ZIMBABWE

Zimbabwe Economic Policy Analysis and Research Unit

ZEPARU

POLICY RESEARCH ON GLOBAL BEST-PRACTICE IN ESTABLISHING AND MANAGING A SOVEREIGN WEALTH FUND IN ZIMBABWE

POLICY BRIEF

October 2016

PREAMBLE

This policy brief offers recommendations on how Zimbabwe should establish and manage its Sovereign Wealth Fund using global best practices. Cognizant of the prevailing economic challenges, recommendations proffered range from those that are required to address macroeconomic fundamentals to those that are needed to strengthen the current Sovereign Wealth Fund Act of Zimbabwe of 2014.

BACKGROUND

In 2012 the Zimbabwe Economic Policy Analysis and Research Unit (ZEPARU) conducted the Mining Sector Policy Study which recommended the establishment of a Sovereign Wealth Fund (SWF) for Zimbabwe to harness savings from mineral rents. This was in recognition that the recovery of the mining sector can unleash immense potential to anchor inclusive economic growth and development. It is further observed that the successful implementation of the Zimbabwe Agenda for Sustainable Socio-Economic Transformation (ZIMASSET) largely depends on the judicious exploitation of mineral resources.The SWF is expected to provide additional funding for the implementation of priority programmes and projects under the ZIMASSET national economic blueprint.

It is against this background that ZEPARU in collaboration with the Ministry of Mines and Mining Development undertook this study as part of the Governance and Institutional Support Project (GISP) between the Government of Zimbabwe and the African Development Bank (AfDB) which culminated into this Policy Brief as one of the outputs. The study followed gazetting of the Sovereign Wealth Fund of Zimbabwe Act on 10 November 2014 which was operationalised on 26 June 2015.

The overall objective of the study was to identify best practice in the establishment and management of commodity SWF. Specific objectives include:

- To review other countries experiences on the establishment and management of SWFs;
- To learn from other countries good practices that Zimbabwe can adapt to manage its SWF;
- To establish from other countries bad practices that Zimbabwe should avoid in establishing and managing its own SWF;
- To inform the policy process to support the development and management of the SWF in Zimbabwe and;
- To provide actionable recommendations to policy makers and practitioners on mineral resources management using commodity SWFs.

This Policy Brief is a synthesis of the recommendations emanating from the above study.

BEST PRACTICES

Following consultations, the International Monetary Fund (IMF) and the International Working Group (IWG) on SWFs launched in October 2008 the Santiago Principles whose goal was to foster trust, openness, transparency and probity in the management of SWFs. These principles have become known as the Generally Accepted Principles and Practices (GAPPs) on SWFs. In April 2009 the IWG further established the International Forum of Sovereign Wealth Funds (IFSWF), a voluntary group of SWFs that meets to exchange views on issues of common interest, and facilitates understanding of Santiago Principles and SWF activities. In essence, the IFSWF promotes best practices in the management of SWFs.

The Santiago Principles comprises 24 GAPPs that are broadly arranged in three pillars, viz.:

- Pillar 1: Legal Framework, Objectives, and Coordination with Macroeconomic Policies;

- Pillar 2: Institutional Framework and Governance Structure; and
- Pillar 3: Investment and Risk Management Framework.

Adherence to Santiago Principles is considered as a barometer for best practices. The SWF of Zimbabwe Act explicitly subscribes to Santiago Principles by restating them in the Third Schedule of the Act. The Act lays out legal, governance and institutional arrangements that are to a large extent consistent with the GAPPs (Santiago Principles) governing SWFs. The challenge that remains for the Board and management of the SWF is to enforce institutional arrangement and devise innovative strategies to propel the growth of the SWF which was set up in 2015 given the fiscal space constraints.

POLICY RECOMMENDATIONS

This policy brief offers recommendations in four key areas: (1) strengthening macroeconomic fundamentals; (2) addressing shortcomings in the current Act; (3) capacity building to manage natural resources and the SWF; and (4) paying attention to long-term policy considerations.

Strengthening macroeconomic fundamentals to support establishment of SWF

Firstly, cognisant that the SWF is not a substitute for building up international reserves, the Reserve Bank of Zimbabwe should address this aspect. Having usable international reserves below the standard 3-month threshold, there is a pressing need to build international reserves.

Secondly, the initial conditions under which Zimbabwe has set-up the SWF are characterised by high debt over-hang; binding fiscal space constraints and widening balance of payments deficit. In this regard the Government's economic policy and legislative reform initiatives; debt and arrears clearance program and doing business reforms have a positive bearing to the successful implementation of the SWF. The setting up of the SWF can be viewed as a conscious strategy to induce a culture of public savings and fiscal discipline that will ensure that a portion of mineral revenues are harnessed and invested through a SWF.

Thirdly, leveraging on the abundant mineral resources to build a SWF requires government to put in place policies and programs to boost value added mineral exports, and improve transparency and accountability in the management of natural resources revenues. This can be achieved by formulating enforceable fiscal rules that ensure that some resource revenues are saved in a SWF rather than used to meet current consumption.

Fourthly, the Government should adopt economic measures of performance other than gross domestic product (GDP) or gross national income (GNI) that take into account depletion of natural resources, viz.: the adjusted net income measure, the adjusted net savings measure and the adjusted net operating balance metric. The Ministry of Finance and Economic Development should seek technical expertise to facilitate the implementation of these economic measures of performance. Implementation of these economic measures of performance may require deliberate programs to build and sustain capacity which can be developed with technical assistance from development partners like the AfDB, World Bank and IMF.

