Fiscal Policy

Despite the range of negative overall developments, there are also signs of positive steps in other areas. The budget deficit was reduced from 22.9 % in 2000 to 12.6 % in 2001. The lower domestic borrowing requirement contributed to a sharp decline in interest rates and facilitated a restructuring of domestic debt. The authorities were also successful in exercising restraint in public sector wage increases despite tremendous pressures. However, the envisaged withdrawal of Zimbabwean troops from the Democratic Republic of Congo did not materialize, although peace negotiations are advancing.

The budget for 2002 entails an effort to improve services in education and health, including fighting the spread of the HIV/AIDS pandemic, while limiting non-productive, non-social sector related outlays, a task that would be extremely difficult without external assistance. The projected increase in security expenditure reflects the priority being given to enforcing the rule of law and to maintain law and order ahead of the presidential elections. The authorities remain hopeful that consensus will be reached soon in the DRC to facilitate the withdrawal of Zimbabwean troops and to allow redeployment of resources into social sectors and the re-building of infrastructure.

Downsizing the Civil Service

Progress has been made in a number of structural areas, many of which will help to facilitate fiscal consolidation. In this regard, a number of ministries have been rationalised and some services previously performed by Government have been subcontracted or commercialised. Consequently, the civil service was downsized by a total of 13,100 posts during 2000 and 2001 and will be further reduced by 8,350 posts in 2002. This has contributed to budgetary savings of Z$3 billion in the current year and further savings are projected for 2002.

Strengthening Revenue Collection

The authorities concur with staff that revenue performance is being affected by organizational issues. To address these problems and to strengthen revenue collection and administration, the Zimbabwe Revenue Authority was established in September 2001 and efforts are underway to make it fully operational. The authorities are confident that VAT will be introduced in 2002. To assist in these preparations, technical assistance is being received from South Africa and Zambia, while public awareness campaigns are underway. However, it is expected that the shortage of foreign currency will hamper the upgrading of computer and software systems used for revenue collection.

Privatisation

The authorities have also moved ahead with privatisation. Government has sold its holdings in a number of listed companies. A major privatisation exercise, involving the telecommunication company, NetOne, has been delayed to 2002, to allow for the completion

of the due diligence process. To facilitate further acceleration of the privatisation process, the World Bank is assisting in developing the regulatory environment in the privatised sectors, including utilities, telecommunications and the railway system. The medium term objective of the privatisation is not only to promote foreign direct investment and encourage the transfer of technology, managerial and technical skills as well as to mobilize foreign exchange resources, but also to encourage, as much as possible, local participation so as to avoid a skewed distribution of assets as has been the case in regard to land.

Price Controls

On price controls, it is important to note that the authorities have been cognisant of the need to allow the free interplay of market forces and efficient utilization of resources. In this connection, a full cost recovery system was introduced for most government services during the year. Those sectors that were commercialised were allowed to charge market prices for their services. The price of fuel was also increased consecutively, towards the end of 2000 and during the first half of 2001, to reflect both the cost of importing and scarcity. However, these measures, taken in the context of a deepening recession, contributed to an exacerbation of inflationary pressures.

The authorities have engaged stakeholders in tripartite negotiations involving labour, employers and government with a view to agreeing on a social contract that would end the inflation spiral. Although agreement has not yet been reached and the social contract in not fully operational, the authorities have taken a lead by moving in to monitor the behaviour of prices of basics and key inputs. They have also provided a strong signal for wage negotiations during 2002, by granting civil servants a wage increase below the rate of inflation. The authorities are aware that these measures do not provide a long-term solution but feel that they are necessary in the short-term to avert major social upheaval. The authorities have expressed commitment to eliminate prices controls once the environment allows them to take credible measures that have a lasting impact on inflationary expectations.

Monetary and Exchange Rate Polices

Monetary policy has placed priority on mitigating the economic recession and sustaining the export sectors. In this connection subsidized facilities for the productive and export sectors were put in place. These were adopted on a temporary basis and the authorities expressed their intention to unwind these facilities once the economic and foreign exchange situation improves. The authorities believe that without these facilities, the economic situation would have been worse. Nevertheless, they have also realized the impact of these accommodatory monetary policy on inflation and agree with the staff on the need to tighten monetary policy. Since the staff mission in September 2001, interest rates have started increasing gradually. The authorities are also mindful that the ongoing economic decline will have serious consequences for the health of the financial system and the central bank in strengthening its supervisory functions to enforce standards and to deal with problem banks.

