

# Zimbabwe

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### key figures

- Land area, thousands of km<sup>2</sup> 391
- Population, thousands (2001) 12 852
- GDP per capita, \$ (2001) 371
- Life expectancy (2000-2005) 42.9
- Illiteracy rate (2001) 10.6



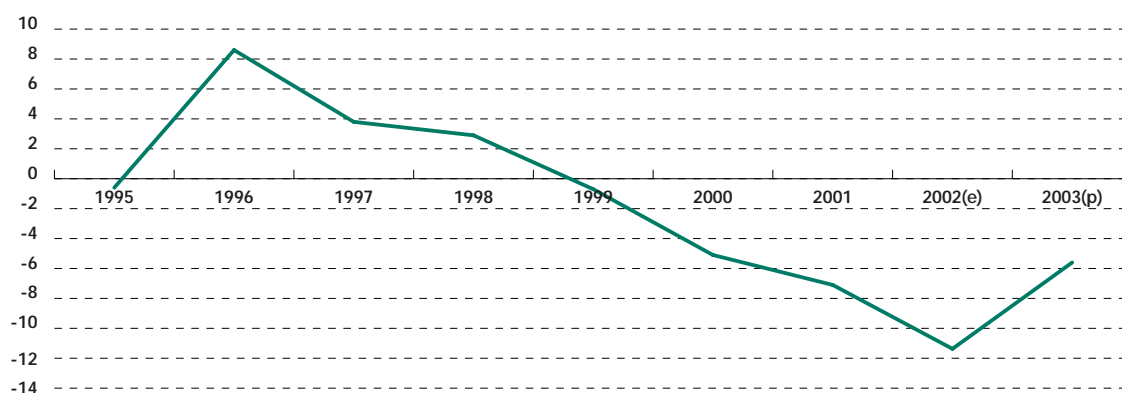
# Zimbabwe

THE SEVERE ECONOMIC AND POLITICAL CRISIS that has embroiled the country since 1997, deteriorated further in 2001 and 2002, owing to the combined effect of the increasing macroeconomic imbalances, the massive drought that hit the country during the first quarter of 2002 and the acceleration of the fast-track land reform programme, following the disputed re-election of President Robert Mugabe. As a consequence, the country is currently facing a dramatic food crisis. The cereal gap is forecast to be about 1.8 million tons and half of the population is expected to face starvation, while food importation is hampered by deepening foreign currency shortages. On top of this alarming food situation, the economy has continued to deteriorate in 2002 with the unemployment rate reaching an estimated 60 per cent. Although the government has been successful in reducing the fiscal deficit from 20.7 per cent of GDP in 2000 to 8.1 per cent in 2001, the economy has

suffered from the general decline in business confidence, the loose monetary policy that more than doubled average inflation, and an overvalued fixed exchange rate. Real GDP, which had already shrunk by 7.4 per cent in 2001, is expected to contract by 11.4 per cent in 2002 against a background of continuous weaknesses in the agricultural, mining, manufacturing and tourism sectors. The current crisis is expected to worsen an already worrying social context with a society characterised by strong and persistent dualism, at least 2 million people living with HIV/AIDS, and collapsing healthcare and education systems. An increasingly worrying scenario, together with the intensification of the land redistribution process and resulting reduced agricultural productivity, are likely to determine a further GDP decline in 2003 of about 5.6 per cent.

The Zimbabwe economic and political situation continues to deteriorate aggravating an already worrying social context

Figure 1 - Real GDP Growth



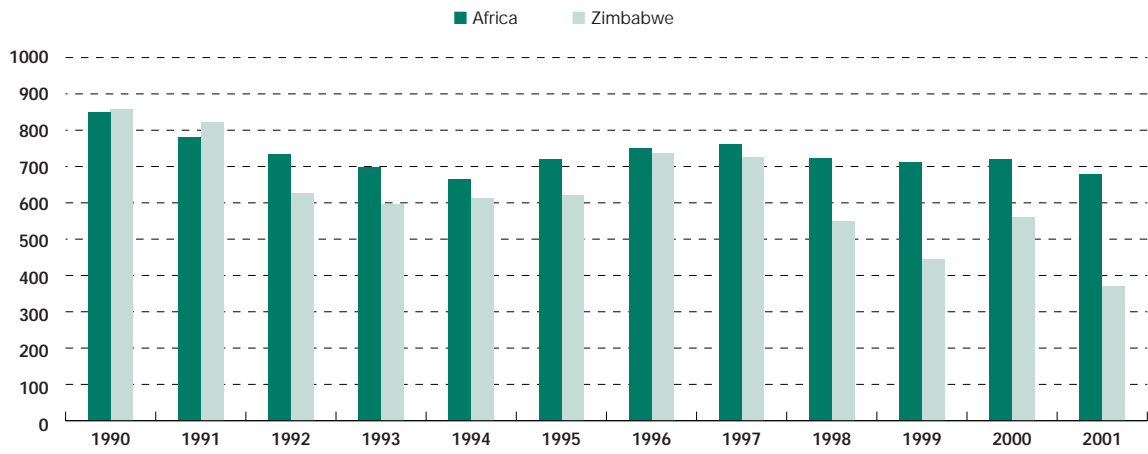
Source: : Authors' estimates and predictions based on IMF and domestic authorities' data.

## Recent Economic Developments

After a period of sustained growth, the macroeconomic situation in Zimbabwe has deteriorated markedly over the last five years, and since 1998 the country has been facing a deep crisis. Following a flat real GDP in 1999, the crisis has exacerbated and GDP

declined by 5.1 per in 2000 and a further 7.4 per cent in 2001. The excessive recourse to bank finance by the *fiscus* (treasury) fuelled money supply growth which led to an upsurge in inflation. The impact of such an inflationary environment has been a dramatic increase in production costs and reduced export competitiveness. Moreover, the economy suffered from continued

Figure 2 - GDP Per Capita in Zimbabwe and in Africa (\$ current)



Source: Authors' estimates based on IMF data.

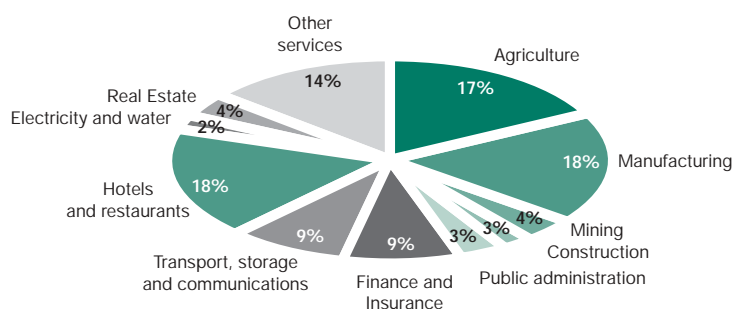
uncertainty over the land reform programme, declining business confidence and shortages of foreign exchange, which resulted in a drastic reduction in imports of raw material. Agriculture, manufacturing, mining and tourism – the economy's growth engines – have been the sectors most affected by the crisis.

