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DEPARTMENT OF DEVELOPMENT STUDIES

THE IMPACT OF TAXATION ON INVESTMENT AND DEVELOPMENT IN DEVELOPING
COUNTRIES; A CASE OF ZIMBABWE

BY

TAKUNDA SAMANTHA MHIZHA

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APPROVAL FORM

The undersigned confirm and certify that they have supervised and recommend to the Midlands State University for acceptance a research dissertation entitled: THE IMPACT OF TAXATION ON INVESTMENT AND DEVELOPMENT IN DEVELOPING COUNTRIES; A CASE OF ZIMBABWE submitted by Takunda Samantha Mhizha in partial fulfilment of the requirements of the Master of Art Degree in Development Studies.

Student's signature..... Date.....

Supervisor's signature..... Date.....

Chairperson's signature.....Date.....

Signature of the Examiner(s).....Date.....

DECLARATION

I, Takunda Samantha Mhizha honestly declare that this study is my work and affirm that I have not submitted it to any other university or institution in fulfilment of any qualification.

Student Signature..... Date.....

DEDICATIONS

For my late grandfathers and my late grandmother...I wish you were here to see how much I have grown. And to my grandmother, thank you for believing in me.

ACKNOWLEDGEMENTS

I am deeply humbled by the people who have given up so much for me to be where I am today – my parents, my brothers, friends and relatives.

ABSTRACT

The study critically analysed the impact of taxation on investment and development. Desk research was employed with data being sourced from books, publications and the internet. The study was aimed at examining the impact of taxation on investment in Zimbabwe; to determine whether the extent of cross sectional allocation of resources through tax revenue has impacted on the level of development in Zimbabwe and to establish measures that can be adopted for taxation to be an aid of economic growth. Various literatures was implored – both theoretical and empirical and evidence from the literature show that taxation has an impact on investment and development. Most of the literature pointed that the impact is on the increase across the globe due to the economic climate. This study found that taxation is an important factor which determines the investors' choice of an investment destination. However, it is not a sufficient condition; there are a number of other conditions which include political stability, macroeconomic stability, and availability of skilled workforce, developed infrastructure and road network among others. The study also found that taxation has a positive condition on development. Revenue collected through taxation is allocated by government to fund projects for development. A number of these projects were identified and they include construction of schools, building dams, building clinics in rural areas among others. The study also recommended strategies which the government can adopt in order to strengthen the impact of taxation on investment and development. The strategies include reforming tax policy so as to reduce the tax burden on companies thereby increasing their income after taxation. The government was also recommended to allocate resources equitably.

ACRONYMS

cgt	capital gains tax
unctad	united nations conference on trade and development
rbz	reserve bank of Zimbabwe
mne	multinational enterprise
zimasset	Zimbabwe agenda for sustainable socio economic transformation
idbz	infrastructure development bank of Zimbabwe
zia	Zimbabwe investment authority
zesa	Zimbabwe electricity
dbsa	development bank of southern Africa
zinara	Zimbabwe
zimra	Zimbabwe revenue authority
gdp	gross domestic product
dda	district development administration
mma	minerals and mines act
wto	world
fdi	foreign direct investment
beam	basic education assistance model
vat	value added tax
paye	pay as you earn
(ESPP)	enhanced social protection project

TABLE OF CONTENTS

APPROVAL FORM	i
DECLARATION	ii
DEDICATIONS.....	iii
ACKNOWLEDGEMENTS.....	iv
ABSTRACT.....	v
ACRONYMS	vi
LIST OF FIGURES	xi
LIST OF APPENDICES.....	xii
LIST OF TABLES.....	xiii
CHAPTER 1	1
PROBLEM AND ITS SETTING	1
1.0 INTRODUCTION	1
1.1 BACKGROUND	3
1.2 SIGNIFICANCE OF THE STUDY.....	6
1.3 STATEMENT OF PROBLEM.....	7
1.4 OBJECTIVES.....	7
1.5 DELINEATION.....	7
1.6 LIMITATIONS.....	8
1.7 DEFINITION OF TERMS.....	8
1.8 THEORETICAL AND EMPIRICAL LITERATURE	8
1.8.1 THEORETICAL LITERATURE.....	8
1.9 EMPIRICAL LITERATURE REVIEW	Error! Bookmark not defined.
1.10 METHODOLOGY	17
1.10.1 RESEARCH PHILOSOPHY.....	17
1.11 RESEARCH DESIGN	18
1.12 HYPOTHESIS	19
1.13 DISSERTATION STRUCTURE.....	19
1.14 CHAPTER SUMMARY.....	19
CHAPTER 2	20
THE IMPACT OF TAXATION ON INVESTMENT IN ZIMBABWE.....	20
2.0 INTRODUCTION	20

2.1. INDIRECT EFFECTS OF TAXATION ON INVESTMENT	20
2.2 AN OVERVIEW OF THE LINKAGES BETWEEN HOST COUNTRY TAXATION AND FDI	22
2.3 CORPORATE TAX.....	23
2.4 IMPACT OF CORPORATE TAXATION ON FOREIGN DIRECT INVESTORS.....	26
2.5 OTHER TAXES LEVIED ON BUSINESSES IN ZIMBABWE.....	28
2.5.1 WINDFALL TAX	28
2.5.2 VALUED ADDED TAX.....	28
2.5.3 TAX ON SMES	29
2.6 FDI AND OTHER FACTORS THAT INFLUENCE IT IN AFRICA	31
2.9 FOREIGN EXCHANGE POLICY	34
2.10 PROPERTY RIGHT	34
2.11 SADC Foreign Direct Investment at Glance.....	Error! Bookmark not defined.
2.12 CHAPTER SUMMARY.....	35
CHAPTER THREE	Error! Bookmark not defined.
DETERMINING WHETHER THE EXTENT OF CROSS SECTIONAL ALLOCATION OF RESOURCES THROUGH TAX REVENUE HAS CONTRIBUTED TO DEVELOPMENT IN ZIMBABWE.....	36
3.0 INTRODUCTION	36
3.1 OVERVIEW OF THE TAX STRUCTURE IN ZIMBABWE	36
3.1.1 INDIVIDUAL TAX (PAY AS YOU EARN)	37
3.1.2 CORPORATE INCOME TAX.....	38
3.1.3 VALUE ADDED TAX	38
3.1.4 CUSTOMS DUTY	38
3.1.5 EXCISE DUTY.....	39
3.1.6 CARBON TAX	39
3.1.7 OTHER TAXES	39
3.2 TAX AND DEVELOPMENT	41
3.3 THE GRANT FINANCING OF ZIM ASSET CLUSTER JANUARY TO SEPTEMBER 2014 FROM REVENUES.....	43
3.4.1 COMMUNITY DEVELOPMENT	44
3.4.2 LOCAL AUTHORITY.	44
3.5 SOCIAL DEVELOPMENT.....	45

3.5.1 GENDER MAINSTREAMING	45
3.5.2 ESTABLISHMENT OF THE WOMEN’S BANK.....	45
3.5.3 EDUCATION.....	46
3.6 ECONOMIC DEVELOPMENT.....	48
3.6.1 INFRASTRUCTURE PROJECTS	48
3.6.2 ENERGY SECTOR.....	48
3.6.3 HWANGE THERMAL POWER STATION REHABILITATION.....	49
3.6.4 TRANSPORT PROJECTS.....	Error! Bookmark not defined.
3.6.5 TRANSPORT.....	Error! Bookmark not defined.
3.8 CHAPTER SUMMARY.....	52
CHAPTER 4	54
ESTABLISHING MEASURES THAT CAN BE ADOPTED FOR BROADENING TAX BASE AND TO MAKE TAXATION TO BE AN AID OF ECONOMIC GROWTH AND DEVELOPMENT	54
4.0 INTRODUCTION	54
4.1 DRAFTING TAX POLICIES.....	54
4.2 AWARENESS	55
4.3 REDUCED CORPORATE INCOME TAX RATE.....	56
4.4 TAX INCENTIVES.....	56
4.5 TAX HOLIDAYS	Error! Bookmark not defined.
4.6 REDUCED TARIFFS.....	Error! Bookmark not defined.
4.7 SIMPLICITY OF THE TAX POLICIES.....	Error! Bookmark not defined.
4.8 EASE AND COST OF DOING BUSINESS	60
4.8.1 Licencing Processes.....	60
4.8.2 Multiplicity of Authorities	61
4.8.3 Multiplicity of Levies	61
4.8.4 Utility Connections.....	61
4.8.5 Enhancing Border Posts Efficiency.....	62
4.9 TAX AND DEVELOPMENT	62
4.10 CHAPTER SUMMARY.....	64
CHAPTER 5	65
SUMMARY, CONCLUSIONS, RECOMMENDATIONS AND SUGGESTED AREAS FOR FURTHER STUDIES.....	65

5.0 INTRODUCTION	65
5.1 SUMMARY	65
5.3 CONCLUSION.....	66
5.4 RECOMMENDATIONS	67
5.4.1 TAX ADMINISTRATION.....	67
5.4.2 FISCAL TRANSPARENCY.....	67
REFERENCES	69

LIST OF FIGURES

- Fig 1 illustrating the nexus between taxation, development and investment.
- Fig 2 relationship between investment and cost of capital
- Fig 3 illustration of the impact of tax policies, investment, taxation and development.
- Fig 4 factors affecting investment
- Fig 5 contribution to revenue by tax heads
- Fig 6 monthly revenue collection (2013-2014)
- Fig 7 illustration of allocation of tax revenue
- Fig 8 financing of ZIMASSET clusters
- Fig 9 budget allocations to ministries
- Fig 10 illustration of unbalanced allocation of government resources
- Fig 11 relationship between taxation and investment
- Fig 12 nexus between taxation and development

LIST OF APPENDICES

Appendix 1 rankings of countries of ease doing business

LIST OF TABLES

Table 1	GDP statistics
Table 2	Rates of Corporate Taxes
Table 3	Rates of Windfall Taxes
Table 4	Rates of Taxes on SMEs
Table 5	FDI inflows 2014

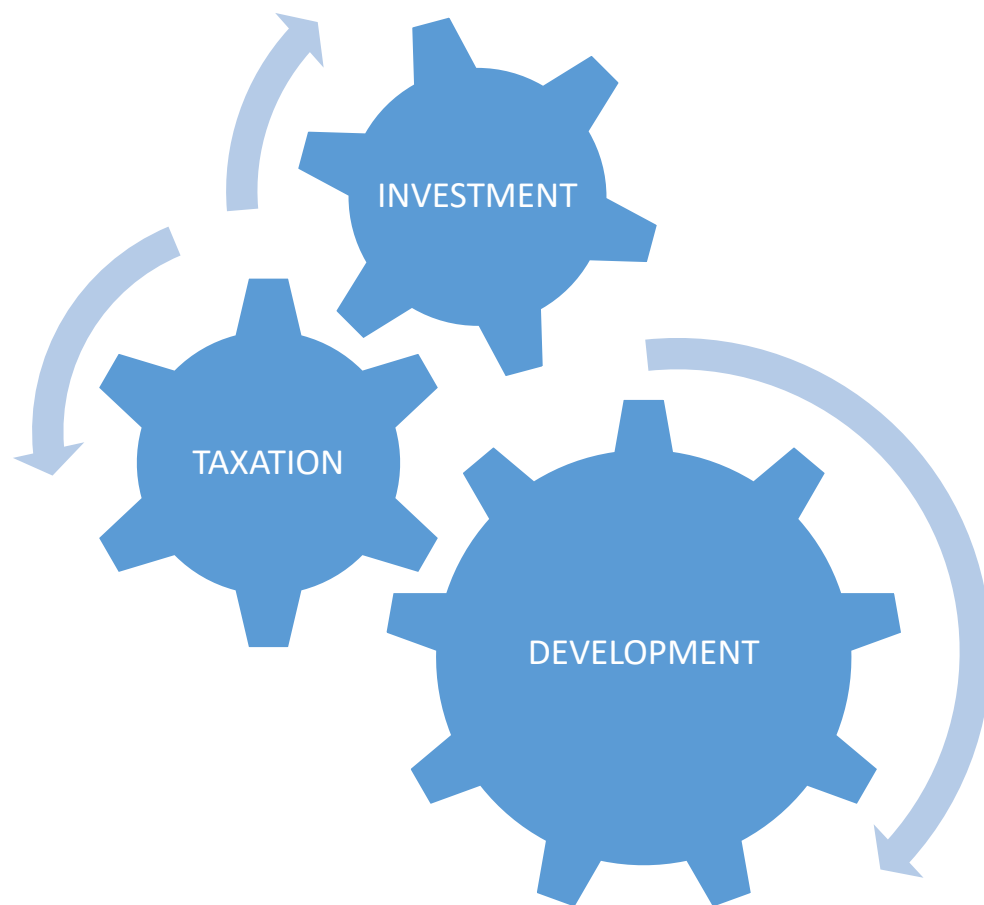
CHAPTER 1

PROBLEM AND ITS SETTING

1.0 INTRODUCTION

The fundamental purpose of taxation is to assemble revenue for the government to enable it to perform its traditional mandate of providing public services and goods. The government allocates tax revenue through the National Budget which is presented annually by the Minister of Finance who is responsible for Treasury. It therefore follows that, the basic principle of tax; policies are to make sure that the system is an effective instrument to raise enough revenue for the government to meet its mandate. Policy formulators have to constantly review the policy to ensure that it remains relevant to its mandate. Taxation also has an indirect role of influencing economic decisions. This is achieved through provision of incentives. Economic agents have a tendency of channelling resources towards sectors with favourable tax rates assuming rationality. As such investors will be willing to invest more in an industry that has relaxed tax rates, and because of this behaviour, governments can influence and direct investments through tax policy. The tax system should therefore be articulated in such a manner as to achieve government objectives. Despite the fact that taxation satisfies the government function, taxes also have a universal impact on economic results of economic agents, and on social equity. Therefore, tax system must be structured to achieve the suitable level of revenue as professionally and equally as possible. A proficient tax policy system must be operational in raising revenue and it should be efficient in its effect on resource allocation and equitable in its impact on different societal classes.

Fig 1: Illustrating the nexus between taxation, development and investment.



Source Author's illustrations

The relationship among these three drivers of the economy is intertwined and this makes taxation the causative that necessitate investment and development to the country. Taxation plays the centre stage in bringing about development and investment. From the diagram above taxation and tax policy bearing it the one which is making development and investment turning. The turning of these gears demonstrates the movement of the economy. The three are dependent on each other and in the absence of one gear; the economy does not function well. If taxation for example was to stop functioning; it would cause development and investment to stop also. The taxation gear lever is dysfunctional if the tax policy is not encouraging to investment by way of high tax rates or if very little is being collected in terms of revenue for the government. Taxation is the centre stage because it is the source government revenue and without tax the government

will stop functioning thus once this happen the whole of the of the nation will fall down. At the same time, investment is critical because the higher the level of investment collected in the economy, the more taxes collected as they are charged against the level of profit.

The study seeks to assess the impact of taxation on investment and development in Zimbabwe. The chapter outlines the intentions of the research which is the problem statement and also how the research was done which is the methodology. The chapter also give a background to taxation, investment and economic development and also a review of theoretical and empirical literature.

1.1 BACKGROUND

Taxation is the fundamental key source to finance of government revenue all over the world. The governments collects revenues from different tax heads. This revenue is therefore used to make the government to provide public goods and services, maintenance of law and order, defence against external aggression, regulation of trade and business to ensure social and economic maintenance. According to Appah, et al (2004), the political, economic and social development of any country depends on the amount of revenue generated for the provision of infrastructure in that given country, thus taxation is often a compulsory levy imposed on persons or upon property by the government to acquire funds to use to provide security, social amenities and create conditions for the economic well-being of the society. Thus, from the previous researches it is evidenced that taxation plays a fundamental role in the economic grow of any nation. To add on to that Tosuu and Abizadeh (2005) says that taxes are used as an instrument to attract investment.

Taxes can inhibit investment rate through such taxes as corporate and personal income, capital gain taxes. These taxes has a direct impact on investors as such investor when are looking for countries to invest in they focus much on corporate personal incoming and capital gain tax. Thus if these tax where to reduced it will go a long in attracting investors as such that if investor are attracted this will cause industrial development. Hence there will employment creation, technology advancement which are the indictors of development. To this end this will widen the tax base and money revenue to the government.

When the government receives revenue collected from taxation, they allocate it to different sectors. These funds are used to finance development projects such as building schools, building

infrastructure, building hospitals and clinics among others. By utilising the resources in such a manner, economic growth is impacted positively. The economic effect can be a challenge to measure in the short run but it will be very visible in the long run. In the long run it will point to the effect of taxation.

Government agents have also the incentive to increase the tax base of taxed activities. In the case of developing countries, which often rely on corporate taxes imposed on large (often state-owned) companies, the tax structure provides incentives to increase the profits of these companies, often to the detriment of competition, which could have significant economic growth effects. However, taxation has an impact on investment and development in developing countries which can be traced back from the time immemorial. Taxes affect the allocation of resources; and often distort the underlying behaviour of economic agents. Regarding economic growth, taxation influences the labour-leisure trade-off and investment decisions. Due to the importance of labour and capital in determining economic growth it is surprising that the relationship between economic growth and taxes has not featured more prominently in previous researches.

Elementary economic analysis of taxation primarily focuses on the tax burden. Under most situations, the primary burden of a tax is a decrease in economic activity, referred to as deadweight loss. A simple extension of the standard model, allowing for taxes on all goods and activities, implies a reduction in economic activity in every market in the economy, and therefore, taxes would be expected to negatively affect economic growth in an economy. However, that simple analysis ignores a number of other issues.

