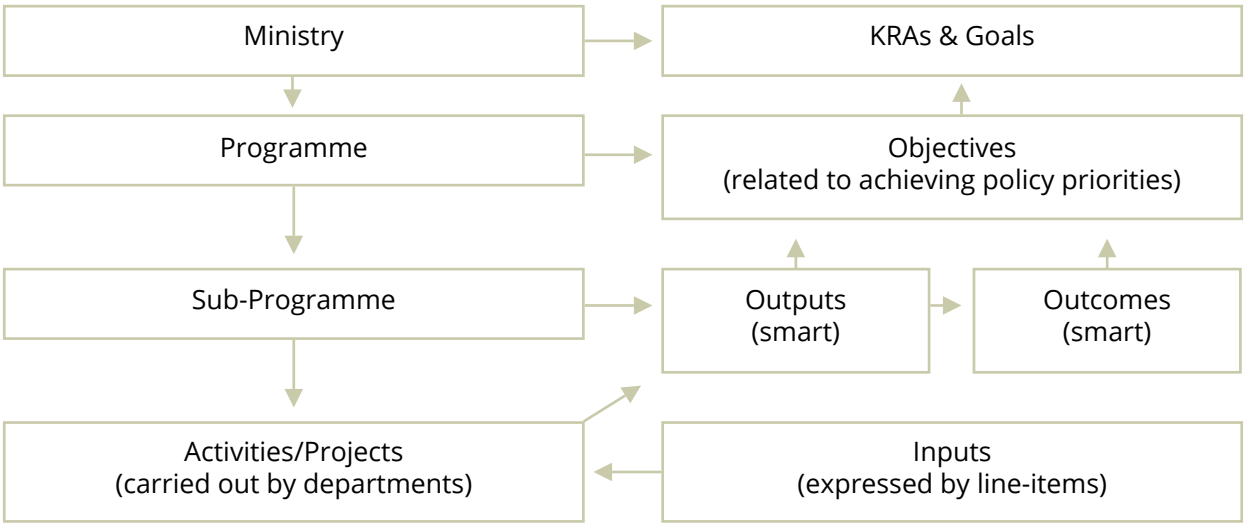
Adopting an RBB system requires a sound financial management foundation and significant administrative capacity. For RBB systems to be effective, foundational reform step must be taken. Certain developing countries such as Thailand attempted to adopt sophisticated RBB systems without first establishing adequate policy and institutional frameworks, resulting in substantial opportunity costs. However, Zimbabwe has rightly embedded its RBB reforms within its broader PFM reform agenda, and tailored reforms to the national context. Figure 4.1 below presents a conceptual framework for the RBB concepts and framework.

[12] IMF, "Manual on Fiscal Transparency". 2014

[13] Excerpted from a speech by the Director of the Recurrent Budget at an October 2014 training event.

[14] The Government of Zimbabwe. 2013. Zimbabwe Agenda for Sustainable Socio-economic Transformation.

Figure 4.1: Overview of Key RBB Concepts[15]



Revisions to the budget calendar and process are intended to facilitate an RBB system. Zimbabwe's RBB system will require ministries to produce quarterly reports detailing their physical outputs and financial performance. Yet contrary to international good practice, which calls for a longer budget timetable when RBB framework is incorporated in the budget presentation, the PFM Act states that, *"the Minister shall lay before the House of Assembly the annual budget for the forthcoming financial year, not earlier than thirty days before or not later than thirty days after the start of the forthcoming financial year"*.[16] Under the proposed budget-planning timetable, budget preparation will take place between May and November. The revised budget cycle recognizes the importance of allowing time for strategic analysis and planning prior to preparing detailed ministry budget estimates. The MoFED will develop the budget framework in August, and line ministries will have already undertaken strategic planning exercise in the August and September. The revised cycle supports regular reporting, monitoring and performance evaluation throughout the year.

The Government is committed to implementing RBB reforms quickly and comprehensively.[17] In 2016, authorities will pilot RBB in three ministries: Health and Child Welfare; Primary and Secondary Education; and Public Service, Labour and Social Welfare. At a workshop in February 2015, the Blue Book was reformulated according to an RBB-based structure for these ministries. Officials from these ministries reviewed and verified the appropriateness of strategic objectives linked to output and outcome indicators, and set targets for indicators based on expected funding.