Exchange rate adjustments in Zimbabwe have been adopted against the background of fiscal problems, deteriorating terms of trade losses, sluggish growth in exports despite several devaluations since 1996, spiralling inflation and a lack of confidence in the economy. In these circumstances, currency devaluation has not resulted in the expected benefits. Further devaluation of the currency has been the subject of protracted internal debates, that have also put a hold on the necessary adjustments to the crawling peg regime that was adopted in August 2000. The authorities consider that further exchange rate adjustments will have the desired effect only if taken in the context of a comprehensive package of measures that are anti-inflationary and confidence building. They consider that their preferred exchange rate regime remains the crawling peg but do not preclude moving to a float once macroeconomic stability has been secured.

External Payment Arrears

The foreign exchange situation remains very tight and has worsened since the last Board discussion on Zimbabwe, reflecting the lack of improvement in the economic situation and the added impact of the adverse global environment. Nevertheless, the authorities are according high priority to normalize relations with Fund and have made a commitment to making payments to the Fund on a quarterly basis. Since the last Board meeting they have cleared their arrears in the SDR department. The authorities intend to increase payments with a view to stabilize and eventually eliminate arrears to the Fund and to other creditors, once the foreign situation improves.

Capacity Building and Statistical Issues

The authorities have been concerned about the weaknesses in their capacity for macroeconomic management and in the country's economic database. Measures are being taken to address these issues. The authorities have requested and welcomed an STA advisor on real sector statistics. Technical assistance from the Fund has also been received to evaluate the health of the banking system in conjunction with the intention to establish a deposit insurance scheme. Technical assistance has also been requested to launch the VAT. The UNDP, in consultation with the Fund, is sponsoring a macroeconomic advisor, as well as an advisor on budget accounting and debt management. The authorities intend to put this technical assistance and advice to good use.

Comments by the Authorities of Zimbabwe

COMMENTS ON THE IMF STAFF REPORT FOR THE 2001 ARTICLE IV CONSULTATION

1 SUMMARY OF ISSUES RAISED BY IMF

The IMF team, which visited Zimbabwe from September 3 to 15, 2001 on Article IV, has produced its report. The report raised the following issues.

- The economic decline in Zimbabwe was accelerating;
- Loose fiscal policy was making it difficult for Government to meet budget targets on the primary deficit;
- The 2002 budget projected an Increase in revenue in 2002 in the absence of measures to increase tax collections.
- The Introduction of Value Added Tax (VAT) in 2002 may not be feasible given that VAT legislation is not yet in place.
- It may not be possible to accelerate privatisation when foreign participation is discouraged by a deteriorating political and economic situation;
- Pursuit of a loose monetary policy, subsidized credit lines and negative real interest rates will worsen;
- Status of the banking system in view of the low interest rates and the deteriorating economic situation;
- The Zimbabwe dollar needs to be devalued to realistic levels and implementation of the August 2000 Exchange Rate policy resumed;

- The parallel market should be tolerated in the absence of devaluation because it facilitates trade and other foreign currency transactions;
- The Government should make an effort to pay arrears to the Fund or at least stabilize the arrears;
- The tariff rates charged by Zimbabwe are inconsistent with trade liberalization and regional initiatives;
- The Zimbabwe database still suffers from deficiencies regarding accuracy, methodology, coverage and timeliness; and
- That price controls cause shortages and the collapse of businesses.

2.1 The mission expressed concern over the accelerated economic deterioration in Zimbabwe and attributed this to weakening law and order in the context of the fast-track land reform programme, damaged confidence, discouraged investment and destroyed capital.

Comment

The performance of the economy continue to deteriorate in 2001 owing to:

- High inflation that increased cost of production and reduced export competitiveness;
- Low commodity prices mainly for agriculture and mining;
- Acute foreign currency shortages, which resulted in reduced imports of raw materials, spare parts and machinery;
- The fixed exchange rate; and
- Shrinking domestic demand, due to increased unemployment and declining purchasing power.

To arrest the economic decline, Government is currently working on a package for economic stabilisation, recovery and sustainable growth and development. To address inflation, fiscal policy shall focus on strict control of Government Expenditures, especially recurrent or consumption expenditure. However, the budget is under severe pressure due to the current drought. As such, Government's immediate priority will be to ensure enough food supplies in the country. Government is revising the 2002 budget and reprioritizing expenditures towards food importation and distribution with the intention of containing the fiscal deficit at

the budgeted level of 14.9% of GDP. The current measures to support tobacco prices will not have an impact on the budget deficit as Government is looking for non-budgetary resources of financing.

