

Zimbabwe

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key figures

- Land area, thousands of km² 391
- Population, thousands (2002) 12 835
- GDP per capita, \$ (2002) 1 380
- Life expectancy (2000-2005) 33.1
- Illiteracy rate (2002) 10.0

Zimbabwe

THE COUNTRY'S REAL GDP declined for the sixth consecutive year in 2003. It was expected to shrink by 18.5 per cent in 2003 (after 12 per cent in 2002) and by 14 per cent in 2004.

No progress was made in tackling the causes of the severe economic and political crisis that has gripped the country since 1997. The National Economic Revival Programme, launched in February 2003, did not improve conditions for meaningful social dialogue and the government's timid measures failed to reduce macroeconomic imbalances (very high inflation, constant central bank funding of the fiscal deficit, and an overvalued exchange rate) and increase the chances of economic recovery.

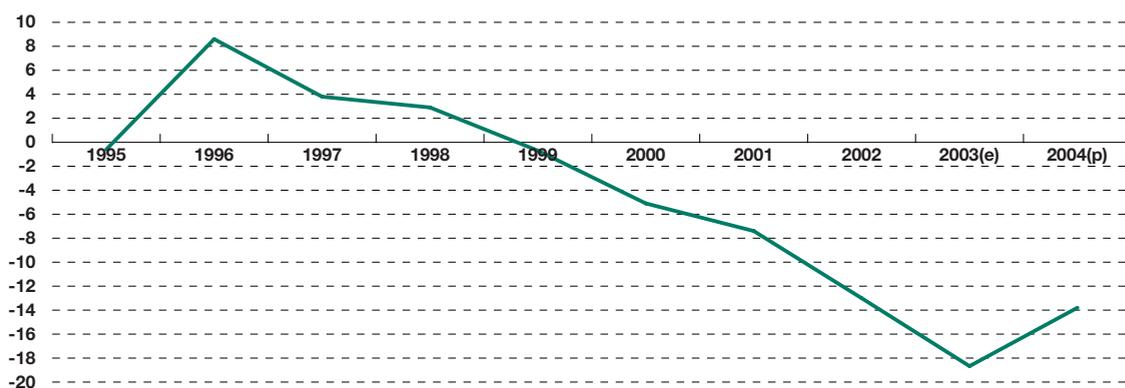
Although authorities have partly removed price controls on fuel, the overall approach has largely been incoherent, further deepening distortions in the allocation of scarce resources, such as credit and foreign currency, and widening the quasi-fiscal deficit. In what was once the

breadbasket of Southern Africa, food supply remains well below the country's requirements, as a sharp decline in productivity in agriculture accentuates the combined effects of foreign currency and working capital shortages and accelerating inflation.

Concerns about governance, including lack of political rights and press freedom, continued to create mistrust between government and opposition. The decision to pull out of the Commonwealth in December 2003 will further isolate Zimbabwe and complicate resumption of political dialogue. The long-running crisis is increasing deep divisions in an already fragile social fabric, helped along by collapsing health-care and education systems and two million people suffering from HIV/AIDS. These problems are reflected in the steep rise in the number of Zimbabweans living abroad, now estimated at more than three million (about a quarter of the population).

The lack of government flexibility in undertaking macroeconomic adjustments is expected to intensify the crisis and perpetuate isolation.

Figure 1 - Real GDP Growth

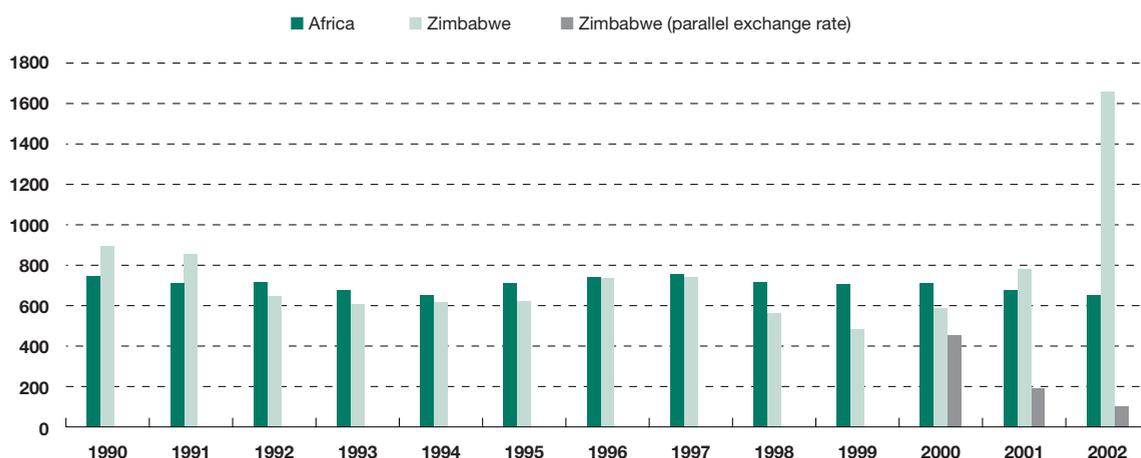


Source: IMF and domestic authorities' data; projections based on authors' calculations.

Recent Economic Developments

Zimbabwe's macroeconomic environment has deteriorated sharply over the past six years. Real GDP

fell by an average of more than 6 per cent in 2000-01 and by more than 30 per cent in 2002-03. Inflationary pressures worsened in 2003 and the lack of anchors further reduced economic activity and the

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

a. The peak in GDP per capita in 2002 is due to the distortion of using the overvalued official exchange rate. As 70 per cent of the transactions take place in the parallel market, the official rate is not representative of the GDP per capita. The official rate used is Z\$43:1US\$ in 2000 and \$55:1US\$ in 2001 and 2002; the parallel rate is Z\$56:1US\$ in 2000, Z\$214:1US\$ in 2001 and Z\$729:1US\$ 2002.

Source: IMF.

competitiveness of exports. The economy also suffered from continued uncertainty over the land reform programme, declining productivity on resettled farms and shortages of foreign exchange.

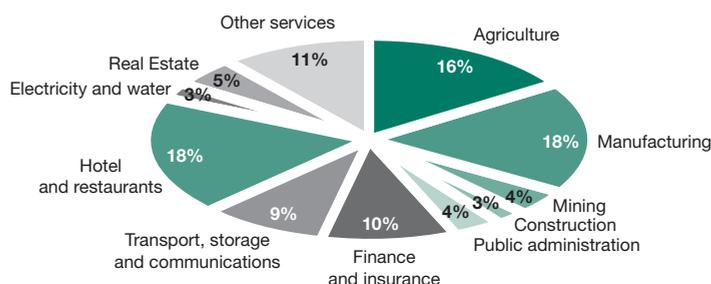
Severe bottlenecks emerged as imports of raw materials (such as fuel) and production inputs (fertilizers and spare parts) were drastically cut and infrastructure (railways, electricity and urban water supplies) deteriorated badly. Agriculture and manufacturing were the most affected in 2002 and 2003. The financial sector grew for the fourth straight year but this was due to huge distortions in the foreign exchange market and speculation by banks in real estate and other physical assets markets.

