NATIONAL COMPETITIVENESS COMMISSION

**Enhancing Zimbabwe's Global Competitiveness**

# ANALYSIS ON THE EFFECTS OF AN INCREASE OF CIVIL SERVANTS' PART USD SALARY ON ZIMBABWE'S COMPETITIVENESS

**4 April 2022**

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### 1.0 Introduction

1.1 On 8 February 2022, Government announced the increase in civil servants' salaries by 20% in local currency (ZWL) component backdated to 01 January 2022 plus US$ 100-00 per month with effect from 1 March 2022, among other non-monetary benefits. This development entails that the civil servants would be getting part of their salary in both ZWL and USD currencies. The USD component will be USD175 including the Covid -19 allowance of US$ 75-00.

1.2 The partial payment of Civil Servants salary in USD currency contrasts with Government's new measures to promote use of local currency introduced on 04 February 2022, namely payment of 50% of taxes in ZWL of the total amount due.

1.3 Whilst increasing workers' salaries is a noble idea expected to reduce civil servants' industrial actions, improve morale at work and subsequently production, the use of strong currency such as USD in Zimbabwe do negatively impact competitiveness as it results in high-cost base for production.

1.4 However, the downside risk is the perception that Government is slowly returning to dollarization of the economy, resulting in loss of monetary autonomy by the Reserve Bank of Zimbabwe. The likely impact of this measure has been analyzed in short to long term

### 2.0 Short term impact of partial dollarization on Zimbabwe's competitiveness

2.1 0n the positive, the USD175 payment represents an injection of foreign currency into the economy. Money is not static but has velocity as it circulates in the economy. As Civil servants spend the money, it finds its way to the private sector, in which a share goes back to the fiscus through taxation. In turn, industry will have access to foreign currency to import critical equipment and raw materials, complimenting their requirements from the auction floor.

2.2 Furthermore, the allocative inefficiencies of the forex auction floor, particularly inadequacy and delays in accessing foreign currency, will be alleviated, thereby enhancing efficiency, productivity, and competitiveness.

2.3 Contrary to this, the use of foreign currency may discourage local industries from exporting if they can generate adequate foreign currency in the domestic market, as well as avoiding the payment of the 20 to 40% surrender requirement to the Reserve Bank of Zimbabwe depending on the sector.

2.4 Whereas the USD injection into the economy through civil servants' salaries appears to be a reversal of previously announced policies to promote use of the local currency, it is a step to stabilize the exchange rate since it dampens the chase for the USD by both the business and civil servants from the parallel market thereby inducing exchange rate stability.

2.5 However, the use USD in the domestic market has adverse impact on competitiveness given that it is a strong currency, which results in high-cost base for production compared to other regional countries. As a result, products produced will be expensive domestically as well as externally when exported.

**3.0 Long-term impact of partial dollarization on Zimbabwe's competitiveness**

3.1 Given that wage changes have been made in non-productive sectors of the economy, it is unlikely that this would directly trigger changes in commodity prices. All things being equal, the policy measure is expected not to jeopardize Zimbabwe's international price competitiveness but rather threatens other macroeconomic fundamentals such as inflation and exchange rate by increasing the country's import bill.

3.2 The other downside risk is where other economic sectors, also demand payment in part USD resulting in high production costs making local products expensive on the international market rendering them uncompetitive in price terms. Given the intimate relationship between inflation and exchange rate especially in open economies like Zimbabwe, instability on these macroeconomic variables is likely, as evidenced by the current macroeconomic environment, although this is also exacerbated by the Russia/Ukraine war resulting in imported inflation.

3.3 However, there are chances that these effects on inflation and exchange rate may be dampened in cases where an increase in the USD salary translates into a proportionate increase in efficiency and productivity of labour resulting in increased growth of the economy.

**4.0 Conclusion and Recommendations**

4.1 In conclusion, the commission is of the view that, in the short term, the policy is likely to improve the country's competitiveness, as the increase is expected to complement the Foreign Exchange Auction Trading system and ease the USD shortage in the economy.

4.2 However, in the long-term pressures on inflation and exchange rate may have indirect impact to the country's competitiveness, given that the country is an open economy.

4.3 This policy measure is anticipated to worsen the situation as this culminates into the use of USD as a store of value and the ZWL for immediate transaction purposes due to lack of confidence on the local currency.

4.4 To this end, the Commission recommends the following in order to enhance competitiveness:

- Continue with the dual currency in the short term;
- Promotion of the use of local currency with USD being a reserve currency in the long term;
- Continued support of the productive sectors in the importation of raw materials and capital equipment required for production. This will neutralise the anticipated effect of the salary increment on inflation and exchange rate in the long-term; and
- Continued tightening of the monetary policy in an endeavour to reduce speculative behaviours;

**National Competitiveness Commission**

**04 April 2022**