Further, the 2002 Budget contains various measures, which are aimed at rejuvenating performance by the major sectors of the economy. The measures in the budget include:

- Z$10.64 billion to finance the agricultural input scheme and infrastructure development under the land reform programme;
- Z$2 billion for Small to Medium Enterprises and micro projects;
- Z$2 billion for resuscitation of closed businesses; and
- Z$1.5 billion for public works programmes.

In addition, Government introduced export incentives to stimulate exports. Further, the Government still maintains special windows under which concessional finance is provided to exporters and productive sectors.

2.2 The IMF were concerned that although the budget Deficit is expected to decline from 24% of GDP in 2000 to 12.5% in 2001, the Government has not been able to meet its budget target for the primary surplus in 2001 of 4,3% of GDP.

Comment

Government has not been able to meet its targeted primary surplus (Revenues less Expenditure excluding interest bill) in 2001 because there were no reductions in total expenditure despite interest payments savings on domestic debt. In fact, other expenditure items actually increased and a supplementary budget of $17.5 billion was incurred, which was wholly financed from savings from the 2001 budget.

However, Government has attained an operational budget deficit of about 9%, lower than the original target of 15.5% of GDP. It should be noted that the decline in the deficit was largely due to deferred expenditures on external payments, rather than

actual expenditure cuts. As soon as the balance of payments situation improves, most of these expenditures will have to be met, thus creating pressures in the economy.

2,3 The IMF expressed concern that the Budget assumes an increase in total revenue of 3-4% of GDP in 2002 while there are no measures to increase tax collections, which are already under pressure.

Comment

Government projects an increase in total revenue owing to the fact that tax efforts and tax administration are expected to improve now that the Zimbabwe Revenue Authority (ZIMRA) is operational. The structure of the Authority is such that loopholes that were inherent in the then Department of Customs and Taxes will be closed. Administration has been decentralized to regional commissioners who are in charge of regions. This will ensure the netting of defectors as well as close monitoring of activities of companies in the regions.

A good example on the closure of loopholes is on the abuse of sales tax numbers by companies and

individuals. An ST3 form validation exercise has already been carried out by ZIMRA. Under the exercise, traders were required to complete ST3 forms with names of suppliers written thereon, and submit original ST2 forms and sales tax receipts for the past 12 months. The intention of the exercise was to update the sales tax register thereby closing loopholes inherent in the sales tax system, where traders use those forms to purchase goods for personal use. It will also stamp out false sales tax certificates that are unscrupulously forged for the same purpose.

2.4 The mission encouraged the Government to continue its efforts to cut costs and increase the efficiency of Government operations.

Comment

Although the scope for expenditure reduction is limited due to increased cost in service delivery as well as the major programmes being implemented (like the land reform programme), Government is committed to reorienting the expenditure distribution by reducing the proportion of recurrent expenditure, while increasing capital expenditure from about 7% of the total expenditure

and net lending in 2001 to 20% by 2004. The cumulative budget outturn to end of April 2002 show that the capital expenditure as a percentage of total expenditure and net lending was 8,6%. Government is in consultation with the World Bank with a view to carrying out a Public Expenditure Review. Efficiency gains are expected through:

- Strengthening of Overall Financial Management through appointment of professional Finance Directors. So far Government has appointed Finance Directors in all Ministries except for one.
- Public Financial Management System (PFMS). So far the Government has rolled over nine ministries. Others are indirectly connected through the Central Payments Office. It should however be noted that Government will have to shoulder additional responsibilities especially those pertaining to drought mitigation, food relief, AIDS control and management and poverty reduction. This will inevitably put pressure on the budget.

2.5 The IMF was concerned that although the introduction of VAT is planned in 2002, the supporting legislation has not yet been passed.

Comment

The VAT system will be introduced once the legislation is in place. The VAT Bill has been approved by Cabinet and will be tabled before Parliament in the second half of 2002.

When the Bill passes through Parliament, Government will finalise preparatory work of carrying out awareness campaigns, registration of traders and putting in place the necessary computer networks in both the public and private sectors.

Below is a summary of activities that ZIMRA has engaged in preparation for the implementation of VAT:

- The Information Technology teams are working with the Central Computing Services on computerization system for VAT. The team is in the process of floating an international tender for both software and hardware for the computerization of the system.