Fifthly, the Government should streamline the levels of mining fees and charges to levels that promote the competitiveness of the sector and harmonise systems of agencies that collect mineral revenues. The Ministry of Mines and Mining Development should expedite the development of a new mining fiscal regime that seeks to enhance the contribution of the mining sector by ensuring accountability and transparency on the part of government and mining companies. Such mining fiscal regime should seek to balance the various fees and taxes being paid by the mining sector and the operational viability of players in the sector as well as encouraging new investment in the sector.

Recommendations on strengthening the SWF Act and improve its implementation

While it is acknowledged that the SWF of Zimbabwe Act explicitly subscribes to the Santiago Principles by restating them in the Third Schedule of the Act, shortcomings should be addressed in the following respects:

(a) The Act should be easily accessible to the public in accordance with Section 16 for public disclosure. The SWF Board can achieve this by creating a website accessible to the general public.

(b) Section 11 of the Act can be relooked in light of the discretionary powers given to the Minister to give direction to the Board which can be viewed within the context of GAPP as interfering with the operational independence of the Board. The GAPP 6 states that once an investment mandate is given to the SWF Board, Government should neither direct nor interfere with Fund investment decisions, but leave the Board to account for overall portfolio performance.

(c) The Act should provide a rule on how much can be withdrawn from the SWF for purposes of closing a budget deficit. Good practice requires withdrawal rules to be closely linked to the government budget surplus/deficit, and the amount to be determined as part of the annual budget process or pre-agreed rules.

(d) The Act should explicitly provide for the establishment of a Future Generations Fund among the segregated accounts of the Fund mentioned in Section 15. This would be consistent with Section 4 of the Act that states one of the objectives of the Fund as "to secure investments for the benefit and enjoyment of future generations of Zimbabweans".

(e) The Act should provide criteria for allocating resources among the segregated accounts of the Fund.

(f) The Act should not explicitly specify the types of assets that the Fund should invest in. This should be decided by the Board and embodied in the Investment Policy which would allow flexibility required for the investment strategy to respond to changes in market conditions to meet the objectives of the SWF.

Addressing capacity to manage resources and the SWF

The SWF is a new institution in Zimbabwe and inevitably there is inadequate human capital with the capacity and experience in managing a SWF. In this regard government with support of development partners like the AfDB should undertake a capacity building programme for staff of the SWF. The objective would be to build capacity for a strong public investment management system to safeguard the quality of public investments financed by resource revenues. Furthermore, capacity building should be achieved through collaboration with institutions like the Macroeconomic and Financial Management Institute of Eastern and Southern Africa (MEFMI) which is developing a Natural Resources Management Capacity Building Programme for the MEFMI region (MEFMI NRM-CBP).

Paying attention to long-term policy considerations

Cognisant of the exhaustibility of natural resources, in the long run the Government should ensure that the following factors generally accepted as sources of growth are in place:Stability-oriented and competitiveness enhancing economic policies;

- Flexible and competitive product markets;
- Increasing valued added manufactured exports and promoting a high degree of exposure to foreign trade;
- Flexible labour markets;
- Leveraging on the investment in education and training;
- Simplified tax system and broadened tax base;
- Sustaining and business and investment friendly environment;
- Improving public spending on growth enhancing infrastructure development, and research and development;
- Fostering increased value addition and beneficiation and strengthening of value chains; and
- Development of robust capital markets.

A policy mix that leverages on the country's natural resource endowments through good management of the natural resources and that promotes the above factors is critical to long-term growth.

IMPLEMENTATION

The successful implementation of the recommendations of this Policy Brief requires collective responsibility and co-ordination among various Government ministries and other stakeholders. Hence the following implementation matrix is a useful guide on responsible lead ministries/institutions (Table 1).

POLICY MEASURES	RECOMMENDED ACTIONS
A. Strengthening macroeconomic fundamentals to support establishment of SWF	1. Build international reserves to at least cover 3 months' imports.
	2. Implement economic policy and legislative reform initiatives; debt and arrears clearance program and doing business reforms.
	3. Formulate enforceable fiscal rules that ensure that some resource revenues are saved in a SWF rather than used to meet current consumption.
	4. Adopt economic measures of performance other than GDP or GNI that take into account depletion of natural resources.
	5. Develop a new mining fiscal regime that should seek to balance the various fees and taxes being paid by the mining sector and the operational viability of players in the sector as well as encouraging new investment in the sector.
B. Strengthening the SWF Act and improve its implementation of SWF	• The Act should be made accessible to the public in accordance with Section 16 for public disclosure. • Section 11 of the Act should be amended to remove the discretionary powers given to the Minister. • The Act should provide a rule on how much can be withdrawn from the SWF for purposes of closing a budget deficit. • The Act should be amended to provide for the establishment of a Future Generations Fund among the segregated accounts of the Fund mentioned in Section 15. • The Act should provide criteria for allocating resources among the segregated accounts of the Fund.
C. Addressing capacity to manage resources	• Undertake a capacity building programme for staff of the SWF and line ministries.
Paying attention to long-term policy considerations	• Adopt a policy mix that leverages on the country's natural resource endowments through good governance and promotion of factors generally accepted as sources of growth.

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MG Printers