Reflecting mounting concerns on the implementation of the 2003 budget, business and the unions, under the auspices of the Tripartite Negotiating Forum (TNF), pushed the authorities to launch a National Economic Revival Programme (NERP) in February 2003. As developed further in the note, key elements included introduction of an export support exchange rate equal to Z\$824 per US dollar; from the Z\$55 per US dollar level which had been pegged since October 2000, raising the export surrender requirement from 40 per cent to 50 per cent; and easing price controls.

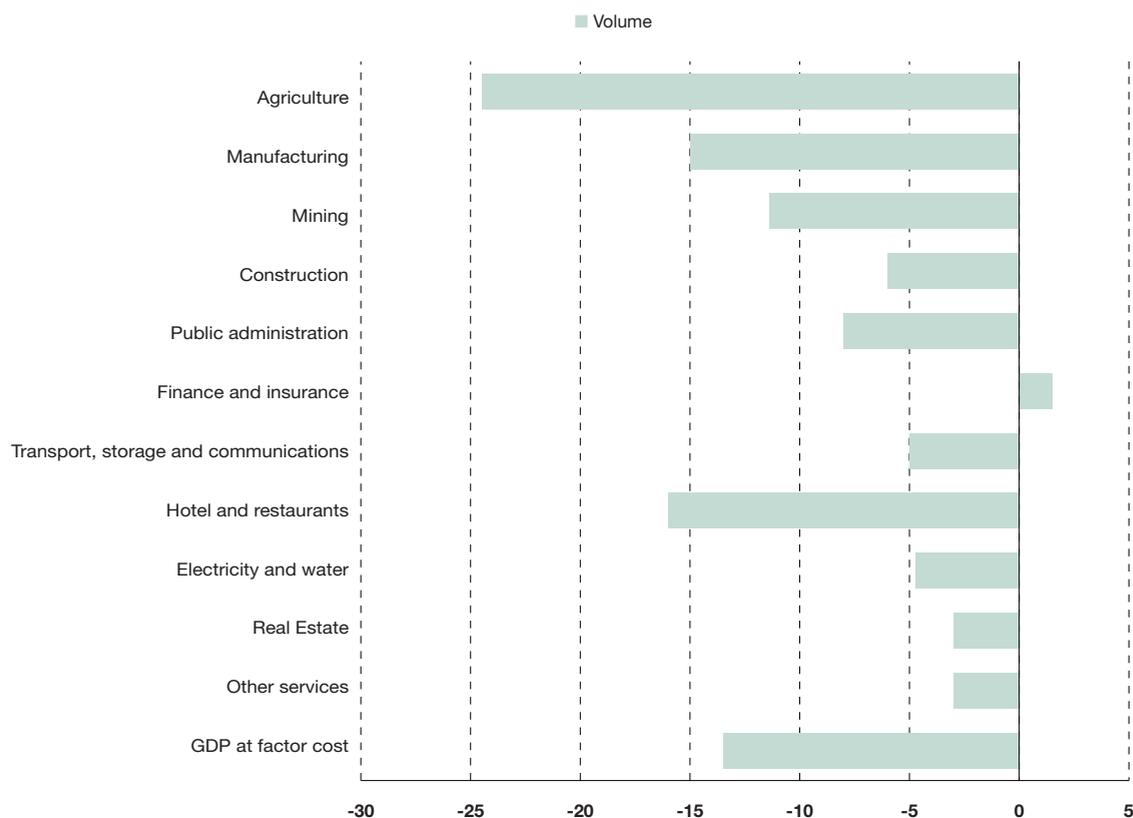
From its very inception, however, the NERP has appeared doomed to failure as it did not provide a clear policy framework to fight macroeconomic imbalances, particularly on fiscal reform and structural bottlenecks in the productive sectors. While prices of fuel and some non-basic commodities have been liberalised, government still maintains price controls over an extensive list of basic items (maize, maize meal, wheat, flour and bread) and introduced monitored prices for seeds, beef and cooking oil. It also undermined the cohesion of stakeholders under the TNF in late 2003 by unilaterally announcing increases in public sector wages and electricity prices to reflect the cost of importing energy. Finally, specific measures outlined in the NERP to boost gold and tobacco production were only partially implemented, while the respective support schemes were withdrawn in March 2003.

The contraction in the agricultural sector – by 13.5 per cent in 2001 worsening to 24.4 per cent in 2002 – is thought to have slowed in 2003 (by 4 per cent). Maize production rose from 0.49 million tonnes in the 2001/02 season to 0.93 million tonnes in 2002/03, still only half the late 1990s level. The 2002 food emergency was modest but food imports by the Grain Marketing Board are estimated at only 18 per cent of the 2002/03 cereal deficit and some 5.5 million people

Figure 3 - GDP by Sector in 2002



Source: Authors' estimates based on national authorities' data.

Figure 4 - Sectoral Contribution to Real Growth in 2002^a

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

Source: Authors' estimates based on domestic data.

(about 45 per cent of the population) need food aid in early 2004.

With the growing social strain of the huge food gap, the government was obliged in July 2003 to appeal

to the World Food Programme for urgent help. Pledged international aid so far covers only 22 per cent of the food aid requirement for the 2003/04 marketing year. A catastrophic food situation in 2004 is expected based on seed sales in 2003, when only 40 per cent

of maize planting needs are thought to have been fulfilled.

The ongoing land resettlement programme also continues to make agricultural prospects uncertain and discourages traditional and indigenous farmers from investing in key capital projects such as irrigation, dams and tobacco-processing barns. This and an acute lack of tillage resources are expected to reduce productivity, even with abundant rainfall. As the full cost of the land reform emerges, 2004 harvest yields are expected to be lower than 2003. In fact planting has been very limited, reflecting acute seed shortages, a sharp rise in the price of inputs (beyond the reach of most small farmers) and low farm take-up by resettled households.

The drought between November 2003 and January 2004 made things worse and 2003/04 maize yields are only expected to be 250 000 tonnes, before recovering to around 1.2 million tonnes in 2004/05. This falls way below the country's average annual maize consumption of 1.8-2 million tonnes.

Beef, a fast-growing export to Europe in the 1990s, has been dealt a huge blow by repeated outbreaks of foot and mouth disease and the devastating effects of the land reform programme and most farmers significantly culled their herds. Beef production, down 22 per cent in 2002/03 (from 64 000 tonnes in 2001/02 to 50 000), is expected to drop another 10 per cent in 2003/04. Predictions for 2004/05 are far below the 2001/02 level.