High levels of spare capacity in manufacturing, one of the most diversified sectors in the African continent since 1999 were mainly the result of the gradual erosion of competitiveness. The high inflation experienced over the 2000-2002 period, the shortage of foreign currency, and shrinking domestic demand due to increasing unemployment and declining purchasing power, have exacerbated the decline of an already depressed sector. The volume of industrial production declined by 10.5 per cent in 2001 and is estimated to have declined by 17.2 per cent in 2002. Moreover, the overvalued exchange rate has dramatically deteriorated the export performance, while many companies (especially non-exporting ones), in the absence of foreign currency, have been forced to use the parallel market (buying US dollars at rates of more than Z\$700 per unit in mid-2002) to import raw materials and spare parts. This led to an upsurge in prices and therefore exacerbated the inflation spiral. Firms that are not in a position to increase prices, owing to price controls on basic commodities put in place since October 2001, face enormous difficulties in covering production costs. The most affected

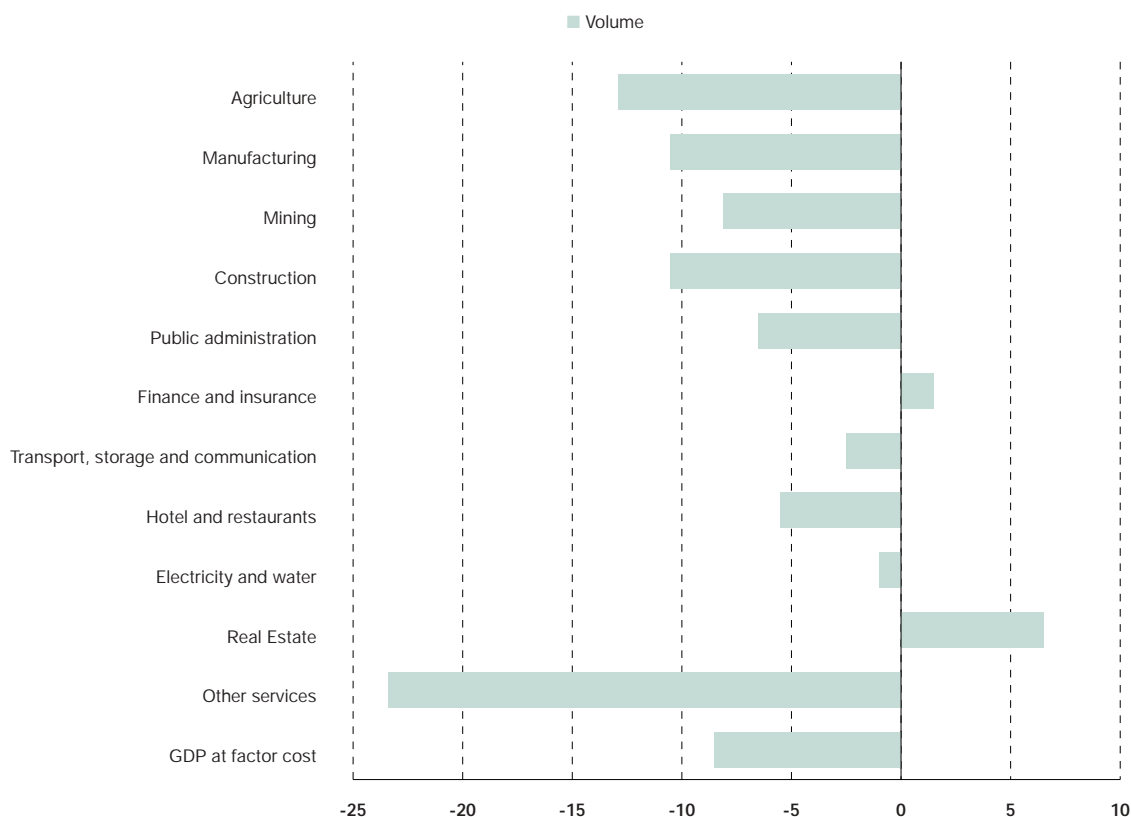
industries have been the bakery, sugar, cooking oil, furniture and milling industries. As a result, manufacturing is operating well below capacity – the average capacity utilisation is about 50 per cent for industry – and at least 500 firms closed during 2000 and 2001. Besides declines in food processing and beverages companies, the machinery and transport sectors have suffered from the weaker demand by commercial farmers as a result of the land reform process and the government's handling of property rights. Such uncertainty linked to the land reform exercise and more generally to fundamental concerns over the government's economic policy has led to a collapse in business confidence and to a continuous fall in private investments.

The agricultural sector is estimated to have declined by 12.9 per cent in 2001. The sharp decline in production is attributable to the erratic rainfall patterns (2000/01 mid-season dry spell and floods), and the disruption of agricultural activity by farm invasion. The sector's performance is estimated to have deteriorated further in 2002 (by 21 per cent) following the severe drought that hit the country from January to March 2002, the reduced agricultural productivity associated with the ongoing land resettlement programme, and the acute foreign currency shortage which hampers the importation of essential inputs. Maize production, which declined by 33 per cent (from a total of 2.1 million tonnes in 1999/2000 season to

Figure 3 - The Structure of GDP in 2001



Source: : Authors' estimates based on domestic data.

Figure 4 - Sectoral Contribution to Real Growth in 2001<sup>a</sup>

a. Data for Figure 4 are at factor cost. Therefore real GDP growth is different from the real GDP at market prices reported in Table 1. No consistent data were available for sectoral price evolution.

Source: Authors' estimates based on domestic data.

about 1.4 million tonnes in the 2000/01 season), is estimated to have declined by 66.2 per cent in the 2001/02 season to 0.49 million tonnes. Also winter wheat is forecast to fall sharply (to 165 000 tonnes compared to 282 000 the previous year), owing to the

land redistribution process as it is almost exclusively grown on large-scale commercial farms which use irrigation systems. The country is therefore facing a serious food crisis with about half of the population in need of food assistance. The Grain Marketing Board

(GMB) can only meet a small fraction of the nation's food needs and grain is supplied irregularly. In April 2002, the President of Zimbabwe declared a national disaster in all communal lands, resettlement and urban areas and, in July 2002, the government established a Drought Relief Food Aid Program and allocated extra budgetary resources to import cereals and inputs. However, the government's ability to import cereals is extremely limited owing to the acute shortage of foreign currency. As at mid-2002, the cereal gap was about 1.8 million tonnes, while the anticipated cereal imports by the government accounted for 300 000 tonnes and food aid pledges of about 100 000 tonnes, following government's acceptance of genetically modified food.