However, authorities face challenges in mapping budget allocations onto RBB frameworks. Currently, expenditures are disaggregated to the level of sub-votes – Departments and Agencies. However, these are not always easy to link to programs and sub-programs, and no clear link exists between departmental budgets and sub-vote budgets. Incorporating personnel costs into the new system is also difficult, as in some cases a single employee contributes to as many as two programs and four sub-programs. Further refinements to the program structure of the RBB system may be required to track personnel costs and resolve these challenges.

An efficient RBB system also relies on financial transparency. The Government used the RBB methodology to prepare the 2016 budget for the three pilot ministries, and is developing a phased approach to implementing RBB based on these pilots.[18] Yet an RBB system needs targets for output

[15] KPA = Key Performance Area, and the source is the MoFED draft budget manual 2013.

[16] Section 28 of the PFM Act.

[17] The World Bank. Mission Report for PBB implementation. 2015

[18] The three initial pilot ministries are referred to as Pilot 1, and a new group of six ministries will be introduced in 2015 as Pilot 2.

and outcome indicators based on a comprehensive fiscal picture including all relevant expenditures. It will thus be necessary to develop a more thorough understanding of sectoral funding sources not included in the national budget, such as project-based foreign aid, and local development programming funded with own source revenues.

2 BUDGET EXECUTION

Numerous ministries and agencies are responsible for budget execution, though all financial flows are controlled by the MoFED. A high and rising wage bill, and inefficient procurement processes are hurdles to successfully implementing the Government's development plan. Major reforms planned to tackle these hurdles will be monitored by the OAG, which reports regularly to Parliament on budget execution issues.

A. STRENGTHENING CASH CONTROLS THROUGH AN INTEGRATED FINANCIAL MANAGEMENT SYSTEM

The budget execution cycle begins in January, when the MoFED requests annual cash-flow projections from line ministries. These projections are based on quarterly expenditure ceilings, and broken down monthly and updated quarterly. MoFED is supposed to release funding to line ministries each month, but cash constraints often force MoFED to base budget releases on available cash to minimize its arrears. Each ministry submits a monthly expenditure report, and the MoFED produces a consolidated financial statement at the end of the year.

Budget classification is based on a modified cash accounting system, which records transactions at the time of payment. In 2009, the Government adopted international public sector accounting standards (IPSAS) for cash accounting. The MoFED has a cash management committee, which meets weekly to determine spending priorities.[19] This committee typically gives priority to wages, and ZIMRA is required to make daily submissions of tax payments as received from taxpayers, in times of high fiscal pressure. Under normal circumstances, ZIMRA submits collections to the Treasury every Tuesday and Thursday. Cash-based budgeting is problematic in Zimbabwe because a large share of private sector activity relies on government spending. In other words, the country faces a vicious circle in which fiscal expenditures depend on revenues from the private sector, which depends on fiscal expenditures.

Banking Arrangements for the Central Government

The Zimbabwean Constitution provides for the establishment of a consolidated fund maintained by the RBZ. The Constitution further provides for exceptions in the form of funds established from separate acts of Parliament, such as the Zimbabwe Roads Administration Fund. In addition, the Constitution provides for the establishment of funds laid out in the Public Finance Management Act. Consolidated funds are banked with the RBZ, with all receipts paid into a single exchequer account. For administrative purposes, sub-exchequer bank accounts are established with commercial banks with overnight sweeping arrangements allowing transfers into the main exchequer account. The Government maintains a paymaster general's account and a series of sub-paymaster general's accounts at the RBZ. Line ministries effect payments for services through these sub-paymaster general's accounts. Transfers into these accounts are made to meet specific transactions approved by the Treasury. All transfers into the sub-paymaster general's accounts are effected through direct instructions from the Accountant General to the RBZ.

[19] The Committee is chaired by the Accountant General, and include of officials from ZIMRA.

For funds established under the PFM Act, the fund regulations are reviewed by the Treasury and tabled in Parliament for formal approval. The Treasury approves all bank accounts for these funds. From January 31, 2016, the RBZ will maintain all these accounts unless the Treasury grants an exemption. As technological investments improve, the Treasury expects to move towards a single treasury account covering all central government operations and all extrabudgetary funds, per current best practice. No timetable has been set for this reform.