For the sake of analysis, the main tax challenges facing African countries may be grouped in three categories, although in reality many of them are interrelated;

- Firstly, there are key cross-cutting structural issues: the difficulty of taxing the widespread “informal economy”, the limited capacity of fiscal administrations and limited support from development partners on tax matters.
- Secondly, there are problems with the African tax base: tax evasion and fraud, including the misuse of transfer pricing techniques, the difficulty of taxing extractive industries and overuse of tax preferences.

- Thirdly, there are tax mix imbalances compounded by the challenges of declining trade tax revenues and of ineffective urban property taxes.

Tax mix is a ratio of indirect to direct taxes and has been quite stable and sharply rose since 2000 in Zimbabwe. A number of reasons can be cited;

- Firstly, in 2004 value added tax was introduced in Zimbabwe. It has been shown that VAT is more revenue productive than sales tax.
- Secondly, in 2001, Zimbabwe Revenue Authority (ZIMRA) was established. Probably, revenue collection performance and tax administration efficiency improved significantly hence a surge in the tax mix ratio.
- Thirdly, a wave of de-industrialisation that started since 1999 following the start of the emotive land reform programme meant that the formal economy shrunk and hence the direct tax base.
- Further, it meant that economic activity shifted from the formal to the informal economy as formal employment fell and retrenched workers resorted to informal and underground activities for sustainable livelihoods.

In the same period, in spite of the biting foreign currency constraints, processed food imports rose significantly to fill the gap created by the ailing food processors that were operating below capacity. Therefore, indirect taxes rose through the growth in the trade taxes component against declining direct tax revenue. However, the tax burden also rose significantly since 2003. The imposition of international financial restrictions (de facto sanctions) on Zimbabwe closed all avenues for international finance and as such implied over-reliance on tax policy and printing of money hence a surge in the tax burden.

Across the globe, and particularly in developing countries such as Zimbabwe, the effect of taxes on investment and development is one of the central questions in both public finance and development. This effect matters not only for the evaluation and design of tax policy, but also economic growth (Baumol, Litan, and Schramm 2007).

These questions are often addressed in an accounting framework first developed by Solow (1956). In this approach, the output, y , of an economy, typically measured by GDP, is determined by its economic resources—the size and skill of its workforce, m , and the size and

technological productivity of its capital stock, k . Thus, a country like the United States might be expected to have a greater per capita output than Zimbabwe because its (per capita) capital stock is so much larger and more technologically advanced and its workers have more skills, or human capital.

Table 1: GDP Statistics

	2009	2010	2011	2012
Nominal GDP (US\$ M)	6.133	7.433	9.433	11.427
Real GDP Growth (%)	5.4	9.6	9.4	5.6
Annual Inflation %	-7.7	-3.1	3.5	5
Exports (US\$ M)	1613.3	3317	4496	5090
Imports (US\$ M)	3213.1	5162.8	7562	8215

Figures from ZIA Website

. 1.2 SIGNIFICANCE OF THE STUDY

This research will provide insight to the people of Zimbabwe particularly those in commerce and those in policy making and help them in policy making, to make some reforms on the current tax policies so that there will be an increase of investor inflow to the country. It also helps the government on allocation of resources mobilised through tax revenue to consider and/or prioritise issues of real development and not to politicise the resources. The study also gives insight on challenges faced by ZIMRA in collecting revenue and it seeks to ensure adherence to tax payment and discourage tax evasion and avoidance by highlighting how taxation might actually contribute to development. For the purpose of this study, the researcher would be concerned with the impact of taxation as an aid to the economic development of Zimbabwe.

1.3 STATEMENT OF PROBLEM

Taxation is an important part of fiscal policy which can be used effectively by governments in developing economies. Taxation plays a vital role in economic development of a country which includes: mobilising resources, control the economy, improving social welfare, regional development and controlling inflation. However, Zimbabwe is in a crisis where it is characterized by low economic growth, low productivity, and low investment among other economic challenge. Taxation has been vehemently accused of scaring away investors and stifling growth of infant industries. It is also not clear whether the extent of cross sectional allocation of resources through tax revenue has impacted the level of development in Zimbabwe. In addition there are still challenges on measures that can be adopted for taxation to be an aid of economic growth by way of policy reforms. Thus the result from this study will help in solving such issues.

1.4 OBJECTIVES

The specific of this study

- I. To examine the impact of taxation on investment in Zimbabwe.
- II. To determine whether the extent of cross sectional allocation of resources through tax revenue has impacted the level of development in Zimbabwe.
- III. To establish measures that can be adopted to broaden the tax base and to make tax an aid of development.

1.5 DELINEATION

The study was carried out in Zimbabwe, and the effects of taxation on investment and development were analysed only in that context. Zimbabwe is a land locked country situated in Southern Africa and as such it might not represent the impacts of taxation on taxation and investment in all developing countries.

1.6 LIMITATIONS

The study employed the use of desk research which relies on information gathered by other people and internet. The data were not collected to answer the specific research questions of this particular study, and might also be untrue to the population chosen for this study.

1.7 DEFINITION OF TERMS

Tax: A compulsory levy by the government on its citizen for the provision of public goods and services.

Tax Rate: The rate at which tax is charged.

Tax Base: The object which is taxed for instance personal income, company profit.

Tax Incidence: It offers to the effect of and where the burden is finally rested.

Tax evasion: Is an illegal practice where a person, organization or corporation intentionally avoids paying.

Tax burden: Is the analysis of the effect of a particular tax on the distribution of economic welfare. Tax incidence is said to "fall" upon the group that ultimately bears the burden of, or ultimately has to pay, the tax.

Development: Is the improvement in people's well-being socially economically as well as politically.

1.8 THEORETICAL AND EMPIRICAL LITERATURE

1.8.1 THEORETICAL LITERATURE

Gordon and Wilson (1999) developed a theoretical model showing that incentives within government are likely to be just as important in explaining government behaviour as are incentives in explaining other economic agents' behaviour. In their study, they developed a model of government behaviour and also they explore the implications of government and private responses to tax policy. They argue that changes in tax policies affect all aspects of the economy, government, corporate and individual expenditures and incomes are affected, and as

such, behaviours and decision making tools are affected. Their model presents the assertion that taxes affect the incentive of individuals when they make decisions. It states that the resulting efficiency costs are the ultimate interest of any optimal tax policy. The model also explains that the incentives are a heavily dependent creature of the nature of a tax policy, and in turn they influence the behaviour of economic agents towards decisions such as expenditure, spending, saving and investment. Their study urges that any study of optimal tax policy should take into consideration the possible effects each policy brings aboard and how it will affect the economy. This model presented by Gordon and Wilson (1999) is very relevant in the Zimbabwean context and also to the objectives of this study. Investment and development are incentives that the policy makers need to consider before adopting a tax structure in Zimbabwe. Investment is an incentive to government as it brings economic growth, foreign currency, creates employment and ultimately improves the GDP among other effects. Development is an incentive to individuals, availability of clean and safe water, access to health services, and access to affordable education among other indicators for development motivate individuals to pay their taxes thereby doing away with tax evasion and avoidance.

Hall (1968) developed a savings-consumption model and found that tax changes only led to transitory changes in growth. A neoclassical growth model was applied and it relied on exogenous technical change and population growth. The study assumed that these were unlikely to be significantly influenced by the economy's tax structure. They vindicated that, if exogenous technical progress is the main determinant of economic growth, tax policy can only affect long-run income and not long-run economic growth, primarily because capital accumulation only covers depreciation and population growth in these models. With this model, it is implied that tax policy does not have a long run effect on economic growth but that it only affects income. However this is difficult to validate in the Zimbabwean context, and as income has an inevitable impact on economic growth. Incomes affect spending; saving and investment decisions and these are directly linked to economic growth. An increase in investment for example leads to economic growth. In the context of this research, the model implies that taxation has no impact on economic growth which can be measured by investment levels and development in the long run.

Endogenous growth models, unlike exogenous suggest a link between tax policy and economic growth. They permit capital accumulation to continue beyond depreciation and population

growth. They capitulate that since capital accumulation is dependent on the net return to investment which is affected by tax policy it therefore goes to say that capital accumulation is affected by tax policy just as investment is affected by tax policy. Overly, economic growth which can be borne to investment and capital accumulation is affected by tax policy. The argument of endogenous growth models therefore centres on the fact that taxation retards economic growth (Lucas 1990).

Marsden (1990) presents two theories – the Hayekian perspective and the Keynesian perspective and their nexus to investment. He presents the Hayekian perspective as conceiving investment as an adjustment to equilibrium. This therefore means that a decision of the optimal amount of investment cannot be separated from the decision on the optimal speed of adjustment. Optimal speed of adjustment simply refers to how an economic agent might want to expend a decision, how long they want to take on a particular project in terms of time, how much they want to spend on the resources per given period that is the resources and how much the projected investment will benefit the firm. The adjustments also include the decisions about the levels of expenditure, levels of spending and levels of production. This is realistic; it takes into consideration the fact that resources are scarce and adjustments should be made to efficiently and effectively allocate resources. It entails that, resources are never enough to invest, but adjustments can be made, an economic agent sacrifices by adjusting in order to be able to invest. While the Hayekian focuses on the adjustment nature of investment, the Keynesian focuses on the behaviour that influences investment decisions. The approach highlights the renowned assertion that businesses are driven by profits and as such, because of their behaviour, investment becomes a part of every business plan, firms seek to invest in order to maximise their motive of doing business which is to maximise profits. The Keynesian approach vindicates that, businesses are always seeking to make a decision as to the optimal amount of business which will yield more returns, an investment that will effectively and efficiently utilise their resources at any given time. The Keynesian approach rightly took into consideration how behaviours of economic agents affect investment. This is a valid assertion; some individuals will never invest even if they have excess resources because of their behaviour. Whether one is a risk taker or an averse is a behaviour that can affect the decision to invest. In Zimbabwe for instance, people have lost confidence with investing and saving after they lost out from a number of banking institutions that closed and failed to repay depositors monies. Resultantly, the behaviour of individuals in Zimbabwe is such

that, even if tax policy gives incentive to investing, they are less keen to invest their monies, they would rather hold on to it. The difference between the two approaches brought together by Marsden (1990) is that Hayekian approach suggests that optimal investment is about optimal adjustment whereas the Keynesian approach suggests that optimal investment is about optimal behaviour.

Jorgenson (1963) modelled a neoclassical theory of optimal capital accumulation. This theory attempts to offer an explanation on investment. Assuming perfect competition and profit maximisation, the framework capitulates that desired capital stock is determined by technology and factor pricing.

This theory was a deliberate alternative to views expressed initially by Keynes (1936) and Kalecki (1937) that fixed capital investment depends on firms' expectations of demand relative to existing capacity and on their ability to generate investment funds, Fazzari and Mott (1986). Several studies have challenged the neoclassical assumption that any desired investment project can be financed. Asymmetric information about the quality of a loan could lead to credit rationing, implying that not all borrowers seeking loans at the prevailing cost of capital may be able to obtain financing (Greenwald, Stiglitz and Weiss, 1984). Consequently, firms tend to rely on internal sources of funds to finance investment, and to prefer debt to equity if external financing is required.

Marginal efficiency of capital is the principal theory which gives light to economic agents in order towards appreciating the contributing factors of personal investment. The classical theory of investment states that investment depends on the rate of interest (marginal efficiency of capital) and it is a discount rate that will make the expected flow of income equal to supply. In the General Theory established by Keynes (1936) an investment function was proposed;

$$I = I_0 + I(r)$$

where the relationship between investment and interest rate was of a rather naive form. Businesses are assumed to rank their investments according to their internal rate of return. This is also termed marginal efficiency of investment (MEI) and afterward, confronted by a given rate of interest (r). The theory stated that the choice of investment would be that project with an

internal rate of return exceeding the interest rate. If endless investments are assumed, then the interest rate and the marginal efficiency of investment would be equal such that $MEI = r$.

Keynes claimed that marginal efficiency of capital could be defined as being equal to the rate of discount which would make the present value of the series of annuities given by the returns expected from the capital asset during its life just equal its supply price (Keynes, 1936, page 135). Supply price of the capital asset is the price which would just induce a manufacturer to newly produce an additional unit of such assets, i.e. what is sometimes called its replacement cost (Keynes 1936). He further said that the relationship between the prospective yield of a capital asset and its supply price or replacement cost, i.e. the relationship between the prospective yield of one more unit of that type of capital and the cost of producing that unit, furnishes us with the marginal efficiency of capital of that type, Keynes General theory (1936). Marginal efficiency of capital can also be defined as an annual percentage yield earned by the last additional unit of capital. It is also known as marginal productivity of capital, natural interest rate, net capital productivity, and rate of return over cost.

Fisher (1930), in his theory of investment, stated that the optimum condition for the firm's investment decision is that marginal efficiency of investment is equated with rate of interest ($MEI = r$) and he added a condition that investment in any time period yields output only in the next period. Whether rate of interest rises, then to equate r and MEI , it must be that investment declines and thus there is a negative relationship between investment and interest rate.

Ability to pay, the dominant theory of taxation, is usually interpreted in terms of sacrifice. It is held to justify progressive taxation under any one of three possible interpretations of sacrifice: the equal, equal-proportional, and least-sacrifice theories. These theories rest in turn on three assumptions: the declining marginal utility of money with an increase in its supply, the existence of sacrifice. Analysis discloses each of these supports to be defective and thereby breaks down the theory of ability to pay. Progressive taxation may, however, be justified on other grounds. These grounds should be founded on the broad realities of the economic system. Taxes have economic effects, and these effects entail social consequences. The choice of the taxes to be laid and rates at which they are to be applied expresses a preference for one set of economic effects, and hence of social consequences, to another. The theory of taxation, progressive or other, should correspond to these facts.

1.9 EMPIRICAL LITERATURE REVIEW

According to Wang and Yip (1992) the systems of tax is of great importance than the rate at which taxation is levelled in illustrating the economic development of China in the early 1980s. Thus it is clear that tax structure if were to be put in place correctly and well administered they will bring about development. The tax structures will have significant to economic growth if they are flexible to meet the demands to the global economic. In this view the researcher mean by flexible taxation that tax must be used as corrective measure to stabilise the economy. When there is high need for investors then the policy maker must relax the corporate tax perhaps reduce the tariffs on imported equipment and raw materials. On the other hand tax impacted negatively to the economy in so many ways such as high corporate tax will scare away investors. In addition to that if the tax system is not clear the investors will not be willing to put their money in countries where tax system is not clear. However Wang and Yip (1992)'s research will not suit very well with Zimbabwean situation because tax in Zimbabwe is the major source of government revenue it should be crafted with caution fail to plan it will lead down fall of the government. To this end the purpose of this research is to try to examine the impact investment and development as a way to try to widening the tax base by increase efficiency in tax collection.

Kim (1998) after comparing the economic growth and taxation in United States of America with that of in Korea. According to findings, 35% of the difference between USA and Korean economic growth can be explained in the tax structure. Be though as it may the purpose of this research is the find the impact of taxation in Zimbabwe however the results might be the same because taxation has same way of impacting the economy if it is implemented the same way. To this end it shows that tax system can be a tailor made loophole if the system is over emphasised. Thus the researcher is of the notion that taxation need to be used effectively so that in can control the economy. In this view the researcher means that the government may intentionally increase certain tax on certain industries so as to monitor its business. Suppose there is over production of goods in the country and the market is flooded thus the government need to increate tariffs on the importation of that product. By so doing it means that the government would have control the macroeconomic problems. Although Tanzi and Shome made their research their finding might not suit very with the Zimbabwean situation. Thus the results from this researcher will help to come up with working strategy for economic development.

Due to the structural problems in African economies and the results of Tanzi and Shome's analysis, they expect that effects of taxation to economy are marginal in Africa. This is because taxation in Africa is minor in terms of the problems that are faced by Africa today. The problems such as civil wars, corruption, political instability, dictatorship, bad governments and poor policies, only to mention but just a few. Thus to make tax an instrument that controls the economy it will not be impacted very well. Skinner (1987) finds that personal and corporate income taxes have a significant and negative effect on economic growth. This is against the background that the major reason that scares away the investor is high taxes in Africa. Thus if it's true that high taxation will lower FDI inflow to the country then Zimbabwe has to lower its tax so as to attract investors. However it is not fair to generalise the findings of the African continent because each country is unique in its own. More so this research is not based on attracting FDIs alone but also to make taxation an aid to development through equitability of allocation of resources. Furthermore this Zimbabwe research was carried out way back much that to use them as the benchmark of the way forward for economic development through taxation is not fair.

The African governments in most cases do not properly use the tax revenues rather they use that money to fund their political agendas hence it will be difficult to see the benefits of taxation. According to Skinner (1987) developing countries may not return taxes back to the public in an efficient manner. Governments might be corrupt or otherwise not trustworthy, for example, by changing tax policies. To this end it is true that the African governments have a tendency of protecting the throne rather than anything else. This scholar might be correct in the sense that in Africa there is political unrest, civil war erupts every now and then thus it will be difficult to channel the tax revenue to development projects. The ruling government will try all means possible to safeguard their throne. In other words African governments have a tendency of using the tax revenues to fund their political agendas which will make it difficult to see the benefits of the tax system. For the fact that taxation is the base of government funds and the indicator of the improved tax base can be shown through the government's improvement in providing public goods and services. Thus when the government officials are corrupt the benefits may not trickle down to the marginal groups. Hence from a mere look one cannot see the benefits of taxation. Skinner's research was more of a general view of the African government which means to use his results to justify the situation in Zimbabwe is not fair because Zimbabwe is unique in its own. In addition to that this research was carried out about twenty-eight years back which is not fair enough to

conclude with the Zimbabwean context. This is because the world is fast changing, economic situation that prevailed a year ago will not be the same.