Prospects for cotton are equally gloomy. With an estimated 85 per cent of the crop being produced by small- to medium-scale producers, the general expectation was that cotton production would be marginally affected by the general meltdown in Zimbabwe's agriculture. Cotton tonnage has, however, been reduced by the soaring cost of seeds and fumigation and fell by 30 per cent in 2000/01-2002/03, with a further 39 per cent decline (to 0.14 million tonnes) expected in 2003/04. Major cotton marketing houses say prospects for 2004/05 are bleak, with production below 0.25 million tonnes though slightly higher than in 2003/04 due to government concessional funding to productive sectors, including farming.

Output of tobacco, Zimbabwe's traditional major hard-currency earner (a third of total exports), fell from 173 million kg in 2002 to 103 million in 2003, the lowest level since independence in 1980 (the annual 1998-2001 average was 219 million kg). The drop was due to the one-third reduction in crop area (from 69 000 hectares to 46 500 over the year). About 85 million kg was auctioned off at an average US\$2.26/kg during the April/October 2003 sales (compared with 165.7 million kg in 2002, itself a sharp fall from the 2000 record of 237 million kg). The sales earned only US\$183 million – compared with US\$368.6 million in 2002 and way below the 1996 peak of US\$593.4 million – further exacerbating the foreign currency crisis.

Based on the amount of seeds sold in 2003, tobacco output is expected to reach at best 60 million kg in 2004, a 44 per cent decline on the year. Mainly indigenous small farmers are particularly affected by inflation and lack of affordable chemicals, fertilisers, tillage and finance. The overvalued exchange rate reduced the return per hectare to US\$3 886 from US\$8 473 in 2002. For farmers to break even, an estimated rate of Z\$9 000 per US\$ is required, compared with the official rate of 824 and a parallel rate of Z\$5 300 per US\$ in autumn 2003.

Finally, the Tobacco Growers Trust (TGT) funds proved inadequate, with the Reserve Bank releasing only US\$6 million out of US\$36 million from the 20 per cent retention of tobacco export proceeds. The scheme was abolished in March 2003 as it imposed substantial deadweight losses on the economy. The Reserve Bank introduced a highly-managed foreign exchange auction system on 12 January 2004, allowing exporters to sell 75 per cent of their foreign currency, with the other 25 per cent still sold at Z\$824 per US\$ for government use. The outlook for 2005 is a further decline in production to about 40 million kg – about 17 per cent of what it was in 2000.

Clarification of the government's land tenure policy, easing the foreign currency shortage, reducing input costs and improving the transport system are priorities for farmers and access to credit the chief long-term

bottleneck. The main government-owned agro-finance bank, Agribank, was turned into a land bank (Agricultural Development Bank of Zimbabwe) in 2003 with the job of providing cheap credit to farmers in resettled areas. A concessional credit programme of Z\$60 billion (Z\$40 billion for maize, Z\$15 billion for cotton inputs, Z\$5 billion for sorghum and millet) was announced, but was a drop in the ocean compared with the estimated Z\$600 billion needed to finance the 2003/04 cropping season.

To accommodate the newly resettled farmers who received land under the fast track reform programme, the Zimbabwe Farmers Union (ZFU) called government to put in place a guarantee mechanism and banks to accept farm leases and other loan security options such as movable assets as collateral. In order to boost exports from the currently depressed levels, the ZFU also suggested establishing an agricultural export retention scheme whereby a reserve of foreign currency would be used to procure inputs at the start of each farming season. An expanded special irrigation finance scheme for new farmers was also suggested to the government.

Manufacturing (18 per cent of GDP) contracted by 15 per cent in 2002 and probably a further 13 per cent in 2003. The level of capacity utilisation fell again, to an all-time low of 55 per cent (from about 60 per cent in 2002), due to shrinking domestic demand and less competitive exports. Industrial production, which relies on imports, was badly hit by the acute foreign currency shortage and output of non-metallic minerals fell 40 per cent, food 30 per cent, textiles 26 per cent, wood and furniture 20 per cent and transport equipment 12 per cent.

The lack of foreign currency meant non-exporting companies wanting to import raw materials and spare parts were forced to seek it on the parallel market – where the Z\$ traded at multiples of the official exchange rate – thus fuelling inflation and straining cash flows for big firms. Producers of goods still subject to price controls (bread, sugar, cooking oil, furniture and milling) faced extra problems recovering their costs. Other obstacles for manufacturing were scarcity of liquid fuel,

electricity and coal and the inability of the railways to move goods. The Confederation of Zimbabwe Industries (CZI) said 60 per cent of companies did not plan any investment in 2002-03 and those that did mainly bought replacements, limiting the creation of jobs and expanded production.

Virtually the entire mining sector was severely affected by the overvalued exchange rate, foreign currency shortage, limited rail services and dearth of fuel. Output of gold – the second largest hard currency earner, with 14 per cent of total 2002 exports, and accounting for half the mining sector's production – fell by 14.3 per cent in 2002 (to 15.47 tonnes from 18.05 in 2001) and was expected to drop by another 20 per cent in 2003. Despite introduction in April 2001 of a price support system (which offered a floor price of US\$531 per ounce in March 2002 when the world price was US\$296) – companies are scaling back operations, including development work, and many mines have closed. The gold support scheme was abolished in March 2003 while the foreign exchange earnings surrender requirement stayed at 50 per cent.

Despite the foreign exchange auction system that the central bank introduced on 12 January 2004 and the 50 per cent foreign exchange retention allowance, the burden of the 1999-2003 structural and pricing distortions is expected to cut gold production by 10 per cent in 2004 and 5 per cent in 2005. Coal production also slumped by a third in 2001-03. The only sub-sector showing a spectacular increase was platinum, whose 2003 production volume was eight times higher than in 2001. The Chamber of Mines said this was due to completion of the Mimosa phase 1 expansion project in 2002 and the second full year of production of the Makwiro mine. Mimosa increased monthly production by an average 329 per cent in 2003 compared with 2002 and Makwiro by an average 36 per cent.

The financial sector (10 per cent of GDP) is the only one that has shown some resilience, with a real growth of about one per cent in 2002 and 2003. This reflects the distortions of the overvalued exchange rate and the arbitrage opportunities of dealing in foreign currency on the parallel market. The steady economic decline

has also pushed banks to put cash in riskier assets, including stock as well as real estate, and the low interest rate led to a dramatic surge in the stock market, unrelated to the basic facts of the economy. In 2003 (up to 29 December), industrial and mining indices rose 315 and 2 650 per cent respectively, against year-end annual inflation of 598.7 per cent.