The lack of foreign currency is exacerbated by the poor performance of the tobacco and cotton production exports, which represent the most important foreign exchange earners. Tobacco production declined by 15.4 per cent in 2000/01 owing to the land invasions and seizures of many commercial farms. The forecast for the next crop is bleak since investments have slumped owing to such an uncertain environment. Tobacco seeds sales have been very limited compared to last year and, consequently, land preparation for the next crop season has been very inadequate. Such cautious behaviour derives also from the difficulties in accessing credit to finance the next year's crop, as banks are reluctant to extend credit to farmers whose land has been occupied or "listed" for compulsory acquisition. Tobacco growers also continue to be adversely affected by the central bank's imposed marketing and financing rules. Despite the fact that the crop is the country's foreign exchange earner, growers are paid in local currency (at a highly overvalued exchange rate). All foreign currency related to tobacco sales at the auction floors is controlled by the central bank, with growers only allowed a marginal pooled foreign currency reserve of 20 per cent for importation of inputs. This fragile situation of the sector also stems from the poor Zimbabwe dollar prices received by producers, at the beginning of the year's auction (May 2002) owing to the conversion of the US auction floor price at the overvalued official exchange rate of US\$1:Z\$55. In order to support the depressed seasonal

sale of tobacco, and to earn more currency for food imports, the government has then progressively devalued the dollar for the tobacco industry. Since July 2002, tobacco farmers have been granted a subsidy, being allowed to use an exchange rate of Z\$159 for every dollar they earn on the tobacco auction floors. However, against a background of almost doubled production costs, such a measure still provides a tiny margin to tobacco producers.

The crisis in the mining sector, which began in 2000 deteriorated still further in 2001. Gold production – accounting for about half of the total value of the mining sector – declined by 18.2 per cent in 2001, to 18.04 tonnes from 22.07 tonnes recorded in 2000, as a result of the combined effect of declining international prices and the overvalued exchange rate. Indeed, gold producers, while they must sell the entire production to the Central Bank, have to acquire part of the imported inputs with a premium on the parallel exchange rate market. The viability problems, resulting from increased mismatch between the rising cost and the revenue, led companies to scale down operations and many have been forced to close. In order to avert further mine closures, the government introduced a gold price support scheme in April 2001, which has been revised upwards four times until March 2002, when it reached a floor price of US\$531 per ounce, compared with the international price of US\$296 per ounce. Against a background of high inflation and a continuing overvalued exchange rate, the extent of the assistance of the gold support scheme has however been very limited. The situation has been exacerbated by the slump in foreign investment due to the political environment. Production in 2002 is estimated to have declined by a further 22 per cent.

The tourism sector, the fastest growing sector during the 1990s, experienced a profound decline in 2000 owing to the country's deepening economic crisis and the perceived unstable political climate in the lead up to the March 2002 presidential elections. The decline continued in 2001 when activity dropped by 38 per cent, exacerbating the shortage of foreign reserves. This represents the worst consecutive decline experienced in the sector since independence. The current political

situation is hampering the development of the sector and preliminary estimates for 2002 are projecting a further decrease in the tourism activity.

Real estate has recorded an estimated modest growth of 6.5 per cent in 2001, benefiting from the switching of investments from productive activities towards properties, leading to the emergence of artificial property market values. The sector has also been propped up by an upsurge in demand for properties by Zimbabwean citizens working abroad, remitting hard currency at parallel market exchange rates.

The financial sector, which accounts for about 9 per cent of GDP, is the other resilient sector in the economy, having experienced a real growth of about 2 per cent in 2001. The main reason for this growth, however, lies in the distortions created by the overvalued exchange rate and the opportunities of profit through dealing in foreign currency on the parallel market. In addition, banks are the major custodians of domestic debt of the government. Moreover, the low interest rate policies undertaken by the Central Bank have led to a dramatic surge in the stock market, unrelated to the economic

fundamentals of the counters being traded. Whilst Zimbabwe has largely liberalised its balance-of-payments current account in line with the IMF Article VIII, the country's capital account still has residual controls where particularly outward investments by local residents have to be under Central Bank approval. This, coupled with foreign exchange shortages, has seen most institutional investors taking recourse on the Zimbabwe Stock Exchange (ZSE) as a hedge against the highly negative returns on the money market. Buoyancy of the ZSE contrasts sharply with the general slump in economic productivity, underscoring a pronounced stock market bubble.

However, the sector is beginning to show signs of recession, stemming from the contagious effect of the drowning productive sector. The effect of the land reform crisis is posing major challenges, both in terms of non-performing loans arising from the commercial farms evicted and the risky lending to the newly resettled farmers that may be imposed by the government. Moreover, the increased government control on the foreign exchange market may contract the profits that banks make on trading on the parallel market.

Table 1 - Demand Composition (percentage of GDP)

	1995	1999	2000	2001	2002 (e)	2003 (p)
<b>Gross capital formation</b>	<b>24.5</b>	<b>15.1</b>	<b>14.0</b>	<b>0.4</b>	<b>1.8</b>	<b>2.5</b>
Public	4.6	1.9	1.6	2.4	3.1	3.2
Private	19.9	13.2	12.4	-2.0	-1.3	-0.7
<b>Consumption</b>	<b>78.2</b>	<b>85.4</b>	<b>87.2</b>	<b>100.8</b>	<b>99.5</b>	<b>98.8</b>
Public	17.8	15.4	24.8	33.8	33.0	34.0
Private	60.4	70.0	62.4	67.0	66.5	64.8
<b>External demand</b>	<b>-2.7</b>	<b>-0.4</b>	<b>-1.2</b>	<b>-1.2</b>	<b>-1.3</b>	<b>-1.4</b>
Exports	37.8	46.8	30.3	23.3	9.4	4.0
Imports	-40.4	-47.2	-31.6	-24.6	-10.7	-5.3

Source: : Authors' estimates and predictions based on IMF and domestic authorities' data.

The recent crisis has changed the demand structure. From 2001 onwards, gross capital formation has declined substantially, as a result of the macroeconomic imbalance and the economic disruption that involved farming activities. In particular, private gross capital formation has been negative since 2001, reflecting the farming equipment that has been destroyed following the farm invasions and the transfer of properties carried

out under the land reform process. Since 2002, consumption patterns have deteriorated mirroring the increasing inflation, while the budgeted increase in public spending has been severely constrained by the shortage of foreign currency.