Socio political theory: This theory of taxation states that social and political goals should be the major factors in selecting taxes. This theory is good way attain social and political development however the researcher is of the view that taxation should be used as an instrument to foster economic development. In addition to that it is difficult to make social and political the only goals for taxation because taxation is directly linked to the economic development. Therefore social and political developments are indirect benefits of taxation. From this angle the researcher means systems of taxation implicates the economic activities for example the corporate tax has direct impact on the investors. Even high income tax will also impact the investors.

- Benefit received theory: This theory proceeds on the assumption that there is basically an exchange relationship between tax-payers and the state. This is true that the government should provide goods and services to its people for the reason that they are taking tax from them. However this research is much focused on determining whether taxation will impact on development of not
- (Bhartia, 2009). Anyanfo (1996) argues that taxes should be allocated on the basis of benefits received from government expenditure. The theory explains the need to tax put much tax on those who benefits much from the government. However this might not be safe politically because it turns to benefits more on the politicians they are the policy designers. In addition to that it turns to widen the gap on the rich and the poor. Yet the main objective of this research is to try to analyse if tax bring about development or not.
- Cost of service theory: It emphasizes the semi- commercial relationship between the state and the citizens to a greater extent. This theory implies a balanced budget policy. This theory is of the view that the government should propose budget which is correspondence with the income revenue that is a balanced budget policy. Therefore the national budgets must be hand in glove with revenue income. This theory further articulates for the need to priorities what is important

in terms of allocation of funds to the ministries. Though its true theoretical but the tendency of the African government is to manipulate the revenues to fund their political agendas. However the main focus of this study is to find means and way on how to make tax an aid to development.

- Faculty theory: According to Anyanfo (1996), this theory propound that one should be taxed according to the ability to pay. This theory is the one that can be adopted by Zimbabwe because it show some equity in it. For the fact that one should be taxed according to his ability it means that the more one can afford the more tax they pay. In other terms for example PAY deductions will be calculated in percentages this means that the more one earns the more tax they pay. In addition to that the tax that a small business can pay will not be compared the large businesses. This system can be a way to development because there is trickling down of the resource from the rich to the poor.

Grieson, Hamovitch and Morgenstern (1977) used econometric techniques to argue that high taxes discouraged business entrepreneurs as employers had to compensate employees for the burden of high taxes. This view is of great importance actually it's an eye opener to the researcher because there was no much link between the employee's tax like how does PAY affect investment. To this end Zimbabwe need to low employees taxes as the ultimately affect investor. But however these studies where carried away some thirty eight years and the results will not fit well to the Zimbabwean situation.

In addition to the above findings Goss, Preston and Phillips (1994 support with this high taxes reduce job opportunities and sometimes lead to higher unemployment. The researcher concur with the observation by the above prominent scholar in that high taxes on the employee will force the employer to compensate workers for the burden of high taxation. But however findings may not be the same with the researcher's find because of different methodologies used.

In a study in the National Tax Journal, Ladd and Bradbury (1988) observed that high property taxes lower property values can cause significant loss of real wealth. This view is very important

though many may not see its implication to investment. The implications of this are that tax rate will remain the same but the value of the asset will depreciate over the time. For example when the investor pay \$100 as tax for the property valued at \$100 000 this mean over a period of time that property will not cost the \$100 000 due to depreciation but in the books of tax the investor will still pay that \$100. In addition to that the researcher is of the view that there much be flexible tax system that can updated and reviewed every now and then. However the is no one size fit all because Zimbabwean situation property tax is different from Ladd and Bradbury's National Tax Journal.

Bende-Nabende (2002) found that FDI liberalization is among the most dominant long- run determinants of FDI in Africa. This means that if African country were to attract more investors they have to liberalise their economy. Also the classical economic theory support the notion that there should be liberalisation of the economy. In this view it means that the government should remove tariffs and the government should not put too much control to the economy. This means that some policies should be removed. To this end the scholar has put too much emphasis on nontax framework to attract the FDIs but the main focus of this research is to determine the impact of taxation of the investment and development.

1.10 METHODOLOGY

1.10.1 RESEARCH PHILOSOPHY

The researcher used both the positivist and pragmatism philosophies. Positivist is based on objective knowledge emanating from quantitative research while pragmatism bases on qualitative research, what happens around us and common sense. Saunders et al (2009) emphasize that it is important for researchers to understand the concept of positivism which relates to the study of natural science and pragmatism which believes that research questions play a critical role in the outcome of the research. This study is therefore anchored in the impact of taxation on investment and development as represented by statistics and studying the trends of the three variables over time which are taxation, investment and development. It is also based on the opinion of people on the impact of taxation and investment which have been captured and documented in secondary data sources such as publications, books and the internet. This study therefore depended on secondary data. In order to analyse some relationships, simple

econometric models were adapted and formulated. Tables and graphical representations were used to present some findings.

1.11 RESEARCH DESIGN

Desk research was used where the use of secondary data was employed. Time series data on taxation was collected from ZIMRA. Time series data on investment were collected from ZIA and data on GDP was sought from RBZ and Ministry of Finance. The time series data is from 2009-2015. Findings will be presented in tables, graphs and pie charts. A trend analysis will also be done to analyse the behaviour of the variables over the period. Secondary data sources have fewer resource requirements particularly time and money. Desk research also provides comparative and contextual data. Saunders et al (2007) also points that; the use of secondary data can result in unforeseen and/or unexpected discoveries through re-analysing data.

The methodology for the study included both literature review. Literature reviewed included government documents from the Ministry of Finance, budget statements, tax laws, literature on local government, investment brochures and ZIMRA reports. The researcher reviewed other relevant documents and websites including COMESA regional trade protocols that specify duty exemptions for goods manufactured in the region, OECD and other publications for the regional perspective.

Desk top research has got a number of advantages such as ease of access information. The desk top research does not need much money as compare with field research. In addition there is no need to move around searching information which means one can spend less time and achieving equally more with field research.

However, desk research also has also some disadvantages such as one might get a very valuable and promising document that fit well with the study but it might not complete this is because the supplier of the government might have put just summary for free and the rest much be purchased online. In addition to that the secondary data need to be scrutinised so that it can be meet the demands of the study. The secondary research is difficult to use because of different it terms of methodology, time bound, areas and people.

1.12 HYPOTHESIS

The hypothesis for this study was that taxation has no impact on investment and development in Zimbabwe.

1.13 DISSERTATION STRUCTURE

The research is categorized into five chapters as follows;

Chapter One: The Introduction. This chapter outlined the background of the problem, Review of Related Literature and The research methodology.

Chapter Two: examining the impact of taxation on investment in Zimbabwe.

Chapter Three: determining whether the extent of cross sectional allocation of resources through tax revenue has impacted the level of development in Zimbabwe.

Chapter Four: establishing measures that can be adopted for taxation to be an aid of economic growth.

Chapter five: Summary, Conclusions, Recommendations and suggested areas for further studies.

1.14 CHAPTER SUMMARY

The chapter gave the reader an introduction to the study. The researcher started by highlighting the importance taxation to government as well as the different effects that taxation has on investment and development. In this chapter also research objectives were developed and research questions were derived. The proposition, the significance of the study were discussed where it was stated that if the impact of taxation on investment and development is dissected, the findings will add value to the existing body of knowledge as well as come up with indicators to the policy makers on how to strengthen the tax policies in Zimbabwe. The scope of research, definition of terms and dissertation structure were also discussed in this chapter. Empirical and theoretical literature was reviewed and the methodology was outlined.

CHAPTER 2

THE IMPACT OF TAXATION ON INVESTMENT IN ZIMBABWE

2.0 INTRODUCTION

Taxation has got a number of negative and positive impacts on investment. The tax policy of a country is one of the factors which influences the decision of the investor whether or not to invest in that country. Therefore in case of Zimbabwean tax policies are equally an instrument that can be used to lure investors. Business and media have accused taxation of scaring away investors as the tax policy is not attractive. Tax policy has therefore failed to attract foreign direct investors and even the local investors but actually contributed to their shunning the destination. Taxation also has an impact on the living standards of individuals in a particular study as it affects the determinants of GDP per capita which include productivity, labour and capital and these factors affects investment. The mushrooming of informal trade and markets and the perpetual decline in foreign direct investment is a sign that things are not well on the home front. Foreign direct investment is unarguably a critical component for economic development. FDIs bring in capital to the host country and also transfer technology, influence organisational and managerial practices and also transfer skills and international markets are accessed through FDIs. More and more countries are striving to create a favourable and enabling climate to attract FDI as a policy priority.

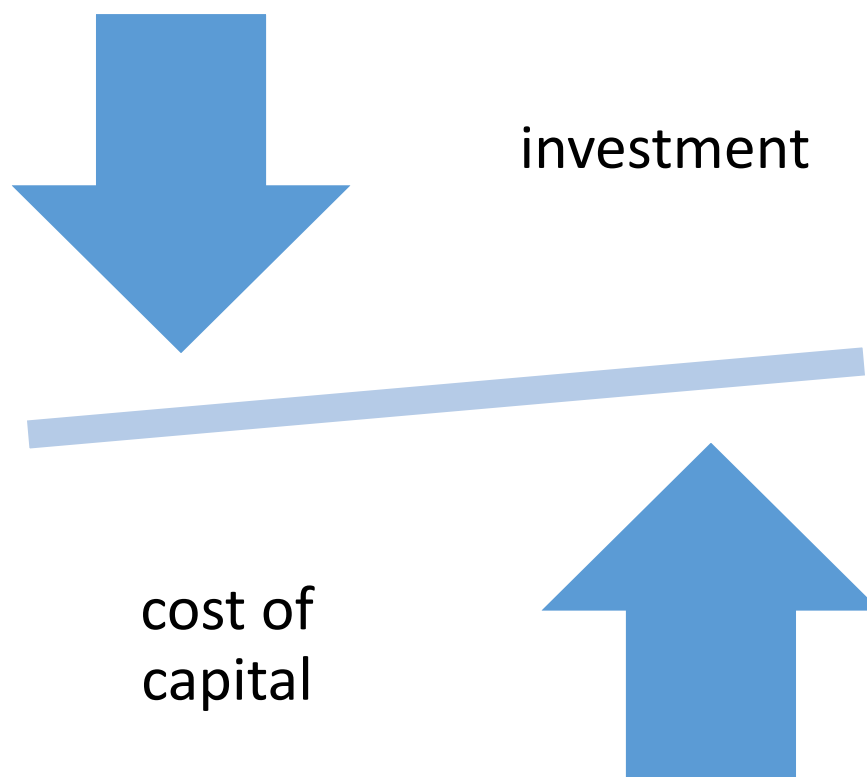
2.1. INDIRECT EFFECTS OF TAXATION ON INVESTMENT

Investment designs can be modelled by analysing how taxes affect cost and return to development. Taxation affects investment by increasing the costs of investors such as cost of capital, running costs and operating costs. Taxes such as VAT and importation duties such as customs duties and surtax distort investors' cost of acquiring capital. State-of-the art machinery is imported as Zimbabwe does not manufacture these and as such, are subject to these taxes. Corporate tax, capital gains tax and capital gains withholding tax affect the running and operating costs of the company as they increase the cost of doing business for the company. Capital gains and withholding taxes are levied on the disposal of specified assets by companies such as immovable and marketable securities. As such, tax policies tend to affect productivity of companies. The efficiency of tax policies should be evaluated continually to ensure that taxation

does not suffocate investors. It is however very important to note that tax effects are not uniform across all industries. Tax policies might put incentives in some industries to lure investors to invest in those industries and might put harsh tax strategies in other industries to discourage investors from investing in those industries.

According to (Hassett and Hubbard, 2002), taxes have a hostile effect on investment, particularly at industry level. They found the long run price elasticity of investment to capital to lie between -0.1 and -0.35. This means that the responsiveness of investment to changes in the price of capital is elastic. A small increase in the price (cost) of capital will result in a big decrease in investment.

Fig 2: Relationship between investment and cost of capital



Since taxation, particularly corporate tax, increases the cost of capital, it lowers the level of investment by scaring away investors. Taxation also affects levels of investment by lowering productivity. Productivity is lowered by both corporate taxes and individual income taxes.

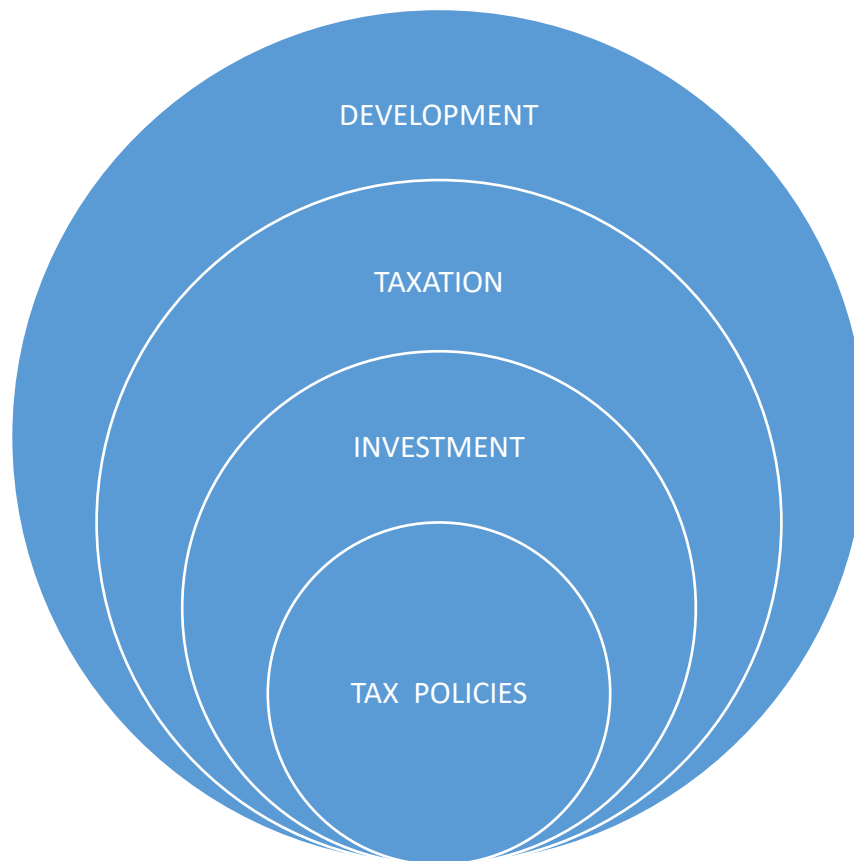
Individual income taxes affect in that, it lowers the net income of the employee resulting in low motivation and morale. The higher the income tax, the lower the net profit and the lower the motivation of the workers which results in reduced productivity. Productivity is measured by total factor productivity (TFP).

2.2 AN OVERVIEW OF THE LINKAGES BETWEEN HOST COUNTRY TAXATION AND FDI

A country attracts foreign direct investment through a number of factors which include tax policies, political climate, infrastructure, skilled labour, macroeconomic stability, flexibility of labour markets, trade agreements with foreign markets and supportive legal framework. Evidently, there are a number of other factors that investors take into consideration other than taxation. However, it is a good tax policy that gives way to developed infrastructure and macroeconomic stability which make the country an attractive destination. Ensuring that the revenue functions are kept abreast therefore form the back bone of any tax policy.

Investment is very critical for economic growth, and ultimately stirs development. The illustration below attempts to demonstrate how critical investment is to development and why tax policies should be reviewed to attract investment. Favourable tax policies are at the centre for development. Holding other things constant, if the tax policy in place encourages investment through tax incentives such as tax reliefs, tax holidays and low tax rates, then investors are likely to come into the economy and inject capital. Investors such as multinational companies are attracted to invest in countries with such relaxed tax policy. The bigger the investments as encouraged by favourable tax policies, the wider the tax base broadens for taxation. Therefore tax revenue increases as a result of increased investment as illustrated by the diagram. An increase in tax revenue collection will result in increased resources for the government which then allocates the resources to different development projects. Development is therefore achieved when the government has more resources to finance the provision of things like affordable health, affordable education, and access to clean water among other issues of development. As the sequence continues, governments will be able to fund macro issues as well as subsidise industries and the country continues to develop.

Fig 3: illustration of the impact of tax policies, investment, taxation and development



It is very important to note that the tax elasticity of investment varies across factors such as type of industry, time and host country doing business environment as well as some macroeconomic factors. Statutory tax rates, which are applied in Zimbabwe, ignore the effects of tax planning as well as special tax preparations. Progressive peripheral effective tax rates and retrospective average effective tax rates are better substitutes to it. This is because, investors' factor in tax planning and valuable rates inclusive of tax base requirements and yet statutory planning does not take these into consideration. It therefore becomes difficult to tailor tax policies which use statutory tax rates to lure investors.

2.3 CORPORATE TAX

The standard tax rate was levied at 35% before dollarization and was reviewed to 30% in 2009 and is currently being levied at 25% since 2010. These are tabulated below together with other taxes that affect companies.

