THE INVESTMENT CLIMATE IN ZIMBABWE - HOW IT INFLUENCES DECISIONS

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A. Introduction

My talk about the investment climate today concentrates on two aspects:-

- The negative image for investment that Zimbabwe has and how this has come about, and
- What has changed since the beginning of last year and why Zimbabwe is now a good investment destination

When investment in Zimbabwe is referred to it usually generates a lack of enthusiasm. This image stems mainly from the economic chaos that reigned in this country prior to 2009.

Therefore, let us first examine some of the negative perceptions of Zimbabwe that are reflected in the statistics by where the country is positioned in world rankings.

Zimbabwe generally ranks poorly in global comparisons of competitiveness and corruption.

Index	**Year**	**Zimbabwe's Ranking**
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TI Corruption Perceptions	2009	146 of 180
Heritage Economic Freedom	2009	178 of 179
World Bank Doing Business	2010	159 of 183

In addition, Zimbabwe ranked second-to-last out of 133 countries in the World Economic Forum's Global Competitiveness Index for 2009-10.

Zimbabwe's severe economic problems drove foreign direct investment (FDI) inflows from US$103 million in 2005 to US$40 million in 2006, according to the World Investment Report compiled by the United Nations Conference on Trade and Development (UNCTAD). In 2008 net FDI declined from US$66 million the year before to US$44 million.

Zimbabwe Net Direct Investment Flows 2000 – 2008 (US$ million)

2000	**2001**	**2002**	**2003**	**2004**	**2005**	**006**	**2007**	**2008**
16	0	23	4	9	103	40	66	44

Source: UNCTAD, World Investment Report 2009.

B. How Negative Perceptions Developed of Zimbabwe

Macroeconomic Developments

Due to inappropriate policies and gross economic mismanagement Zimbabwe endured a decade of a very severe shrinking of its economy. Zimbabwe's gross domestic product (GDP) contracted by more than 50 percent during the ten years prior to 2009. The International Monetary Fund (IMF) estimates that GDP shrank by 14 percent in 2008 alone.

The main indicator of economic decline during this period was hyperinflation. This was largely due to the uncontrolled printing of money to fund government operations and the central bank’s quasi-fiscal activities. The very rapid fall in purchasing power of the Zimbabwean dollar led to redenomination of the currency on three occasions, and in total removing an incredible 25 zeros off the face value of notes. In July 2008 inflation reached the officially estimated level of 231 million percent. Although the hyperinflation accelerated in subsequent months official figures were no longer published. Attempts were made to stop the rampant inflation through measures like price controls. All that achieved was for basic goods to disappear from shops and reappear in the black market at much inflated prices. Speculation thus became one of the main drivers of hyperinflation.

Zimbabwe's exchange rate policies during this period made it difficult for firms to obtain foreign currency, and this in turn caused acute shortages of fuel and other imported intermediate and final goods. Other outcomes of economic collapse included defaults in local and foreign debt payments and sharp declines in productive sector output.

Non-Economic Factors That Supported a Negative Investment Climate.

Property Rights

Governments that have scant regard for property rights cannot expect to readily attract foreign investment to develop their economies. Zimbabwe is no exception and this is demonstrated by the minimal amounts of direct foreign investment per annum in the table that was shown previously.

Zimbabwe's constitution prohibits the acquisition of private property without compensation. However, in 2000 the government authorized the confiscation of privately owned commercial farms. The constitution was amended in 2000 to allow the compulsory acquisition of these farms with compensation limited to the improvements made on the land. In 2005, the government amended the constitution again to transfer ownership of all expropriated land to the government. Farm seizures continue to this day.

The program to confiscate commercial farms without compensating the titleholders has raised serious questions about any respect for property rights and the rule of law in Zimbabwe. The lack of secure long term tenure that is tradable has led to the collapse of the market for rural land.

To counter this development the government issued a batch of 99-year leases for land re-allocated to 125 farmers in 2006. These leases, however, are not readily transferable because government retains the right to withdraw the lease at any time. Commercial farms no longer have a collateral value and this is a major disincentive for investment in the agricultural sector.

Right to Private Ownership

Although Zimbabwean law guarantees the right to private ownership, this right is increasingly not respected in practice. As noted above, the government has in recent years seized thousands of private farms and conservancies, including ones belonging to foreign investors, without due process or compensation. Most of the foreign property owners held Zimbabwe Investment Authority investment certificates and purchased their land after independence in 1980.

Bilateral Investment Promotion and Protection Agreements (BIPPA)

Although Zimbabwe has BIPPA’s with 17 countries; only four of these treaties (with the Netherlands, Denmark, Germany, and Switzerland) have been ratified. In spite of these agreements, the government has not protected investments undertaken by nationals from these countries, particularly with regard to land.