External demand has changed severely as well. Already weak exports have faced an erratic exchange-

rate policy while foreign currency shortages have crippled the level of imports. Consequently, imports are estimated to have fallen from 47.2 per cent of GDP in 1999 to 10.7 per cent in 2002 as exports were cut to 9.4 per cent (compared to 46.8 per cent in 1999). The export and imports pattern is expected to contract even further in 2003, against the background of worsening exchange rate overvaluation and acute foreign exchange shortages.

## Macroeconomic Policy

### Fiscal and Monetary Policy

The country's fiscal situation over the last decade has been characterised by a high and persistent budget deficit, averaging around 8 per cent of GDP. The overall budget deficit (including grants) rose to about -21 per cent of GDP in 2000, mainly on account of large, unbudgeted increases in civil service wages in the run up to the parliamentary elections in June 2000.

Sustained inflation, an overvalued exchange rate, almost no access to external financing and the skyrocketing deficit have changed the structure of public debt. External public debt represented 41 per cent of total public debt in 2000 (38 per cent in 2001) from a share of 78 per cent just two years before. The share of domestic public debt has increased accordingly and, in 2000, interest payments on domestic public debt have absorbed almost 60 per cent of total revenues. In 2001, the government managed to reduce pressure on

servicing of government domestic debt though a debt rescheduling policy, switching from under six-month Treasury bills (T-bills) to longer-term T-bills at lower interest rates. Indeed, as at the end of 2001, the share of short-term debt declined to 67 per cent compared to 94 per cent at the end of 2000 and, as examined later in the monetary section, the average effective yields on T-bills slumped from 65-70 per cent in 2000 to 11-27 per cent in 2001. This huge shift gave respite to the *fiscus*. As a result of this policy, and below-target expenditure owing to foreign currency shortages, the fiscal deficit was 8.1 per cent of GDP in 2001, compared to the original target of 15.5 per cent (interest payments in 2001 accounted for about 30 per cent of total revenue).

The 2002 budget approved in November 2001, targeted a deficit before grants of 14.9 per cent of GDP suggesting significant domestic borrowing financed through a further increase of the proportion of medium- and long-term debt to at least 40 per cent. Total government expenditures were targeted to increase from about 35 per cent to 42 per cent of GDP, on account of increased allocations for land reforms and the wage bill, while revenue was targeted to increase by 3 per cent of GDP thanks to the full operation of the Zimbabwe Revenue Authority. However such a projection was based on the authorities' estimation that GDP was contracting by only 5.2 per cent GDP. The whole exercise is blurred by the fact that the GDP forecast made by the government is very uncertain. Nevertheless, as at mid-2002, despite a prolonged

Table 2 - Public Finances (percentage of GDP)

	1995	1999	2000	2001	2002(e)	2003(p)
<b>Total revenue and grants<sup>a</sup></b>	<b>28.2</b>	<b>29.2</b>	<b>28.1</b>	<b>26.6</b>	<b>26.7</b>	<b>27.6</b>
Tax revenue	23.4	26.7	25.4	24.6	25.1	26.0
<b>Total expenditure and net lending<sup>a</sup></b>	<b>44.6</b>	<b>38.7</b>	<b>48.8</b>	<b>34.7</b>	<b>35.9</b>	<b>37.0</b>
Current expenditure	39.1	34.7	46.0	32.2	32.4	33.6
<i>Excluding interests</i>	29.9	24.4	29.0	24.3	27.7	28.4
Wages and salaries	11.1	13.5	16.9	13.4	13.2	13.7
Interest	9.3	10.3	17.1	7.9	4.7	5.2
Capital expenditure	2.9	2.8	1.8	2.5	3.1	3.3
<b>Primary balance</b>	<b>-7.2</b>	<b>0.9</b>	<b>-3.6</b>	<b>-0.2</b>	<b>-4.5</b>	<b>-4.3</b>
<b>Overall balance</b>	<b>-16.4</b>	<b>-9.5</b>	<b>-20.7</b>	<b>-8.1</b>	<b>-9.2</b>	<b>-9.5</b>

a. Only major items are reported.

Source: Authors' estimates and predictions based on IMF and domestic authorities' data.



contraction in export duties, revenue performance improved by about 16 per cent (the revenue collected was Z\$115 billion against a target of Z\$99.5)<sup>1</sup> on the corporate and individual tax lines, as a result of the enhanced revenue collection efforts by the Revenue Authority and of price rises. Meanwhile, expenditures were below anticipated levels (being about 142 against a target of \$191 billion, by about 25 per cent)<sup>2</sup> owing to shortages of commodities and foreign currency in the economy. In addition, the low interest rate environment prevailing in the market enabled the government to make savings on interest on domestic debt payments by 51 per cent as at June 2002. In response to the acute food shortages following the 2001/02 drought, a supplementary budget was approved in July 2002 in order to finance the need for food imports. Additional funds were also allocated to support resettled farmers and to adjust the cost of living of public employees. Despite these additional expenses, the 2002 deficit is expected to be lower than targeted owing to the combined impact of lower interest rates and shortage of foreign currency.

Since January 1999, monetary developments have been influenced by the government's rising borrowing requirements. Indeed, government borrowings have mainly been through Treasury bills and the Reserve Bank of Zimbabwe (RBZ) overdraft facility. Financing of the budget deficit from the banking sector fuelled annual money supply growth, which rose from 56.9 per cent in January 2001 to 102.7 per cent by the end of the year. Recent figures by the RBZ show that yearly growth in M3 rose significantly from 99.5 per cent in January 2002 to 124 per cent in September 2002. Such expansion in M3, at a time when production of goods and services was shrinking, caused inflation to rise from 103.8 per cent in November 2001, to an all time high of 175.5 per cent in November 2002.

Through the enforcement of the 45 per cent statutory requirement for the holding of long-term government paper by institutional investors – such as

insurance companies, pension schemes and mutual funds – the RBZ has been able to reduce the interest rate of the 90-day T-bills from a level of 68 per cent in December 2000 to a level of 27 per cent at the end of the year (having reached a minimum of 11.4 per cent in April 2001). Furthermore, the RBZ released statutory reserves to commercial and merchant banks, for on lending at concessional rates of 30 per cent to productive and 15 per cent to export sectors. In October 2002, the rates were reduced to 15 and 5 per cent for the productive and export sectors, respectively. Commercial lending and deposit rates averaged 32.5 per cent and 17.6 per cent respectively in the first half of 2002. Against the background of a 116 per cent average inflation in the first half of 2002, the sharply negative real interest rates have adversely impacted on the ability of pension funds, insurance companies and deposit-taking institutions to reward investors and savers, respectively. In addition, investors are switching from investing in productive activities towards consumptive and speculative borrowing, such as foreign currency trading, shares and real estate causing a sharp rise in these asset prices. In order to support the government's debt policy, the RBZ is expected to maintain its current monetary policy for as long as possible.