Table 2: Rates of Corporate Tax

	2008	2009	2010 to present
Corporate tax	35%	30%	25%
AIDS Levy	3%	3%	3%
Withholding Tax		15%	10%
Tax on Bank Interest		15%	

Source; Author's illustration

The Income Tax Act allows from income, deductions of expenses which were incurred in the earning of income and in the carrying on of trade. However, the revised Income Tax Act intends to disallow these expenses incurred during trade in order to broaden the tax base. Corporate taxes affect investment by distorting the operating cost of an entity. It is charged at 25% of the profit of a firm during a given taxable period, thereby reducing the profit by a quarter. The corporate tax rate is however not uniform across all countries in the world, they vary with a country's policy and ideology. Some countries prefer lower rates of corporate tax so that companies have an incentive to produce more. Other governments are the other extreme and they levy higher corporate taxes, arguing that higher rates of corporate tax are a way of financing the expenditure of government as well as subsidising programs for the benefit of the populace. Baumol, Litan and Schramm (2007) are of the opinion that, the effect of the level of corporate tax charged is relevant to design and evaluate tax policy and to ascertain how economic growth will be impacted. Davis and Henrekson (2004) points out further that the effect of corporate tax is dependent on the type of industry, the profit margins and how much was invested as initial capital. Some industries have a huge capital outlay such that one cannot just decide to stop operating.

Hall and Jorgenson carried out a study on how to compute the economically correct marginal tax rates using projected profits. They managed to develop elaborate constructs of corporate tax rates which are pertinent to specific investment decisions. They concluded that, sometimes statutory tax rates determine the correct marginal rates. However, Devereux and Griffith (2003) found that

average rates are also relevant as measures of investment decisions provided that the companies are constrained by credit or assuming that they make discrete investment choices. This study found Devereux and Griffith (2003)'s assumptions to be farfetched and as such, adapted Hall and Jorgenson (2009)'s ideology which uses projected profits to compute the marginal tax rates.

Even as much consideration is usually given to corporate income tax, the latent significance of other tax heads should not be ignored. There are other taxes which are also levied to corporate; particularly on commencement that also needs consideration. These taxes and levied are often charged by government departments for the particular industry for example mining is charged by the ministry of mines and those who deal with the environment by the Environmental Management Agency (EMA).

Nearly every corporation is mandated to pay corporate income tax to the Revenue Authority. Corporate income taxes are similar to individual income taxes in that all companies are liable to pay them, it is imperative to understand that corporate income taxes influence the decisions and policies of companies. Corporate income taxes may affect a company when they are levied at a high rate that affects the growth of companies. Company which pays high taxes has reduced chances to growth. Instead of creating employment, most companies lay off staff when tax is increased. The argument raised by Devereux and Griffith (2003) is that, while the increased tax revenue realised from higher rates of corporate tax benefits the average citizen through increased government revenue, some people who rely on the company for a living may also lose their jobs. In the extreme case, a company might choose to move to another location or country with favourable tax rates and this kind of a transfer results in loss of revenue that the company used to spend as well as loss of jobs which causes unemployment.

Tax avoidance could be another option for a company operating in an environment where high corporate taxes are being charged by designing services and products that are exempt and/or that enjoy deductions and tax credits. This will help the company maintain high profit margins.

Taxation plays a distinct function in influencing where multinational corporations locate their businesses.

2.4 IMPACT OF CORPORATE TAXATION ON FOREIGN DIRECT INVESTORS

The burden of corporate taxation has an influence on where foreign direct investments locate as well as their volumes. This is because corporate taxation reduces the returns to investment after tax. However, as has been alluded to before, taxation as a factor on its own is not enough to influence relocation or to ensure that an organisation stays. The decision is based on a number of factors where the issue of tax burden forms a part of. It should be noted that there are some instances where, even when companies are enjoying a significant advantage in terms of being tax competitiveness, they still relocate to other countries. This could be because of political instability, ballooning inflation rates, or dilapidated infrastructure such that companies will be incurring huge costs through monthly repairs. This therefore translates that, a favourable tax policy is a necessary but insufficient condition of attracting foreign direct investment. Afghanistan for instance has a zero rate of corporate income tax but it does not enjoy a lot of foreign investment and on the contrary, UAE also levies its corporate tax at zero per cent and realises high levels of inward FDI because their competitive tax policy coupled together with their stable political climate and other factors. A study by OECD (2015) shows that internationally, countries are competing to put in place tax policies that will attract investors. These tax competitions are fast extinguishing the competitive tax burden on business which countries were battling for previously. While the findings by OECD (2015) cannot be disputed, it is important to point once again to the fact that, the factors being discussed here do not work in isolation. A tax policy might be competitive but if the risk of doing business in a host country is high, the FDIs will not be attracted.

Another study carried out by OECD (2011) gave findings which this study dispute; that the taxation is increasingly impacting on FDI. They reported that FDI is becoming more responsive to the level of taxation in a host country. They argue that as the economy weakens, companies are going to become more sensitive to tax rates as they will be under pressure to retain high after tax income. According to the findings of this study, taxation has a limited impact on FDIs on its own. As a single drive, taxation is unlikely to hinder a decision to invest assuming that all the other factors considered by the investor are attractive. According to the rankings by World Bank (2014) on doing business environment, New Zealand ranks second in the world on the overall environment but it is number 22 as far as paying taxes indicator is considered. The list of these rankings has been attached as an annexure to this study. UAE is first on the taxes indicator but is

22nd on the overall. This shows that, the attractiveness of a host country is not entirely dependent on taxation but other factors also influence the decision of a company.

Price water house Coopers also publish data on labour tax rates, corporate tax rates among other tax rates which they use to calculate an estimate of total tax rate. The rankings from their survey bring a very interesting debate to this research. Their rankings place United Kingdom, France and Zimbabwe at positions 59, 160 and 156 respectively. It is fascinating that the total tax rate of Zimbabwe ranks better than that of France. This makes Zimbabwe a better investment than France. This is not true in practice, but France has a range of reliefs and allowances, which would give it a low effective rate of corporate tax. The methodology used by PCW however also puts into consideration payroll taxes which are high in France resulting in a high overall total tax rate. This further supports the findings of this research that considering tax rates on their own does not give a true position for an investor on the outlook of the business environment of a host country enough to decide whether or not to invest in that country.

It would be inadequate to explain the impact of taxation on investment without emphasizing the importance of deadweight loss. Deadweight loss entails the excess burden of taxation that is the impact to society and not just to the affected company. It can also be defined in the context of the output which would have been produced had the corporate tax had not been charged. This can be termed output loss. Deadweight loss can also be analysed in the view of economic welfare lost against the revenue collected. More often than not, deadweight loss goes unnoticed, but it is a real cause of concern as it points to the impact of taxation on society. Strictly speaking, even the taxpayers might be oblivious to this concept as it measures what they would have had and not only what they had which is the tax liability.

To attract FDIs, most developing countries embrace the use of tax incentives. The incentives commonly adopted include property tax abatements, research credits, concessionary tax rates and additional tax depreciation (Davis and Henrekson, 2004). The motive behind employing these tax incentive schemes is the hope that they will be attractive to investors in developed companies who have the capacity to stimulate economic growth and create jobs in host countries.

Hassett and Hubbard (2002) in their study on Asian countries found that, developing countries that have skilled labour and good infrastructure have a competitive advantage over countries

with favourable market characteristics if they employ tax breaks. However, tax incentives need to be strategically and thoroughly thought through otherwise they might become ineffective.

2.5 OTHER TAXES LEVIED ON BUSINESSES IN ZIMBABWE.

2.5.1 WINDFALL TAX

Holders of special mining leases in Zimbabwe are liable to a tax at 15%. This particular tax is exclusively levied at a standard rate of 15%. Additional Profits tax can however be chargeable on top of the standard rate according to the level of profit. Windfall taxes are levied if the price of a commodity rises above a specified level. The rates are tabulated below;

Table 3: Rates of Windfall tax

Windfall tax	Rate
Standard rate	15%
First positive accumulated net cash position	31.176%
Second net cash accumulated position	27.78%

Source: ZIMRA Website.

2.5.2 VALUED ADDED TAX

VAT is an indirect tax levied on supply of services and goods in Zimbabwe and on the importation of goods and services in terms of the Value Added Tax Act [Chapter 23:12]. VAT refunds are refundable using the formula;

$A - B$ where A is output tax and B is input tax

If input tax exceeds output tax, then the registered operator claims a refund and if it is less, the registered operator has to settle the tax payable as calculated in any given tax period.

The payment of VAT may be deferred for some specified goods with the authority of the Commissioner of the Zimbabwe Revenue Authority for a period that should not exceed 90 days.

2.5.3 TAX ON SMES

Small and medium enterprises in Zimbabwe are subject to taxes such as PAYE, VAT and Presumptive Tax. These three are the most common for SMEs and they are levied at different rates as tabulated below;

Table 4: Rates of Taxes on SMEs

Tax head	Basis of taxation	Rate of taxation
Informal traders	Rental amount payable	10%
Small scale miners	Selling price of precious metal or stones	2%
Operators of taxicabs (quarterly)	Seating capacity up to 7 passengers	100
	Seating capacity 8-14 passengers	US\$150
	Seating capacity 15 – 24 passengers	US\$175
	Seating capacity 25 – 36 passengers	US\$300
	Seating capacity exceeding 36 passengers	US\$450
driving schools (quarterly)	Class 4 training	US\$500

	Class 1 and 2	US600
Haulage trucks (quarterly)	Exceeding 10 tonnes but not exceeding 20 tonnes Including trailers Exceeding 20 tonnes	US\$1000 US\$2500 US\$2500
Hair salons (quarterly)	-	US\$1500
Restaurants and bottle stores (quarterly)	Presumptive tax	US\$300
Cottage industry (quarterly)	Presumptive tax	US\$300
Tobacco levy	Selling price	1.5%

Source: KPMG (2015)

A survey was conducted on small and medium enterprises (SMEs) by Zimbabwe Vulnerability Assessment Survey (2009). The survey found that SME operators are facing cash flow challenges as a result of taxation. However, the survey also found that most SMEs were evading taxes with most of them having no idea of the tax rates. Presumptive tax on SMEs is levied by local authorities. The survey carried out by Zimbabwe Vulnerability Assessment Survey (2009) reported that, SME operators generally agreed that it was important to pay taxes to the government as responsible citizens so as to finance government expenditure. However, the report points that the operators were not very happy about presumptive tax levied by local authorities and could not understand its purpose. While the research does not dismiss the findings of the survey by Zimbabwe Vulnerability Assessment Survey (2009), the researcher notes the difficulty in taxing the informal sector in Zimbabwe. The government adopted the idea of taxing SMEs from the government of South Korea which has support policies for SMEs. However, the difference in approach is that, the government of South Korea have mandated themselves to help and finance entrepreneurs in starting up their own businesses. However, in Zimbabwe, SMEs do

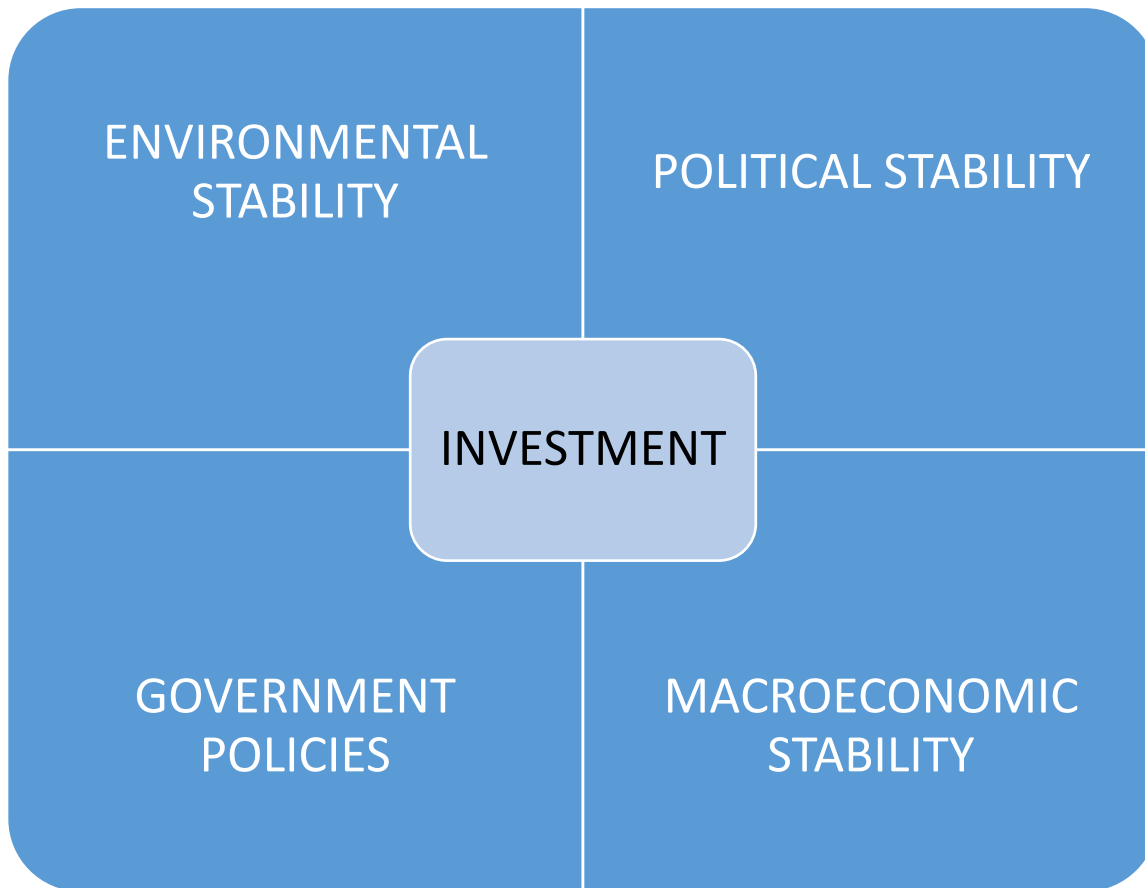
not have access to funding, including loans from banks as they lack collateral. This presents a challenge for the Zimbabwean SMEs as they are not getting adequate support to help them grow.

The revenue, which is distributed by the minister of finance through a budget, does not allocate adequate resources to SMEs to at least subsidise their operations. The government is also not helping SMEs to penetrate foreign markets.

2.6 FDI AND OTHER FACTORS THAT INFLUENCE IT IN AFRICA

The study has pointed that, inasmuch as taxation impacts on investment decisions by investors, it is not a sufficient factor. Taxation is not the only factor that stalls and scares away investors in developing countries. There are a number of other factors that reduces investor confidence on investment considerations. The World Bank carries out a survey annually of the doing business environment where they rank countries according to their ease of doing business. Zimbabwe ranked number 171 in the world out of 189 countries which is not attractive to investors. The World Bank looks at 10 indicators to the doing business environment to which taxation is one of them.

Fig 4: Factors affecting investment



The illustration presented above tries to show that investment is an output of a number of factors.

FDIs are attracted by the availability of natural resources in African countries. Countries with large endowments of natural resources lure investors more easily than countries whose resources have depleted. Countries with less restrictive laws on exploitation attract more investors than those with strict ones. In 2014, Africa attracted US\$82 billion according to Okauru (2015). Of this, Mozambique attracted FDIs of over US\$4,9 billion and Zimbabwe received US\$545million worth of FDIs in the same period. Statistics obtained from a report by ZIA (2015) give the FDI inflows in the region as tabulated below;

Table 5: FDI Inflows (2014)

country	FDI inflow (2014) US\$
Mozambique	4,9 billion
South Africa	5,7 billion
Zambia	2,4 billion
Zimbabwe	545 million
Malawi	130 million
Swaziland	13 million

Source: ZIA website

The fact that Zimbabwe has a smaller market share than Mozambique might help to explain this huge margin between the two countries. On the Ease of doing business rankings produced by World Bank (2014), Mozambique overall ranked number 127 and Zimbabwe was ranked number 171 out of 189 countries in the world. On the taxes indicator, Mozambique ranked 123 and Zimbabwe was number 143. This shows that, even though the infrastructure in Zimbabwe is better than those in Mozambique, Mozambique attracts more investors.

FDIs also consider the market size of the host country, that is influenced by the population size in a particular economy, the issue of corruption and transparency – how a country deals with corruption, do they tolerate it or not and political uncertainty as well as the ease of doing business. A country's population is a proxy for its market size and as such investors consider it. Zimbabwe has a population of 13 million people which is relatively a small population as compared to other countries in Africa. Countries with political instability are unlikely to attract FDIs even if their tax policy is favourable. This shows that, weak investment conditions cannot be overshadowed by an attractive tax policy. Making reference to the World Bank survey again, the example of Afghanistan can be referred to. It ranks 183 out of 189 on its ease of doing

business, but its taxes indicator ranks 79. Afghanistan has a 0% corporate tax but investors still shun it as an investment destination.

Inconsistencies in policies is also another factor that keeps investors away despite the tax policy. In Zimbabwe, policies are continuously changed and this causes uncertainty and in turn, chases investors away. Investors want to put their capital where it is secure, not where there is a high risk. Consistency, accountability and transparency are therefore very critical to lure investors. A zero-tolerance to corruption stance is also imperative.

Zimbabwe ranks poorly in the World Bank Doing Business Indices as well as other indications of investment attractiveness. The World Bank indices are a barometer for international investors seeking to come into a country. It is critical that Zimbabwe makes it easier for investors to do business in Zimbabwe and addresses some of the concerns highlighted in the World Bank Doing Business Report 2013.