- **An exercise to update the sales tax database, which would be used under VAT in order to *smoothen the registration process*, is underway.**
- **The VAT staff training team has been expanded from 15 to 30. Internal staff training is currently underway and is expected to be finalized by the end of June. South Africa and Zambia have agreed to hold mentorship programmes with ZIMRA staff in July.**
- **Industry is meeting with the VAT trainers during the first two weeks of June in order to map up training methodologies using industry structures. Seminars will be based on the gazetted VAT Bill and will agree on how VAT will affect different sectors.**
- **Preparations for publicity campaigns are at an advanced stage.**
- **Registration forms and certificates have been drafted but will be finalized once the software is in place while 25 pamphlets in various forms and targeted to different sectors are now ready.**

2.6 The mission urged the authorities to accelerate the privatisation process but noted that foreign participation is discouraged by the deteriorating political and economic situation, and by the exchange

rate policy, which makes valuations extremely high in US dollars at the official exchange rate.

Comment

Government is still committed to the privatisation/commercialization of state owned enterprises. About seventeen parastatals are targeted for privatisation in 2002, and the required technical groundwork for this has already been carried out. Despite the difficult economic situation the privatization process has received the support of foreign investors. TelOne, the telecommunications entity is now considering offers from four prospective investors.

2.7 The staff urged the authorities to tighten monetary policy immediately by mopping up excess liquidity through open market operations and by dismantling subsidized credit facilities, thereby allowing interest rates to move to positive levels in real terms.

Comment

While low interest rate regime has provided relief to the productive and export sectors and enabled the restructuring of public domestic debt, it has also resulted in shifting of funds from the money

market towards speculative activities in equity and property markets.

In order to reduce money supply growth and inflation, Government will relate domestic money supply growth to developments in output production in the economy. The concessional facilities introduced in August 2000 to support export and productive sectors will be converted into a revolving fund, and this will prevent a second round effect on monetary expansion. The Reserve Bank will ensure that interest rates adjust to levels which are attractive to the saving public but at the same time do not discourage investment. Positive real interest rate will eventually be obtained through reduction in inflation.

2.8 The mission emphasized that the RBZ needs to take steps to ensure the soundness of the banking system, as well as deal with troubled banks promptly.

Comment

The Banking Act and the Banking Regulations have widened the supervisory scope and empowered the RBZ to carry out more effective

supervision through both offsite and onsite means. This effective monitoring has led to an improved overall health and financial conditions of banks. The Act also provides for the establishment of a Deposit Protection Fund for purposes of compensating depositors for losses incurred in the event of bank insolvency. Although the Fund is not yet operational, plans on its implementation have reached an advanced stage. The Troubled Bank Policy has also been developed to enable timely and effective responses by the RBZ to problems at banking institutions. To date six institutions have been subjected to supervisory actions consistent with this policy. One institution, which has been under curatorship for about one year, has been successfully taken over by new shareholders.

2.9 The mission urged the authorities to devalue the official exchange rate to a more realistic level, supported by the tighter monetary and fiscal policies, and to adjust the exchange rate thereafter based on expected inflation differentials with Zimbabwe's trading partners.

Comment

The exchange rate has remained fixed since October 2000, in spite of high inflation of above

100% by last quarter of 2001. Government as a whole does not recognise that there is an urgent need to adjust the exchange rate in line with key fundamentals, as part of efforts to recover and grow the economy. Currently, discussions on the appropriate exchange rate level in line with the already announced August 2000 exchange rate policy are underway.

2.10 The mission stressed that the ultimate objective should be the establishment of a unified, floating exchange rate. Where devaluation is not feasible in the short term, the IMF urges Government to tolerate the parallel market. The parallel market, already handles the bulk of transactions, facilitates trade, encourages the repatriation of foreign currency receipts, and minimizes supply-side bottlenecks arising from the shortage of foreign exchange in the official market.

Comment

Government is committed to a unified exchange rate for all transactions in Zimbabwe. However, the prevailing divergence between the official and parallel rates would imply a long-term horizon for the convergence of the two rates.

2.11 The mission raised concerns about the accumulation of payment arrears to the Fund and urged the authorities to make every effort to pay or, at a minimum, stabilize the overdue obligations to the Fund.

Comment

Government remains committed to stabilising its arrears to the 2001 level. However, this would require additional measures to generate foreign exchange through increased exports and stabilizing macroeconomic fundamentals.