Notwithstanding efforts in market-clearing operations, the Zimbabwe dollar remains substantially overvalued. In August 2000, the RBZ abandoned the fixed peg of Z\$38 to the US dollar that applied from January 1999. A 24 per cent step devaluation, as well as periodic devaluations based on inflation differentials with trading partners, had been introduced. Despite having depreciated by 31 per cent *vis-à-vis* the US dollar by the end of 2000, the Zimbabwe dollar remained above its market-clearing value, pegged at Z\$55 to US\$1. Pegging the exchange rate at this level against a background of high inflation *vis-à-vis* that of major trading partners had serious repercussions on export competitiveness, foreign currency availability in the economy and overall economic performance. Moreover, the monetary policy of artificially lowering

1. Equivalent to US\$2 billion and US\$1.8 billion, respectively, at the official exchange rate of Z\$55:US\$1.

2. Equivalent to US\$2.8 billion and US\$ 3.5 billion, respectively, at the official exchange rate of Z\$55:US\$1.

interest rates introduced in 2001 added pressures to the exchange rate. Importers can now borrow at a negative real interest rate. As a result, the parallel exchange market, so far crucial for the functioning of the economy, registered a steep premium increase by mid-2001, from a 25 per cent premium towards the end of 2000, to a 635 per cent premium in December 2001, the US dollar being exchanged above 400 Zimbabwe dollars. Having stood at around Z\$320 to the US dollar just before the presidential elections, the parallel rate depreciated to Z\$850 towards the end of June 2002, reflecting the renewed surge in demand for foreign currency owing to the general loss of confidence by the business community. However, following increased control on commercial banks and *bureaux de change* alleged to be involved in parallel market activities, the local currency has firmed to around Z\$680 per US\$1 in July 2002. This represents a premium of 1136 per cent on the official exchange rate, leaving room for significant arbitrage opportunities for speculators which in turn is fuelling the parallel market. Despite this worrying scenario, the current exchange rate is expected to be maintained for the year 2003, owing to strong political resistance to devaluation, witnessed also by the cabinet reshuffle of August 2002. Indeed, the former Finance Minister, Simba Makoni, the only proponent of devaluation, was replaced by his predecessor, Herbert Murewa, supporter of the current currency peg.

As mentioned earlier, the years 2001 and 2002 experienced a dramatic upsurge in inflation, resulting from a combination of demand pull and cost push pressures. On one side, the high level of liquidity in a contracting economy created speculative tendencies in the market pushing up prices of equity and property markets. Another determinant of inflationary pressure was the continued shortage of foreign currency, which forced producers to source foreign currency on the parallel market at high rates, at a cost subsequently passed to consumers. In addition, inflationary expectations driven by the macroeconomic instability became self-fulfilling, as economic agents increased prices in anticipation of price increases in other critical inputs, such as labour and raw material. In order to contain inflation, the government introduced direct

controls on selected prices. The Grain Marketing Board was re-established as a monopoly in June 2001 to control the pricing and distribution of maize and wheat and, since October 2001, controls on the wholesale and retail prices of other basic commodities have been introduced. Such intervention did not produce the expected effects since the price controls led to shortages of some of the controlled goods, which in turn fuelled black market activities, resulting in scarce commodities sold at very high prices.

Inflation for 2002 is estimated to have averaged 129 per cent and is projected to remain at three-digit level in 2003, as fiscal and monetary policy will be unchanged for most of the period under review.

## External Position

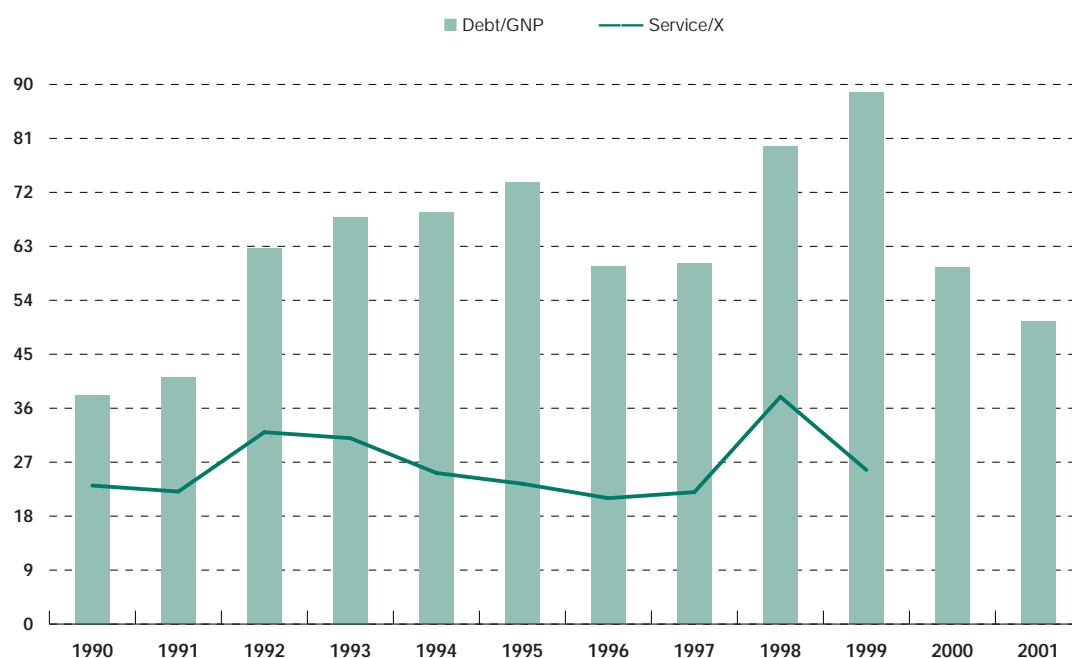
Despite major efforts pursued in the last ten years to liberalise trade, Zimbabwe is still characterised by a restrictive trade regime, particularly on the capital account. The foreign exchange allocation system, relaxed at the beginning of the decade, has recently been restored in the form of stringent foreign exchange controls as a measure to regulate the growth of imports. A system of permits and monopolies for some exports is still active: as alluded earlier, the Grain Marketing Board has the monopoly for maize exports and gold is exported only by the RBZ. The Minerals Marketing Council of Zimbabwe (MMCZ) controls the bulk of Zimbabwe's mineral exporting. During 2001, several measures were introduced in order to mitigate the loss of competitiveness and curb parallel market activity. In particular, the RBZ increased the import surrender requirement to 40 per cent for exporters which imposes the repatriation of export receipts through the official market. Given the wide spread between the official and the parallel market exchange rate, the 40 per cent surrender requirement is an effective tax on exporters. In March 2001, the authorities raised the effective level of protection by increasing tariff rates on certain processed items that have domestically produced substitutes, such as food, and reducing rates on some raw material and capital goods, mostly machinery. However, in mid-2002, in order to reduce the cost of