The RBZ operates the centralized payment process under which budget appropriations are deducted from the consolidated fund through an integrated financial management system (IFMIS).[20] IFMIS transaction records are reliable and current,[21] and fiscal controls adequate. The IFMIS helps to ensure the timely publication of monthly, quarterly and annual reports. Appropriate security software is in place, but no security audit has yet been performed. The Government is planning to incorporate two statutory and two treasury funds into the IFMIS from July 1, 2016. The targeted funds include the Zimbabwe Roads Administration Fund, the Zimbabwe Manpower Development Fund, the Zimbabwe Republic Police Retention Fund, and the Zimbabwe National Registry Retention Fund.

B. WAGE BILL

The Government could improve how it administers and audits Zimbabwe's public employment. Contracts for employment continue to create recurrent spending obligations, but inadequate commitment controls fail to ensure sufficient resources are available to fund new positions. An audit undertaken by the Civil Service Commission (CSC) in 2015 indicated over-establishments in some posts, including 5,588 teachers over the authorized level. The CSC's audit was limited to members governed by the Public Service Act (Chapter 16.04), as the CSC is not authorized to audit the uniformed services, the judiciary, the health sector, and officials employed by local authorities. The former three have their own Service Commissions, while the Ministry of Local Government provides oversight over local authorities.

While reducing the size of the civil service will be necessary to ensure long-term fiscal sustainability, these reforms are administratively complex and will take time to yield significant savings. Taking the recommendations from the 2015 civil service audit, the government have started to eliminate duplications and redundancies. The 2016 National Budget Statement indicates government's commitment to reducing the wage bill through, rationalizing posts, reviewing leave policy in the education sector, reducing employment cost obligations to grant-aided institutions and cutting government top-ups to teachers in private schools. These and other measures are expected to generate savings of $170 million, which amounts to about 1.2 percent of GDP in 2016.

C. PUBLIC INVESTMENT MANAGEMENT

Historically, Zimbabwe has exhibited relatively low rates of capital spending. Capital expenditures averaged less than ten percent of total primary expenditures in the mid-1980s. Expenditures rose to around 12.5 percent in the early 1990s, but collapsed to 2.3 percent in 2000. Now at nine percent, Zimbabwe's capital budget is far below the international standard for developing countries of 25 percent of total primary expenditures.

The execution of capital budgets remains a challenge for the Government. In 2009, when hyperinflation reached its peak, government institutions disbursed only 25 percent of the approved capital budget. After the adoption of the multi-currency regime, such institutions disbursed in 2010 a much higher 90 percent of the capital budget. However, expenditure execution weakened again in 2011, as rising revenues outstripped the relatively low absorptive capacity of public institutions. As a result, only 65 percent of budget allocations were disbursed in 2011. This trend continued from 2012 to 2014 – even as revenue levels stabilized.

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[20] The Committee is chaired by the Accountant General, and include of officials from ZIMRA.

[21] Introduced in 2004, the IFMIS is based on SAP /R3 software, and is being implemented in all 37 line ministries and ten provincial areas.

Weaknesses in the project cycle compound limited absorption capacity and uneven execution rates. Zimbabwe's public investment management (PIM) system suffers from inefficiencies in project selection, delays in the designing and completing projects, procurement delays, cost overruns, incomplete projects, and a failure to operate and maintain assets effectively.[22] Challenges in planning, procurement, human capital, and organizational and institutional capacity jeopardize the success of investment projects, even when financial resources are available.[23] Zim-Asset provides strategic guidance for line ministries to prepare and pre-screen project proposals, but linkages are unclear between sectoral strategies, budget allocations, and actual disbursements.

Existing contracts with implementing firms are rarely reviewed to determine whether they continue to reflect value for money. In most PIM systems, existing commitments are typically the first to receive budget allocations. Existing projects – if correctly prioritized when approved – should take precedence over later (and lower-priority) projects. In Zimbabwe, due to long delays, completing a project may no longer represent the best use of funds.