The stock market surge did not spill over into the construction industry, which further declined (15.5 per cent) in 2003 after shrinking 6 per cent in 2002. Acute

shortage of cement and sharp increases in building material costs were the main cause. Despite the drop, real estate prices have risen sharply due to firms switching investment from production to property. The buoyancy of both sectors, however, is not expected to last because of systemic deterioration of assets quality. The expected increase in interest rates will most likely hurt prices of speculative assets. As the government tightens enforcement of exchange control regulations, most banks will also find it hard to get high rents from parallel market activities.

Table 1 - Demand Composition (percentage of GDP)

	1995	1999	2000	2001	2002	2003(e)	2004(p)
Gross capital formation	24.5	15.1	14.0	0.4	-8.3	-11.8	-11.5
Public	4.6	1.9	1.6	2.4	-1.5	-2.2	-2.1
Private	19.9	13.2	12.4	-2.0	-6.7	-9.6	-9.4
Consumption	78.2	85.4	87.2	100.8	114.8	132.2	133.1
Public	17.8	15.4	24.8	33.8	20.4	20.8	16.9
Private	60.4	70.0	62.4	67.0	94.4	111.4	116.2
External sector	-2.7	-0.4	-1.2	-1.2	-6.5	-20.5	-21.6
Exports	37.8	46.8	30.3	23.3	9.6	34.6	34.0
Imports	-40.4	-47.2	-31.6	-24.6	-16.1	-55.0	-55.6

Source: IMF and domestic authorities data; projections based on authors' calculations.

Other services – notably distribution, hotels and restaurants – suffered from the crisis and continued to decline. Tourism remains highly sensitive to the bad publicity Zimbabwe has attracted and to limited airline accessibility. Visitor arrivals in the first half of 2002 were 739 000 compared with 1.45 million in the same period of 2001, reflecting the uncertainty and violence in the run-up to the presidential elections. Although total tourist arrivals in the first quarter of 2003, at just over one million, were 47 per cent higher than in the first quarter of 2002, this was more due to the below-average 2002 figure than to a solid recovery.

Persistent high inflation and concern about the land reform programme have drastically altered the structure of economic demand. Private gross capital formation, critical for economic growth and job creation, has declined in recent years – from 19.9 per cent of GDP in 1995 to -6.7 per cent in 2002 – reflecting the disastrous effect of the grab-and-take fever in the

agricultural sector that has led to the destruction of most farming equipment.

Continuing cuts in real government spending to restore telecommunications, road and railway networks, electricity and water supplies and the health system produced negative gross fixed capital formation also in the public sector. Overall, gross capital formation is estimated to have further declined in 2003 and 2004 in percentage of GDP.

Matching the big drop in investment, consumption surged to well above annual production levels. Negative real interest rates and high recurrent budgetary expenditure accentuated this trend, pushing aggregate consumption to an estimated 132.2 per cent of GDP in 2003, and a projected 133.1 per cent in 2004.

External sector position continued to deteriorate, as net external demand worsened from -0.4 per cent of GDP

in 1999 to an estimated -20.5 per cent in 2003. Sustained overvaluation of the Zimbabwe dollar and structural distortions in major export sectors continued to whittle down exports, from 30.3 per cent of GDP in 2000 to 9.6 per cent in 2002¹. The rebound in export and import percentage over GDP in 2003 was due to the adjustment of the exchange rate to Z\$824 per US dollar instead of Z\$55, as dollar exports continued to fall during the year.

Poor export performance and low capital inflows produced a painful squeeze on imports. Total imports fell from 31.4 per cent of GDP in 2000 to 16 per cent in 2002. As with exports, the decline and rebound in the import/GDP ratio was due to the exchange rate effect.

A more accurate account of Zimbabwe's demand structure is hampered by lack of data. The main source, the Central Statistical Office (CSO), is in crisis after losing most of its key staff to the private sector and abroad. The severe economic crisis has also made the private sector disinclined to respond to national statistical questionnaires, whose return rate is sometimes as low as 20 per cent. As a result, this country survey was based on combined data from often divergent sources, including the CSO, the Reserve Bank, IMF publications and the authors' own estimates and projections. In

addition, the extreme uncertainty of Zimbabwe's economic and political evolution hampers a macroeconomic forecast for 2005. In current economic circumstances, this would require arbitrary assumptions on governance development and economic policies that could result in a multiplicity of more or less plausible scenarios.

Macroeconomic Policy

Fiscal and Monetary Policy

Lack of fiscal restraint plus a very accommodating monetary policy are still the biggest threats to the country's macroeconomic good health. Support for investment and social sectors continues to decline in real terms as recurrent expenditure remains disproportionately high. Monetary financing of the deficit and sustained growth of credit to the private sector fuelled the 12-month money supply growth rate, which rose from 56.9 per cent in January 2001 to around 400 per cent by December 2003. Annual inflation reached an all-time high of 622.8 per cent in January 2004, up from 228 per cent in March 2003.

The fiscal deficit in 2003 is estimated at 3.7 per cent of GDP compared to 10.2 per cent in 2002. This is

Table 2 - Public Finances (percentage of GDP)

	1995	1999	2000	2001	2002	2003(e)	2004(p)
Total revenue and grants^a	28.2	29.2	28.1	26.6	28.0	28.8	25.4
Tax revenue	23.4	26.7	25.4	24.6	26.4	27.4	24.0
Total expenditure and net lending^a	44.6	38.7	48.8	34.7	38.2	32.5	29.3
Current expenditure	39.1	34.7	46.0	32.2	37.9	32.1	28.9
<i>Excluding interest</i>	29.9	24.4	29.0	24.3	28.0	27.5	22.7
Wages and salaries	11.1	13.5	16.9	13.4	12.9	16.0	13.3
Interest	9.3	10.3	17.1	7.9	9.9	4.7	6.2
Capital expenditure	2.9	2.8	1.8	2.5	0.3	0.4	0.4
Primary balance	-7.2	0.9	-3.6	-0.2	-0.3	1.0	2.3
Overall balance	-16.4	-9.5	-20.7	-8.1	-10.2	-3.7	-3.9

a. Only major items are reported.

Source: IMF and domestic authorities' data; projections based on authors' calculations.

1. The drop was also due to the distortion of using the official exchange rate of Z\$55/US\$ to calculate imports and exports. Two-thirds of all transactions took place on the parallel market at an average rate of Z\$729 in 2002 and Z\$3 900 in 2003.

mainly due to artificially low interest rates and high revenues. Revenues grew as a result of bracket creep (delayed adjustment of income tax brackets for inflation) and better collection by the Zimbabwe Revenue Authority, which became operational in 2002 and introduced VAT on 1 January 2004. Customs revenue was much lower than budgeted, however, because the crisis reduced aggregate imports.

Low interest rates kept debt service costs down and helped reduce stock levels from 50.6 per cent of GDP at end-2000 to 14.4 per cent at end-2003. But the government budget concealed the impact of sizeable quasi-fiscal operations by the Reserve Bank of Zimbabwe (RBZ) to boost gold and tobacco productivity and support the Grain Marketing Board and other loss-making public enterprises. Quasi-fiscal operations also include use of the foreign exchange surrender at a rate of Z\$55 per US dollar. Inclusion of such spending should have swelled the deficit to 11 per cent in 2003.