2.9 FOREIGN EXCHANGE POLICY

It is a fact to all that the national exchange rate policy was a catastrophe which caused a lot of macroeconomic damage. The divergence between the parallel exchange rate and the official exchange rate affected players in the economy as well as the ordinary Zimbabwean. Industries crumbled down, people lost jobs, and trade became meaningless as inflation soared above unimaginable heights. Investors shunned the economy, and they still have not regained trust in the economy even after adopting the multicurrency. In total, they have lost confidence in the economy. The foreign exchange policy is a ghost that continues to haunt this economy and even if the tax policy was to be fine-tuned to be a very attractive one – it will take great strides to convince international investors that Zimbabwe is a good investment.

2.10 INSTITUTIONAL FACTORS

Property rights and the legal system play a critical role in terms of selecting a destination for investment. Issues such as these are of utmost importance as they give investors security. The legal system should be efficient and upright. A corrupt legal system increases the risk of an investor. Property rights are also equally important for the security of an investor.

2.12 CHAPTER SUMMARY

According to the International Monetary Fund (IMF), Zimbabwe's external position appears vulnerable, with a wide current account deficit, an overvalued exchange rate and low international reserves. Key risks to the outlook include lower-than-projected tax revenues, policy slippages, financial sector stress and the decline in global commodity prices. Zimbabwe faces these risks with "very thin buffers". In the absence of any international financial support for Zimbabwe, it is imperative that policymakers take bold decisions to resuscitate the economy and boost both consumer and investor confidence. Given this, government needs to act decisively if it is to resuscitate the economy which now appears in a free-fall. Key to this would be attracting much-needed FDI to kick-start economic recovery.

CHAPTER 3

DETERMINING WHETHER THE EXTENT OF CROSS SECTIONAL ALLOCATION OF RESOURCES THROUGH TAX REVENUE HAS CONTRIBUTED TO DEVELOPMENT IN ZIMBABWE

3.0 INTRODUCTION

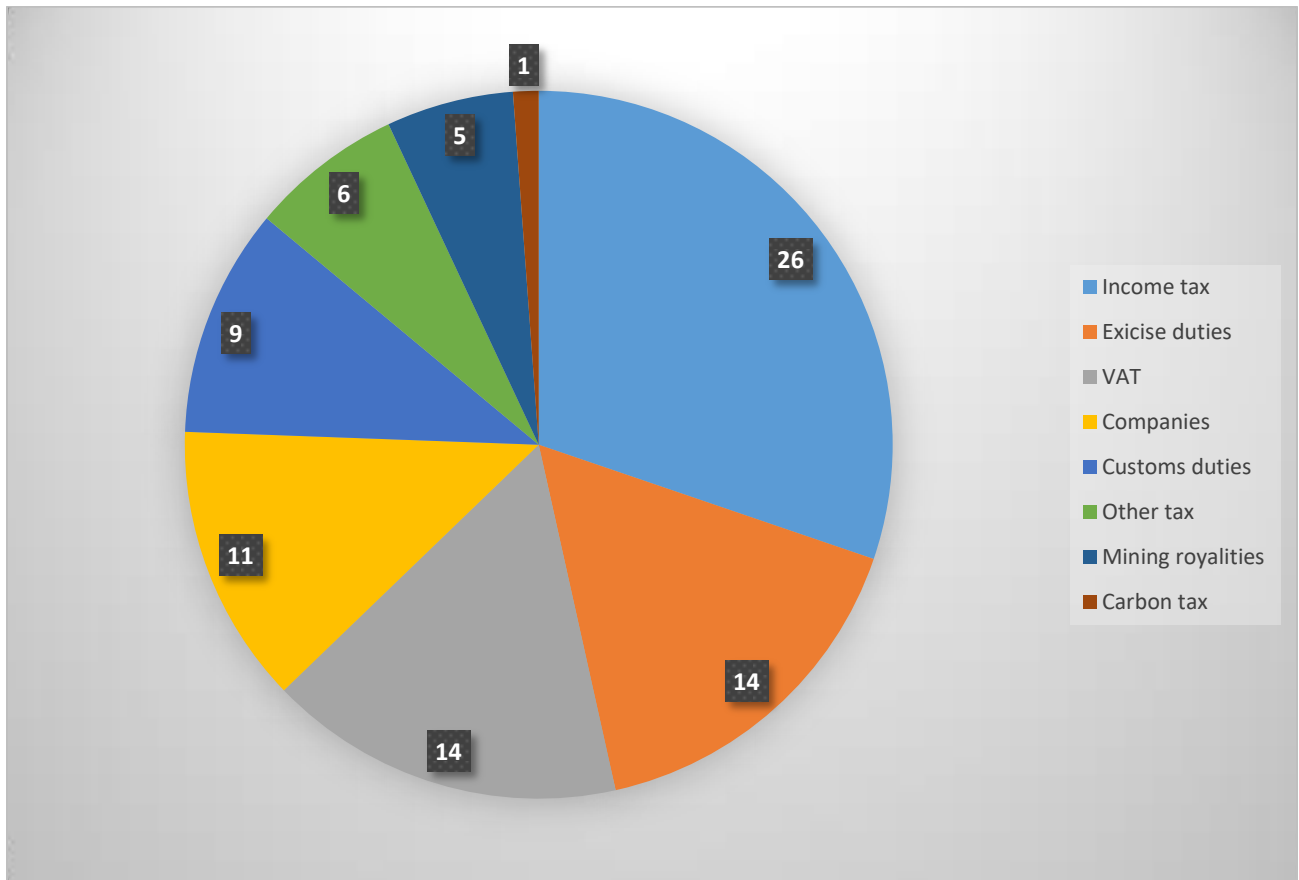
The fundamental resolution of taxation is to establish how funds and expenditure on public services and other obligations can influence behaviour, such as to help deliver environmental objectives, support growth, employment and a diversified industrial base. In Zimbabwe taxation has emerged as the major source of government fund which enable it to perform its traditional duties of providing public goods and services. The government collects different types of tax revenues to boost its financial need. This revenue will then contribute to the budget to finance various sector of the government. Thus one can safely say taxation and development are two sisters, whereby taxation actually fosters development because it will facilitate redistribution of resources. While fulfilling the revenue function, taxes similarly have a universal influence on development. This chapter will look at how taxation impacts development by reviewing how government allocates tax revenue.

3.1 OVERVIEW OF THE TAX STRUCTURE IN ZIMBABWE

According to ZIMRA annual report of 2014 it articulated in 2014, ZIMRA collected 3.3 billion United States dollars. The report shows that every ZIMRA tax sections have made its contributed to the above mentioned total collection. This money was collected from various revenue heads such VAT, income tax, customs duties, carbon tax mining royalties and other tax

Fig 5: Contribution by tax heads

The graph below explained the statistics of contribution of each tax head.



Source: ZIMRA 2014 annual report

The pie chart above shows that ZIMRA collect revenue from various sectors which will ultimately contribute to the nation budget.

3.1.1 INDIVIDUAL TAX (PAY AS YOU EARN)

The individual Tax in 2014 made a distinct contribution to the target of US\$911.8 million. This revenue sector has contribute 26% of ultimate annual revenue surpassed the targeted of 20% of total annual revenue. This great improvement of has been caused by a number of reason reasons such as improved compliance because Zimbabwe Revenue Authority (ZIMRA) has made a serious audits campaign last and some follow-ups were also undertaken. To add on to that although at the end of 2014 was experience with low economic performance in general business

but some companies has managed to award bonuses and performance based awards to their employees and this aided the performance of the revenue sector.

3.1.2 CORPORATE INCOME TAX

The corporate income tax made a total amount of US\$373.9 million, This low performance of the revenue sector has attributed to universal poor performance of the economy due to numerous factors like liquidity crunch, lack of credit lines, high cost of production and according to CZI another cause for general poor performance of this sector is reduction in industrial capacity operation from around 39.6% in 2013 to 36.3% in 2014. This had a negative impact on company profits thereby contributing to the revenue sector's failure to meet anticipated target. This negative performance by corporate income tax will also have effect of the national budget because the government will be expecting that money to cover some of its duties.

3.1.3 VALUE ADDED TAX

The gross collections for 2014 amounted to US\$1.22 billion against a target of US\$1.24 billion. There are several reasons for low contribution from this sector such as fall of local industrial capacity performance which resulted in low levels of production on goods that attract VAT. The liquidity constrains have negatively affected production as well as companies' capability to secure funds for the procurement of efficient production machinery and manage cash flows. Low disposable incomes negatively affected consumer spending on goods that attract VAT. Thus to this end VAT contribute 14 percent to the total annual budget. Though it seem like 14 percent is huge money but looking at situation of the government it will not cover much to the national budget. This is because the government is not get funds from outside if it does that money will total directed towards something else. Much of this revenue is used for the salaries of civil servants therefore every cent from revenue is much needed to cover government expenses.

3.1.4 CUSTOMS DUTY

According to ZIMRA 2014 report, customs duty has made a gross contribution of US\$341.6 million in 2014 but the targeted was US\$430.0 million. This low performance of the revenue sector can be the reason that of the liquidity challenges which resulted in the reduction in volumes of imports that attract duty. In addition to that since there is low industry capacity

utilisation it means that companies which used to import raw material in high volumes are had reduced there volumes. However this short fore will negatively impacted on the national budget. As a result there will be some areas of development which will ultimately suffer the burden. In other wards for example the some children who shall not go to school because the government has failed support BEAM program. Thus it is true to say tax and development are intertwined.

3.1.5 EXCISE DUTY

Excise duty is a type of tax charged on good produced within the country. This sector of tax in 2014 has made a total contribution of US\$512.2 million, against a target of US\$569.0million, resulting in a negative variance of 10%. Excise Duty on fuel and beer contributed 71% and20% respectively. The poor performance of the sector can be contributed according to Zimbabwe Revenue Authority ZIMRA report to decline in volumes of petroleum products in 2014 as compared to 2013. Petrol imports declined from 472.9 million litres in 2013 to 455.2 million litres in 2014. Diesel imports declined from935.5 million litres in 2013 to 910.7 million litres in 2014.

3.1.6 CARBON TAX

This revenue sector has made a contribution of US\$34.9 million against a target of US\$40.0 million, which interprets to a negative variance of 13%. This is because to a drop in volumes of petroleum products as illuminated above under Excise Duty. This money will also help to fund government budget. The reason why there is much emphases on tax and development is that the government is in deep crisis for finance to perform its duties. Therefore as mention earlier on, that tax is the back bone of the government funds contributing over 50% to the national budget.

3.1.7 OTHER TAXES

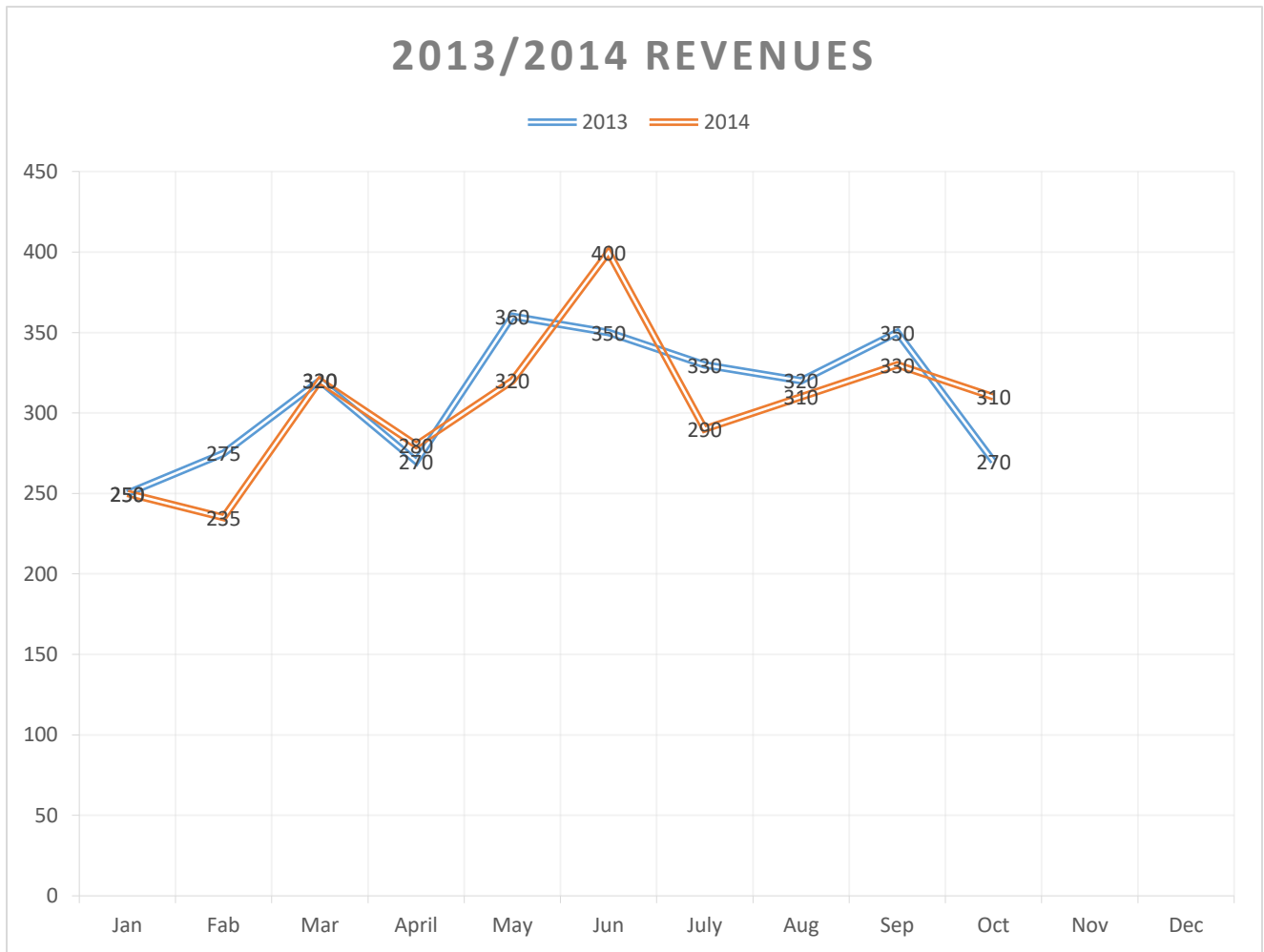
Other Taxes include revenues from Withholding Tax on Tenders, Domestic Dividends, Interest, Remittances, Fees and Tobacco Levy. The cumulative collections amounted to US\$211.6 million against a target of US\$189.7 million. The positive performance was because of various reasons such as some companies has managed to pay dividends to their shareholders and this led to enhancement of revenue collections. The improved revenue collections from Non-Residents' Tax on Fees and Remittances due to surveys and audits done during the year

Taxation is central to development and provides governments with the funding they require to finance social, political and economic development. Taxation creates an environment in which business is carried on and plays a role in shaping the way in which the activities of government are carried out. Taxation has the major role to pay to the government's budget. Through taxation the government will therefore be able to perform its traditional duties of providing public goods and services.

The revenue collections for the ten months to October 2014 amounted to US\$3.037 billion, against a target of US\$3.27 billion and US\$3.01 billion realised over the same period in 2013 as shown in the graph below.

Fig 6: Monthly revenue collections (2013-2014)

Millions



Source 2015 National Budget

This is a picture that should teach a lesson to the budget consultancy that the major source of the government funds is not predictable hence when budgeting they should bear in their minds that in as much they predict their expenditure they should know that the revenue base is not stable and predictable. The outcomes of the revenues will depend on economic performance at that particular period of time.

