June 2002
IMF Country Report No. 02/125

Zimbabwe: 2001 Article IV Consultation—Staff Report; Staff Statement; Public Information Notice on the Executive Board Discussion; Statement by the Executive Director for Zimbabwe and Statement by the Authorites of Zimbabwe

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2001 Article IV consultation with Zimbabwe, the following documents have been released and are included in this package:

- the staff report for the 2001 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on **September 15, 2001,** with the officials of Zimbabwe on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on November 29, 2001.** The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- a staff statement of **December 14, 2001** updating information on recent developments.
- a Public Information Notice (PIN) summarizing the **views of the Executive Board as expressed during its December 14, 2001 discussion** of the staff report that concluded the Article IV consultation.
- a statement by the Executive Director for Zimbabwe.
- a statement by the Authorities of Zimbabwe.

The document(s) listed below will be separately released.

Statistical Appendix

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to Publicationpolicy@imf.org.

Copies of this report are available to the public from

International Monetary Fund • Publication Services
700 19th Street, N.W. • Washington, D.C. 20431
Telephone: (202) 623-7430 • Telefax: (202) 623-7201
E-mail: publications@imf.org Internet: http://www.imf.org

Price: $15.00 a copy

International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

ZIMBABWE

Staff Report for the 2001 Article IV Consultation

Prepared by the Staff Representatives for the
2001 Consultation with Zimbabwe

Approved by José Fajgenbaum and Liam P. Ebrill

November 29, 2001

Contents Page

Executive Summary 3

I. Introduction 4

II. Recent Economic Performance 5

III. Outlook and Risks 15

IV. Policy Discussions 17

A. Fiscal and Public Sector Policies 17
B. Monetary and Exchange Rate Policies 19
C. Relations with the Fund and Other Issues 20

V. Staff Appraisal 22

Tables

1. Selected Economic Indicators, 1998-2002 25
2. Central Government Operations, 1998-2002 26
3. Monetary Survey, 1998-2002 28
4. Balance of Payments, 1998-2002 30
5. Medium Term Outlook, 2002-07 31
6. Indicators of Debt-Servicing Capacity, 1998-2002 32

Contents

Page

Figures

1. Selected Indicators 33
2. Macroeconomic Indicators, 1997-2007 34
3. Effective Exchange Rates, January 1990 to September 2001 35

Boxes

1. Financial Sector Vulnerabilities 9
2. Recent Developments in Trade and Exchange Regimes 12
3. Disincentives to Trade 13
4. Recent Developments in Land Reform 14
5. Medium-Term Outlook 16

Appendices

I. Relations with the Fund 36

II. Relations with the World Bank Group 39

III. Statistical Issues 41

IV. Selected Social and Demographic Indicators 44

Executive Summary

- The deterioration of economic activity accelerated during 2001. Inappropriate macroeconomic policies and the general breakdown in law and order have further damaged confidence, destroyed capital, and eroded institutions important for economic development. Output is projected to decline substantially in 2001, bringing the cumulative decline since 1997 in real per capita GDP to 23 percent. Expansionary macroeconomic policies in the context of declining productive capacity have been reflected in inflation accelerating toward triple-digit levels, sharply negative real interest rates, and a bubble in asset prices. The financial position of the banking system has weakened significantly.

- Poverty and unemployment are increasing. Food shortages stemming from crop destruction, adverse climatic conditions in early 2001, and the inability to import, are becoming increasingly serious. Prices of staples have risen sharply and the re-introduction of price controls on basic consumer goods in October 2001 will exacerbate shortages. One-third of the adult population is infected with the HIV/AIDS virus according to some estimates. Zimbabwe's severe economic and social problems are spilling over to other countries in the region in the form of illegal immigration, weakened investor confidence, and financial market turmoil.

- Zimbabwe's arrears to the Fund amounted to SDR 53.7 million at the end of October. Two payments totaling SDR 0.6 million have been received since late September, far short of what would be required to stabilize the stock of arrears, with another payment of SDR 0.6 million expected before the end of the year.

- Economic policy adjustments and the adoption of a transparent and orderly land reform program are needed if the process of deindustrialization, a reversion to subsistence agriculture, and collapsing trade is to be halted and reversed. Restoring macroeconomic equilibrium requires restraints on government expenditure, while shifting spending to high priority areas; measures to bolster revenue, strengthen the finances of parastatals, and accelerate privatization; an immediate tightening of monetary policies that would allow real interest rates to rise substantially to positive levels; a significant devaluation of the Zimbabwe dollar in the official market and a return to the crawling peg exchange rate policy that was suspended in October 2000; and the elimination of recently introduced price controls and other distortions.

- As key economic policy decisions are made by the political leadership, and in view of the intensified electoral campaign, significant changes are not expected before the presidential election that is to be held before April 2002.

I. Introduction

1. The 2001 Article IV consultation discussions between the Zimbabwean authorities and staff were held in Harare during September 3-15, 2001. The staff met with the Ministers of Finance and Economic Development, and Labor and Social Welfare; the Governor of the Reserve Bank of Zimbabwe (RBZ); and other senior government officials. It also met with representatives of the private sector, civil society, nongovernmental organizations, and donors.[1]

2. Zimbabwe is on the standard 12-month consultation cycle. In concluding the Article IV consultation on December 6, 2000 (EBM/00/120), Directors expressed concern about the decline in per capita incomes and the deterioration in social conditions caused by Zimbabwe's inappropriate macroeconomic policies, the rapid spread of the HIV/AIDS pandemic, poor governance, and escalating tension and uncertainty related to the government's land reform program. Directors agreed that the restoration of economic stability—a prerequisite for recovery—would hinge on the implementation of a credible adjustment program, anchored by a return to a sustainable fiscal path and the restoration of external competitiveness. Rebuilding investor confidence would require determined efforts from the government to improve the economic environment, including decisive steps to strengthen governance, ensure a speedy return to the rule of law, and implement an orderly and transparent land reform program that could garner broad domestic and international support.

3. Zimbabwe has been in continuous arrears to the Fund's General Department and to the Poverty Reduction and Growth Facility (PRGF) Trust since February 2001; its overdue obligations amounted to SDR 53.7 million at end-October. On June 8, 2001, the Executive Board considered a complaint under Rule K-1 of the Fund's Rules and Regulations (EBS/01/67; 5/4/01) and decided that Zimbabwe shall not make use of the general resources of the Fund until such time as it becomes current in its obligations to the General Department of the Fund (EBM/01/59). The Executive Board further reviewed Zimbabwe's overdue obligations to the Fund on September 24, 2001 (EBM/01/99). While acknowledging Zimbabwe's intention to make quarterly payments of US$1.5 million (SDR 1.2 million), the Executive Board noted that these payments would represent only 5-6 percent of obligations falling due during the remainder of 2001 and in 2002. In light of the lack of cooperation with the Fund on policies and payments, the Executive Board declared Zimbabwe ineligible to use the general resources of the Fund and removed it from the list of countries eligible to borrow resources from the PRGF Trust. The Executive Board will review the status of Zimbabwe's arrears to the Fund at the same time it considers this Article IV consultation report.

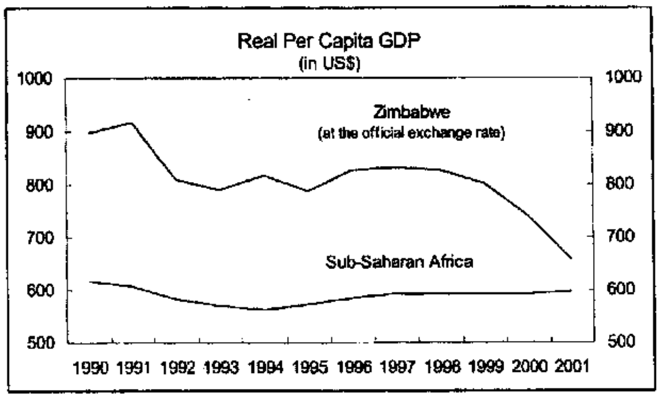
[1] The mission comprised Messrs. Coe (head), Kovanen, Erasmus, Bagattini (all AFR), and Bulir (PDR). Mr. Neuhaus (AFR, outgoing head) participated in the discussions during September 3-5. The mission was assisted by Mr. Johnson, the Fund's Senior Resident Representative in Harare. Mr. Yagci (World Bank) participated in several meetings.

4. Because of the scarcity of foreign exchange in the official market, Zimbabwe has introduced foreign exchange allocation schemes that are inconsistent with Article VIII, Section 2(a), and Article XIX, Section 7(a). Given that the scarcities which give rise to the restrictions reflect inappropriate policies, the staff does not recommend that the restrictions be approved by the Executive Board.

5. Zimbabwe's economic data suffer from deficiencies with respect to accuracy, methodology, coverage, and timeliness that hamper Fund surveillance.

II. Recent Economic Performance

6. **Zimbabwe's economic crisis continues to deepen.** The deterioration has mainly been the result of inappropriate macroeconomic policies and poor governance, including a general breakdown in law and order in the context of the government's fast-track land reform program launched in early 2000. This has undermined investor confidence, contributed to the rise in unemployment, destroyed capital, and eroded institutions important for economic development, darkening the longer-term outlook.



7. Real GDP is projected to contract 8½ percent this year, reflecting weaknesses in agriculture, mining, manufacturing, and tourism.[2] **This brings the cumulative decline in real per capita GDP since 1997 to 23 percent.** Expansionary monetary policies, reflected in highly negative real interest rates, have pushed inflation toward triple-digit levels and created an asset price bubble. Poverty is rising, and food shortages—stemming from price controls on main commodities and foods, crop destruction and farm occupations, drought and floods, and the lack of foreign exchange—are becoming serious. Zimbabwe may have to import as much as 600,000 metric tons of maize

Selected Economic Indicators

	1998	1999	2000 Est.	2001 Proj.
	(percent change)			
Real GDP (market prices)	2.9	-0.7	-5.1	-8.4
Real per capita GDP (US$)	-0.2	-3.8	-7.9	-10.4
CPI inflation (annual average)	31.5	58.2	55.7	70.1
CPI inflation (end of period)	46.6	56.9	55.2	102.5
Broad money (M3)	14.1	29.8	59.9	79.8
	(percent of GDP)			
Overall fiscal balance, excluding grants	-4.7	-10.3	-22.9	-12.6
Current account balance (excluding official transfers)	-5.3	0.5	-1.4	-1.2

Sources: Zimbabwean authorities; and staff estimates and projections.

[2] Manufacturing production declined by 6½ percent in the year to July 2001; 204 companies ceased operations in the first quarter of 2001, following the closure of 400 companies in 2000. Mining output declined by 9 percent in the year to June, and tourism arrivals fell by 23 percent over the same period.

and wheat during the 2001-02 harvest season, about one-fourth of its annual consumption. To cushion the impact of the economic decline on the poor, the government began a "food-for-work" program in 2001. And on October 18, 2001, the government launched an appeal for Z$19.8 billion (US$360 million) of humanitarian assistance.