For example, a group of Dutch farmers whose farms were seized under the land reform program presented their case to the International Centre for the Settlement of Investment Disputes (ICSID) in April 2005, demanding that Zimbabwe honor its BIPPA with the Netherlands. The case was heard by a tribunal in Paris in November 2007, and the tribunal issued a verdict favorable to the farmers. Zimbabwe's government acknowledged that the farmers had been deprived of their land without payment of compensation but the amount the farmers claimed in damages is still in dispute.

Dispute Settlement

Zimbabwe has acceded to the 1965 convention on the settlement of investment disputes between states and nationals of other states.

In the event of an investment dispute, the Government of Zimbabwe has agreed to submit the matter for settlement by arbitration. This is done according to the rules and procedures promulgated by the United Nations Commission on International Trade Law (UNCITRAL) once the investor has exhausted the administrative and judicial remedies available locally.

However, despite these agreements Constitutional Amendment 17, was enacted in 2005, and removed the right of landowners whose land has been acquired by the government to challenge the acquisition in court. Also in a land related case the government has refused to recognize a ruling by a SADC Tribunal in Windhoek, Namibia. It stated that Zimbabwe had withdrawn from the jurisdiction of the SADC Tribunal because the protocol establishing the Tribunal had not been ratified by the required two-thirds majority of SADC.

The judiciary generally upholds the sanctity of contracts between private companies. However, in the case of contracts involving the government or politically influential individuals, judgments sometimes appear biased. Administration of justice in those commercial cases that lack political overtones is still generally impartial.

Corruption

In 2005 the government enacted an Anti-Corruption Act that established a government-appointed Anti-Corruption Commission to investigate corruption. The Commission includes no members from civil society or the private sector. Although corruption exists, government officials and police lack sufficient backing to effectively investigate cases.

The current inclusive government intends to enhance the institutional capacity of the Anti-Corruption Commission, whose members are yet to be interviewed and selected. In addition, the government intends to improve accountability in the use of state resources.

Summary

To summarize, the collapse of the economy prior to 2009, the disregard of property rights, political interference in the judicial process, and corruption have all played a role in projecting a negative image of Zimbabwe to the outside world. The harsh situation that I have described to you is hardly favourable to investment. What then has altered and why should foreign investors come to this country?

C. <u>Positive Economic Developments since February 2009</u>

The change began in September 2008 when the three main political parties in the country signed the Global Political Agreement (GPA) to form a Government of National Unity (GNU). The GPA, for all its flaws, has brought about a slight improvement in the level of political stability. Since then much more rational economic policies have been adopted to stabilize the economy. The main measures that have been taken are:-

- Government officially abandoned the local currency and "dollarized" the economy by introducing a multicurrency system early in 2009. This effectively eliminated hyperinflation
- Foreign currency accounts were restored and foreign exchange surrender requirements were removed.
- Price controls that had been applied to control inflation were removed
- Expansionary fiscal policies were ended by requiring government ministries to apply cash budgeting in managing their finances and to exercise fiscal discipline
- Expansionary monetary policies were discontinued with the Reserve Bank of Zimbabwe no longer being allowed to undertake quasi-fiscal activities.
- In agriculture the marketing of all commodities was decontrolled and the Grain Marketing Board monopoly removed.
- In mining the surrender requirements of proceeds were removed. Gold marketing was liberalized.
- Exporters now retain 100 percent of their foreign currency account balance for their own use. This has removed the anti-export bias associated with the previous system of surrendering a certain proportion to the RBZ at the highly over-valued official exchange rate.

These measures have had a remarkable effect in turning the economy around and setting it on a growth path. The benefits are:-

- In 2009 Zimbabwe recorded a positive GDP growth (of 4.0%) for the first time in a decade, albeit from a low base.
- Official GDP growth of 7 percent is forecast for 2010.
- Zimbabwe's consumer price index fell by 7.7 percent between January and December 2009.
- Inflation is expected to close out this year at around 6 percent,

The economy is currently more liberalized than it has been for some considerable time, as the government has allowed market forces to operate in virtually all sectors. It has reduced corporate and personal taxes, and has also decreased or eliminated import duties on raw materials and other essential industrial inputs, in a bid to stimulate the economy.

Although government lifted exchange controls last year with most transactions now conducted in U.S. dollars, the country's continued poor export performance and lack of access to multilateral concessional lending means that external financing is still hard to come by.