Table 3 - Current Account (percentage of GDP)

	1995	1999	2000	2001	2002(e)	2003(p)
Trade balance	1.2	4.6	3.7	0.8	-0.1	-0.6
Exports of goods (f.o.b.)	30.8	35.5	24.5	17.9	7.4	3.2
Imports of goods (f.o.b.)	-29.6	-30.9	-20.8	-17.1	-7.5	-3.7
Services	-3.5	0.4	-1.5	-2.1		
Factor income	-4.5	-6.6	-5.3	-2.6		
Current transfers	1.7	2.1	1.7	1.3		
<b>Balance on current account</b>	<b>-5.1</b>	<b>0.5</b>	<b>-1.4</b>	<b>-2.7</b>		

Source: Authors' estimates and predictions based on IMF and domestic authorities' data.

Figure 5 - Stock of Total External Debt (percentage of GNP) and Debt Service (percentage of exports of goods and services)



Source: World Bank.

maize to alleviate the sufferings caused by the drought, duty on maize and wheat imports have been suspended.

The country's external position has seriously deteriorated since 2000, reflecting the combined impact of the freeze on foreign assistance and declining exports. High inflation, against a fixed exchange rate, compromised competitiveness and caused a contraction in exports by 6.6 per cent in 2001. More specifically, the shortage of foreign currency forced companies to use the parallel market to procure raw materials, chemicals, machinery and equipment as well as fuel and electricity. Such increases in production costs had a

negative impact on the already weak mining and manufacturing sectors. In the wake of the current political instability, tourism receipts fell sharply in 2001 with a negative impact on the services account which passed from a surplus of US\$21 million in 1999 to a deficit of US\$198 million. As a result, the current account has registered a deficit of 2.7 per cent as a percentage of GDP. Export and imports are estimated to have further contracted in 2002 and 2003.

Agriculture, manufacturing, and mining exports are estimated to have declined even further in 2002. Foreign exchange shortage and the lack of access to most

lines of credit continued to limit severely the country's ability to import. Food imports, necessary to compensate the decrease in staple food production, constituted about 19 per cent of total imports in 2002, reducing resources available for other critical imports such as raw material, fuel and capital goods.

The negative developments on the current account are exacerbated by the deterioration of the capital account, recorded since 2000. Long- and short-term capital inflows as well as foreign investments have declined substantially in response to the unfavourable macroeconomic and socio-political environment and the consequent increased loss of confidence of the business community. Another determinant of the deterioration in the capital account has been the continued withdrawal of donor funding.

Financial budgetary support from international official and commercial lenders has been widely used by Zimbabwe since its independence. Although on paper the stock of foreign debt has remained unchanged since 1997, reflecting the cutback in aid inflow and lending by multilaterals, the country's offshore obligations have risen sharply with the build-up of foreign arrears. The stock of total external debt – excluding arrears – declined to 50.4 per cent of GNP in 2001 after the steep increase registered in 1999 (where it amounted to 88.7 per cent of GNP). In terms of structure, external debt, being around 70 per cent public, is overwhelmingly medium- and long-term debt. Half of the public external debt is owed to multilateral institutions, notably the World Bank and the IMF, while the rest of it is contracted with foreign governments and to a lesser extent with private creditors. Foreign exchange shortages experienced over the last two years have made debt repayments increasingly difficult and, by mid-1999, the government had defaulted on most of its external debt commitments. Foreign arrears have build up dramatically from US\$197.5 million in 2000 to US\$762.7 million in 2001. In mid-2002, external payments arrears stood at around US\$1.1 billion, of which more than 450 million was owed to the multilateral creditors. In June 2002, in response to the accumulation of arrears (of more than US\$132 million) the IMF suspended the provision of technical assistance.

## Structural Issues

With quite a diversified economy compared to other African countries, Zimbabwe has been, until the beginning of the 1990s, structurally characterised by strong state intervention and rigid controls over prices. The gradual liberalisation of the economy which occurred throughout the 1990s has partly lifted the degree of state intervention. Nevertheless, core areas are still strictly controlled and the context of economic downturn has not helped the implementation of planned reforms.

Although the government's decision to privatise public enterprises has been announced as part of the liberalisation process which started in 1991, the Privatisation Agency of Zimbabwe (PAZ) was not established until September 1999. The Agency is to date not backed by any legislation but the authority of the PAZ derives directly from the Cabinet. Indeed, it is a semi-autonomous institution, housed in the Office of the President and Cabinet (OPC) with its Director reporting to the Cabinet through the Chief Secretary. The stated key objectives of the privatisation programme were to eliminate the large budgetary burden of public enterprises and to promote economic local empowerment through the ownership of assets. The larger state-owned enterprises (SOEs) (about 10 out of a total of 45) are related to public utilities in the energy sector (both in production and distribution), air and railway transport, and other strategic sectors such as telecommunications, industrial development, financial services and the banking sector. As of 2002, the privatisation process still lacked an overarching regulatory policy framework, although the PAZ has released a privatisation manual which sets up the procedures of the process. The manual, though, provides general guidelines and remains subordinated to the Companies Act and other specific sector legislation. The process is therefore conducted on a case-by-case basis, with sectors adopting different approaches in developing regulatory authorities. Privatisation has been implemented starting from a fast-track divestiture of firms already listed on the stock exchange. In 2001, seven out of the 12 companies listed were divested. These include: the Cotton Company of Zimbabwe (Cottco),

the Zimbabwe Reinsurance Company (ZimRE), and the Zimbabwe Development Corporation (ZDC). At a second stage, several other public utilities will be divested (the national airlines and national railways are envisaged as the first priorities); then parastatals which have some social functions (such as universities and colleges) are also set for eventual privatisation.

Over the past decade, the whole privatisation process has been slow and, owing to the nature of its authority, the PZA seems to have been marginalised by political interference in the allocation of the SOEs. Proceeds from privatisation in 2001 were only 32 per cent of the target, amounting to Z\$7.1 billion, compared to a target of Z\$22 billion. According to the 2002 budget, the proceeds by year-end were targeted at Z\$40.9 billion. However, as at November 2002, these amounted to only Z\$10.2 million.