8. **Unsustainable fiscal policy has been at the center of the deteriorating macro-economic situation.** The overall budget deficit (excluding grants) rose sharply to 23 percent of GDP in 2000, mainly on account of large, unbudgeted increases in civil service wages in the run-up to parliamentary elections in June 2000; a sharp increase in military spending, reflecting Zimbabwe's involvement in the Democratic Republic of Congo (DRC) conflict; and a significant rise in government interest payments following a rapid increase in domestic borrowing. Health and education spending, however, declined at a time when the HIV/AIDS pandemic was erasing some of the gains in health and education achieved during the last 20 years: according to some estimates, one-third of the adult population is infected by the HIV/AIDS virus, one of the highest in the world, and this has contributed to a sharp decline in life expectancy from 58 years in 1985 to 40 years in 1999.

Central Government Operations
(in percent of GDP)

	1998	1999	2000	2001 Proj.
Total revenues	30.5	27.8	27.9	23.5
Of which: tax revenue	28.2	26.4	26.2	22.1
Total expenditure and net lending	35.2	38.1	50.8	36.1
Of which				
Wages and salaries	12.3	13.4	15.6	13.5
Interest payments	9.6	10.3	17.5	11.0
Budget balance (excluding grants and arrears) 1/	-4.7	-10.3	-22.9	-12.6
Of which: primary balance	4.9	0.0	-5.4	-1.6
Budget balance (including grants and arrears) 1/	-3.0	-9.2	-21.1	-10.3
Memorandum item:				
Domestic financing	5.5	10.3	17.3	10.5

Sources: Zimbabwean authorities; and staff estimates and projections.
1/ Commitments with respect to foreign interest payments.

9. **The government's budget for 2001 represented an encouraging step to bring the fiscal position back to a sustainable path.** Recurrent expenditure was to be reduced, with particular emphasis on containing the increase in civil service wages and lowering military spending, the latter premised on an early withdrawal from the DRC. In September 2001, parliament approved a supplementary budget that added expenditures of Z$17½ billion,[3] equivalent to 3½ percent of GDP, including increases in civil service salaries and higher spending on defense, land reform, drought relief, and medicines. The staff projects that despite a weaker-than-budgeted revenue performance, the overall deficit will be about 12½ percent of GDP in 2001, below the target of 15½ percent of GDP in the initial budget. **However, this reduction would be achieved mainly through a sharp decline equivalent to 8¾ percent of GDP in domestic interest payments** stemming from a forced restructuring of government debt and inappropriately lax monetary policies. The staff projects a primary deficit of 1⅔ percent of GDP, compared with the budgeted primary surplus of 4⅓ percent of GDP.

[3] Of which Z$4 billion will be financed from foreign grants already received.

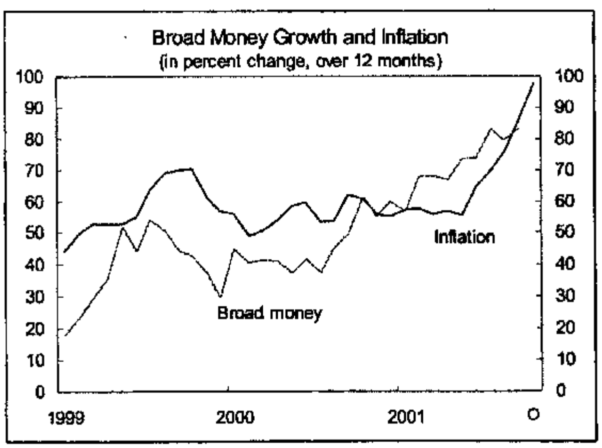
10. **The finances of public sector enterprises remain precarious.** Parastatals have been operating at a loss and have accumulated arrears on their large, government-guaranteed domestic and foreign debt, including arrears to suppliers and to the social security and pension funds. The finances of municipalities are also under pressure, owing to the devolution of functions in the areas of education and health from the central government, as well as limits to their ability to raise revenue and borrow, which are subject to government approval.

Financial Position of the Major Parastatals
(in percent of GDP, unless otherwise indicated)

	1999	2000	2001 Jan-Jun
Profit and loss (including financial charges, loss -)	-3.4	-5.8	-0.1
Total debt stock	24.6	23.8	14.1
Of which (as percent of total debt stock)			
Direct foreign loans	46.2	46.9	47.4
Government or government-guaranteed loans	86.3	83.4	83.1
Short-term loans	...	37.8	36.6
Memorandum items:			
Total debt stock (valued at parallel market rate)	24.6	27.3	28.4
Change in domestic arrears	...	...	0.4
Change in foreign arrears	...	3.4	2.6

Source: Zimbabwean authorities; and staff calculations.

11. **Monetary policy was relaxed during the second half of 2000 as the government's domestic borrowing requirement rose rapidly.** The RBZ capped the bank rate at 2½ percentage points above the 12-month rate of increase in the consumer price index, and capped treasury bill yields at 1 percentage point below the bank rate. In addition, the RBZ allowed banks to on-lend half of their statutory reserves to exporters at a subsidized rate.[4] Consequently, broad money growth accelerated from 30 percent in 1999 to 60 percent in 2000.



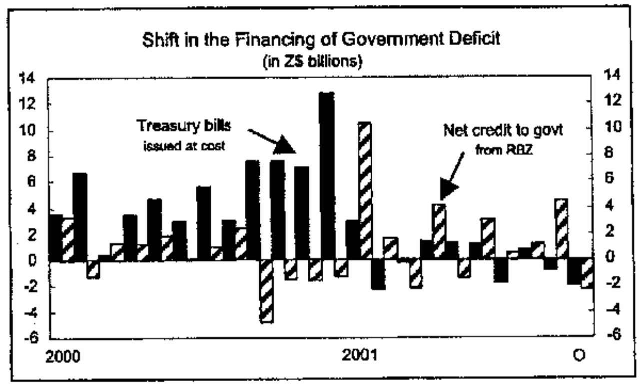
Contributions to Broad Money Growth
(in percent of broad money, lagged 12 months)

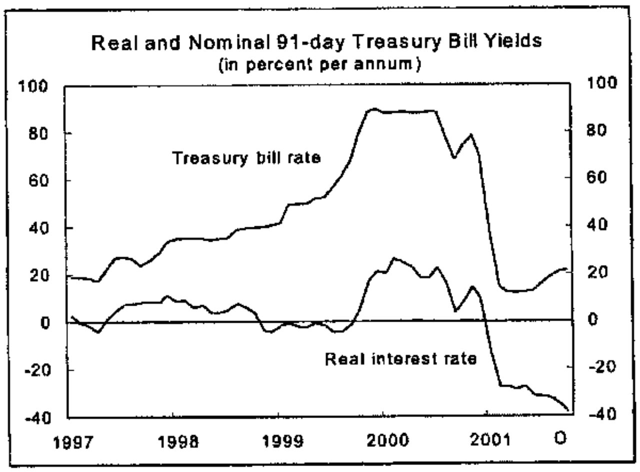
	1999 Dec	2000 Mar	2000 Jun	2000 Sep	2000 Dec	2001 Mar	2001 Jun	2001 Sep
Net foreign assets	21.4	10.2	6.0	2.1	2.4	6.3	5.8	4.7
Net domestic assets	8.4	31.1	35.9	47.8	57.5	62.0	68.2	79.1
Domestic credit	23.1	36.6	51.2	66.9	74.8	86.8	95.2	87.3
Of which								
Claims on government (net)	10.5	20.2	27.7	29.6	35.5	53.2	54.6	49.3
Claims on private sector	10.5	13.4	22.1	31.6	33.2	26.8	30.0	32.9
Broad money	29.8	41.3	41.9	49.9	59.9	68.3	73.9	83.5

Sources: Zimbabwean authorities.

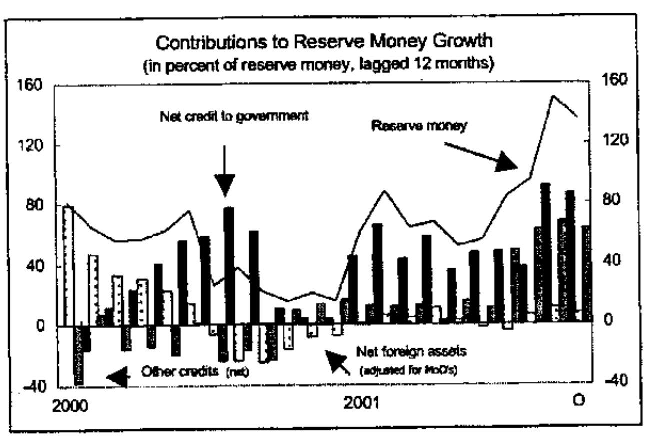
[4] In August 2000, the RBZ released through this scheme the equivalent of about 30 percent of reserve money at an interest rate of 30 percent, compared with the bank rate of 56 percent and year-on-year inflation of 54 percent.

12. In January 2001, **the government unilaterally restructured its domestic debt** by limiting the issuance of short-term treasury bills (the bulk of current domestic debt is in 91-day bills), while offering maturities up to five years at low yields. **The sharp increase in liquidity as short-term treasury bills were (involuntarily) redeemed, together with heavy government borrowing from the RBZ, caused interest rates to collapse from 65 percent at end-2000 to 14 percent in January 2001.** As inflation accelerated after mid-2001, and government borrowing from the RBZ approached the statutory limit of 20 percent of the previous year's revenue, yields on treasury bills rose somewhat, although remaining sharply negative in real terms. The government has started to enforce a requirement that 45 percent of institutional investors' portfolios be held in longer-term government paper. This, together with the collapse of interest rates, has weakened the financial positions of insurance companies, pension funds, and banks, which have seen a decline in profitability measured in terms of returns on assets and on equity.





13. **Monetary policy became highly expansionary in 2001 as the RBZ passively accommodated the surge in liquidity resulting from the forced restructuring of government domestic debt and heavy government borrowing.** The RBZ also released the remaining pool of banks' statutory reserves for on-lending at concessional rates of 30 percent to the "productive sectors" and 15 percent to exporters, exerted moral suasion on banks to narrow the spread between deposit and lending rates, and increased liquidity support to banks. As a result, reserve money growth increased sharply to 150 percent in the year to



September 2001 compared with 22 percent in the same period in 2000. Asset substitution away from money market instruments has created bubbles in equity and residential real estate prices. The deteriorating economic environment has increased financial sector vulnerability (Box 1).

14. In an attempt to contain inflation, particularly the prices of key staples, **the government introduced direct controls on prices in 2001**. The Grain Marketing Board was reestablished as a monopoly in June to control the pricing and distribution of maize and wheat. Since October 10, the wholesale and retail prices of basic commodities and foods have been administered, resulting in immediate shortages of these commodities. Moreover, private sector minimum wages were increased, in some cases by more than 100 percent, in October.