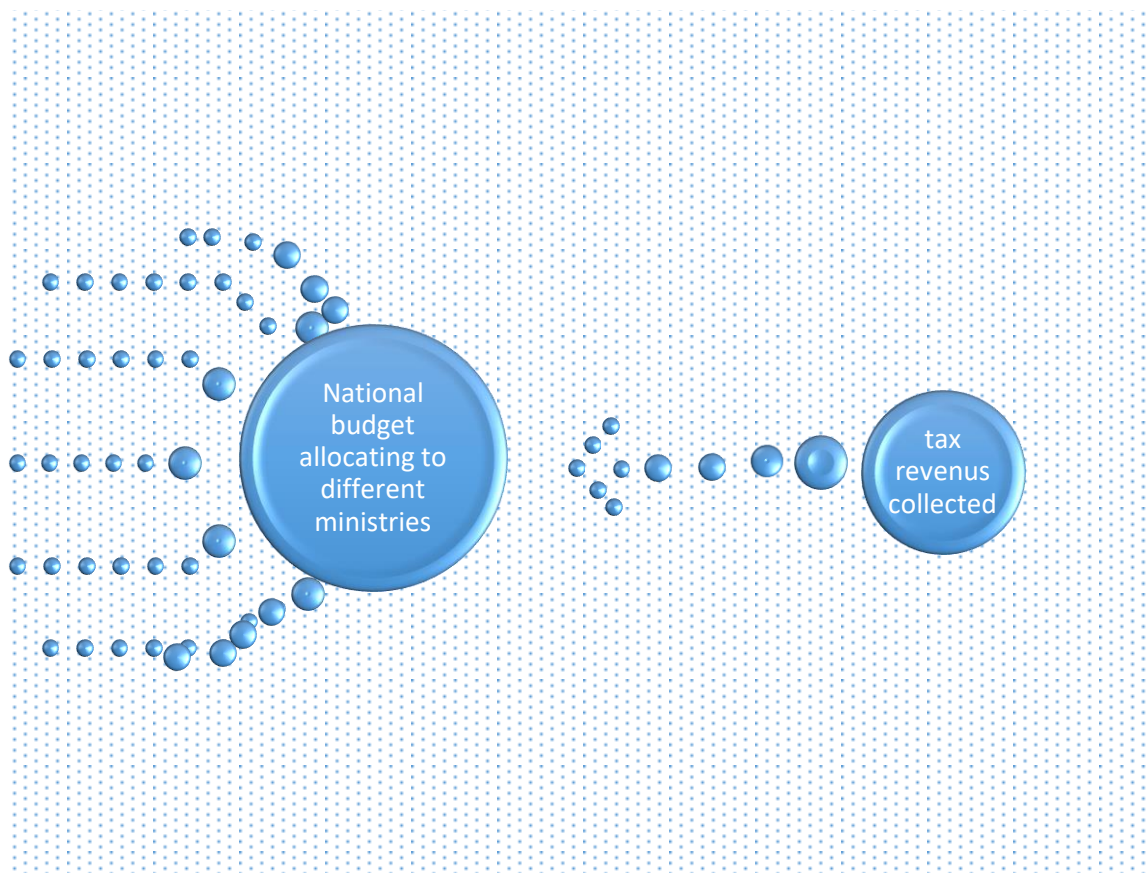
3.2 TAX AND DEVELOPMENT

The 2015 budget allocated US\$ 987.58 million to sustain the momentum created towards implementation of priority ZIM ASSET projects, critical in sponsoring domestic economic

activity, fighting poverty and reducing vulnerability. The Minister proposed to raise the required US\$987.56 million from various sources. Tax revenues contributed an amount of US\$38.3 million towards the financing of infrastructure development. This is quiet evidenced that revenue pays a significant role in fostering development. The infrastructure project such road construction, dam construction, schools and hospitals construction. These projects will uplift the living standards of the majority of Zimbabwe. To this end one can say taxation has an impact on development. If the funds are channelled through this was revenue would be the base of development.

The diagram below is a revenue chart flow from the collection agents to the government then finally to various ministries

Fig 7: illustration of allocation of tax revenue

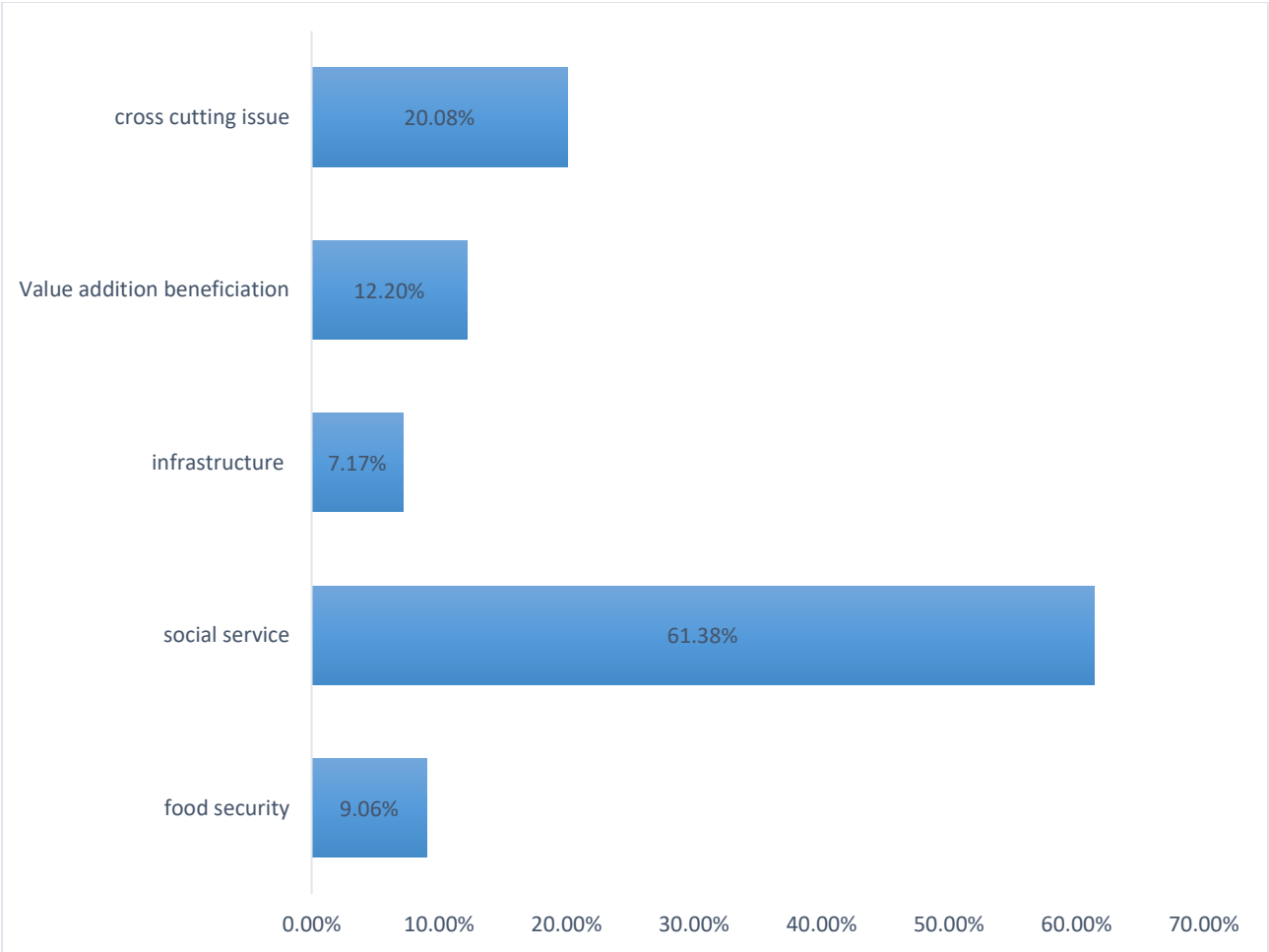


The most basic principle of taxation is to raise funds to support government expenditure. Thus the diagram above explain the channel to which the revenue is being collected up to the end

where it is being allocated to different ministries. However is also show that though the main fundamental principle of revenue collection is to fund government projects there is bias towards security ministries because the security ministries is getting large balls from the national budget.

Taxation is also means to provide equity redistribution of resources. Thus the equity objectives can range from providing a 'safety net' to support those on low incomes , providing temporary assistance in the event of an unforeseen event, during drought government provide food to the disadvantaged group of people through to more fundamental and comprehensive redistribution of resources. Therefore, linkages between the taxation and social welfare support is of great importance.

Fig 8: THE GRANT FINANCING OF ZIM ASSET CLUSTERS JANUARY TO SEPTEMBER 2014 FROM REVENUES



Source: MOFED

From the collection of revenue the government has manage to support the above, targeted at food security, social services, infrastructure, value addition and beneficiation, as well as cross cutting issues. The support above the government has shown that cross sectional allocation of resources through tax revenue is real fundamental base for development in Zimbabwe.

3.3 COMMUNITY DEVELOPMENT

For equitability and sustainability development, tax burdens should be fairly and justly distributed to everyone as the allocation of the resources will be equitable. With the funds from revenue, there is need to ensure equal opportunity and access to all local government facilities and opportunities without looking at disadvantaged and disabled of local authorities and individuals. In practice, however, the test of equity and fairness something doesn't exist in this country. The system seem as if it protects and empowers those who are weak and disadvantaged yet in reality local authorities are more access to direct funds from revenue therefore they will end up manipulating the system and enriching themselves at the expense of the poor. Tax is a good instrument that can be used to foster development is it used correctly.

3.4 LOCAL AUTHORITY.

Local authorities also receive funding from the national budget allocation. These Local Authority are the administrative bodies that are officially responsible for all the public services in specific geographical areas such as cities, towns, municipalities, countries and boards. According to Zimbabwe Institute, 2005 Local authorities, receive grants from the government. This funds are then being used to maintain community roads and other service. However due to long chain to hand over the funds from the government to local authority some of the money is being misdirected at the end it will not show any significant contribution of taxation to the local authority. In support to this there serous cases of corruption in these local authorities hence once the government disbursed money to these authorities it will be swapped away by corrupt officials. At the end it will then appears like as if the government is not try its best. Over depends of revenue as the major source funds will also make local authorities struggle to providing services to its people.

3.5 SOCIAL DEVELOPMENT

3.5.1 GENDER MAINSTREAMING

In showing full commitment to cross sectional allocation of resources through tax revenue that will make a remarkable contribution to development in Zimbabwe, government have coordinating, through the Ministry of Women's Affairs, Gender and Community Development, sectorial gender mainstreaming initiatives which will see the training of women entrepreneurs. This show that the government has got a focus to empower the marginalised group of people sense in most case women are always found and lower levels of social classes. The money from revenue was already set aside by the ministry of finance to facilitate these initiatives. In support of women empowerment the government has funded initiatives for women capacity building, value addition and beneficiation by women in agriculture, mining, tourism and trade. To this end, the minister of finance proposed to provide resources amounting to US\$400 000 in the 2015 national budget. This will be supplemented by carrying out of nutrition and health awareness programmes nationwide. Furthermore, the ministry of finance has proposed in 2015 budget to allocate US\$120 000 to operationalize the Zimbabwe Gender Commission, the remaining identified Community. However it is questionable that who is going to benefit from these project. Of cause the project will be for every women empowerment but in most cases this projects will be politicised only those who support the ruling party will enjoy the benefits. Thus so say revenue has got a direct impact to the development it not fair as some of the funds are being politicised.

3.5.2 ESTABLISHMENT OF THE WOMEN'S BANK

To support the above idea the Zimbabwean government recognises that women are an integral part of Zimbabwe's socio-economic transformation. Therefore to this end, the establishment of Women's Bank as proposed by the Minister of Finance in 2015 budget will facilitate women access to credit through formal institutions which will also overcome their financial segregation. This would also be consistent with the Constitution which requires practical action towards empowerment of women. The linkage between women empowerment and taxation is that the money used to fund the women empowerment projects is from tax revenues. This alone is one of the most fundamental indicators of cross sectional allocation of resources through taxation to

enhance development. However as discover by the researcher not everything that has been allocated funds for will get that money. In most cases the Finance Minister will just make some mire budget statement that they propose to fund this project by such a time but when it comes to the disbursement of the funds it will be a different story all together.

3.5.3 EDUCATION

Student Grant and Loan Scheme

According to Nelson Mandela in Schools for Africa campaign 2008 “we all know that education, more than anything else improves our chances of building better lives”. Thus it is against this at background that the government of Zimbabwe has took a robust stance to help those Zimbabwean vulnerable children through Cadetship programme. It is also quiet noticed from this research that human capital investment is a groundwork for economic development. Thus to this end the researcher has noticed that government from revenue has reinforced the training of polytechnic and university students through the providing of financial support, primarily under a Grant and Loan Scheme which supported the payment of tuition, accommodation and meal expenses and recently through the Cadetship Programme. The notion of the funding is to provision of stipend support to tertiary students, especially those from disadvantaged backgrounds; the support of financial institutions in the mobilisation of resources for onward lending to students will be pursued. Thus revenue can be said to greater extent is a cross sectional distributor of resources which has contributed to development in Zimbabwe.

Presidential Scholarship

Taxation has dual mandate which boosting government revenues, apart from that is also provide a sense of poverty eradication remedy to the marginalised group of people. This has been done through presidential scholarship. From the research done by the student the government has shown its commitment to help student from disadvantaged background. The finance minister has proposed an allocation of US\$5 million towards the Presidential Scholarship. The presidential scholarship programme will go a long way to bridge skills gaps. However though it seems like presidential scholarship is open to everyone the intake process to the scholarship is being politicised. One would found out that it is the children of war- veterans’ children of ZANU PF supporters who are being enrolled to the programme. This will leave many will unanswered

questions, that if this funds coming from revenue that are being collected from everyone why is it that only those affiliate to a certain political party are benefiting. Thus to this end revenues are being manipulated somehow by political party.

Through taxation the government has been able to support vulnerable children who were not going to school due to lack of funds and some of them are child headed families. From various collection revenue the money will then channelled sponsor various government entities to foster development and chief among them is BEAM. BEAM is part of the government project to help orphan and vulnerable children to get access to school and participation of marginalised children in education policy and processes. In the 2014 national budget presented by the Finance Minister it showed that the government would only be able to support the education of 83 000 secondary school pupils after BEAM was allocated just \$15 million yet the ministry of Labour and Social Welfare had asked for a budget allocation of \$73 million to cover BEAM. From the figures highlighted above the shows that the government is in financial crisis to fund the crucial sector. These children are looking up to the government for fees. \$ 15 million allocated is will not cover much as compared with the number of children who in need of government support. Thus due to the fact that government has based most of its incomes from revenues yet revenues collections will depends of the prevailing economic condition of that period of the time, it is not fix, when there is favourable economic conditions such as money is circulating in the market and industrial capacity utilisation.

Health

In the 2014 national budget presented by Minister of finance it was evidenced that the Health and Child Care ministry got \$337 million which is 8,2 % of the total budget allocation. This shows that the government of Zimbabwe is not prioritise the health sector. According to Rusike (2009). The government has failed to meet health allocation of 15 % of all national budgets should go towards health, stipulated by the 2001 Abuja Declaration on Health that Zimbabwe is a signatory. The government depend of foreign donor to fund the health sector this might seem like it is the just help from the developed nation yet the reality of the matter is that these aid from the developed nation will be attached with conditions which are not favourable to the development of the nation. It's not as if the government has too shrink revenue base. But its only mean that they are failing to priorities on the health issue. The researcher has found out that much of the

government funds are being channelled to the security ministries for example in 2014 the security ministries got a 1 billion United State dollars. Failing to prioritise on the key ministries it will appear as if the revenue being collected are not making the government to perform its traditional duties.

The statistic above clearly shows is in shambles because government has failed to increase access and utilisation of quality primary health care and referral facilities and these are key of indicators of country's development. The research found out that government's inability to fund its own people's health has meant relying on international donors to supplement health funding. This creates a dependence syndrome from the donor and ultimate results are quiet obvious that donor funds are attached with unfavourable conditions to the country's political arena.

3.6 ECONOMIC DEVELOPMENT

3.6.1 INFRASTRUCTURE PROJECTS

From the supplements from revenue the government had earmarked on number of infrastructure projects that are being carried out under the Public Sector Investment Programme. These projects were to be transferred to the Bank for funding, but be though as it may, the government had allocate on the budget money to facilitate the progress of these project. The major sectors to be covered included energy, transport, housing, water, aviation and information and communications technology. Thus government has managed cross sectional allocation of resources through tax revenue which has marked a significant contribution to development in Zimbabwe.

3.6.2 ENERGY SECTOR

Energy sector is the cornerstone of economic development, from the research it was evidenced that the government has taken into consideration energy supply shortages that the country is currently experiencing has disrupted industry and commerce operations in the country. With additional money collected from taxation the government is now looking at additional power generation capacity. To address the power deficit, Zimbabwe Power Company has developed a number of projects and these are awaiting financing from the government. The projects are the expansion of Kariba South Hydro-electric Power Station and Hwange Thermal Power Station.

To this end, the government has a statutory mandate to spearhead the conscription of funding for infrastructure in all sectors of the economy, with power being one of the top priority areas. According to 2015 national budget the total portfolio of projects under agency arrangement with government exceeds US\$100 million, of which UUS\$25 million was allocated for power projects. Thus government is under pressure for funding these project as they are the cornerstone of economic development. From analytical point of view it seem like the funding of these projects will go a long way in boosting economic development when there enough electricity this will ultimately boost the FDI inflow because so many investor are will to invest in the mining industries but it's not possible became the current state of the country in terms of electricity supply is not attractive. To this end government is struggling to make ends meet due to various factors the major one is that it is too depending on the revenues.