The process faces many challenges associated with the current macroeconomic environment. In particular, foreign participation in the privatisation process is hampered by the deteriorating political and economic situation and by the exchange policy, which makes valuations extremely high in US dollars at the official exchange rate. Moreover, before the privatisation of public utilities can actually be implemented, it is necessary to put in place a comprehensive and consistent privatisation law.

The highly unequal distribution of land has always threatened social cohesion since the inception of independent Zimbabwe and, since June 2000, agrarian reform has become the government's highest priority. In order to understand better the land crisis in Zimbabwe, it is worth considering the different phases of the land redistribution process. Since 1980, when the country attained political independence, and before the massive redistribution that took place in 2001 and 2002, the distribution of land was highly skewed. Some 4 500 large-scale commercial farms were owned largely by white farmers, living on 11 million hectares (ha) of the most fertile and best-irrigated land. On the other hand, 1.2 million households, around half of the population then, were living on 16.3 million ha of communal poor quality, drought-prone land. In

addition, according to the World Bank, about 40-50 per cent of the high potential arable commercial land was left unused for various reasons, including restrictions on the subdivision of land, the allocation of water rights and the absence of a land tax. The resettlement process began soon after independence to achieve a more equitable land distribution. Nevertheless, after a period (1980-84) of fast resettlement, the process started to slow down beginning the mid-1980s. As a result, until 1997 the government had redistributed only 3.5 million ha of commercial land, equivalent to 10 per cent of arable land, and 25 per cent of the pre-independence white-owned land. In a context of economic downturn with a subsequent lack of financial resources to fund the high cost of the resettlement process, growing political and popular discontent led the government to decide a more radical policy of land reform. In November 1997, the *willing-buyer-willing-seller* system had been abandoned and replaced by the government announcement of 1 471 commercial farms (almost 40 per cent of white-owned land) for compulsory purchase. The decision plunged the country into considerable confusion. Despite the International Donors' Conference held in Harare in September 1998, where all major donors, government and stakeholders agreed on a two-year Inception Phase, the situation has worsened over the last three years. In mid-2000, the government launched the Fast-Track Development Programme covering 5 million ha and 150 000 families compared to 3.5 million ha and 73 000 families resettled with the new principle of compensation for capital improvement and not for the value of the land. Aside from the official process, there have also been informal farm invasions which have occurred regardless of the legal status of those farms under the land reform programme. Despite the Abuja agreement, signed in September 2001 by the Commonwealth Ministries, which provided for the withdrawal of settlers from unlisted – or illegally listed – farms, as well as a return to the rule of law and a peaceful and smooth transition, the occupation and disruption of farms has continued. Since the March 2002 election, the government has accelerated the land redistribution process and extended the parameters of the programme. In particular, the Land Acquisition Act was amended in May 2002 granting the government full rights on land listed for acquisition.

Moreover, the amended Act required farmers, whose properties had been listed, to cease all operations and to leave the property within three months. The Act also poses the basis of an Agriculture, Technical and Extension Service Scheme, earmarked to support the development of irrigation and agro-mechanisation and training of the newly resettled farmers. According to official figures, as at July 2002, the government had “gazetted” for acquisition and resettlement 5 153 farms with a total area of 9.8 million hectares. Of this land, 6.2 million hectares had been allocated to about 210 000 households for small subsistence farming (3 to 6 hectares) and 3.6 million hectares have been assigned to 54 600 new commercial farmers (from 50 to 300 hectares). As far as the number of farms listed is concerned, the Commercial Farmers’ Union (CFU) presents slightly different data. According to it, from the beginning of the fast-track reform in July 2000, a total of 5 909 commercial farms (10.5 million hectares) out of 6 032 (10.6 million hectares) have been listed for compulsory acquisition. Out of the farms under notice, about 51 per cent were issued with eviction orders, requiring the farmers to cease all operations and leave the farms within three months<sup>3</sup>. Twenty-seven per cent of all operating farms had been closed, but operations on the remainder were either wholly or partially in place. The land reform process has failed to address the plight of 350 000 farm workers and estimated 200 000 to 300 000 casual labourers, whose jobs are threatened by the eviction of white farmers. Only 2 per cent of farm labourers are estimated to have been allocated land under the fast-track reform and most of them have not been re-employed by the resettled farmers. Against a background of increasing politicisation of the land issue, the likely prospects for next year are sizeable output losses and unemployment of agriculture workers. Indeed, as seen earlier, wheat and tobacco crops are threatened by the uncertainty surrounding the land issue since the remaining white farmers face enormous difficulties in getting finance for

the next crop owing to the difficulties in using land and machinery as collateral. On the other hand, most resettled farmers lack the capacity, the infrastructure and the back-up service from financial institutions. The problem of funding the next crop is therefore crucial. The main challenge for the government will be to assist newly resettled farmers to operate viably through the provision of fertiliser, seeds, irrigation infrastructure and credit. In order to reach these goals, the government has earmarked Z\$8.5 billion and it is likely that commercial banks will be roped in to support the agricultural sector. Beginning the last quarter of 2002, commercial banks had already started floating agro-bills on the back of Government guarantees for working capital financing of the new farmers. Official indications have been that between November 2002 and April 2003, sale of these agro-bills and agro-bonds would raise a targeted Z\$60 billion<sup>4</sup>.

### Political and Social Context

After a political campaign marked by violence, Robert Mugabe was re-elected to the presidency of the country at the disputed election in March 2002. Condemned as not free and fair, the result was contested by the opposition and the international community. The country has been suspended from the Commonwealth and smart sanctions have been imposed by the United States and the European Union. Despite the isolation into which the country has been plunged, and the efforts of Presidents Mbeki and Obasanjo to broker negotiations between the ruling party (the Zimbabwe African National Union Patriotic Front – ZANU PF) and the opposition (Movement for Democratic Change – MDC), the political impasse has not been solved. The MDC candidate, Morgan Tsvangirai, stated that he would only participate in an interim government if it led to fresh elections, while Mugabe is unlikely to leave office voluntarily. Since the

3. The deadline for 2900 farms expired on 10 August 2002, however most of the farmers have defied the order and many have charges laid against them by the police. A new law adopted in September forces farmers to leave their land within a week of being served eviction notices rather than the 90-day deadline previously in place.