The structure of budgetary spending remains a major source of macroeconomic imbalance. Capital expenditure (including net lending), which averaged 11 per cent of total fiscal spending from 1995 until 2000, fell to about 7 per cent over the period 2001-2003, while the combined bill for wages and salaries and interest payments, though declining, was still a huge 56 per cent.

Although the government has attempted to improve investors' confidence in the 2004 budget, announcing in particular a cash budgeting framework to match expenditures to revenues, the articulation and implementation of a comprehensive reform programme remains of paramount importance. Streamlining the public sector by commercialisation and privatisation of state enterprises seems vital for economic stabilisation.

A bloated wage bill (itself a result of high inflation), an upsurge in the cost of domestic borrowing and increasing quasi-fiscal interventions in agriculture and other key export sectors are expected to boost expenditures in 2004. However, the surge in spending is projected to be lower than the skyrocketing rate of inflation, leading to a deficit of 3.9 per cent. Inflation

is expected to remain highly sticky downwards, as fiscal deficits are mostly funded by domestic banks.

As regards monetary policy, the RBZ introduced a dual interest rate system in November 2002. Lending for productive and export sectors was set at concessional rates of 30, 10 and 5 per cent while rates for consumption borrowing were left market-determined. Lack of buyers for T-bills forced the bank to raise interest rates on longer-dated T-bills to around 100 per cent in April 2003. Although lending rates by commercial banks had risen to between 220 per cent and 600 per cent by the first week of January 2004, real interest rates remain negative and thus discourage saving.

For three years, the Zimbabwe dollar was pegged at an overvalued Z\$55 per US dollar. In March 2003, the rate for most official market transactions by non-state entities was set at Z\$824, still well below its market clearing value, estimated at around Z\$5 000 in January 2004. Despite increased controls on commercial banks and the closure of *bureaux de change* in November 2002, rates on the parallel market continued to rise, reaching around Z\$3 000-3 500 at the end of July 2003 and Z\$6 000-6 500 at the end of the year.

In December 2003, the monetary authorities said they would adopt an auction system from 12 January 2004, obliging exporters to sell a quarter of their hard currency earnings at the fixed rate of Z\$824 and another 25 per cent at the auction rate. They can keep the remaining half in their foreign currency accounts (FCA) for use within 21 days, after which they must offload the remainder in the market at the auction rate.

An acute shortage of Z\$ banknotes, due to lack of hard currency to import paper and ink, developed during the first nine months of 2003 and threatened public order in August. The central bank eased the situation by printing bearer cheques in denominations of 5 000, 10 000 and 20 000, which are circulating as cash.

A new RBZ governor was appointed in November 2003 and the 2004 monetary policy announced on 18 December is expected to focus on inflation control,

financial sector stability and foreign exchange generation. The dual interest rate system has been maintained, though the subsidised funding rate for targeted productive sectors has been set at 30 per cent². As in the past, there is a risk that concessional funds may be diverted into non-productive and speculative uses, thus generating more inflation in the economy. Furthermore, the piecemeal measures envisaged by authorities cannot provide a lasting solution to the crisis. Without tight monetary policies and appropriate exchange-rate realignment, macroeconomic imbalances are unlikely to diminish and inflation in 2004 is expected to average 456 per cent, compared to an average rate of 377 per cent in 2003.

To curb speculative trading by the financial system, the new Reserve Bank governor tightened the central bank's accommodation of banks. This sparked a huge liquidity crisis in the last two weeks of 2003 and into January 2004, causing the collapse of Century Discount House on 3 January. At least eight banks were out of clearing in early January for failure to fund their batches under the new real time gross settlement (RTGS) arrangement, significantly dampening market confidence in the financial system. A major goal of monetary policy must be to restore this confidence.

External Position

Despite major efforts over the past decade, Zimbabwe still has a restrictive trade regime, particularly on the capital account. A system of permits and monopolies operates for some exports: the Grain Marketing Board has a monopoly on maize and the RBZ on gold. The Minerals Marketing Council of Zimbabwe (MMCZ) controls most mineral exporting. The foreign exchange allocation system, eased in the early 1990s, has recently been revived in the form of stringent exchange controls as a way of regulating import growth.

Other government efforts to raise foreign exchange have included increasing the export surrender requirement to 50 per cent in March 2003, obliging

the repatriation of export receipts through the official market and adopting the foreign exchange auction system in January 2004. The wide spread between official and parallel exchange rates means that such requirements, along with the existing obligation to deposit the foreign currency balance on a special RBZ-controlled account, serve as a tax on exporters. Furthermore, shortage of foreign exchange on the official market forced non-state importers to resort to the parallel one at a premium of over 600 per cent before introduction of the foreign exchange auction.

With the auction rate averaging Z\$3 800 per US dollar in the first fortnight of trading from mid-January 2004, the gap between the official and parallel rate has narrowed and at the end of the month, the parallel rate was about Z\$4 800. However, in spite of the initial enthusiasm of the business community, the auction system turned out to be highly controlled by the central bank with detrimental consequences for exporters. In particular, the controls included the rejections of bids considered to be unacceptably high and therefore potential stimulants for inflation. An additional control was to reject bids for currency that would be used for purposes not considered of high priority. The effect of these controls was that exporters had to sell 25 per cent of export proceeds at an unduly low weighted average auction rate, realising return on exports much lower than their costs. In addition, while some importers benefited from the lower cost of foreign currency compared to the one prevailing on the parallel market, others have been adversely affected by the prioritisation process that did not allow them to source the imports necessary to conduct their business operations.

Zimbabwe's external position has badly deteriorated since 2000. The impact of the foreign aid freeze and declining exports caused a dramatic foreign currency shortage that in turn reduced imports. High inflation, against an overvalued fixed exchange rate, harmed competitiveness and exports in 2002 were 36 per cent down on 2000. Exports in 2003 are estimated at half the 1996 figure.

2. Total cumulative support for productive sectors in 2004 will amount to some Z\$750 billion, up 51 per cent from the Z\$497 billion as at 30 September 2003.

Agricultural export sales fell by 22.4 per cent in 2002 – mainly due to the decline of tobacco, sugar and livestock that more than offset the small increase in horticulture – and in 2003 are estimated to have fallen a further 31.6 per cent. Mineral exports contracted by 23.8 per cent in 2002, as sales of gold and asbestos plunged. Nevertheless, in 2003 the drop was held to 11.4 per cent by a boom in platinum sales. Manufacturing exports, including cotton lint, declined by 11.9 per cent in 2002 and are estimated to have fallen 7.7 per cent in 2003.