Box 1. Financial Sector Vulnerabilities

The worsening economic situation has put strains on the banking system. Some banks have weakened considerably and further deterioration is likely. **Reported high capital adequacy ratios overstate banks' capital** because of widespread underprovisioning for bad loans. The overall capital loss to the banking system arising from additional provisioning would amount to about one-fifth of total capital.

Credit, liquidity, and interest rate risks are substantial for a number of banks; these risks could be compounded by direct or indirect exposure to equity and real estate price corrections. **Credit risk** has been magnified by a decline in the quality of borrowers. The reported ratio of nonperforming loans to total loans at commercial banks increased from 14 percent at end-1999 to 19 percent at end-September 2001. However, these figures may understate the problem, as a number of banks could become insolvent if they provisioned for nonperforming loans according to regulatory requirements. The asset quality of merchant banks is particularly worrisome. Some banks have experienced **liquidity problems**, as indicated by frequent overnight borrowing from the RBZ, while other banks have received substantial liquidity support for extended periods. Liquid asset ratios overstate the actual positions since these include treasury bills that have been pledged to attract deposits, as well as treasury bills held at the RBZ. The current policy of highly negative real interest rates has exposed banks to **interest rate risks** owing to maturity mismatches. A substantial rise in nominal interest rates by, for example, 40 percentage points or more could result in negative capital for a number of banks

The new Bank Act has strengthened the RBZ's regulatory role as well as its ability to supervise banks and deal with problem institutions. However, the authority to license and delicense remains with the Registrar of Banking Institutions in the Ministry of Finance and Economic Development (MFED) and banking regulations have to be approved by the MFED. **This poses problems for an effective licensing and supervision of the banking sector**; a preliminary assessment of the Basel Core Principles for Effective Banking Supervision indicates that Zimbabwe does not comply with several, primarily owing to the continued separation of the licensing and supervision functions and the lack of central bank autonomy. Furthermore, due to the understaffing and inexperience of the Banking Supervision Department (BSD) in the RBZ, on-site examinations and follow-up are not being conducted in a timely manner. While minimum capital requirements were doubled in 1999, they are not adjusted regularly, and thus their real value has eroded owing to high inflation.

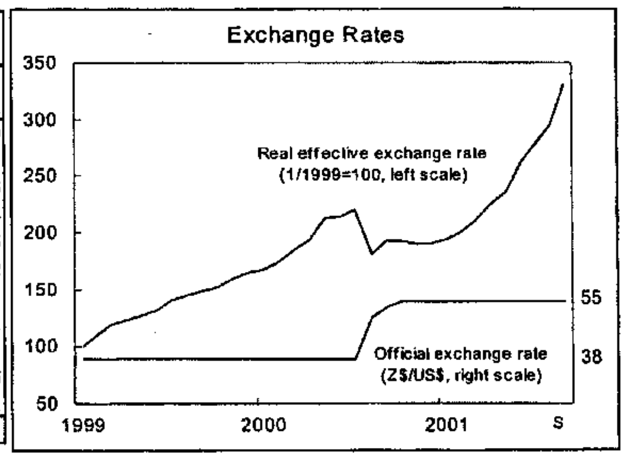
While the BSD is taking steps to deal with **problem institutions,** these have not been timely, and follow-up and enforcement of remedial measures have been ineffective. On-site examinations are not in compliance with existing policy, including the frequency with which known or suspected banking problems are examined. Liquidity support to some problem banks has violated the RBZ's policy to provide liquidity only on a temporary and fully secured basis.

15. **With the exchange rate fixed in an environment of high inflation, the Zimbabwe dollar has appreciated sharply in real effective terms in the official market.** The weakening of external competitiveness, terms of trade losses, and the absence of foreign financing caused the overall current account balance to shift from a small surplus in 1999 to a deficit of 1½ percent of GDP in 2000. Reflecting the severe shortage of foreign exchange and the exhaustion of usable reserves, Zimbabwe started to accumulate external payments arrears in 1999. The authorities estimate that external arrears at the end of October 2001 totaled US$722 million, including to the World Bank of US$81 million and to the African Development Bank of US$102 million. The continued shortage of foreign exchange—usable reserves are currently equivalent to only about four days of imports of goods and nonfactor services—and limited access to foreign financing have also led to widespread import scarcities that are crippling economic activity.[5]

Balance of Payments
(in millions of US$)

	1998	1999	2000	2001 Proj.
Current account (excluding official transfers)	-355	27	-102	-119
Of which				
Exports, fob	1,925	1,924	1,791	1,715
Imports, fob	-2,020	-1,675	-1,520	-1,454
Overall balance	-157	17	-185	-515
Official reserves (- increase)	64	8	25	2
Memorandum items:				
Arrears (end of period stock)	0	109	471	1,161
Of which				
Trade credit arrears	0	0	60	155
Central government arrears	0	5	154	461

Sources: Zimbabwean authorities; and staff estimates and projections.

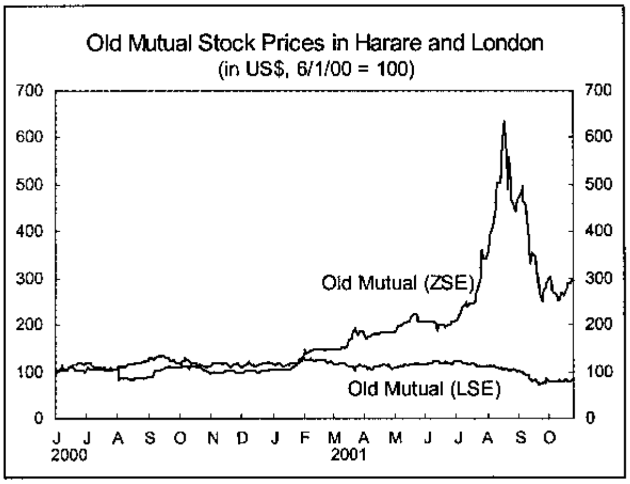


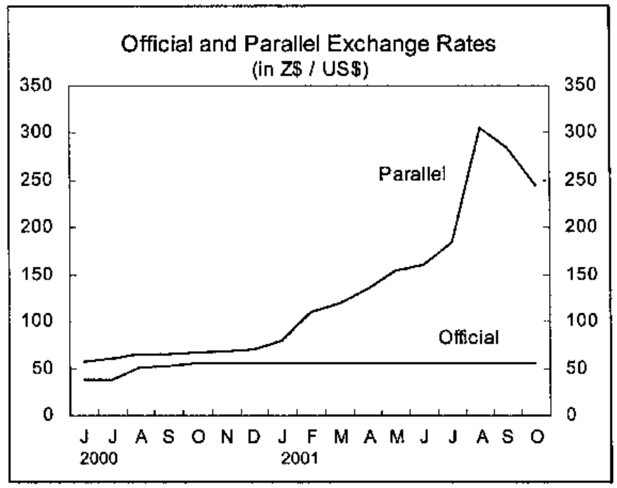
16. In the beginning of August 2000, **the RBZ announced a 24 percent devaluation of the Zimbabwe dollar to Z$50 per US$1 and introduced a crawling peg** with periodic adjustments based on inflation differentials with Zimbabwe's trading partners. The exchange rate was subsequently adjusted to US$55 per US$1, but in mid-October the RBZ effectively returned to a fixed exchange rate regime. Owing to high and rising inflation and the generalized loss of confidence, the Zimbabwe dollar has depreciated sharply in the parallel market, recently reaching a level roughly six times the official rate.[6] Recent developments in

[5] Recently, Zimbabwe reached an agreement to procure fuels from Libya, which will provide a one-year revolving credit facility of US$90 million per quarter.

[6] There are no official data on the parallel exchange rate. However, the price differential of Old Mutual, which is the only stock that is traded both on the Zimbabwe Stock Exchange and the London Stock Exchange, provides an indication of the spread between the official and parallel market exchange rates, and has moved in line with parallel market quotations.

Zimbabwe's trade and exchange rate regimes are discussed in Box 2, and disincentives to trade, including the export surrender requirement at the official rate, are discussed in Box 3.





17. Developments in Zimbabwe are having adverse impacts on neighboring countries, and Zimbabwe's relations with the international community have become strained.[7] Neighboring countries fear that a continuation or worsening of the economic situation could increase illegal immigration, especially as these countries, with the exception of South Africa, are also facing severe grain shortages. Moreover, the Southern African Development Community (SADC), the Commonwealth, the European Union, and the United States have launched initiatives or proposed legislation to put pressure on the Zimbabwean government to restore the rule of law, while suspending all official development assistance except for humanitarian causes. Although the Zimbabwean government agreed to potentially important changes in its approach to land reform following the meeting of Commonwealth Foreign Ministers in Abuja and the SADC summit in Harare, it has also taken steps to accelerate the implementation of its current fast-track land reform program (Box 4).

[7] For example, developments in Zimbabwe have contributed to the recent depreciation in the South African rand.

Box 2. Recent Developments in Trade and Exchange Regimes

Zimbabwe's trade regime continues to be restrictive, with a rating of 8 on the Fund staff restrictiveness scale ranging from zero to 10, with 10 being the most restrictive. The number of tariff lines and maximum tariff rates were reduced in September 2000, but 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 materials and capital goods, mostly machinery. Zimbabwe maintains a few nontariff barriers to protect agriculture and mining.

Zimbabwe participates in a number of regional arrangements, including the Southern African Development Community (SADC), the Common Market for Eastern and Southern Africa (COMESA), and the Regional Integration Facilitation Forum (RIFF). In June 2001, Zimbabwe passed legislation to fulfill its commitments under the SADC Trade Protocol that facilitates preferential access to SADC markets. Bilateral agreements are maintained with Botswana, Malawi, Namibia, and South Africa. The recent increase in tariffs are inconsistent with Zimbabwe's commitments to trade liberalization in the context of regional initiatives.

The authorities introduced several ad hoc exchange measures in 2000-01 aimed at mitigating the loss of competitiveness and curbing parallel market activity. With the objective of earmarking scarce foreign exchange for imports of fuel and electricity and government debt-service payments, the RBZ has modified the **export surrender requirements.** In May 2000, it earmarked one-half of tobacco export proceeds for key imports and public sector debt-service payments, while 20 percent of the proceeds are surrendered and credited to the tobacco growers' pooled foreign currency account to finance the sector's imports; the remainder will be sold to authorized foreign exchange dealers. In June 2001, the RBZ increased the surrender requirement for all other exports from 25 percent to 40 percent.

In an attempt to shore up the depressed gold sector and avoid further mine closings, the RBZ in August 2000 allowed gold producers to hold foreign currency accounts; and, in April 2001, it reintroduced a minimum price (in Zimbabwe dollars) for gold that is well above the world market price when valued at the official exchange rate. This subsidy is expected to cost the RBZ at least 0.5 percent of GDP a year. In July 2001, the RBZ halved the allowances for travel to US$2,500 a person a year. The government is also trying to curb parallel foreign exchange market activity, as discussed in Box 3.