4. Agro-bills are for short-term working capital finance, whilst agro-bonds are meant to finance infrastructure development, with planned maturities of 3-5 years.

election, the government has accelerated the controversial fast-track reform and has suppressed forms of opposition in the independent press, labour movement and political parties. Discontent is increasing among the people as it has been since 2000. Support for Mugabe has started to wane since 2000 owing to the negative impact of the 1990s reforms on people's living standards and to rising corruption amongst political leaders. The MDC was therefore formed to represent this discontent and since the national election held in June 2000 (where the MDC won 57 out of the 120 contested seats), Mugabe and the ZANU-PF have been confronted by an organised and strong political opposition.

Since the presidential election of March 2002, however, the MDC seems to have adopted a wait-and-see attitude and is now focusing on local elections, after an MDC candidate was elected mayor of the capital. In the meantime, Mr Tsvangirai faces a legal challenge as the government presses treason charges against him.

The current food crisis, the deepening economic crisis and the disordered land redistribution process are exacerbating the people's discontent, while donors' concerns over political interference in the distribution of food has slowed down the food aid operations.

Against this background, large-scale protests against the government, although announced by the opposition, are unlikely to take place. Moreover, under new security laws, it is illegal to call for a general strike and such mass action would probably be suppressed by the government army and war veterans. Presidents Mbeki and Obasanjo are expected to insist on finding a conciliatory path to resolve the political crisis and to re-establish relations with international donors. What drives the attempts of the South African and Nigerian leaders to find a solution is the concern that lack of progress in their intermediation would compromise US and EU financial support to their ambitious NEPAD (New Partnership for African Development) initiative which foresees a peer review mechanism on governance issues. Zimbabwe is widely seen as the first test of this procedure. The most likely scenario would be that President Mugabe

remains in power for the period of his mandate but will soon identify his successor.

International relations over recent years have been characterised by Zimbabwe's military involvement in the Democratic Republic of Congo (DRC) war. Zimbabwe has been fighting in the DRC since 1998, in support of President Kabila and, by mid-2001, an estimated 12 000 troops had been sent there. Zimbabwe had, however, started withdrawing its troops from the DRC at the beginning of September 2002, following peace deals signed separately between the DRC and Rwanda and Uganda during the third quarter of 2002.

A key factor that will continue to chart the socio-economic evolution of Zimbabwe is the worsening income distribution. The country has, over the past few years seen a persistent and increasing dualism in which the richest 20 per cent of the population receive 60 per cent of total income. Moreover, the recent economic crisis and subsequent shrinkage of national resources available for social services are hampering the sustainability of the highly developed health care and education systems that had placed Zimbabwe at the forefront of the continent ten years after independence. Coupled with this, the spread of HIV/AIDS amongst the population is fast erasing the gains in life expectancy achieved in the last twenty years and the high prevalence of HIV/AIDS amongst the population is also directly disorganising the health care system.

Inequalities between rural and urban areas are still large. According to a recent 1995/96 World Bank study, the poverty incidence was equal to 48 per cent in rural areas compared to a level of 7.9 per cent in urban areas. Moreover, all major indices of poverty – incidence, depth and distribution sensitive measure of severity – increased during the first part of the 1990s by more than a quarter. The absence of reliable data does not allow an accurate monitoring of the present situation. Nevertheless, some indicators suggest a worsening of the poverty context. Given the relatively high growth elasticity of poverty (0.68) and of extreme poverty (1.2) to growth, it is likely that poverty has increased over the last five years. The 1995-2001 average GDP growth of 0.1 per cent is far below the 4.7 per cent per

year required to prevent the increase of the total number of the extremely poor segment of society. The situation deteriorated further in 2002 owing to the combined effects of the general economic difficulties, the strain in relations with donor groups and the massive drought. As mentioned earlier, over 6 million people are at risk due to the worsening food shortage in the country.

According to a joint health assessment carried out by the Ministry of Health and the World Health Organisation in May 2002, the large-scale movement of people under the current humanitarian crisis has resulted in those populations not accessing health services including safe water supplies and adequate sanitation. Consequently, it is estimated that 1 million people are vulnerable to disease outbreaks. Since 2000, economic hardships have resulted in a brain drain to other countries, health services are becoming increasingly difficult to access and basic drugs are in short supply. One hundred and fifty thousand children are estimated to be in desperate need of protection services and 600 000 require targeted nutrition initiatives. The worsening food crisis is acting as a multiplier on previously existing problems such as chronic malnutrition and HIV/AIDS.

With an estimated 28 per cent of the adult population living with HIV/AIDS, Zimbabwe is one of the most infected populations in the world, overtaken only by Botswana and Swaziland. UNAIDS estimates that about 2.2 million people are living with HIV/AIDS. The mortality rate for HIV/AIDS has increased from 18.29 per thousand in 1998 to 34.14 in 2001. However, those figures are expected to increase following the 2002 food crisis that exacerbated the vulnerability to infections and exposed people already living with HIV/AIDS to secondary infections as their resistance declined due to poor nutrition. The epidemic is concentrated on major highways and with the current food insecurity and the consequent increase of high risk behaviours such as prostitution or migration, the risk of contagion rises dramatically. Another serious effect of HIV/AIDS has been the number of orphans. The number of living orphans is about 600 000. The estimated 1.2 million orphans by 2010 (almost 10 per cent of total population) are likely to have a severe

impact on social services and on the country's social cohesion. Although estimates of the economic impact are unclear, preliminary studies suggest a drop of 1 per cent in per capita output yearly growth. In order to fight the threat, an AIDS levy (a 3 per cent pay-as-you-earn tax) and a corporate tax have been introduced in 2000. In 2001, the Parliament instituted an AIDS Council, which is mandated to implement the national strategy against HIV/AIDS, and to disburse the funds to the districts AIDS Committees. So far, the lack of a clear agenda has prevented the implementation of an effective strategy, and mismanagement and lack of capacity at the district level have prevented the effective utilisation of the funds.

By developing country standards, the education system has, however, made tremendous progress since independence and now Zimbabwe boasts of a well-educated population. The most dramatic achievements in providing education were made in the first decade of independence, between 1980 and 1990. The number of primary and secondary schools increased by 42 per cent and 662 per cent, respectively, and enrolments increased by over 200 per cent across the whole system. As a result of this dramatic progress, primary education is free and universal and more than half of the 15-19 age group was enrolled in secondary schools in 1999. The adult literacy rate has increased accordingly passing from 70 per cent in 1980 to 88 per cent in 1999 (ADB Statistics). Nevertheless, current political and economic difficulties, HIV/AIDS, population displacement and resettlement have slowed down the progress. Dropouts, especially in the 15-19 year age group are increasing. It is estimated that over 200 000 children will be affected by the resettlement process.