The scarce foreign currency available for imports was mostly allocated to food to compensate for the fall in production of staples. Food imports rose from 3.3 per cent of total imports in 2000 to 16.7 per cent in 2002, crowding out key items such as raw materials (fuel, electricity) and production inputs (chemicals,

equipment). Yet imports of transport equipment grew by a robust 8.8 per cent, with the distorted foreign exchange market in a hyperinflationary environment feeding an upsurge of motor vehicle imports, including luxury brands.

The trade deficit widened from 2.4 per cent of GDP in 2001 to an estimated 15.6 per cent in 2003. The worsening trade balance in percentage of GDP is also largely explained by the exchange rate adjustment in 2003 from Z\$55 to Z\$824 per US\$.

Contrary to expectations, the new foreign exchange auction system has not so far created the necessary flexible conditions to boost export performance. The trade deficit is projected to widen in 2004, as exports, especially of tobacco and gold, are expected to fall more rapidly than imports.

Table 3 - Current Account (percentage of GDP)

	1995	1999	2000	2001	2002	2003(e)	2004(p)
Trade balance	1.2	4.6	3.7	-2.4	-4.5	-15.6	-16.8
Exports of goods (f.o.b.)	30.8	35.5	24.5	17.7	7.8	27.4	26.6
Imports of goods (f.o.b.)	-29.6	-30.9	-20.8	-20.1	-12.4	-43.0	-43.4
Services	3.5	0.4	-1.5	-2.2	-1.3		
Factor income	-4.5	-6.6	-5.3	-3.7	-1.4		
Current transfers	1.7	2.1	1.7	1.3	1.3		
Current account balance	-5.1	0.5	-1.4	-7.1	-5.9		

Source: IMF and domestic authorities' data; projections based on authors' calculations.

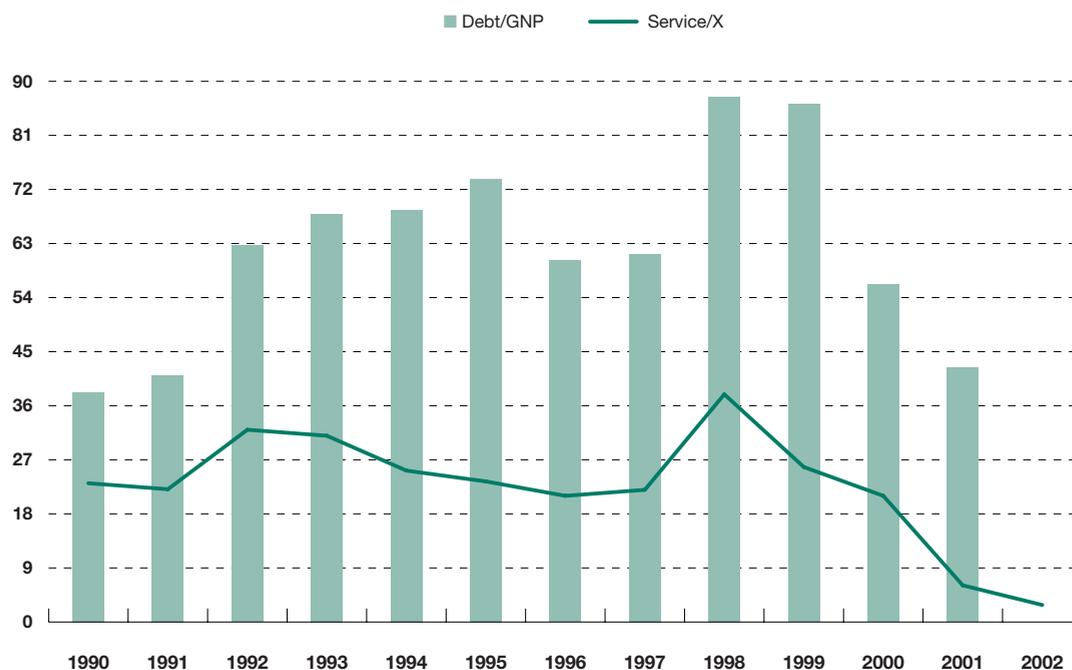
The negative developments on the current account and the deterioration of the capital account since 2000 have exacerbated the foreign currency crisis. Foreign investment and long- and short-term capital inflows have fallen substantially due to the poor macroeconomic and socio-political environment and the private sector's loss of confidence. The exception is platinum, where Impala Platinum (the world's second largest producer) made a formal bid to increase its stake in Zimbabwe Platinum Mines (Zimplats) from 35.7 to 85.2 per cent. Short-term speculative inflows were marginally positive, with investors attracted by the strong performance of the Zimbabwe Stock Exchange (ZSE).

Another reason for deterioration of the capital account has been the continued withdrawal of donor funding.

Since 2000, total external debt (excluding arrears) has begun to fall, reflecting the cutback in aid and lending by multilaterals. Foreign exchange shortages have made debt repayments increasingly difficult and by mid-1999 the government had defaulted on most of its external debts. The country's usable reserves averaged precarious levels of under US\$20 million (about 3 days of imports) in 2003.

Foreign payment arrears have built up dramatically, from US\$109 million in 1999 to US\$1.5 billion at the end of 2002 (more than 40 per cent of it owed to multilaterals) and US\$2.5 billion by the end of 2003. They were expected to worsen to US\$4 billion by the end of 2004, further undermining the country's creditworthiness in international markets. The IMF

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



Source: World Bank.

suspended technical assistance in June 2002 because of arrears of more than US\$132 million and in November 2003 began compulsory withdrawal procedures for Zimbabwe. The balance-of-payments financing gap at the end of 2003 equalled nearly two years' exports at current levels. Closing this gap is a daunting task for the government.

Structural Issues

Economic performance is hampered by deteriorating infrastructure due to lack of state funding, inappropriate pricing and acute shortage of foreign currency to buy spare parts. The country's only railway company cannot handle freight efficiently, the Wankie Colliery mine does not produce enough coal and electricity supply is unreliable. Only half the National Railways of Zimbabwe (NRZ) 60 locomotives were functional at the end of 2003, while 120 were needed to meet

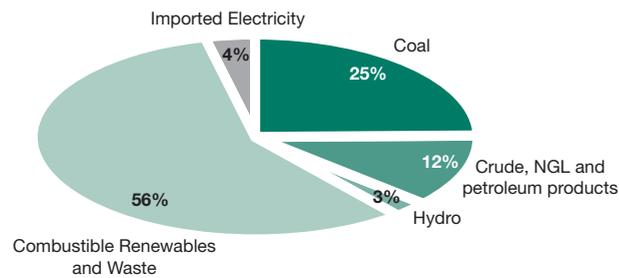
demand. Poor maintenance and lack of qualified personnel have steadily increased delays and accidents.