The Public Sector Investment Program (PSIP) of MoFED and implementing ministries engage in consultations to appraise public investment projects. Both central agencies and line ministries require capacity building in appraising and analyzing the feasibility of projects. Currently, the Infrastructure Development Bank of Zimbabwe (IDBZ)[24] is providing project management assistance for some government infrastructure projects.

Zimbabwe has taken steps to use public-private partnerships (PPPs) to increase capital spending. The Government issued PPP guidelines in 2004, which established the institutional framework and mechanisms for awarding PPP contracts. A new act covering PPPs was enacted in February 2016. Despite government efforts to attract investments and implement large projects under the new law, PPPs have not yet emerged as a sustainable model for financing capital investments in the country. Current negotiations on the proposed PPP structure of the BeitBridgeHarare-Chirundu Road could provide an early opportunity to assess the viability of PPPs in Zimbabwe.

The impact of external assistance on public investment is not fully accounted for in the Government's budget.[25] Donor-financed projects, though monitored by line ministries and the MoFED, are mostly excluded from the budget formulation process. In practice, developing partners commonly make initial investments, but projects may entail recurrent costs and complementary capital expenditures not fully accounted for in the budget. Excluding projects from the normal budget process prevents ministries from accounting for the full costs of projects, and coordinating their investment decisions accordingly.

Some of Zimbabwe's international partners are preparing to provide investment budget support at the sector level, which risks suffering from the same accounting deficiencies. China has started providing government-to-government grants and loans to invest in sectors, such as health, education, and transportation. Japan has expressed an interest in investing in an energy project in partnership with the Ministry of Energy and Power Development. The Indian Government plans to offer a concessional loan of US$87 million in the energy sector. Authorities have not signed formal agreements, and continue to negotiate the details of these arrangements. However, this bilateral assistance would also fall outside the normal budget process, clouding the real costs of investments.

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[22] Rajaram, A et al. 2010. A Diagnostic Framework for Assessing Public Investment Management. World Bank.

[23] 2011 National Budget Statement.

[24] IDBZ is a government- and privately-financed development bank.

[25] World Bank. Public Investment Management Efficiency Review. June 26, 2012

D. PUBLIC PROCUREMENT

Strengthening procurement is important to the PFM agenda. Zimbabwe must have a well-functioning public procurement system to ensure its public finances are used effectively and efficiently – even more so given the scale of public spending in the country. Yet Zimbabwe's procurement system only recently resumed its normal functions after severe disruptions during the hyper inflationary period of the mid-2000s.

Zimbabwe is implementing far reaching public procurement reforms. The reforms entail developing a revised legal and institutional framework supported by new public procurement practices and regulations. Key elements of the proposed framework are:

- Replacing the State Procurement Board with an independent procurement agency, which will serve as a regulatory authority;
- Decentralizing procurement to individual procurement entities, and establishing the administrative structures needed to effectively implement decentralized procurement;
- Incorporating inspection arrangements, performance monitoring, and evaluation into the procurement framework, including a policy where the failure of a service provider to meet minimum standards could lead to suspension;
- Improving the planning and efficiency of procurement and supply management, and providing linkages to available budgets; and
- Creating and enforcing penalties for procurement officers and offending service providers.

As part of this reform effort, the Government recognizes the need to invest in capacity building for the regulator and procurement entities. A capacity building initiative implemented over a two-year period should be adequate. The roadmap for promulgating the new law runs to June 2016.

3 AUDITING & REPORTING

The PFM Act aims to establish a framework for ensuring the *"transparency, accountability and sound management of (public) revenues, expenditures and liabilities."* The law specifies the responsibilities and obligations of major PFM authorities, reporting requirements for the use of public funds, financial management obligations of public agencies, provisions for government borrowing and guarantees, audit requirements, and protections against financial misconduct.