Measures to support the export as well as increased investment, both domestic and external, are being pursued on an on-going basis. Some of the privatisation proceeds would also support increased foreign exchange availability, thus creating additional capacity for meeting our external arrears. It should be noted that Government made an interim commitment to pay US$1.5 million quarterly payments to the Fund. The payments for the last quarter of 2001 as well as the first and second quarter of 2002 have been made.

2.12 The mission was concerned that the changes in tariff rates in March 2001 had increased the effective rate of protection and that these tariff changes were

inconsistent with Zimbabwe's commitments to trade liberalisation in the context of regional initiatives.

Comment

Zimbabwe remains committed to fulfilling its international trade obligations under bilateral and multi-lateral agreements and treaties. Tariffs continue to be in line with the abovementioned agreements and treaties.

There was an increase in tariffs in 2001 on certain products deemed to be luxury goods. The increases were necessitated by the need to curtail import demand in a bid to reduce the outflow of foreign currency at a time when the level of foreign currency in the country had dropped to unprecedented levels.

Zimbabwe has complied with COMESA decision to establish a Free Trade Area (FTA) by October 2000 and is among member states, which form the FTA. Under the SADC Trade Protocol, a commitment to move to Free Trade Area has been made. Zimbabwe gazetted its first scheme of tariff reduction in June 2001 and will meet further obligations as they arise.

2.13 The IMF were concerned about the state of the

Zimbabwe's database, which continues to suffer from numerous deficiencies with respect to accuracy, methodology, coverage, and timelines.

Comment

Government is aware of the problems with our data and measures are being taken to improve the availability and reliability of data. The country subscribed to the General Data Dissemination System (GDDS) in February 2002 and the relevant departments, which include the Central Statistical Office (CSO), Treasury and the Reserve Bank, are now working on improving the quality and the dissemination of data.

Efforts to strengthen the relevant data gathering institutions such as CSO are already under way.

Zimbabwe was among fourteen countries invited to the two-week IMF workshop held in Namibia in February/March 2002 to prepare metadata to be put on the IMF Bulletin Board. Each of the country teams worked with the team of consultants. The Zimbabwe team comprised of two officials from the CSO, one official from the Ministry of Finance and Economic Development and one officer from the

Reserve Bank of Zimbabwe. The CSO, Ministry of Finance and Economic Development and the Reserve Bank of Zimbabwe brought the metadata back to Zimbabwe for further improvements.

The final metadata templates which describe all the current statistics systems and plans for improvement were submitted to the IMF for inclusion on IMF Bulletin Board within the time set by the IMF. Each of the institutions concerned is working on the implementation of plans for improvement.

The IMF and the Department for International Development are offering assistance to all member countries in the GDDS project and the GDDS Project Manager is expected to visit Zimbabwe before the end of June 2002. The CSO requested for technical assistance from the International Monetary Fund. An IMF statistics expert, Mr. Andel, came on a mission to the CSO in December 2001 and the office worked with him. Mr. Andel is expected to come back to Zimbabwe in the second half of 2002.

2.14 The IMF expressed concern that price controls would cause food shortages and collapse of businesses. In

the same context, they were also concerned about the increase in the minimum wage in October 2001.

Comment

The hyperinflationary environment coupled with some monopolistic tendencies necessitated the introduction of a fairly restrictive price control regime for basic commodities to protect consumers from the unfair trade practices.

Government recognises that prices should be determined rationally and realistically to ensure viability of producers taking into account production and distribution costs. In line with this, Government will progressively move away from price controls to price monitoring and surveillance.

3. MONETARY POLICY ISSUES

3.1 Monetary Policy Stance

The IMF expresses concern on the RBZ's accommodative and perceived expansionary monetary policy stance. The report highlights the potential negative implications of this stance on the wider macro

economy, particularly on money supply growth, exchange rate stability and economic growth.

Comment

Government is aware of the inflationary implications of rapid money supply growth implied by concessional financial facilities at the Reserve Bank. Focus is therefore on limiting resources to such windows by transforming them into once-off revolving fund facilities. This would contain the secondary effects of the current facilities on money supply growth and inflation.

3.2 Low Interest Rates

The IMF expressed concern over the prevailing negative real rates of interest on the market, as well as the large spreads between the lending and deposit rates. The report highlights the potential implications of low interest on savings mobilization as well as shifting funds towards speculative activities-which fuel asset price inflation.