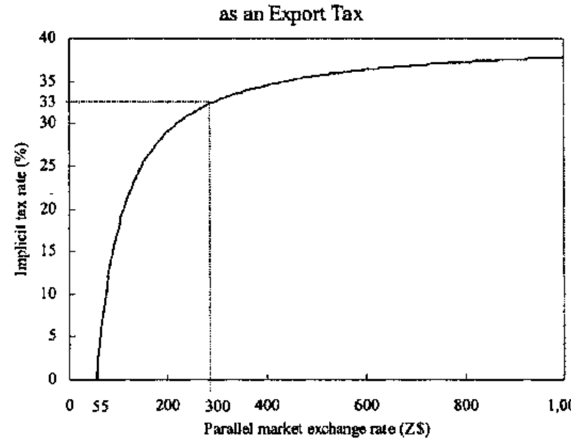
18. **A presidential election is to be held before April 2002.** President Mugabe is expected to stand for reelection as the candidate of the ruling ZANU-PF (Zimbabwe African National Union-Patriotic Front) party, whose campaign is partially based on the fast-track land reform program. Morgan Tsvangirai, a former labor leader and the head of the opposition party, the Movement for Democratic Change (MDC), is expected to be a candidate following the MDC's strong showing in the June 2000 parliamentary elections, particularly among urban voters. As the campaign intensifies, hopes for corrective actions in economic policies are vanishing rapidly.

Box 3. Disincentives to Trade

Zimbabwe's recorded international trade has contracted by about 30 percent since 1996-97. During 2001, the authorities introduced several measures aimed at boosting exports and the collection of foreign exchange, while limiting the growth of the parallel market, where the bulk of foreign exchange is traded. Most of these measures are ad hoc, could give rise to large quasi-fiscal losses, and discourage trade through formal channels.

The main disincentive for exports is the unrealistic official exchange rate, pegged at Z$55 to US$1, while the parallel market rate has been as high as Z$350 to US$1 in 2001. The across-the-board (except for tobacco) export surrender requirement of 40 percent effectively penalizes exporters who comply by repatriating their receipts through the official market.[1/] Given the wide spread between the official and the parallel market exchange rates, the 40 percent surrender requirement is an effective tax on exporters: at a parallel market rate of Z$300 per US$1, for example, the effective tax rate is about 33 percent.

The 40 Percent Surrender Requirement as an Export Tax



The RBZ administers three schemes aimed at minimizing the impact of the economic crisis and reducing fuel and foreign exchange shortages for exporters: an incremental export incentive scheme, a subsidized credit scheme, and a price floor for gold producers. Under the first, for each incremental U.S. dollar of exports, the exporter receives a certificate for import duty exemption equivalent to 10 cents, converted into Zimbabwe dollars at the year-end exchange rate. Very small amounts have been disbursed under this scheme, primarily because few sectors have recorded any year-on-year export value increases. Under the subsidized credit scheme, the RBZ has released required reserves at commercial banks and on-lent those resources to export-oriented sectors. While this scheme has provided low-cost domestic working capital to exporters, it has also lessened their motivation to repatriate export proceeds. Moreover, this scheme has added liquidity to the financial system and helped to fuel the asset price bubble as these resources have in part been used to buy shares on the local bourse or real estate. Finally, the price floor for gold producers, established as a multiple of the world price (at the official exchange rate), is aimed at limiting further closures in the hard-hit mining sector; however, the overvalued official exchange rate and the RBZ monopsony have rendered most producers unprofitable.

The authorities have also introduced measures to rein in the parallel market in foreign exchange. These include increased capital requirements, a tenfold increase in licensing and renewal fees for foreign exchange bureaus, more stringent reporting requirements, limits on the foreign exchange positions of banks and foreign exchange bureaus, and enhanced supervision by the RBZ.

[1/] The collapse of interest rates in early 2001 is discouraging repatriation as firms may choose to borrow from local banks to finance their domestic operations (e.g., the payment of wages) instead of selling foreign exchange for local currency.

Box 4. Recent Developments in Land Reform[1/]

In December 2000, **the Supreme Court ruled that the fast-track land reform program violated the constitutional rights of commercial farmers and issued an interdict against further land acquisitions.** The interdict gave the government six months to formulate a lawful land reform program, restore law and order, and remove illegal occupants from the farms; none of these conditions have been met. Instead, the government has continued implementing its fast-track program. In July 2001, the government increased the amount of land to be resettled from 5 million hectares to 8.3 million hectares, almost 70 percent of the land used by the large-scale commercial farming sector.

In December 2000, **the UNDP proposed a two-stage approach to land reform based on the principles agreed at the 1998 Land Conference**. The first stage was aimed at rebuilding confidence by establishing a common reporting system and data base regarding law-and-order issues, establishing a revolving fund to finance land acquisition, and reestablishing the UNDP technical unit to assist with capacity building and planning. The second stage, involving the resettlement of farmers, would be implemented consistent with the capacity to support resettled farmers and subject to a framework consisting of six key principles, including compensation to farmers, support for displaced workers, and respect for the rule of law. The UNDP proposed beginning with an initial tranche of 1 million hectares. The government's response was noncommittal, and the initiative was not implemented.

Following continued invasions of farmland and escalation of tensions, **the Commercial Farmers' Union (CFU), in conjunction with the private business community, launched the Zimbabwe Joint Resettlement Initiative in May 2001**. The initiative was premised on the provision of 1 million hectares of land, which were handed over to the government in November, and financial and logistical support for the new farmers. While the government formally accepted the initiative, it has made no progress toward implementation.

Two regional meetings on land reform have been held recently: **the Committee of Commonwealth Foreign Ministers on Zimbabwe** met in Abuja on September 6 and **the Summit of the Southern African Development Community Task Force on Zimbabwe** met in Harare on September 10-11. At the Abuja meeting, Zimbabwe agreed to restore the rule of law to the process of land reform, including by halting further occupation of farm lands, delisting farms that do not meet specified criteria, and removing people from farms that are not designated for acquisition. Zimbabwe also agreed to engage the UNDP in pursuing an effective and sustainable land reform program on the basis of the UNDP proposals of December 2000. The United Kingdom reaffirmed its commitment to a significant financial contribution to such a land reform program and undertook to encourage other international donors to do the same. The SADC summit welcomed Zimbabwe's commitment at Abuja to undertake land reform in accordance with the country's laws and emphasized the need to reach an agreement with the UNDP. However, despite reports that the security services have been instructed to enforce the law, as yet there is little evidence that the situation has changed: there have been more farm invasions and occupations, and violence has continued.

Disregarding international concerns, the government accelerated the fast-track land reform program in early November with a presidential decree amending the Land Acquisition Act to allow the government to assume immediate ownership of land targeted for acquisition. The government subsequently ordered the immediate suspension of all work on targeted farms and instructed current owners to vacate farms within three months.

[1/] The background to land reform in Zimbabwe and the launching of the fast track land reform program were discussed in the staff report for the 2000 Article IV Consultation (SM/00/254).

III. Outlook and Risks

19. A return to a path of sustainable economic growth over the medium term will be critical to permit the authorities to address pressing social needs, including the spread of HIV/AIDS. **Progress in stabilizing the economy, however, hinges not only on the implementation of prudent macroeconomic policies, but also on the quick easing of political tensions, a return of law and order, resolution of governance issues, and normalization of relations with foreign creditors.**

Staff Projections				
	2001	2002	2003	2004-07 average
	(percent change)			
Real GDP (market prices)	-8.4	-5.6	3.2	5.2
CPI inflation (annual average)	70	108	54	14
CPI inflation (end of period)	103	86	38	...
Broad money (M3)	87	67	35	17
	(percent of GDP, unless otherwise)			
Overall fiscal balance, excluding grants	-12.6	-12.9	-11.9	-4.3
Total public debt (end of period)	91.6	78.0	86.9	76.3
Of which: domestic debt	52.5	37.6	34.3	22.7
(in billions of Zimbabwe dollars)	256	366	533	714
Current account balance, excluding official transfers	-1.3	-1.0	-4.9	-7.3

20. **While there is some uncertainty about the direction of policies ahead of the 2002 presidential election,** it is likely that economic policies will continue to be guided mainly by political considerations, and hence policy adjustments in line with the staff's recommendations (see below) are unlikely before the election. Based on the assumption that the implementation of appropriate policies starts in mid-2002 (Box 5), economic activity is assumed to begin to turn around during the second half of 2002, but to contract a further 5½ percent for the year 2002 as a whole, and to expand in 2003 as policy changes begin to take effect, supply constraints are addressed, and confidence improves. Only modest progress is made to lower inflation in 2002, but a more significant reduction is achieved in 2003. The fiscal position would remain precarious in 2002-03 given the delay in policy adjustments and the weak economy.

21. **Over the medium term, and assuming sustained implementation of appropriate policies, output growth is assumed to gradually rise to about 5 percent**—comparable to rates of growth in the late 1980s and the early 1990s—as business investment recovers, and inflation declines to single digits. While the primary fiscal surplus may average about 3 percent of GDP during 2004-07, the overall fiscal balance is expected to remain in deficit, as higher spending on land reform, social services, and capital projects are assumed to be financed mainly by foreign grants and concessional loans. This shift to foreign financing helps to reduce substantially the government's domestic debt over the medium term. The current account deficit (excluding official transfers) could widen to about 7 percent of GDP in 2004, reflecting the recovery of imports. Because of the limited reserve coverage for short-term debt and the assumed partial payment of external arrears in 2003, the external position is expected to remain vulnerable until 2004. As usable foreign exchange reserves are rebuilt, the cover for imports of goods and services increases to about 4 months by 2007. The debt-service ratio also declines from an estimated 27 percent in 2001 to less than 20 percent in 2007.

Box 5. Medium-Term Outlook

The baseline scenario presented in Tables 1-6 assumes that economic and governance problems are effectively addressed following the 2002 presidential election. An orderly and funded land reform program is adopted in cooperation with the UNDP and the World Bank, the rule of law is restored, relations with donors are improved, and an appropriate economic program, including the elimination of price controls and other distortions, is adopted.

The government is assumed to launch an economic adjustment package in mid-2002, perhaps in the context of a staff- or Fund-monitored arrangement. After a period of satisfactory performance, this could result in the clearance of arrears to the Fund, the World Bank, and the African Development Bank; new bilateral financing; and a possible rescheduling under the Paris Club in early 2003. With stronger economic policies, a positive "confidence shock," and resumption of external assistance, supply bottlenecks begin to ease and the recession bottoms out during the second half of 2002. Over the medium term, improvements in the composition of public spending, troop withdrawal from the DRC, and new concessional foreign financing permit increases in spending on priority social areas and in government investment, thereby easing social tensions and more effectively addressing the HIV/AIDS pandemic. As these improvements take hold, private domestic and foreign investment begins to recover and external viability is gradually restored.