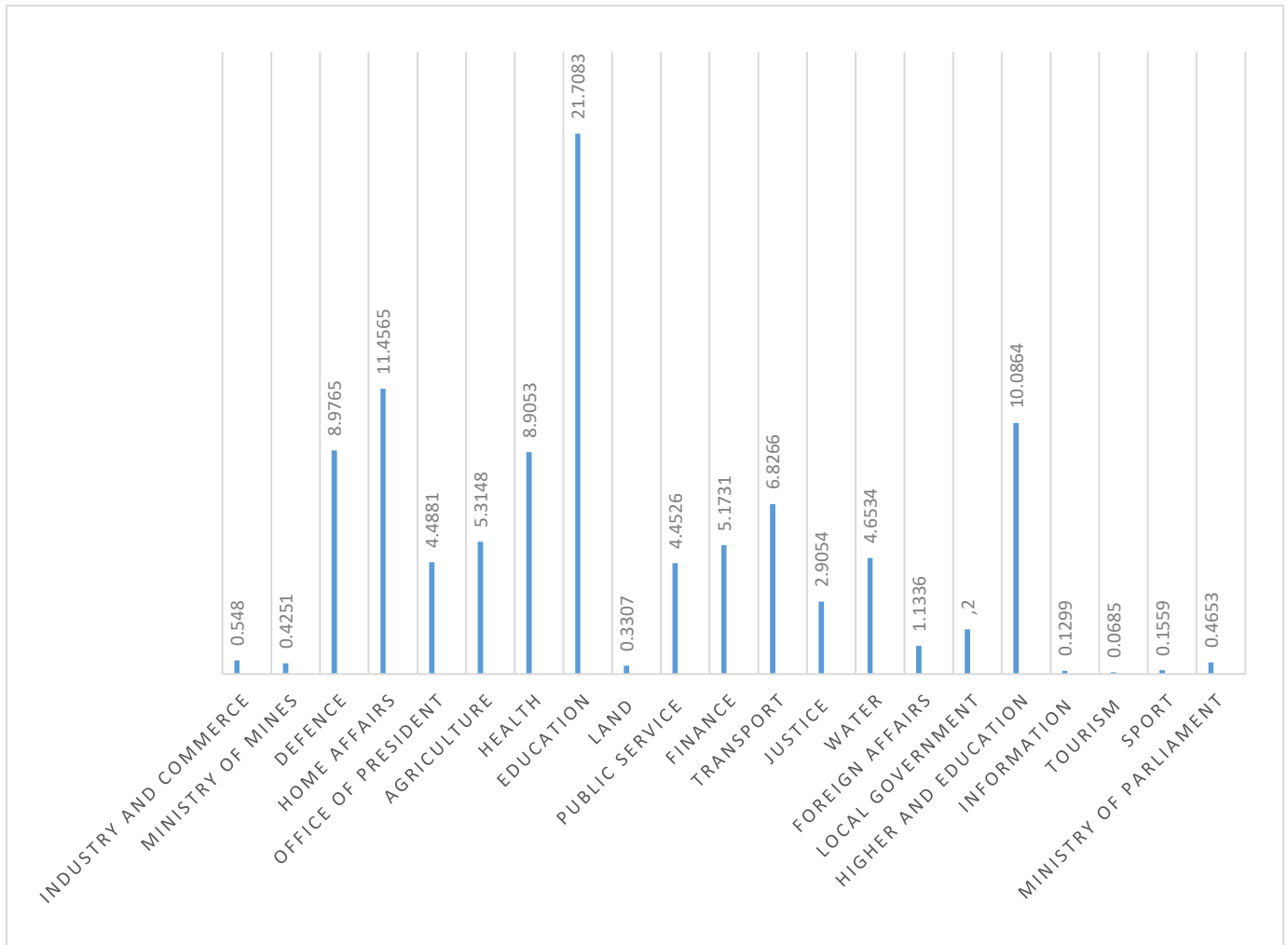
3.6.3 HWANGE THERMAL POWER STATION REHABILITATION

Electricity

Electricity is a cause of concern in national economic development, the government has shown its commitment finance the on-going rehabilitation programmes at Hwange, Kariba and small thermal power stations, power supply remains a major challenge for economic recovery. The researcher found out that in 2011, the government disbursed US\$40 million to boost energy programme. This is a crucial area that need to be improved because so many investor are much will to invest to this country but they are failing to invest because the country is already in deficit in electricity supply. Thus if the government were to invest much on the electricity projects it will go a long way in attracting the investors. The allocation of resources in one key factor that has to be considered in Zimbabwe if there need to draw some positive gains from the revenues. The researcher found out that the government is too focused on miner issues such as funding their political ambitions at the expense of the economic development. When the investor are attracted they will bring so many positive developments to the economy which will at the end broaden the tax base. In addition to the tax revenues, the ZIM Fund will also avail US\$3 million for rehabilitation of Hwange Power Station under the Emergency Power Infrastructure Rehabilitation Project, targeting rehabilitation of the dust suppression system for the coal handling plant, dirty drains system and replacement of the vacuum cleaning plant. Although is seem like government is showing commitments to support these project the research has review

that the funds for economic development projects are far outweighed with security funding. This make the researcher to conclude that Zimbabwe will for some time remain surviving from hand to mouth until there is review on the allocation of resources to cutter for economic projects.

Fig 9: Budget allocation to different ministries.



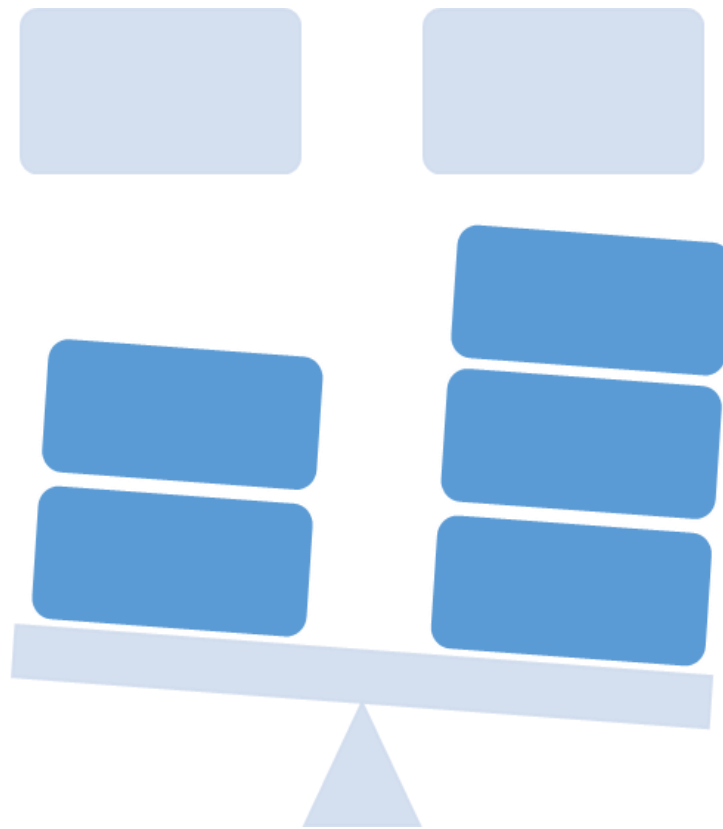
Source 2015 National Budget

The graph above highlights government’s allocation of funds to different ministries in the 2015 national budget. This clearly shows that the government is not putting in consideration the issues of economic growth. Rather it spend too much on security ministries allocating US \$1 billion to

them, while key ministries which are the cornerstone of country's economy development were allocated meagre resources.

In 2014 national budget again shows from the total budget of US\$4,1bn, US\$3,7bn was spent on recurrent expenditures such as labour costs, resulting in an insignificant amount remaining for crucial development projects and service delivery. In 2011 again Ministry of Defence received US\$35,8 million out of US\$101,4 million, while the Office of the President and Cabinet received US\$30,7 million out of its US\$114 million allocation. This means that, government has to review its priorities when allocating tax revenue so that it is directed mostly to development projects than. The former finance minister Tendai Biti has previously complained about government's prioritisation on expenditure, saying Zimbabwe spends more on defence and foreign travel than on education and health yet these are the key economic ministries that that will have direct impact on development. Thus one can say it is not an effect of revenue collected but it is about what to prioritise the little resources that are available. As if this not enough there is incomplete disbursement of the key ministry such as health, thus would mean these figures could be lower as noted in the National Child Survival Strategy for Zimbabwe 2010-2015 report.

Fig 10: Illustration unbalanced budget allocations to Ministries



Source: author's illustration.

The diagram above shows that ministries were divided in two that is economic ministries and security ministries. The one with three blocks is economic ministry and the other with four block is security ministry. Thus it is quiet evidenced that the current ruling party is much concerned with issue that protect the thrown than issues of economic development. This because of the funds being allocated to security ministries are more than economic ministries

3.8 CHAPTER SUMMARY.

In a summary it was noticed that in 2014 the economy was characterised by low economic activity. Revenues were suppressed by a number of challenges. This has resulted in underfunding of the national budget. As the major source of the government funds revenue has manage to support government projects. However one might say it is not the issue of little resources or the revenue is not enough to cater for the government expenditure but the real issue is of political will to support economic projects and also in prioritise the allocation of resources. This is against

the background that much funds was allocated to the security ministries and economic ministries were being underfunded. As if this is not enough the disbursement of the allocated money was not equal the security ministries would get its funds in time were as economic ministries sometimes the allocated funds may not be disbursed. Hence this further narrow down money received for economic project from the government.

CHAPTER 4

MEASURES THAT CAN BE ADOPTED TO BROADEN THE TAX BASE AND TO ENSURE TAXATION IS AN AID OF ECONOMIC GROWTH AND DEVELOPMENT

4.0 INTRODUCTION

A number of measures can be implemented so as to broaden the tax base in Zimbabwe. One of such measures is to reduce the tax rates. This encourages tax compliancy. Measures to improve economic development can also be explored. One of such is reforming the tax policy to attract FDIs who will bring in capital. Tax incentives, reduction of tariff, adopting a tax flexibility strategy are all measures that can be adopted. These should however be moderated. They might be inefficient and ineffective if they are not well planned.

4.1 DRAFTING TAX POLICIES.

Development should be the ultimate goal, and policy makers should seek to align their policies to meet this goal. The tax policy should, likewise be formulated taking into cognisance that development has to be achieved. Each policy should be cognisant to each facet of development that is political, economic, social, technological, environmental and legal development. Increased FDI help in improving the facets of development outlined above, and tax policies play a role in luring investment. As such the process of drafting and implementing tax policy should be treated as a delicate process. This is because it determines the level of development of a country. A tax policy should also consider that some people are rich and others are poor. A progressive tax system is therefore ideal to distribute factors in the economy by collecting more from the rich and less from the poor.

To attract investors, a tax policy might include tax incentives such as tax breaks, tax reliefs and tax holidays. These might be very effective in luring investors, if they are well formulated. But Zee et al (2002) pointed to the need to be cautious when crafting the tax policies. They refer to what they term criterion of cost effectiveness. They argue that the incentive favoured activity should yield more than the cost of the incentive. The yield of the incentive favoured activity is measured by the benefit to the economy expected from the activity with the incentive. Policy makers should therefore be cautious when considering incentives to put in place. A tax policy

should be effective in invigorating productive investment. It is also important to consider how the intended incentive will be managed. Some incentives are difficult to put in place as they are difficult to control whereas others are manageable. Having said that, a good tax incentive is one whose impact on tax administration, projected contribution to economic growth, impact on economic efficiency, government revenue and social equity have been considered.

4.2 AWARENESS

One of the weaknesses that have been noticed by the researcher was that many of SMEs are not aware of the tax that they need to pay. Henceforth they do not comply with the tax policies due to lack of information. This has resulted in tax invasion. Thus to this end the researcher has come to the suggestion that ZIMRA need to embark on the awareness strategy. The research suggests that ZIMRA should conduct more tax seminars and workshops to educate tax payers. the student has further on recommends that ZIMRA should engage tax professionals in publicising current tax information to all taxpayers. In addition to that the researcher also suggests that ZIMRA should establish Small Business Taxpayer Offices around the country to cater for the special needs of SMEs. From the research the student came to the conclusion that there is need for amendment on tax laws and regulations to include SMEs as special taxpayers like the current industrial park developers and other licensed investors who are accorded special tax incentives. Having done that this will go a long way in boosting government revenue for the low funded budget. In addition to that this will enhance effectiveness in the revenue collection system.

Communication

There is disaggregated taxpayer information which is affecting the dissemination of informant to various taxpayers. Delivery of such information is partial due to preservation of secrecy enshrined in the Revenue Authority Act, because the act is trying to safeguard taxpayer confidentiality. Thus to this end the government should allow the Zimbabwe Revenue Authority (ZIMRA) the central of information dissemination which means should provide information which is limited to the total amount of taxable income. ZIMRA need to be empowered in order to facilitate the dissemination of information. There must be exchange of information among three government entities that means ZIMRA will avail information to the Minister of Finance and Economic Development or the ZIMRA Board without limitation. Then further to the

Reserve Bank of Zimbabwe. These three government entities should work hand in glove for the development of the nation.

4.3 REDUCED CORPORATE INCOME TAX RATE

It has been established through this research that corporate tax is one of the major factors that FDI's are much concerned with when deciding the country to invest in. Because of this reason of attracting FDI's the researcher has noticed that if policy maker were to reduce corporate income tax rate this will go a long way in attracting FDI's. Although this seems to be a loss for a short term benefits because corporate tax made a huge contribution to the government budget. But in the long run this will reward the dividend. This will benefit the government in so many ways than one. Once the FDI gets attracted with tax environment in Zimbabwe they will state flock in to the country will boost the economic condition as well as boost GDP. In addition to that Zimbabwe is blessed with vast mineral deposits but lacks capital and technique to extract them. Thus investors will provide a lasting solution to Zimbabwe's current economic problem. Investors will bring technology and capital. To the national budget when there are many investors they will open up companies and will then comply with tax policies in line with their line of business. Hence more revenue can be collected. Apart from revenue being collected from companies these investors will create employment hence boost income tax.

4.4 TAX INCENTIVES

According to Villegas Sanche (2009), tax incentives clearly enhance returns on investment, as they are relatively easy to target and fine tune; they also signal openness to private investment. This means that they are attracted or they act like a magnet that pulls investors to the country. Scully, Gerald. (1988) concluded their study with the view that incentives compensate for other deficiencies in the investment climate. This means that even where there are unfavourable policies for investment such as indigenisation, tax incentives will still attract investors. Wanniski, Jude (1978) concurs with the notion that taxation actually stimulates investment in the sense that without joining with other measures that alone will create a welcoming investment climate. Thus the introducing of tax incentives for investors can signal a country's commitment to facilitating investment. It also provides a headline banner for marketing the country as a desirable investment destination. However it might seem that way but in the eyes of Baumol, Litan

and Schramm (2007) saying in some cases tax incentives may be essential to attract a particular investment, but the benefit package is more generous than necessary. The incentive is then partially redundant, and a portion of the tax break is a genuine revenue loss to the treasury. Be though as it may, tax breaks still in less developed countries remains the major driver for attracting investors.

Another common argument is that incentives can actually enhance revenue by stimulating investments that generate other taxable income via employment and linkage effects. Tax incentives also offer political advantages over direct expenditure programs to stimulate investment. Finally, proponents point out that tax incentives have been successfully used in well known cases like Malaysia, Ireland, and Mauritius.

4.5 TAX HOLIDAYS

Zimbabwe can also use tax holidays which are a common form of tax incentives used by developing countries. Tax holidays is where by the government may not collect tax to particular industries to allow them to establish or to allow them grow for a certain period of time. This tax holiday are of great importance to the attraction of FDIs. This because for the first year the investor will be trying to establish their business so to impose heavy tax on them will be not fair to them. There are so many benefits the can be drawn from tax holiday. Such as tax holidays will attract investor to the country will ultimately increase revenue to the government and also it create employment, it also increase the GDP of the country. However Sethi Guisinge and Berg 2003 were against this view for the reason that this cause revenue leakage through avoidance and evasion. Although they view it that way this tax holidays in eyes the researcher it create opportunities for economic growth. Thus the researcher recommend that the government can adopt the tax incentive with caution because it might be a noble idea to offer tax incentive but it might ultimately affect the economic growth by shrinking the revenue base for the budget.

4.6 REDUCED TARIFFS

The main reason for the government tax policies should be centred on attracting investors as well protecting their industries once they have invested. To this end the governments can offer two types of tariff incentives. Firstly the government can reduce tariffs on imported capital equipment and spare parts for qualifying investment projects. This is one way that can attracted

investor also it increase the improvement on technology hence boost industrial development. Once there is industrial development the tax base will broaden because the government will allocate much revenue from different companies. This has the effect of reducing the cost of investment which makes investor to expand their business. On the other hand, they can increase tariffs on the final products of the investor in order to protect these invest from outside multinational companies who intent to invade the local market. Zimbabwe can adopt this measure so as to boost investment inflow. Tariff protection has been quite a common form of investment incentive in many countries. However the adoption of this measure should be treated with caution Adam Smith (1998) concluded that investment stimulated through tariff protection often leads to an inefficient, high-cost, distorted industrial structure.

4.7 SIMPLICITY OF THE TAX POLICIES

Simplifying tax policies is another way to foster development through taxation. A simple tax system is one in which tax regulations in very simple terms. In explaining the taxation structure the government must find means and way of making the taxpayer aware or well informed of every update or reviews that can be done in tax structures. This will go a long way in attracting investor be they will well versed of the current structure. Unlike a situation where by the tax structure is so complicated and one can need a consultancy to explain what is on the tax structure. This will also help the investor to plan in advance how much they are going to allocate on taxes. In addition to that the simplicity of tax policies will also reduce tax avoidance and invasions. Zimbabwe through this simple tax policy will improves transparency in return there will be political and administrative accountability. This is one way that the government can adopt to widening the tax collection which will ultimately increase income revenue to the government to foster development.