The Confederation of Zimbabwe Industries reacted in November 2003 to the slowness of reforms with efforts to pool resources to solve the private sector's most urgent problems. One proposal was that railway users issue bills guaranteed by the Reserve Bank to raise local and foreign currency to get locomotives and wagons back into service. But this requires a stable cash flow, which is not guaranteed in the current macroeconomic environment³.

Only one excavator is used for open-cast coal mining at the Wankie Colliery, which operates at only half-capacity. Despite its huge reserves, Zimbabwe is forced to import more expensive coal from Botswana. Since coal is used for tobacco drying, sugar processing, cement production and especially electricity generation, the shortage affects the whole economy. Electricity comes,

3. Major exporters are also pooling foreign currencies to help NOCZIM (National Oil Company of Zimbabwe) import fuel.

Figure 7 - Structure of Domestic Energy Supply in 2001



Source: International Energy Agency.

in roughly equal shares, from thermal plants, the Kariba hydro power plant and imports from Cahora Bassa (Mozambique), SNEL (DRC) and ESKOM (South Africa) through the Southern African Power Pool (SAPP).

Zimbabwe has failed to pay outstanding debts and arrears, forcing Mozambique and South Africa to sharply cut back deliveries since January 2003 and the Zimbabwe Electricity Supply Authority (ZESA) to engage in load-shedding and cut-offs. In order to raise funds to settle external debts, ZESA has asked exporters to pay their bills in foreign currency. On top of these operational problems, SAPP's energy surplus is expected to vanish by 2007. Internal resources to maintain the current system and finance new investments are clearly insufficient. Over 61 per cent of the population (82 per cent in rural areas) are still without access to electricity.

To solve these problems, the government has initiated a reform programme to open up the power sector to private capital. Under the January 2002 Electricity Act, ZESA was unbundled into three companies (generation, transmission and distribution). In mid-2003, the cabinet approved dilution of state control of the generating company (Zimbabwe Power Company, ZPC), though the Act limits private participation to 49 per cent.

Other provisions of the Act – establishment of an Electricity Regulatory Commission (ZERC), a pricing study and unbundling generation, transmission and distribution tariffs and their regulations – have been greatly delayed. Uncertainty over the structure and

current level of tariffs also increases the regulatory risks faced by potential investors. Appointing a regulator, doing the pricing study and clarifying the tariff structure are immediate priorities for obtaining badly-needed financing to increase capacity. In the longer run, the government intends to acquire a 25 per cent stake in the Cahora Bassa dam and expand the Hwange power station.

Liquid fuel supplies have also been under pressure since 1999 as foreign exchange has become scarcer. Libya ended the special agreement to barter oil against Zimbabwe's physical assets (including land) and equities after Harare failed to keep its side of the deal.

In order to fight the burgeoning black market in fuel, the government introduced a dual pricing system in 2003. Public sector entities and other critical economic operators are entitled to buy fuel at a regulated price from NOCZIM (National Oil Company of Zimbabwe), whereas private sector companies (BP, Caltex, Mobil, Shell, and Total) are allowed to import and distribute their own supplies independently. Although the government has gradually eased the rules, controlled prices remain far too low to clear the market. In November 2003, the regulated price was Z\$450 per litre (compared with Z\$76 in February) but the parallel market was asking more than Z\$3 000.

In early 2002, 30 state-owned enterprises (SOEs) were awaiting privatisation, after the sale of 15 since 1999. Selling off the commercial part of the Grain Marketing Board (GMB) was planned and the Privatisation Agency of Zimbabwe (PAZ) has presented for cabinet approval

a concession agreement for NRZ. However, the PAZ, does not have autonomous powers and can only execute cabinet decisions, a predicament that favours political interferences in SOE management. Privatisation came to a complete halt in 2003 because of the poor economic climate and withdrawal of donors' support. In November, the government said it would suspend it indefinitely and instead restructure NOCZIM and Air Zimbabwe and create a regulatory agency for the oil sector.

Highly unequal land distribution has threatened social cohesion since independence, when about 4 500 big commercial farms were owned mainly by whites on 11 million hectares of the most fertile and best-irrigated land, while 1.2 million households (half the then population) lived on 16.3 million hectares of poor-quality, drought-prone communal land. About 40-50 per cent of the high-potential commercial arable land was not used for various reasons, including restrictions on subdivision, allocation of water rights and absence of a land tax, according to the World Bank.

Agrarian reform has become the government's top priority since June 2000. The Fast-Track Development Programme covers 5 million hectares with a targeted 150 000 families, compared to 3.5 million hectares and 73 000 families resettled in the previous two decades. Under the programme, compensation is based on capital improvement and not on land value. The government says the programme has achieved its main goal of redistributing land to 300 000 small-scale (A1) farmers over the past three years. However, in 2002, an audit led by land reform minister Flora Buka revealed gross violations of the "one man, one farm" principle by prominent politicians who allegedly received several large farms.

President Robert Mugabe disputed the finding and named a close ally, Charles Utete, to do a second audit, which was completed in October 2003 and remains restricted, though parts of it have been leaked to the press. It puts beneficiaries under the A1 model at 127 192 and at only 7 260 under the commercial farmers (A2) model (which aimed for 50 000 new farmers). There are half as many more A2 farmers than

there are white farmers but the total area available to them for production is only 2.2 million hectares, compared with more than 11 million used by the whites. So even if the land was made productive (highly doubtful under current constraints), commercial production would be about a fifth of the previous year's production.

The Utete report also says the government has seized some 8.6 million hectares of land on 4 324 farms and that 1 323 white farmers remain on their land, though only 600 are fully operational, according to the Commercial Farmers Union. About 300 000 of the total 330 000 commercial farm worker families have been laid off. Abuses are also rife in application of the rules on loss of absentee status, ownership of multiple properties and about farms close to mainly indigenous areas.

Even on already resettled land, tenure has not been guaranteed. Instead of title deeds, the government has offered 99-year leases and this absence of collateral has dramatic consequences on ability to finance crop production. About 270 Zimbabwean farmers have moved to neighbouring Zambia and to Mozambique (especially the northern province of Manica), partly drawn by special programmes offered by the governments there.

Political and Social Context

The political crisis deepened after President Robert Mugabe was sworn in for another term in March 2002 after an election the Commonwealth Observer Group said was held in a "climate of fear". Zimbabwe was suspended from the Commonwealth for a year (until March 2003) and the United States and the European Union imposed "smart sanctions", targeting selected officials of the government and the ruling Zimbabwe African National Union Patriotic Front, (ZANU-PF).

In the run-up to the December 2003 Commonwealth summit in Abuja, Nigerian President Olusegun Obasanjo discreetly lobbied Mugabe to get him to resume negotiations with the opposition Movement for

Democratic Change (MDC). This effort proved to be largely unproductive, the political deadlock remained and, on the recommendation of a Commonwealth foreign ministers' working group, Mugabe was not invited to the summit and in December announced Zimbabwe was withdrawing from the Commonwealth.