An alternative, crisis scenario would be based on status quo policies that are unable to stem the economic decline or avert serious food shortages, thereby stoking political and social unrest. Tensions escalate and economic problems could spill over to other SADC members, especially South Africa, which increasingly seek to distance themselves from Zimbabwe.

Driven by dwindling confidence and bad economic policies, including a widespread use of administrative price and exchange controls, the output contraction gathers pace while underlying inflation accelerates. The extent of the economic decline—including the reversion to subsistence agriculture, deindustrialization, and collapsing trade—is difficult to predict, but could be substantial and sustained. While official prices are kept in check through the imposition of price controls, prices on the informal market rise rapidly, reflecting shortages and rent-seeking behavior. In this adverse economic situation, property rights are increasingly breached, which impairs the portfolios of banks and institutional investors and increases the risk of a banking crisis, with potentially large fiscal costs. The parallel market for foreign exchange mitigates the economic decline and fosters currency substitution, possibly culminating in dollarization of the economy. External arrears continue to accumulate. Against the backdrop of a shrinking economy and a weak fiscal position, hard-won social gains achieved during the first two decades of independence are reversed, while an unchecked HIV/AIDS pandemic imposes a heavy burden on longer-term growth prospects.

22. **There are considerable downside risks surrounding the staff's baseline scenario**:

- The deteriorating economic environment has increased vulnerabilities in the financial sector (see Box 1). A significant rise in interest rates such as assumed in the baseline scenario will result in solvency problems for a number of banks, with potentially large adverse effects on the government budget and real economy.
- Although policy adjustments are likely following the presidential elections, the deteriorating political situation and an environment of collapsing output, pervasive unemployment, triple-digit inflation, widespread food shortages, and deepening

poverty could be conducive to social unrest prior to the elections, which could become violent as has happened in the past in Zimbabwe. If this were to happen, it is likely that the decline in output would be even more severe, and a recovery would be delayed.

- If the post-election policy adjustments do not comprehensively address the key macroeconomic, structural, and governance problems, they will not be successful, and the economic situation would deteriorate relative to the staff's medium-term outlook. With no policy adjustments, the economic crisis would deepen and the trend toward a reversion to subsistence agriculture, deindustrialization, and collapsing trade would accelerate (see Box 5).

On the other hand, there is also upside potential if a new government moved rapidly to implement comprehensive and credible policies, and if this resulted in a rapid restoration of domestic and international confidence in Zimbabwe.

IV. Policy Discussions

23. The authorities' strategy to overcome the difficult economic situation, as articulated by the Minister of Finance, is to focus on policies that would help restore public confidence, normalize relations with the international community, reduce the fiscal deficit, and stimulate production. **A considerable strengthening of policies is clearly needed to achieve these objectives**. It will also be important for Zimbabwe to follow through on the commitments made in Abuja to lay a foundation for an orderly land reform program that can be supported by the international community.

A. Fiscal and Public Sector Policies

24. **Although the fiscal deficit is expected to decline from 23 percent of GDP in 2000 to 12½ percent in 2001, the government has not been able to meet its budget target for the primary surplus in 2001,** as savings have come mainly from the lower interest outlays on domestic public debt. This, and the associated rise in inflation, has resulted in a sharply negative real cost of servicing domestic debt, as reflected in the rapid improvement in the operational balance (Table 2). Thus the reduction in the deficit essentially reflects financial repression and inflationary financing. In response, the authorities noted that monthly cash ceilings had helped to contain spending, while certain outlays had been postponed owing to the shortage of foreign exchange. They also noted that the supplementary budget for 2001 was fully financed out of savings from domestic interest outlays and foreign grants.

25. Given the precarious economic situation and the erosion of the revenue base, the mission underscored that the authorities needed to continue exercising expenditure restraint. **For 2002, the mission recommended that the budget should target a primary surplus of**

at least 2½ percent of GDP, which would be feasible if appropriate macroeconomic policies were promptly implemented.[8] Achieving the recommended primary surplus target will require improving revenue collection; restraining noninterest expenditures well below the rate of inflation, which means resisting pressures for large increases in civil service wages; and continued restructuring of the public sector. A withdrawal of troops from the DRC could provide substantial savings in current expenditure and allow a reallocation of resources to priority areas such as health care and education. The authorities indicated that they were aiming for a primary surplus in 2002, although they did not commit to the proposed target of 2½ percent of GDP.

26. **On November 1, 2001, the Minister of Finance outlined the 2002 budget to Parliament**. The budget proposes an overall deficit of 15 percent of GDP, compared with the expected outcome for this year of 12½ percent and the 8 percent of GDP target set last year in the context of the "three-year rolling budget framework." The primary balance is projected to be in deficit equivalent to 1 percent of GDP. Expenditures for defense and land reform rise significantly in real terms, in contrast to roughly unchanged real spending for education, health, and other social services. Total government expenditure increases to 42 percent of GDP, compared with 36 percent projected for 2001. The budget also assumes an increase in total revenue of 3-4 percent of GDP, although there are no measures to increase tax collections, which are already under pressure. Consequently, domestic borrowing is expected to remain substantial, and this will be only partially offset by privatization proceeds.[9]

27. **Progress has been made to restructure the public sector** through the rationalization of ministries and subcontracting or commercializing certain services.[10] More than 6,300 staff positions have already been eliminated, with an additional 6,800 positions targeted for elimination this year and another 8,350 in 2002. The government projects that the restructuring could save Z$3 billion this year and an additional Z$1 billion in 2002, although some of these savings reflect a reallocation of resources from the budget to off-budget entities. The mission encouraged the government to continue its efforts to cut costs and increase the efficiency of government operations.

---

[8] The 2½ percent primary surplus target for 2002 is not met in the staff's baseline projections because the adjustment of interest and exchange rates is assumed to be delayed until mid-2002.

[9] The staff's baseline projections implicitly assume that a supplementary budget will be adopted in mid-2002.

[10] The Zimbabwe National Water Authority, the Zimbabwe Revenue Authority, and the government's medical stores have been commercialized and some food services at schools and universities have been subcontracted out. In addition, a full cost recovery system has been introduced for a number of public services.

28. **The mission emphasized that the Zimbabwe Revenue Authority, established on September 1, 2001, needed to become fully operational as soon as possible in order to bolster revenue.** The authorities noted that revenue collections had been hampered by organizational issues and a lack of foreign exchange to upgrade computer and software systems. Although the introduction of a value-added tax (VAT) is planned in 2002, the supporting legislation has not yet been passed. Nevertheless, the authorities thought that the VAT could become operational quickly, reflecting technical assistance from South Africa and Zambia and a public awareness campaign. The staff emphasized that a successful launch of a VAT would be important to boost revenue and further broaden the tax base.

29. **As part of its privatization strategy, the government has sold shares worth Z$9 billion this year**, mainly from holdings in listed companies. The privatization of the cellular phone operator, NetOne, from which receipts of Z$12 billion were included in the 2001 budget, has been postponed until early 2002, reflecting delays in the due diligence process.[11] The authorities are also developing, with assistance from the World Bank, plans to regulate the privatized sectors, including utilities, telecommunications, and the National Railways of Zimbabwe. The mission urged the authorities to accelerate the privatization process, but noted that foreign participation is discouraged by the deteriorating political and economic situation, and by the exchange policy, which makes valuations extremely high in U.S. dollars at the official exchange rate. To strengthen the finances of the parastatals and facilitate privatization, the mission also emphasized the importance of implementing regular formula-based price adjustment in key tariffs, and of developing a strategy to deal with the government-guaranteed debt of the parastatals.

B. Monetary and Exchange Rate Policies

30. **Monetary policy has passively accommodated the rapid surge in liquidity associated with the forced lengthening of domestic debt maturities and increased government borrowing from the RBZ. The consequent acceleration of inflation has had devastating effects on the poor, pensioners, and others on fixed incomes.** While acknowledging the adverse effects of government policies on inflation, the authorities argued that an expansive monetary policy was needed to stimulate productive activity. **The mission noted that there was no evidence to suggest that the government's strategy was successful,** given that business fixed investments and construction have essentially ceased. Instead, sharply negative real interest rates have encouraged individuals to borrow or switch from fixed-interest financial instruments to alternative assets such as foreign currency, shares, and real estate, causing a sharp rise in these asset prices. Negative real interest rates have also encouraged people to buy now rather than wait, further contributing to the acceleration of inflation. **The staff urged the authorities to tighten monetary policy immediately by mopping up excess liquidity through open market operations and by**

[11] The sale of NetOne is expected to result in more than US$100 million direct investment in 2002.

dismantling subsidized credit facilities, thereby allowing interest rates to move to positive levels in real terms. It also urged the authorities to refrain from moral suasion aimed at capping the spread between bank deposit and lending interest rates.

31. The mission noted that **the sharply negative real interest rates were also undermining the health of the financial system**. In particular, institutional investors who are required to hold a substantial portion of their portfolios in government paper have seen their returns decline sharply. The mission emphasized that the RBZ needs to take steps to ensure the soundness of the banking system, and that the supervisory authorities have to fully enforce compliance with prudential regulations and capital adequacy requirements, particularly in view of risks related to the deteriorating economy and consequent weakening in the quality of banks' assets. Guidelines to deal with troubled banks were introduced earlier this year, and the staff underscored the importance of dealing promptly with nonviable institutions. The authorities noted the usefulness of the July 2001 MAE mission that advised on the modalities of establishing a deposit insurance scheme, and the preconditions that would have to be achieved before going ahead. Despite increasing banking sector vulnerabilities, the authorities are still considering the implementation of such a scheme.

32. **The mission urged the authorities to devalue the official exchange rate to a more realistic level, supported by the tighter monetary and fiscal policies described above, and to adjust the exchange rate thereafter on the basis of expected inflation differentials with Zimbabwe's trading partners.** The large gap between the official and the parallel market exchange rates gives rise to opportunities for corruption to anyone with access to foreign exchange at the official rate; the mission noted that experience in other countries suggests that these opportunities will be exploited. **The mission stressed that the ultimate objective should be the establishment of a unified, floating exchange rate. If political or other considerations preclude such a move in the short term, the authorities should, in the meantime, tolerate the parallel market**, which already handles the bulk of transactions, as it 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. The authorities stated that the crawling peg regime introduced in August 2000 continued to be the official policy; at the same time, they acknowledged the adverse consequences arising from the wide spread between the official and the parallel market exchange rates. They observed that although the Minister of Finance and the RBZ had advocated a step devaluation, there was no political support for this or for a move to a floating exchange rate in the present situation. To boost competitiveness, the government has instead introduced several special schemes for gold and tobacco producers, and for other key export sectors (see Box 2). The government has also taken steps to curb activity in the parallel market, although it is not clear that these have had much of an impact.