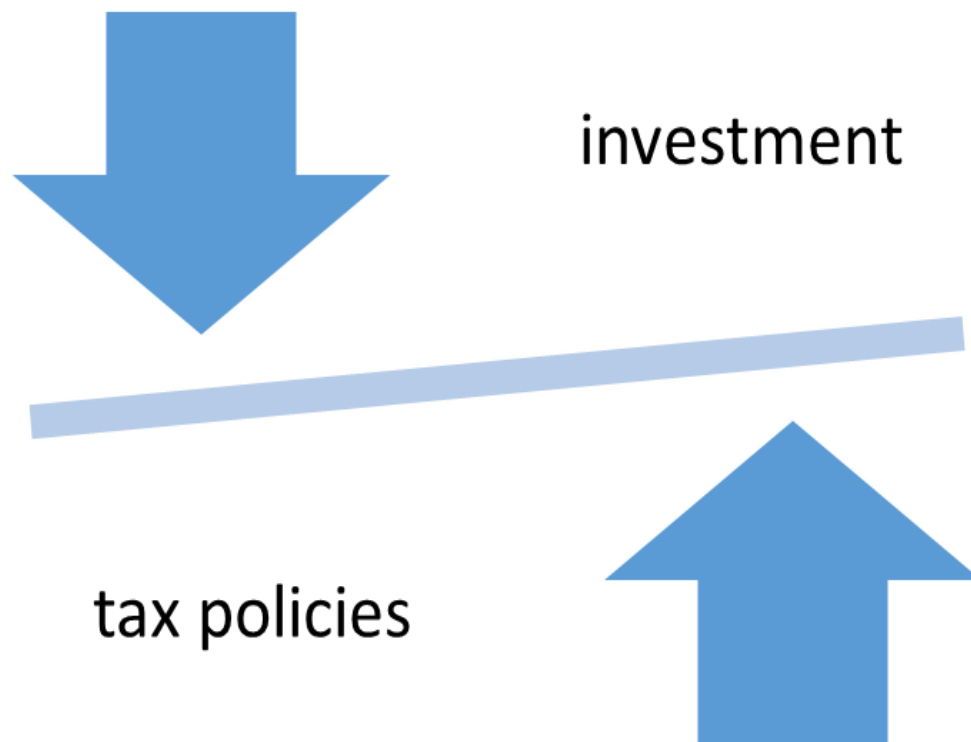
Flexibility

Zimbabwe in light of evolving economic, social, and technological conditions, it is generally accepted that a tax system should be sufficiently flexible to be responsive to change - particularly in a dynamic and constantly evolving global economy. One particular area which policy makers are is that of aligning tax principles and frameworks to better suit the digital age. A well designed tax system strikes an appropriate balance between flexibility and stability, enabling a

government to respond to changes while still creating a system which allows predictability and certainty. Thus tax flexibility can boost economy in so many ways. That in time when the country in need of investors it will reduce the corporate tax for example which is the main centre of attraction to FDIs. Then when they feel like they have enough investor then the increase the corporate tax and introduce taxes that protect the local industries. The flexibility of taxation can act as corrective measure to control the activities of the economy. Thus tax is an instrument that if handled well it turn the economy to a higher levels. However the disadvantage of the system is that it can be politicised. The politician can manipulate the system in trying to gain political mileage.

Zimbabwe government is facing difficulties to raise enough revenues to drive its developmental ambitions. The existence of large informal sectors makes it particularly difficult to trace and capitalise on potential tax sources. More so the issue of unattractive policies which scare way investors. From the little they are getting Zimbabwe is further constrained by weak tax administrations and lack of governance to enforce tax compliance. Furthermore, it has found out from the research that in the recent period a strong mushrooming of a large informal sector constrained the government's capacity to raise sufficient revenue, and thus revenue in proportion of total spending has been declining. The imbalance between government revenue and expenditure resulted in persistent fiscal deficits.

Fig 11: Relationship between investment and tax policies



The diagram above shows two arrows: one is going down and the other one is going up, with a dividing bar. It explains that the tax arrow is going down, which means that if the government relaxed the tax policies by introducing tax incentives, this causes the investment arrow to go up. It means that tax incentives can increase tax investment inflows. The bar in between the arrows is the balancing line, which can be controlled by the tax arrow.

4.8 EASE AND COST OF DOING BUSINESS

4.8.1 LICENCING PROCESSES

Registering a business in Zimbabwe involves a number of registrations and licensing from various departments. This is a challenge which might cause investors to shun the decision to invest in Zimbabwe. The licenses that need to be acquired include operating permit and license issuance, registering for investment, registering to be a taxpayer among others. Most of these

licensing processes are characterised with bureaucracy and this distorts the time it takes to start a business.

4.8.2 MULTIPLICITY OF AUTHORITIES

The fact that there is no one stop centre where an investor can just walk in and do all the necessary formalities is a setback. While there is a Zimbabwe Investment Authority in place, one still has to go from one department to another in order to register a business. A lot of paperwork and processing fees are involved, not to mention the bureaucracy caused at every level of the process. The government should reconsider this and make use of ZIA to be the agent of all the other departments. That way, registration of businesses will be simplified, all the requirements will be found under one roof and bureaucracy is reduced. It is more effective and efficient to have a one stop shop for investors' convenience.

4.8.3 MULTIPLICITY OF LEVIES

The taxpayer is overburdened in Zimbabwe and this scares investors away. ZIMRA has more than 10 tax heads and on top of these, different government departments also have different levies which they levy taxpayers such as the road levy collected by ZINARA, the charges by EMA which vary with the project value among others. At the end of the day, the taxpayer is met with a tax at every turn. The government should review this and come up with a single tax administrator who collects all these revenues for the government. That way all these duplications would be eliminated and taxpayers will clearly understand all the taxes from one administrator.

4.8.4 UTILITY CONNECTIONS

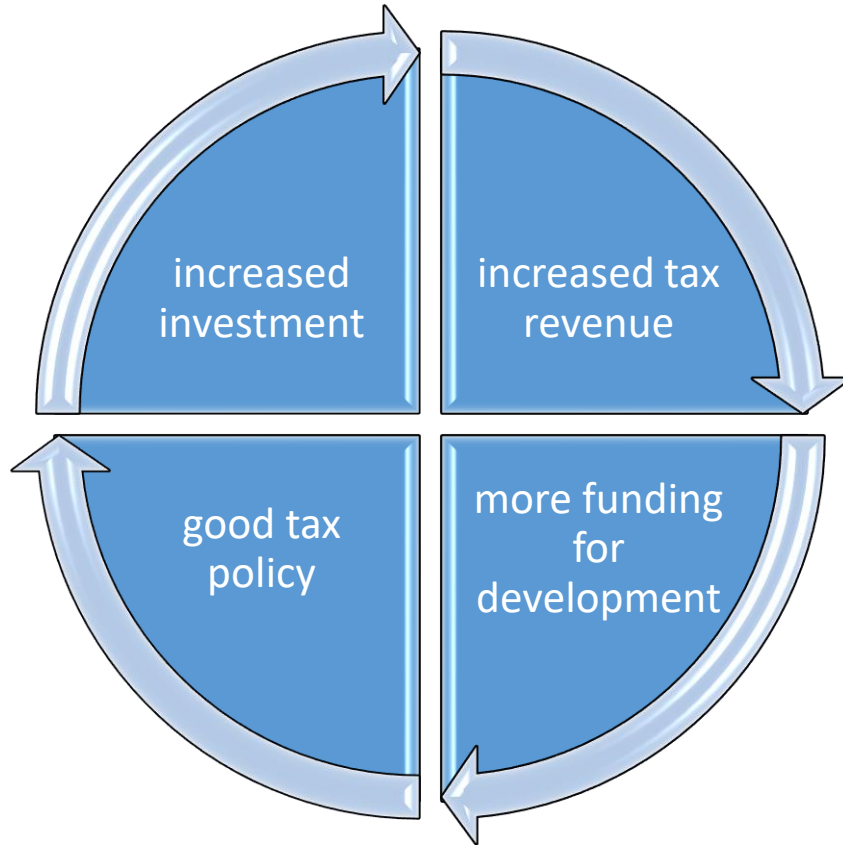
Bureaucracy in service delivery makes it very difficult to start a company in Zimbabwe. There are unnecessary delays and long waiting lists and this does not make Zimbabwe an attractive destination. Connecting utilities is not an easy task in Zimbabwe and yet they are a basic service whose availability is expected to be a priority. The World Bank (2015) places Zimbabwe on 151 of 189 countries on the getting electricity connection indicator. This shows that there is no efficiency at all in these government departments. In the World Bank report, it takes 106 days to get electricity connections for a new business. Connecting water is the same hassle and this scares investors away.

4.8.5 ENHANCING BORDER POSTS EFFICIENCY

From the researcher's point of view, the government need to enhance efficiency at border posts through the use of technology as alluded earlier by the researcher that the world today is fast becoming computerised. Thus the government can also use modern technology used to search evaluate and calculate the value of goods that pays tax. This will restrict the passing of goods without paying the much needed tax. In addition, this will increase the efficiency in collection of goods. Still on that point there is continuing leaking of goods due to poor border infrastructure and security. To add on top of poor infrastructure ZIMRA is deploying very few officers to administrate the activities at the border posts. This is resulting in clearing Agencies gaining much ground for corruption. This has been intensified by the rise of undesignated entry points, where goods are being smuggled.

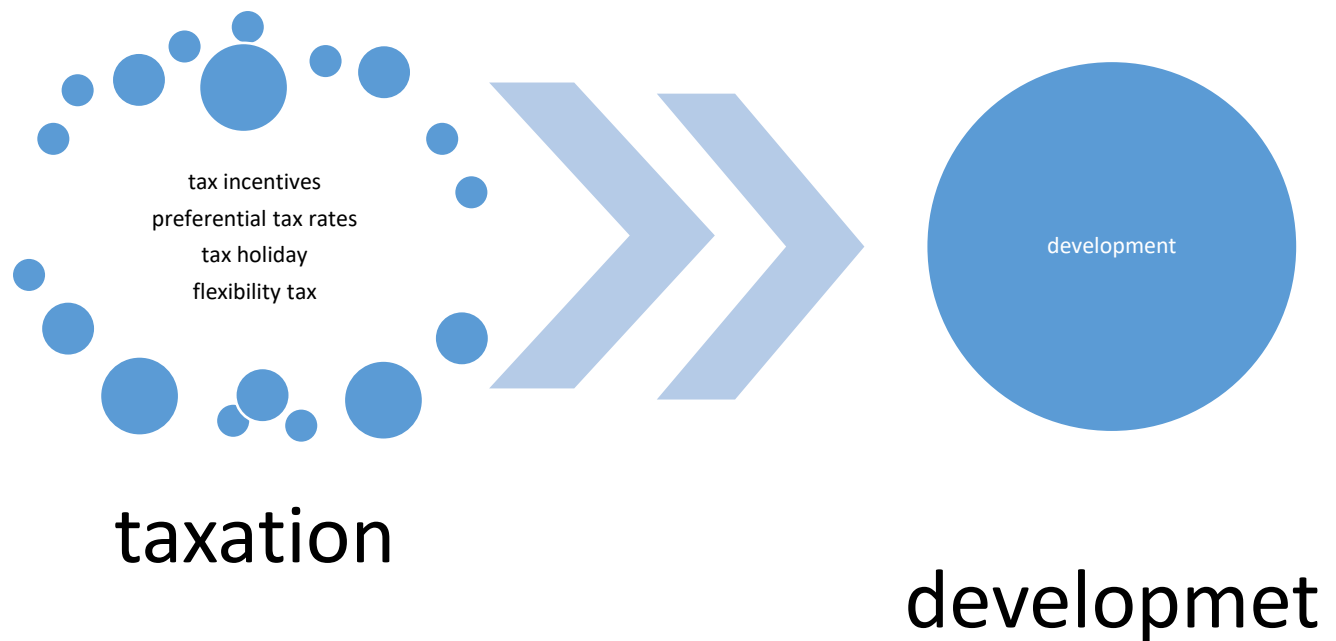
4.9 TAX AND DEVELOPMENT

Taxation has a direct impact on development which is unquestionable. The importance of development is also undisputed; all economies aspire to grow and to develop. The government should therefore prioritise development by channelling much of the tax revenue to development so that the economy grows and will be able to sustain itself instead of relying on FDIs. Policies to support development should be crafted and these should be financed by tax revenue. A policy with low tax rates widens the tax base by attracting investors thereby increasing revenue collected from tax. This circular relationship can be demonstrated graphically below;



The government will benefit more if they come up with a favourable tax policy as its benefits are seen to cascade to everyone in the economy in the long run.

Fig 12: Nexus between taxation and development



Tax incentives are very critical in lubricating the economy. Development is also positively influenced by these tax incentives. They attract investors and they also reduce the cost of production for the investor thereby leaving more revenue to increase productivity. Tax incentives should be crafted carefully and cautiously administered as they can lead to tax evasion and tax avoidance.

4.10 CHAPTER SUMMARY

The government of Zimbabwe should consider reviewing the current tax policy. Taxation was seen to have an impact on both development and investment by this study. This therefore shows that taxation is very important. If the tax policy is reviewed to lower rates and to include tax incentives which investors find to be attractive, then the economy might be able to attract investors again and the economy will be developed.

CHAPTER 5

SUMMARY, CONCLUSIONS, RECOMMENDATIONS AND SUGGESTED AREAS FOR FURTHER STUDIES.

5.0 INTRODUCTION

This chapter gives the summary to the research as well as recommendations to the Government on how to harness and increase positive impact of taxation on investment and development. Taxation was found to have a positive impact on development and as such the study seeks to advise the government on ways of improving revenue collection so as to maximise development which is funded by tax revenue. The study also found that tax policy can have a negative impact on investment by discouraging investors because of high tax rates. The government is therefore advised on ways to come up with better tax policies that attract investors. However, tax incentives should be optimised and set at effective and efficient levels so as to maximise the impact.

5.1 SUMMARY

The research was carried out using desk research. The use of secondary data sources were employed, such as publications and books. The research had aimed to examine the impact of taxation on investment; to determine whether the allocation of resources acquired through tax revenue impacted on development in Zimbabwe; and to establish measures which can be adopted to ensure that taxation does not hinder economic growth. The study found that tax policies have an impact on investment. If high corporate tax rates are set, the cost of production will increase thereby reducing the profit to the investor. This is undesirable to the investor. The study also found that taxation has an impact on development. This is so because Zimbabwe, just like most developing economies gets most of its funding from tax revenue. Because of this, the more revenue collected through taxation, the more government allocates resources to development project. The research also discovered that investment and development also impact each other. If investment increases, more jobs are created and commodities become available at competitive prices thereby developing the life of the ordinary citizen. The ultimate goal of all economies is to become developed. Taxation helps in achieving this. As such, taxation is like a lubricant that oils

investment and development by low tax rates and high tax revenue. The challenge now is to strike a balance to achieve both. It was also established in this research that inasmuch as taxation impacts on investment and development, it is not a factor in isolation. These variables are affected by other factors. Investment is also dependent on macroeconomic factors like GDP, inflation, exchange rate; as well as physical and environmental factors such as good infrastructure, road network, climate, policy on land exploitation and degradation; social factors and political factors among others. Development is dependent on issues such as equity in allocation of resources. After revenue has been collected from taxation, the government through the Ministry of Finance allocates it through a budget. This research found that this allocation is not equally done with security ministries receiving the most of the budget. Development is also affected by social factors. The issue of transparency and accountability is key in allocating resources for development. Corruption has affected the transition between resource allocation and implementation of development projects. The research used its findings to recommend strategies which the government can adopt in order to improve the impact of taxation on development and investment. The strategies identified include reforming tax policies, enhancing border efficiency, reducing bureaucracy in provision of services such as utility connections among others.

5.3 CONCLUSION

The study concluded that taxation impacts on both investment and development. Investment is impacted by tax policies- higher tax rates are unattractive to investors whereas lower rates are desired by investors. Development is impacted in that, tax revenue finances development projects and as such the higher the revenue collected, the more development happens. Lower collections means a slow down on development. The study also concluded that, these effects are not sufficient to determine the levels of development and investment. It is just but one side of the coin. There are other factors that also influence investment and development such that, even if taxation is reformed in Zimbabwe, the economy might still fail to attract FDIs. The hypothesis of this study which had stated that taxation has no impact on investment and development was rejected.

5.4 RECOMMENDATIONS

5.4.1 TAX ADMINISTRATION.

The study recommends that the government should train revenue collectors collect effectively and efficiently and with diligence so as to maximise revenue collection. Administrators such as ZIMRA, ZINARA and local authorities should prioritise training of their staff so that they will not prejudice the country through ignorance. The administrators should also be accountable and transparent. This is very important to eliminate corruption. The general populace should know how much will have been collected, how it will have been allocated and what it will have achieved to the last dollar. If administrators are accountable and transparent, people will voluntarily comply in paying taxes thereby reducing tax evasion and avoidance. The tax administrators should also embrace technology. Computerisation of all revenue collecting systems reduces corruption as they leave an audit trail. Systems such as Asycuda and SAP are already being used by some revenue collecting agencies such as ZIMRA and their use has reduced incidences where officers handle clients' moneys.

5.4.2 FISCAL TRANSPARENCY.

The researcher also recommends the importance of transparency and accountability from the government who are the guardians of tax revenue responsible for allocating it to different causes. The government should ensure that after allocating resources to the people, it follows up to make sure that the resources were utilised for the prescribed purpose, and then give a report to the people in the same manner as they would have presented the budget-to give an outline of the projects that would have been completed. The Code of Good Practices on fiscal transparency by IMF should be practiced. The government should also be transparent about its goals and objectives. Everyone in Zimbabwe should have a clear understanding of what the nation will be envisioning. The government should also prioritise investment and development. In the allocation of finance, economic and social ministries should be allocated more revenue as these have effects that can be enjoyed by every Zimbabwean through the trickledown effect. In the 2014 budget, most of the finances were allocated to the ministries of public service and security. The government should also embrace the importance of consulting stakeholders. The national budget should be inclusive. From the grassroots, everyone should participate in the pre-budget

consultations. The government should also ensure that the budget is specific, measurable, attainable, time bound and realistic and not just a wish list. Equity should also be a principle to guide the drafting of the budget such that everyone gets a fair piece of the cake. The government should also consider the collected revenue at its disposable and ensure that the budget is within those limits.

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