D. Foreign Investment Opportunities

The government's priority sectors for foreign investment are manufacturing, mining, and infrastructure development. In these sectors foreign investors were in the past permitted to own up to 100 percent of an enterprise, although joint ventures with local investors were encouraged. In 2008, however, the government introduced a new law, the Indigenization Act, which requires that "indigenous Zimbabweans" own at least 51 percent of all enterprises. It remains unclear exactly how or when the government intends to enforce this requirement. The government also intends to introduce amendments to the Mines and Minerals Act to spell out indigenization requirements in the mining industry.

These measures have dampened investor sentiment and have been soundly criticized, especially the 51% ownership requirement which compels investors to give majority equity in ventures to indigenous people. However, after much pressure, the authorities have agreed to review and revise the regulations. Sectoral committees have been formed to make recommendations to government and there is a strong possibility that the percentage will be reduced in order to attract foreign investment.

The requirement that local investors have a stake in certain types of business ventures is nothing new. It is as well to mention here those areas which are reserved for local investors.

E. Reserved Investment Areas

The government reserves several sectors for local investors. Under current laws, foreign investors wishing to participate in these sectors may only do so by entering into joint venture arrangements with local partners. The foreign investors may not own more than 35 percent of the operation. These rules apply to the following sectors:

- Agriculture
    - Cultivation of food and cash crops
    - Horticulture
    - Livestock rearing
    - Dairy farming
    - Game ranching
    - Forestry
    - Fishing and fish farming
    - Poultry farming
    - Grain milling

- Sugar refining
- Tobacco packaging and grading

- Transportation

    - Road haulage
    - Passenger services
    - Rail operations

- Retail and wholesale trade, including distribution
- Water provision for domestic and industrial purposes
- Bakery and confectionary
- Cigarette manufacturing

Some minor enterprises like photography and hairdressing are also reserved

F. Current Investment Climate and Opportunities

Most sectors are already responding positively to the improved economic environment, and it is particularly notable in the retail and telecommunications sectors. Because of perceived country risk, asset prices are still heavily discounted.

While there has been a major brain drain, the country still has one of the continent's most educated work forces. Economic and political problems have prompted many of the country's skilled workers to emigrate, and this has led to shortages of labour for some managerial and technical jobs. The contraction of the economy until recently resulted in formal unemployment estimates being as high as 80%. Thus in general there is a large pool of labour to draw from when setting up a business venture.

Collective bargaining takes place through a National Employment Council (NEC) in each industry, comprising representatives from labor, business, and government. In addition, the Zimbabwe Congress of Trade Unions (ZCTU), the country's umbrella labor organization, advocates for workers' rights.

Manufacturing

There are potentially profitable opportunities in Zimbabwe's manufacturing sector for investors. This sector has undergone a substantial contraction over the last decade and government has prioritised it for resuscitation. Average capacity utilization in factories was around 30% in 2008 and emphasis is being placed on increasing the percentage to more than

60% as rapidly as possible. There are plenty of tax incentives that investors can take advantage of.

Some areas for investment have been identified as:-

- Agro – processing, particularly of meat, fruit, vegetables, and timber
- Leather products
- Sugar refining
- Textiles, including cotton ginning, spinning, weaving, finished textiles, and knitting
- Manufacture of cosmetics, medicines, and vaccines
- Chemicals like fertilizers, insecticides, paints, detergents, industrial chemicals
- Cement
- Petroleum products
- Rubber and plastic products
- Saw milling and the production of furniture and wood items
- Computer and electronic items assembly

This list is not exhaustive

Mining

There are tremendous opportunities for investment in this sector. Zimbabwe has a wide range of mineral deposits and some 40 different minerals are extracted. These include precious minerals like gold, platinum, emeralds, and more recently diamonds, and other base metals like chrome, asbestos, iron ore, nickel, and tin. There are large reserves of coal and methane gas as well as rare minerals such as lithium and tantalum that exist in commercially viable quantities. The reserves of chrome and platinum are among the largest in the world.

In 2008 mineral shipments amounted to US$ 676 million which represented 51% of total exports. Mining was a direct employer of some 60,000 persons with many others in support industries.

Some of the investor incentives for mining include:-

- A favourable geological environment
- Access to prospecting and mining claims readily obtained
- Remittability of 100% of after tax profit
- Corporate tax of 25%
- Immediate write off of all capital expenditure
- Operating losses can be carried forward indefinitely
- An active stock market.

An investor wishing to invest in this sector should approach the Chamber of Mines

Infrastructure

Zimbabwe still has one of the most developed infrastructures in sub-Saharan Africa. It has a relatively strong and complex base that includes road and rail networks, power generation and distribution facilities, water supplies, and telecommunications.