C. Relations with the Fund and Other Issues

33. **The mission raised concerns about the accumulation of payments 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.** The authorities stressed their intention to pay fully all

of their obligations, but were unable to make any commitment regarding the timing of when Zimbabwe would clear its arrears to the Fund or begin payments due to the shortage of foreign exchange in the official market and pressing needs for fuel, electricity, and food imports. The domestic currency funds that had been included in the 2001 budget for interest payments have been sequestered, although at the parallel market rate, these fall far short of what would be required. In 2002, the authorities plan to use part of the proceeds from privatization to make payments to the Fund and other creditors. The staff encouraged the authorities to develop a plan to clear its arrears to the Fund and other creditors as part of a comprehensive package to stabilize the economy.

34. **The mission noted that recent changes in tariff rates had increased the effective rate of protection.** The multiple currency practice arising from a discontinued RBZ scheme for forward foreign exchange cover is expected to be phased out by end-2001. The limited availability of foreign exchange from the RBZ has resulted in the accumulation of private sector external payments arrears, the introduction of foreign exchange allocation schemes, and the halving of travel allowances. The mission urged the authorities to eliminate as soon as possible these restrictions and to liberalize Zimbabwe's trade regime.

35. **Zimbabwe's database continues to suffer from numerous deficiencies with respect to accuracy, methodology, coverage, and timeliness** that hamper the Fund's ability to conduct effective surveillance. The most serious problems are:

- a lack of transparency and accuracy in reporting foreign reserves, which include sizable amounts of pledged and illiquid foreign assets;
- budget data, which include off-balance fiscal operations, suffer from discrepancies between fiscal and monetary data on the financing of the government budget deficit, and lack transparency on defense outlays;
- output, price, and external sector data, which are weak and reported with significant lags; and
- the absence of data on unemployment.

The staff urged the authorities to address these shortcomings as soon as possible and stressed that accurate and timely statistics and full disclosure were essential to guide economic policy and allow the Fund to discharge properly its surveillance responsibilities.

36. **The Fund has provided a substantial amount of technical assistance to Zimbabwe over the past decade,** most recently in the context of establishing a deposit insurance scheme. The authorities welcomed the appointment of a STA advisor on real sector statistics, who will be visiting Zimbabwe periodically starting in late 2001, and requested Fund technical assistance in launching the VAT. The UNDP, in consultation with the Fund, is sponsoring a macroeconomic advisor and advisors on budget accounting and debt management to the Ministry of Finance and Economic Development.

V. Staff Appraisal

37. **Economic deterioration in Zimbabwe has accelerated**. The weakening of law and order, related to the fast-track land reform involving farm invasions and occupations, has damaged confidence, discouraged investment, destroyed capital, and eroded institutions important for economic development. The result has been a sharp decline in economic activity and a reduced potential for future growth.

38. **Expansionary macroeconomic policies in the context of declining productive capacity have been reflected in accelerating inflation toward triple-digit levels, sharply negative real interest rates, and a bubble in asset prices**, all of which have increased financial sector vulnerability. Fueled by high and rising inflation, the parallel market exchange rate has depreciated rapidly. As the spread between the parallel and the official exchange rates has widened, the surrender requirement on export earnings has acted as an increasingly high export tax, aggravating the shortage of foreign exchange and exacerbating import scarcities.

39. **Poverty and unemployment are increasing.** Food shortages stemming from recently introduced price controls, crop destruction, drought and floods, and the inability to import have become more serious. By some estimates, one-third of the adult population is infected with HIV/AIDS at a time when budgetary constraints have forced cutbacks in basic social services. Zimbabwe's economic and social problems are also spilling over into other countries in the region in the form of illegal immigration, weakened investor confidence, and financial market turmoil.

40. **Current economic policies in Zimbabwe are largely influenced by political considerations in the run-up to the 2002 presidential election**. This is particularly evident in the 2002 budget, which undermines the modest progress made this year, and by the recent imposition of price controls. The authorities have little confidence in market forces, while inflation is viewed as resulting from avaricious profiteering rather than inappropriately loose monetary policy. Instead of implementing a coherent set of policies to reduce inflation and stabilize the economy, the government is introducing ad hoc—but unsuccessful—schemes to encourage production, while imposing price controls and attempting to suppress the parallel foreign exchange market.

41. **Without significant changes in the government's economic policies, combined with improvements in governance and the adoption of a transparent and orderly land reform program, the economic crisis will gain momentum.** The resultant increase in human suffering will be conducive to disruptive social unrest. A credible return to the rule of law and the introduction of an orderly land reform program that will restore investor confidence and elicit broad support at home and abroad is crucial. Without such a land reform, premised on an agreement between the authorities and the UNDP, the implementation of sound macroeconomic policies will only mitigate the speed and depth of the economic decline. For this reason, the authorities need to implement the commitments made in Abuja.

42. **Restoring macroeconomic equilibrium requires that the fiscal deficit be brought under control.** Some progress has been made this year, despite faltering revenues and additional spending in the supplementary budget. However, the reduction in noninterest spending envisioned in the 2001 budget has not been achieved. For 2002, the authorities need to continue fiscal consolidation, while shifting spending to high priority areas, such as poverty alleviation, health, and education. Measures are needed to bolster revenue collections, strengthen the finances of parastatals, and accelerate privatization. Targeted social safety nets, such as the current "food-for-work" program or other donor-supported programs, should be expanded to protect the poor. By contrast, the recently reintroduced monopoly of the Grain Marketing Board and the price controls on basic commodities and foods should be abolished as they will only intensify economic imbalances and undermine food security.

43. **The monetary authorities must take responsibility for reducing inflation.** To do this and maintain low inflation in future, the Reserve Bank of Zimbabwe should be made more independent. The RBZ should immediately move to mop up excess liquidity and allow interest rates to become positive in real terms; dismantle subsidized credit facilities; and refrain from engaging in moral suasion aimed at capping the spread between bank deposit and lending interest rates. The authorities also need to exert strict vigilance on the financial system, particularly with regard to provisioning and capital adequacy. Nonviable institutions will need to be closed without delay.

44. **Supported by tighter monetary and fiscal policies, the Zimbabwe dollar should be moved to a more realistic level in the official market**, accompanied by a return to the crawling peg arrangement suspended in October 2000. **The ultimate objective should be a unified, floating exchange rate, which would allow the elimination of the export surrender requirement and the foreign exchange allocation scheme.** This needs to be achieved as soon as possible, not least to eliminate the opportunities for corruption available at present to anyone able to purchase foreign exchange at the official exchange rate. Until the exchange rate is unified, however, the authorities should not suppress the parallel market, which facilitates trade, earns foreign exchange, and minimizes supply-side bottlenecks.

45. **The above set of policies, in conjunction with improved "environmental" factors, such as stronger governance and a return to the rule of law, should lead to a resumption of sustainable growth**, which, in turn, would allow the government to better address pressing social needs. In any case, an immediate tightening of macroeconomic policies, together with a move to a more realistic official exchange rate and the elimination of price controls and other distortions, will help reduce inflation and set the stage for stronger economic performance. Conversely, a delay in the implementation of comprehensive policies to correct the existing economic distortions will increase the costs of adjustment.

46. Zimbabwe's trade regime continues to be restrictive, and the tariff changes that were announced in March 2001 have increased protection. **The authorities need to take steps to fulfill their earlier commitment to deepen trade liberalization, while eliminating exchange restrictions as soon as possible.** The government urgently needs to normalize

relations with external creditors and formulate a plan for the elimination of external payments arrears. **It is also important to address the serious weaknesses in the coverage and timeliness of economic statistics**, which continue to complicate the design and monitoring of economic policies in Zimbabwe and hampers the conduct of Fund surveillance.

47. Reaching understanding on a land reform program that can garner broad domestic support and the support of the donor community, together with improved economic policies, **could pave the way for discussions between the staff and the authorities on a staff- or Fund-monitored program and the eventual normalization of relations between Zimbabwe and the Fund, other creditors, and donors.**

48. It is proposed that the next Article IV consultation with Zimbabwe be held on the standard 12-month cycle.

Table 1. Zimbabwe: Selected Economic Indicators, 1998-2002 1/

	1998	1999	2000 Est.	2001 Proj.	2002 Proj. 2/
GDP					
Nominal GDP (billions of Zimbabwe dollars)	143.4	210.4	314.3	493.8	973.0
Nominal GDP (billions of U.S. dollars)	6.7	5.5	7.1	9.0	8.3
Real GDP (market prices; percentage change)	2.9	-0.7	-5.1	-8.4	-5.6
Real per capita GDP (percentage change)	-0.2	-3.8	-7.9	-10.4	-7.4
Savings and investment (percent of GDP)					
Gross national savings (excluding grants)	8.4	9.5	0.2	-2.4	-1.7
Gross investment 3/	13.7	9.0	1.7	-1.1	-0.7
Prices and interest rates (percent)					
Consumer price inflation (annual average)	31.5	58.2	55.7	70.1	107.5
Consumer price inflation (end of period)	46.6	56.9	55.2	102.5	85.7
91-day treasury bills (annualized yield; end of period)	40.4	89.7	71.6	29.5	82.5
Central government budget (percent of GDP; calendar-year basis)					
Revenue	30.5	27.8	27.9	23.5	22.0
Expenditure and net lending	35.2	38.1	50.8	36.1	34.9
Of which: interest on central government debt	9.6	10.3	17.5	11.0	11.8
Overall balance, excluding grants and arrears	-4.7	-10.3	-22.9	-12.6	-12.9
Primary balance, excluding grants	4.9	0.0	-5.4	-1.6	-1.2
Overall balance, including grants and interest arrears	1.7	-9.2	-21.1	-10.3	-9.5
Domestic financing (including privatization)	-2.5	10.3	20.1	10.5	9.5
External financing (including principal arrears)	0.9	-1.1	1.0	-0.2	0.0
Total public debt (percent of GDP; end of period)	81.6	104.2	105.0	91.6	78.0
Domestic debt	27.1	37.1	51.6	52.5	37.6
External debt (public and publicly guaranteed)	54.5	67.2	53.5	39.1	40.4
Money and credit (percentage change; end of period)					
Broad money (M3)	14.1	29.8	59.9	86.6	67.0
Domestic credit	22.6	17.1	61.2	75.0	39.4
Credit to the private sector	27.5	10.5	39.1	48.1	48.5
External trade (percentage change)					
Export volume	-11.3	4.7	-6.7	-1.2	0.1
Import volume	-15.5	-18.4	-13.8	-5.4	-6.4
Terms of trade	-0.6	-6.1	-5.2	-4.2	-3.0
Balance of payments (billions of U.S. dollars; unless otherwise indicated)					
Exports	1.93	1.92	1.79	1.72	1.73
Imports	-2.02	-1.68	-1.52	-1.45	-1.41
Current account balance (excluding official transfers)	-0.36	0.03	-0.10	-0.12	-0.09
(in percent of GDP)	-5.3	0.5	-1.4	-1.3	-1.0
Overall balance	-0.16	0.02	-0.19	-0.51	-0.16
Official reserves (gold valued at market price)					
Usable reserves (millions of U.S. dollars; end of period)	54.5	46.7	22.1	20.0	272.0
(months of imports of goods and services)	0.2	0.2	0.1	0.1	1.4
(percent of short-term debt)	5.4	4.8	2.8	3.4	61.4
(percent of reserve money)	18.4	10.0	5.9	2.1	49.1
External debt and arrears (including private debt)					
Total external debt (percent of GDP; end of period)	77.8	92.5	68.0	46.4	44.3
Debt service (percent of exports of goods and services)	21.2	21.8	27.4	27.0	25.1
Total external arrears (percent of GDP; end of period)	0.0	1.9	6.8	19.4	26.8

Sources: Zimbabwean authorities; and staff estimates and projections.