Political violence and intimidation reportedly continued in 2003. The government won two parliamentary by-elections, though the MDC won two in Harare (Kuwadzana and Highfields) in March 2003, as well as 137 out of 222 municipal council seats and six out of seven executive mayoralties. Stay-aways organised by the MDC between March and June 2003 – the biggest anti-government protests for more than two years – shut down shops, banks, factories and other businesses.

Using the harsh Public Order and Security Act, government-sponsored militia, police and troops responded by arresting and roughing up trade union and civil society activists, including several MPs. The interior minister suspended the mayor of Harare after unspecified allegations of misconduct. Publication of the *Daily News*, the country's only independent daily paper, was suspended in July and then halted in September because it supposedly did not have the necessary authorisation. Reporters Without Borders denounced the closure and the arbitrary arrest of five of the paper's directors as a violation of press freedom.

President Mugabe continues to divide international opinion. The key to his success has been to keep international focus on the land distribution issue and away from the conduct of the 2002 presidential elections, human rights abuses and the undermining of democracy and the rule of law. Zimbabwe's policies have affected the rest of the region and threaten the success of the ambitious NEPAD (New Partnership for Africa's Development) initiative, which includes peer review concerning governance.

South Africa has been a leader of efforts to improve governance in Africa, but has taken a cautious line on Zimbabwe. South African public opinion supports the land reform and the authorities fear a strong stand against the Zimbabwean government could have sub-

regional repercussions. During the Abuja summit, President Thabo Mbeki argued that bringing Zimbabwe back into the international fold would be the best way to solve the crisis. A small but growing number of African countries, such as Botswana and Kenya, are increasingly critical, however, and have called for the African Union to conduct a peer review of Zimbabwe. Others, such as Namibian President Sam Nujoma, consider Mugabe a heroic figure in the independence struggle.

On the domestic front, the MDC is willing to negotiate with Mugabe only if an interim government is formed to organise new elections. Mugabe is very unlikely to leave office voluntarily and there is little indication he would consider resigning even if granted blanket immunity against future prosecution. Hopes rose in late 2003 that he was moving towards a compromise when he appointed a new vice-president, General Vitalis Zvinvashe, the outgoing head of the Zimbabwe Defence Forces (ZDF). But the fact that Zvinvashe said publicly in 2002 that the army would not salute any political leader without liberation war credentials suggested ZANU-PF hardliners still have the upper hand. Civil society, including business associations and trade unions, is increasingly concerned about the future but do not seem to have enough clout, especially in rural areas. Church leaders have emerged as the only mediators.

The long-running crisis and the spread of HIV/AIDS are wiping out gains in life expectancy made over in the last 20 years and increasing deep divisions in an already fragile social fabric – the richest 20 per cent of the population receive 60 per cent of total income – and burdening already collapsing health-care and education systems. The UNDP Human Development Index ranks Zimbabwe as a “low human development” country.

Poverty has worsened since 2000, due to the economic crisis, strained relations with donor groups, the impact of the land reform and the severe drought, and 5.5 million people face starvation in 2004. GMB commercial imports leave a cereals deficit of 610 000 tonnes to be covered by food aid, according to the

UNDP. Donors have pledged 140 000 tonnes, leaving a gap of 470 000 tonnes for the 2003/04 marketing year. The humanitarian agencies' funding shortfall at the end of 2003 was US\$110 million, 57 per cent of the amount sought, mainly due to lack of co-operation between the government and the international community, which, in turn, hampers needs assessment, planning and resource mobilisation.

Vulnerable groups in Zimbabwe are also threatened by poor water quality and sanitation. Urban water and sewage systems are on the verge of collapse for want of foreign currency to buy vital spares and water purification chemicals, according to the UNDP humanitarian contingency planning mission in Zimbabwe. Urban water systems have also suffered from the growing pressures of rural-urban migration and from poor maintenance and can barely provide the required quantity and quality of potable water, as shown by regular cuts in supply and increasingly frequent outbreaks of disease. Rural water supply suffers from poor outreach services, inadequate maintenance and staff shortages. Serious cholera outbreaks have occurred in the Zambezi valley, one of the country's poorest areas.

The health sector is collapsing, hit by a brain drain, deteriorating infrastructure and shortages of medicine. Several hospitals and sections of many others closed down in 2003 for lack of personnel, equipment, medicine and other facilities. An estimated 24.6 per cent (1.8 million) of the adult population had HIV/AIDS at the end of 2003, the second highest figure in the world after Botswana, according to UNAIDS. Some 56.5 per cent of all infected adults aged 15 to 49 were women. The mortality rate rose from 18.29 per thousand in 1998 to 34.14 in 2001. These figures are expected to increase as a result of the 2002 food crisis that increased vulnerability to infection and exposed those already ill to secondary infections as their resistance declined for lack of proper food.

The epidemic is concentrated along major highways and the risk of contagion has risen dramatically with the food insecurity and consequent increase of high risk behaviour such as prostitution or migration. Another serious effect has been the number of orphans – some

761 000 (aged 0 to 14 years) at the end of 2003. The predicted 1.2 million by 2010 (almost 10 per cent of the population) are likely to have a severe impact on social services and social cohesion. An FAO study says 10 per cent of the agricultural labour force was lost in 2000 and up to 23 per cent may be by 2010. To fight the threat, an AIDS levy (a 3 per cent pay-as-you-earn tax) and corporate taxes were introduced in 2000. Parliament set up an AIDS Council in 2001 to implement the national HIV/AIDS strategy and disburse funds to district AIDS committees. Lack of a clear agenda has so far prevented implementation of an effective strategy and mismanagement and lack of capacity at district level have prevented effective use of the funds. Heavily-subsidised government-run voluntary counselling and testing (VCT) centres may also be shut down due to lack of foreign currency to buy essential drugs. Prospects for fighting the disease are bleak as more and more people focus on short-term survival and government capacity remains poor.

Current political and economic problems, HIV/AIDS, population displacement and resettlement have all eroded the tremendous progress made in education since independence. The whole sector suffers from under-spending and loss of qualified teachers and managers due to HIV/AIDS and migration. At least half a million professionals, mainly teachers and health workers, have left the country in the past three years, complaining of low pay and lack of opportunity.

The decline in quality and delivery of education is especially severe in areas affected by the land reform. Many schools in newly resettled areas lack basic infrastructure, water, sanitation and textbooks and are 30 per cent short of qualified teachers. Food shortages make things worse and many teachers and children are spending more time and effort looking for food for their families. Poor transport also seriously undermines school attendance. School fees keep vulnerable children, especially orphans, out of school, with 39 per cent of primary-age children giving fees as the main reason for dropping out. In higher grades, the most affected by this are girls, thus cancelling out progress made towards educational gender parity in the 1980s.