A. INTERNAL AUDIT

Section 80 of the PFM Act grants the PSC the authority to appoint an internal auditor to any ministry or reporting unit of a ministry. Section 80 also defines the functions[24] of internal auditors

[26] These include monitoring the financial administration and procedures of the ministry or reporting unit by ensuring that: (i) Proper accounting and bookkeeping transactions and procedures are carried out; (ii) Proper accounting records are maintained; (iii) Adequate internal checks and controls are observed; (iv) Assets under the control of the ministry or reporting unit are properly accounted for; and (v) Generally, that the requirements of this act are being observed, and to assess the cost-effectiveness of any projects undertaken by the ministry or reporting unit concerned.

in all ministries. Internal auditors are required to prepare an annual audit plan, which is reviewed and approved by the Accountant General. This plan forms the basis for special audit assignments, compliance audits, financial statement reviews, and project reviews. Subsequently, the internal auditor issues an audit report to the relevant ministry's permanent secretary, with copies to the Auditor General, the Accountant General, and the head of the agency. Treasury desk officers are responsible for writing the Director of Finance and Administration at the ministry to follow up on the internal auditor's recommendations. The ministry is expected to submit a detailed action plan to the Treasury.

In practice, Zimbabwe's internal audit function lacks independence, staffing and resources. Ministries tend to understaff and under-resource the internal auditor position, undermining its effectiveness. For example, the Ministry of Public Service, Labour and Social Welfare allocated only 0.005 percent of its 2015 budget to the Department of Internal Audit,[27] while the Ministry of Primary and Secondary Education revealed that certain schools have not been subject to an internal audit since 1980. Institutions have inadequate funds to train professional auditing staff,[28] including in systems application products (SAP) or Information Technology (IT) auditing supported by IT-based approaches. Responses to audit recommendations are inconsistent: ministries and public agencies have a high response rate, but others do not respond at all. The recently launched World Bank Public Financial Management Enhancement Project (PFMEP) will invest in internal auditing improvements, including capacity building and the building blocks for establishing an independent internal audit function.

Section 84 of the PFM Act mandates that internal audits be carried out under the oversight of audit committees in each agency. There are opportunities to extend these committees to other ministries and build their capacity. The positioning of chief internal auditors at the level of deputy director limits their perceived authority within government. Though each ministry is required to have an audit committee, only the Ministry of Health has established one – and even this committee does not meet the Act's requirements.[29] Work to establish internal audit committees should accelerate under the PFMEP.

In principle, internal auditors should conduct performance audits and IT audits; however, in practice, most resources are consumed by compliance audits. The quality of audits has been undermined by the limited use of official auditing manuals and international accounting standards. Consequently, a substantial risk is that the internal audit system may be unable to prevent or detect serious irregularities, indications of misuse, or systemic inefficiencies.

B. EXTERNAL AUDIT

The Office of the Auditor General (OAG) is Zimbabwe's supreme audit institution, but has historically not focused on wage-related spending. The OAG's authority is constitutionally guaranteed. The OAG works with the International Organization of Supreme Audit Institutions (INTOSAI), and the African Organization of Supreme Audit Institutions (AFROSAI) to keep updated on international accounting standards and practices. The OAG's annual operations are based on a three-year Strategic Plan (2013-15).[30]The OAG carries out three types of audits: financial, regularity and IT.[31] It uses risk

[27] US$149,079 out of a total budget of US$27,311,000. To further put this in perspective, the Department of Finance and Administration was allocated US$1,047,252 while the top management received US$301,006.

[28] There are very few auditors who would comply with the International Audit Education Standards in an internal audit. The number of qualified staff (CIA, CA, ACCA, etc.) is insufficient considering the expected work load. Having no professional affiliation means that internal auditors have no one regulating them, continual professional development is absent, and international best practices are not followed.

[29] The committee shall consist of at least three persons. In the case of a ministry: (i) one person shall not be a member of the public service; (ii) the majority shall not be persons employed in that ministry, except with the approval of the appropriate minister; and (iii) the chairperson shall not be a member of the public service employed in the ministry. The committee has not yet met since its formation, though it is required to meet at least twice a year.

[30] Strategic plans are usually for five years.

profiling to determine which agencies to audit.[32] After determining audit priorities, the OAG identifies specific items to audit. Between 2009 and 2014, the OAG's main focus was expenditures, though it sometimes targeted salaries, wages, and revenue flows.

The OAG is well designed, but it lacks adequate financial and human resources to execute its mandate.[33] The Constitution of 2013 expanded the scope of the OAG's mandate to include all local authorities,[34] and the number and regularity of audits has increased progressively over the years. However, resources have not kept pace with the growth of the OAG's responsibilities, limiting its capacity to perform IT audits, special audits, forensic audits, and value-for-money audits. The audits outside of Harare face particular resource constraints.