1/ Foreign currency units are converted into Zimbabwe dollars at the official exchange rate.
2/ Staff projections for 2002 represent the baseline scenario discussed in Section III.
3/ Negative gross investment in 2001-02 represents destruction of productive capital.

Table 2. Zimbabwe: Central Government Operations, 1998-2002

	1998	1999	2000		2001				2002	
	Act.	Est.	Budget	Est.	Jan.-Sep. Act. 1/	Budget	Est.	Staff Proj.	Budget	Staff Proj. 2/
	(In percent of GDP)									
Total revenue	30.5	27.8	29.0	27.9	24.3	26.0	24.8	23.5	27.1	22.0
Tax revenue	28.2	26.4	27.5	26.2	22.9	24.6	23.3	22.1	25.9	20.6
Nontax revenue	2.3	1.4	1.5	1.8	1.5	1.4	1.6	1.4	1.2	1.4
Total expenditure and net lending	35.2	38.1	32.8	50.8	34.6	41.4	36.3	36.1	42.0	34.9
Current expenditure on goods and services	17.5	19.3	16.7	24.7	19.0	15.7	19.0	19.5	19.9	18.2
Of which: wages and salaries	12.3	13.4	11.3	15.6	13.4	11.4	13.2	13.5	13.0	12.4
Interest payments	9.6	10.3	9.4	17.5	9.5	19.7	10.3	11.0	14.0	11.8
Of which: domestic	8.0	8.6	7.7	16.4	6.8	17.5	8.1	8.8	13.0	9.4
Subsidies and transfers	5.8	4.3	4.1	6.0	5.0	4.3	4.5	4.6	4.6	3.5
Capital expenditure and net lending	2.3	4.2	2.7	2.6	1.2	2.0	2.7	1.0	3.5	1.5
Budget balance, excl. grants (commitment basis) 3/	-4.7	-10.3	-3.8	-22.9	-10.3	-15.4	-11.5	-12.6	-14.9	-12.9
Of which										
Primary balance	4.9	0.0	5.5	-5.4	-0.8	4.3	-1.2	-1.6	-0.9	-1.2
Operational balance 4/	2.4	-2.6	...	-7.0	...	...	...	5.7	...	3.8
Grants	1.7	1.0	1.0	1.1	0.3	0.0	1.0	0.1	0.0	1.3
Budget balance, incl. grants and interest arrears 3/	-3.0	-9.2	-2.9	-21.1	-7.4	-15.4	-10.5	-10.3	-14.9	-9.5
Foreign financing (net, including principal arrears)	-2.5	-1.1	-0.6	1.0	-0.2	-4.2	-4.4	-0.2	-3.0	0.0
Domestic financing (net)	5.5	10.3	3.5	20.1	7.6	19.5	14.9	10.5	17.9	9.5
Of which: privatization 5/	...	0.4	0.5	0.0	0.9	4.1	2.0	2.0	4.8	2.6
Memorandum items:										
Health and social welfare 6/	4.5	3.2	2.1	3.4	...	2.2	3.1	...	3.0	3.0
Of which: wages	1.0	1.0	0.7	1.3	...	1.1	...	...	...	1.3
Education outlays	8.5	8.2	7.4	10.4	...	6.2	6.5	...	6.8	6.5
Of which: wages	6.8	6.6	5.3	8.1	...	4.7	...	...	...	5.2
Military expenditure	3.2	3.4	3.0	4.8	...	2.5	3.2	...	3.7	2.7
Of which: wages	2.2	2.4	2.1	3.0	...	2.0	...	...	...	2.0
Health, social, and education outlays 7/	39.7	33.6	31.2	28.6	...	21.2	28.5	...	25.6	28.4
Net savings due to retrenchment	...	...	...	...	...	...	...	...	...	0.3
Cost of land reform	...	...	...	...	...	...	...	...	...	1.1
Interest cost of the debt of privatized parastatals	...	...	...	...	...	...	...	...	...	0.4

Table 2. Zimbabwe: Central Government Operations, 1998-2002 (concluded)

	1998	1999	2000		2001				2002	
	Act.	Est.	Budget	Est.	Jan.-Sep. Act. 1/	Budget	Est.	Staff Proj.	Budget	Staff Proj. 2/
	(In millions of Zimbabwe dollars)									
Total revenue	42,773	58,563	87,216	87,825	90,153	140,284	126,517	115,864	251,886	214,230
Tax revenue	39,483	55,569	82,740	82,275	84,652	132,710	118,447	109,047	240,840	200,609
Domestic taxes	32,377	47,062	65,970	73,731	73,227	112,460	101,897	93,742	191,725	179,027
Customs duties	7,106	8,507	16,770	8,543	11,425	20,250	16,550	15,305	49,115	21,582
Nontax revenue	3,290	2,995	4,476	5,550	5,501	7,574	8,070	6,816	11,046	13,622
Total expenditure and net lending	48,404	80,211	98,727	159,669	128,292	223,157	185,085	178,312	390,139	339,846
Current expenditure on goods and services	23,603	40,640	50,092	77,532	70,452	84,422	96,522	96,363	184,630	176,636
Of which : wages and salaries	17,196	28,175	33,892	48,931	49,615	61,321	67,000	66,571	120,417	121,113
Interest payments	13,466	21,631	28,200	54,896	35,032	105,872	52,467	54,506	130,000	114,426
Of which : domestic	11,158	18,071	23,080	51,460	25,297	94,501	41,096	43,396	120,835	91,868
Subsidies and transfers	8,105	9,007	12,435	18,986	18,425	22,939	23,097	22,626	43,161	34,481
Capital expenditure and net lending	3,231	8,932	8,000	8,255	4,382	9,925	13,000	4,818	32,349	14,302
Budget balance, excl. grants (commitment basis) 3/	-5,631	-21,648	-11,511	-71,844	-38,139	-82,873	-58,568	-62,448	-138,253	-125,615
Of which										
Primary balance	7,834	-17	16,689	-16,948	-3,107	22,999	-6,102	-7,943	-8,253	-11,189
Operational balance 4/	4,152	-5,502	...	-21,932	...	...	...	28,261	...	36,526
Grants	2,322	2,144	2,912	3,517	963	0	4,963	675	0	12,196
Budget balance (incl. grants and interst arrears) 3/	-3,309	-19,330	-8,599	-66,447	-27,515	-82,873	-53,605	-50,763	-138,253	-91,989
Foreign financing (net, including principal arrears)	-3,514	-2,280	-1,804	3,130	-617	-22,382	-22,382	-945	-28,162	-258
Domestic financing (net)	6,823	21,610	10,403	63,317	28,132	105,255	75,987	51,708	166,415	92,247
Of which : privatization 5/	...	841	1,584	0	3,180	22,000	10,000	10,000	45,000	25,485
Memorandum items:										
Health and social welfare 6/	8,775	6,724	6,189	10,608	...	12,078	15,904	...	28,251	29,099
Of which : wages	1,948	2,087	2,041	3,985	...	5,845	...	...	...	12,366
Educational outlays	16,656	17,223	22,108	32,634	...	33,167	33,167	...	63,292	63,311
Of which : wages	13,331	13,848	15,922	25,356	...	25,195	...	...	...	50,763
Military expenditure	6,161	7,202	9,017	15,011	...	13,292	16,208	...	34,403	26,124
Of which : wages	4,336	4,982	6,237	9,445	...	10,610	...	...	...	19,080
Net savings due to retrenchment	...	...	...	...	...	...	...	...	...	2,509
Cost of land reform	...	...	...	...	...	...	...	...	...	10,633

Sources: Zimbabwean authorities; and staff estimates and projections.

1/ At annualized rate.
2/ Staff projections for 2002 represent the baseline scenario discussed in Section III.
3/ Commitments with respect to foreign interest payments.
4/ Operational balance equals overall balance minus the inflation component of interest payments on domestic debt.
5/ Gross proceeds from privatization, that do not take into account possible debt-equity swaps and debt takeovers.
6/ Included in the 2001 budget is Z$2.9 billion, or 0.5 percent of GDP, allocated for drought relief.
7/ As percent of current expenditure.