However, years of economic decline have resulted in a deterioration of much of the infrastructure. As well as the need for rehabilitation, prospective economic growth will necessitate further development and expansion of the infrastructure. Currently, power and water shortages severely hamper business activities. Zimbabwe's power generating capacity must be expanded and its water supplies improved. Sections of major highways need resurfacing and many roads in urban areas should be repaired. Programmes should be implemented to extend the road network linking major centres as well as with neighbouring countries.

There is scope for Public-Private Partnerships in financing and developing infrastructure and government has put a policy framework with guidelines in place.

Financial Sector and Capital Markets

Once one of the most sophisticated banking and financial system by regional standards, Zimbabwe's financial sector contracted greatly in recent years as business evaporated due to the economic downturn. However there is still an extensive country-wide bank branch network. Three major international commercial banks and a number of regional and domestic banks operate with a total of over 200 branches. The finance sector comprises of:-

- 18 commercial banks
- 4 merchant banks
- 1 discount house
- 4 building societies
- 17 asset management companies
- 1 peoples savings bank

There are also various finance houses, insurance companies and pension funds in operation.

Following the failure of a number of financial institutions in 2003 banking regulations have been tightened. The payments system under the multiple currency system introduced last year seems to be functioning well. Liquidity is a major challenge for financial institutions due to low foreign currency inflows. Nevertheless the financial sector is well placed to provide all the banking services required by foreign investors

Zimbabwe's stock market has 79 publicly-listed companies. In September 1996, the government opened the stock and money markets to limited foreign portfolio investment. Since then, a maximum of 40 percent of any locally-listed company can be foreign-owned. Following dollarization of the economy trading on the Zimbabwe stock exchange has been relatively weak. Despite this the market capitalization grew substantially from about US$1 billion in February 2009 to around US$4 billion by the end of December 2009.

G. Requirements for Foreign Investors

Foreign investors wishing to start a new project in Zimbabwe must first register with, and be approved by, the Zimbabwe Investment Authority, which then issues an investment certificate. The Authority will explain the procedures to be undertaken and the documentation to be completed and submitted.

All private firms are required to incorporate and register with the Registrar of Companies within the framework of their investment certificate or to apply for exchange control approval. Foreign investment in existing companies requires approval from the Reserve Bank of Zimbabwe (RBZ). Applications are submitted to the RBZ's Exchange Control Department through the investor's commercial bank or merchant bank or other authorized dealer. Foreign investors with valid investment certificates may acquire real estate.

H. Incentives for Foreign Investors

There are many incentives for foreign investors and details can be obtained from the Zimbabwe Investment Authority. Some of the incentives and specifications for investment are listed here.

- Several tax breaks are available for new investment by foreign and domestic companies. Capital expenditures on new factories, machinery, and improvements are fully tax deductible and the government waives import tax and surtax on capital equipment.
- Investment allowance of 15 percent in the year of purchase of industrial and commercial buildings, staff housing and articles, implements, and machinery;
- Twenty-five percent special initial allowance on the cost of industrial buildings and commercial buildings and machinery in growth point areas is granted as a rebate for the first four years;
- Special mining lease provisions entitling the holder to specific incentive packages to be negotiated with the Ministry of Mines;

- Refund of value added tax (15 percent) for capital goods purchased in Zimbabwe and intended for use in priority projects or investment in growth points.
- There are no general performance requirements outside of Export Processing Zones. Government policy, however, encourages investment in enterprises that contribute to rural development, job creation, exports, use of local materials, and transfer of appropriate technologies.
- There are no discriminatory import or export policies affecting foreign firms, although the government's approval criteria are heavily skewed toward export-oriented projects.
- Export Processing Zone designated companies must export at least 80 percent of output.
- Government participation is required in new investments in strategic industries such as energy, public water provision, railways, and armaments. The terms of government participation are determined on a case-by-case basis during license approval.
- Foreign investors are expected to make maximum use of Zimbabwean management and technical personnel, and any investment proposal that involves the employment of foreigners must present a strong case for doing so in order to obtain work and residence permits. Normally, the maximum contract period for a foreigner is three years, but this will be extended to five years for individuals with highly specialized skills. Foreigners who have prior permission from the RBZ may remit one-third of their salaries.

Conclusion

Most foreign investors have been waiting for the investment climate to improve in Zimbabwe. Negative features still exist that need to be ironed out because Zimbabwe cannot afford to forego the foreign investment that it desperately needs. With the international community engaging the relevant players in Zimbabwe and with the right policies in place the economic environment will be ripe for foreign investment and there will be multiple opportunities to take advantage of.

Thank you.

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President CFU and BCZ

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