The AFROSAI provides trainings to the OAG, focusing on performance audits and related audit types. Despite AFROSAI's assistance, human capital in the OAG remains limited, with few staff possessing internationally recognized auditing and accounting qualifications. The OAG does not prioritize performance audits, and less than 30 percent of OAG resources are allocated to such audits.

Weak standards and practices risk compromising the credibility of the OAG's audit reports. The OAG is expected to follow INTOSAI standards, but its audits often fail to conform to them. Audit procedures vary within the OAG, and different audit teams may produce divergent results. Line ministries are often slow to respond to OAG inquiries, and regulatory requirements governing the timeliness of these responses do not exist.

Though designed to be administratively autonomous, the OAG is vulnerable to potential conflicts of interest. The OAG's perceived independence is compromised by its budget being under the authority of the MoFED. Further, the Auditor General is expected to report to the minister of the MoFED, despite the ministry being subject to audit by the OAG. The OAG's Public Accounts Committee (PAC) determines which agencies to audit, but a legal provision could enable the Government to set the OAG's audit priorities.[35]

Audit reports of SEPs routinely fail to meet statutory deadlines. Zimbabwean law requires the OAG to audit SEPs. Yet given the OAG's limited capacity, many SEPs have audits subcontracted to private auditors. Such SEPs have great discretion over their auditors, and are effectively responsible for their own accountability. Often, SEPs' financial statements are published late, and fail to comply with international financial reporting standards (IFRS).[36]

According to the PFM Act and AFROSAI requirements, the OAG must be audited by private auditors, whose audit report will be presented to the PAC. The first such audit was recently conducted.

C. PARLIAMENTARY OVERSIGHT

The PAC is a post-audit committee under the authority of the parliament. Its mandate is to examine the financial status of government accounts and SEPs. The Accountant General and Auditor General provide technical support to the Public Accounts Committee (PAC), which review all audit reports of the Comptroller and Auditor General. The PAC's responsibilities include, *"the examination of the sums granted by Parliament to meet the public expenditure and of such other accounts laid before Parliament as the committee may think fit."*[37] The PAC is not empowered to enforce the PFM Act or to prosecute malfeasance.

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[31] The OAG has indicated that it would like to devote more resources to systems audits and value-for-money audits.

[32] The usual high risk entities are the Ministries of Home Affair; Health and Child Welfare; and Primary and Secondary Education.

[33] This assessment is shared by the IMF in its report of April 2015 – "Zimbabwe. Public Financial Management Reform Strategy".

[34] The Constitution of Zimbabwe requires the Auditor General to audit all public sector financial statements, including those of SEPs and local authorities.

[35] However, the Government cannot prevent an audit from being carried out.

[36] Subramanian, et al., 2011.

[37] Standing Order 163 of the House of Assembly.

The PAC has failed to present timely reports to Parliament for most of the past five years; however, it has managed to make some important progress. In 2010, the PAC evaluated the 2009 First Quarter Special Report of the Comptroller and Auditor General, which identified abuses of public funds and assets in several ministries and government departments. The PAC then produced two reports tabled in the House of Assembly on February 3 and October 26, 2010.[38] In 2014, the PAC reviewed 32 of 2011 reports, and presented three of its own to Parliament. However, the PAC's backlog of audit reports remains substantial. In 2014, the PAC developed a toolkit[39] for tracking, reviewing, and monitoring its own progress. It conducted two benchmarking visits to the parliaments of Kenya and Uganda, and supported the trainings of 25 journalists in analyzing and reporting on government audits. The PAC, along with the Auditor General, the Accountant General, and the internal audit function will benefit from the World Bank PFMEP.

[38] The committee's findings highlighted: (i) a lack of adherence to rules and regulations in the management of cash, public assets and human resources, and a lack of accountability by government ministries; (ii) weak systems for management and accountability, and a culture of non-performance in government; and (iii) the importance of implementing performance-based management techniques, and addressing irregularities.

[39] The tool kit looks at corporate governance, management of assets, policies and procedures, procurement procedures, supporting documents and fraud, regulatory compliance, audit opinion, financial analysis, VFM, citizen feedback model and repeat violations


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