Table 3. Zimbabwe: Monetary Survey, 1998-2002

	1998	1999	2000	2001				2002
	Dec.	Dec.	Dec.	Mar.	Jun.	Sep.	Dec.	Dec.
							Staff	Staff
	Act.	Act.	Act.	Act.	Act.	Act.	Proj.	Proj. 1/
Monetary authorities				(Annual percentage change)				
Net foreign assets of reserve bank 2/	175.0	-37.3	9.9	-5.8	2.4	-14.5	-18.9	362.0
Net domestic assets of reserve bank 2/	100.5	-1.0	13.6	33.3	36.8	79.7	86.3	13.6
Credit to government (net)	4.0	-45.5	17.7	104.7	97.7	197.7	518.1	17.0
Credit to nonfinancial public enterprises	258.5	-3.1	-0.4	-44.2	74.5	211.5	330.4	35.7
Credit to private sector	325.0	54.3	53.9	63.6	53.7	86.1	23.9	13.3
Other items (net)	140.9	-7.4	-21.5	-23.1	-32.3	-18.7	-12.7	-3.4
Reserve money	37.1	60.9	16.0	64.0	56.4	150.1	152.7	89.6
Currency outside banks	25.6	61.4	37.3	49.5	66.8	146.4	162.9	66.9
Nonbank deposits	381.1	13.7	-45.7	-49.6	628.2	-11.4	80.0	67.0
Other banking institution reserves	38.8	25.4	14.1	13.7	9.4	33.5	80.0	67.0
Deposit money bank reserves	43.2	64.6	2.9	77.6	48.9	162.0	148.9	112.6
Monetary survey								
Net foreign assets	115.6	-44.3	-11.5	-31.4	-36.6	-32.2	-19.4	-373.7
Net domestic assets	34.8	5.6	47.6	51.7	58.9	69.1	74.9	46.4
Domestic credit	22.6	17.1	61.5	72.9	79.7	70.8	75.0	39.4
Claims on government (net)	1.7	36.8	117.6	148.8	141.1	125.3	115.3	34.6
Claims on nonfinancial public enterprises	82.5	34.4	98.2	113.5	204.2	56.9	118.2	5.0
Claims on private sector	27.5	10.5	39.0	34.7	39.7	43.9	48.1	48.5
Other items (net)	9,536.5	-108.1	2,049.0	-2,836.7	721.1	92.3	76.7	-29.2
Broad money (M3)	14.1	29.8	59.9	68.3	73.9	83.5	86.6	67.0
Currency	25.6	61.4	37.3	49.5	66.8	146.6	162.9	66.9
Deposits	13.2	27.3	62.2	69.9	74.6	78.3	80.0	67.0
Monetary authorities				(In percent of lagged reserve money)				
Net foreign assets of reserve bank 2/	-149.2	63.8	-6.6	4.5	-1.4	10.8	11.9	73.3
Net domestic assets of reserve bank 2/	186.2	-2.7	22.6	59.4	57.7	139.3	140.8	16.3
Of which: credit to government (net)	3.4	-29.7	3.9	43.7	47.0	91.6	116.3	9.3
Reserve money	37.1	60.9	16.0	64.0	56.4	150.1	152.7	89.6
Of which: currency outside banks	10.8	23.7	14.4	19.3	25.3	62.8	74.6	31.9
Monetary survey				(In percent of lagged broad money)				
Net foreign assets	-29.6	21.4	2.4	6.3	5.8	4.7	2.2	18.5
Net domestic assets	43.7	8.4	57.5	62.0	68.2	79.1	83.4	48.5
Domestic credit	28.3	23.1	74.8	86.8	95.2	87.3	92.2	45.3
Claims on government (net)	0.6	10.5	35.5	53.2	54.6	49.3	47.3	16.4
Claims on nonfinancial public enterprises	3.1	2.1	6.2	6.9	10.6	5.1	9.2	0.5
Claims on private sector	24.6	10.5	33.2	26.8	30.0	32.9	35.6	28.5
Other items (net)	15.4	-14.7	-17.3	-24.8	-27.1	-8.2	-8.7	3.1
Broad money (M3)	14.1	29.8	59.9	68.3	73.9	83.5	86.6	67.0
Currency	1.8	4.6	3.5	3.9	5.7	11.2	13.1	7.6
Deposits	12.3	25.2	56.4	64.4	68.2	72.3	73.5	59.4
				(Annual percentage change)				
Memorandum items:								
Private sector credit growth (real)	-13.0	-29.6	-10.4	-13.6	-15.0	-22.7	-26.8	-20.0
Adjusted net domestic assets of reserve bank 3/	...	...	19.1	12.4	29.4	43.5	58.3	-56.2

Table 3. Zimbabwe: Monetary Survey, 1998-2002 (concluded)

	1998 Dec. Act.	1999 Dec. Act.	2000 Dec. Act.	2001 Mar. Act.	2001 Jun. Act.	2001 Sep. Act.	2001 Dec. Staff Proj.	2002 Dec. Staff Proj. 1/
Monetary authorities				(In millions of Zimbabwe dollars)				
Net foreign assets of reserve bank 2/	-18,893	-11,845	-13,021	-12,702	-12,502	-12,407	-10,560	27,665
Net domestic assets of reserve bank 2/	29,932	29,631	33,659	40,853	46,187	60,916	62,723	71,229
Credit to government (net)	7,216	3,936	4,633	14,658	20,495	26,742	28,633	33,506
Credit to nonfinancial public enterprises	674	653	651	650	2,034	2,034	2,800	3,800
Credit to private sector	7,497	11,569	17,803	15,806	15,388	22,046	22,056	24,999
Credit to deposit money banks	6,689	10,475	15,766	13,822	13,389	20,023	20,019	22,462
Credit to nonbank private sector	808	1,095	2,037	1,984	2,000	2,023	2,037	2,537
Other items (net)	14,545	13,473	10,573	9,740	8,270	10,094	9,235	8,925
Reserve money	11,040	17,786	20,639	28,152	33,685	48,509	52,163	98,894
Currency outside banks	4,265	6,884	9,451	10,016	13,585	20,484	24,851	41,466
Nonbank deposits	178	202	110	37	428	183	198	331
Other banking institution reserves.	455	583	666	642	539	690	1,198	2,001
Deposit money bank reserves	6,141	10,116	10,411	17,456	19,133	27,152	25,917	55,097
Deposit money banks and other banking institutions								
Net foreign assets	-8,489	-3,413	-482	1,057	2,915	1,758	-330	2,142
Reserves	6,512	10,693	10,392	19,014	20,584	28,237	27,115	57,098
Net credit from the reserve bank (asset +)	-6,689	-10,495	-16,168	-14,625	-13,858	-16,929	-20,019	-22,462
Total credit	67,630	83,716	137,098	158,395	181,784	198,693	219,295	312,411
Credit to government (net)	8,997	18,239	43,619	61,232	69,166	69,769	75,235	106,352
Credit to nonfinancial public enterprises	2,776	3,985	8,542	10,367	13,112	13,296	17,256	17,256
Credit to private sector	55,857	61,493	84,938	86,796	99,505	115,628	126,803	188,803
Other items (net)	-6,778	-14,068	-22,843	-30,282	-38,321	-32,538	-31,743	-24,543
Total deposits	52,185	66,433	107,997	133,559	153,103	179,220	194,357	324,644
Monetary survey								
Net foreign assets	-27,382	-15,258	-13,503	-11,644	-9,587	-10,649	-9,758	30,898
Net domestic assets	84,037	88,778	131,062	155,257	176,703	210,795	229,164	335,543
Domestic credit	76,327	89,399	144,418	175,687	206,312	229,492	252,764	352,253
Claims on government (net)	16,213	22,174	48,251	75,889	89,661	96,511	103,868	139,858
Claims on nonfinancial public enterprises	3,450	4,638	9,192	11,017	15,146	15,330	20,056	21,056
Claims on private sector	56,665	62,587	86,975	88,780	101,505	117,651	128,840	191,340
Other items (net)	7,709	-622	-13,357	-20,430	-29,609	-18,697	-23,601	-16,711
Broad money (M3)	56,628	73,520	117,559	143,612	167,116	199,888	219,406	366,441
Currency	4,265	6,884	9,451	10,016	13,585	20,484	24,851	41,466
Deposits	52,363	66,636	108,107	133,597	153,532	179,403	194,555	324,975
				(In millions of US dollars)				
Memorandum items:								
Net foreign assets of reserve bank	-448	-121	-375	....	....	....	-192	155
Of which: usable reserves	55	47	22	....	....	....	20	272
Net foreign assets of deposit money banks and other banking institutions	-229	-89	-9	....	....	....	-6	12

Sources: Zimbabwean authorities; and staff estimates and projections.

1/ Staff projections for 2002 represent the baseline scenario discussed in Section III.

2/ Reserve Bank of Zimbabwe's net foreign assets and net domestic assets have been adjusted for memorandum of deposits.

3/ Net domestic assets of Reserve Bank of Zimbabwe minus reserve balances.

Table 4. Zimbabwe: Balance of Payments, 1998-2002
(In millions of U.S. dollars, unless otherwise indicated)

	1998	1999	2000 Prel.	2001 Proj.	2002 Proj. 1/
Current account (excluding official transfers)	-355	27	-102	-119	-87
Trade balance	-95	248	272	261	317
Exports, f.o.b.	1,925	1,924	1,791	1,715	1,730
Imports, f.o.b.	-2,020	-1,675	-1,520	-1,454	-1,413
Of which: emergency food imports	...	...	...	75	100
Nonfactor services	-40	21	-109	-155	-153
Receipts	630	621	327	262	269
Payments	-670	-600	-436	-417	-422
Investment income	-348	-357	-387	-380	-354
Interest	-147	-142	-174	-176	-167
Receipts	30	36	25	25	25
Payments	-177	-178	-199	-201	-192
Other	-201	-215	-213	-204	-187
Private transfers	128	115	122	156	103
Capital account (including official transfers)	157	-10	-332	-396	-69
Official transfers	77	101	53	26	67
Direct investment	88	50	15	10	153
Portfolio investment	11	21	-1	-81	-20
Long-term capital	55	34	-238	-286	-249
Government	-50	-60	-177	-204	-177
Public enterprises	54	70	-33	-63	-57
Private sector	51	24	-29	-19	-15
Short-term capital	-74	-216	-161	-65	-20
Errors and omissions	41	0	249	0	0
Overall balance	-157	17	-185	-515	-156
Financing	157	-17	185	515	156
Gross official reserves (- increase)	64	8	25	2	-252
Net use of Fund resources	5	-27	-72	-76	-66
Drawings	53	35	0	0	0
Repayments	-48	-62	-72	-76	-66
Other short-term liabilities (net)	88	-107	-130	-101	0
Change in arrears (decrease, -)	0	109	362	690	474
Debt and arrears rescheduling	0	0	0	0	0
Unidentified financing 2/	0	0	0	0	0
Memorandum items:					
Gross official reserves 2/, 3/	55	47	22	20	272
In months of imports of goods and services	0.2	0.2	0.1	0.1	1.5
External arrears 2/	0	109	471	1,161	1,635
Foreign liabilities (reported by reserve bank) 2/	744	599	397	220	154
Net international reserves (reported by reserve bank) :	-690	-552	-375	-200	118
Current account balance (percent of GDP)	-5.6	0.5	-1.5	-1.3	-1.0
Reserves / short-term debt (percent) 4/	5.4	4.8	2.8	3.4	61.4
External debt service 5/	576	588	620	582	535

Sources: Zimbabwean authorities; and staff estimates and projections.

1/ Staff projections for 2002 represent the baseline scenario discussed in Section III.
2/ End of period.
3/ Gold valued at market prices.
4/ Short-term debt includes medium- and long-term amortization due within 12 months.
5/ Scheduled medium- and long-term amortization plus all interest payments.

Table 5. Zimbabwe: Medium-Term Outlook, 2002-07 1/

	2002 Proj.	2003 Proj.	2004 Proj.	2005 Proj.	2006 Proj.	2007 Proj.
GDP						
Nominal GDP (billions of Zimbabwe dollars)	973.0	1,553.2	2,060.5	2,477.8	2,824.6	3,141.8
Nominal GDP (billions of U.S. dollars)	8.3	7.2	7.7	8.4	9.1	9.8
Real GDP (market prices; percentage change)	-5.6	3.2	5.6	5.0	5.1	5.1
Real per capita GDP (percentage change)	-7.4	1.5	4.0	3.8	4.1	4.4
Savings and investment (percent of GDP)						
Gross national savings (excluding grants)	-1.7	4.1	5.6	7.1	5.7	6.9
Gross investment 2/	-0.7	9.0	13.5	15.0	13.0	13.0
Prices and interest rates (percent)						
Consumer price inflation (annual average)	107.5	54.2	26.2	14.3	8.8	6.2
Consumer price inflation (end of period)	85.7	38.0	19.2	11.1	7.3	5.5
91-day treasury bills (annualized yield; end of period)	82.5	42.1	24.5	17.0	12.7	8.2
Central government budget (percent of GDP; calendar-year basis)						
Revenue	22.0	24.2	25.8	26.6	27.0	27.2
Expenditure and net lending	34.9	36.2	32.5	30.7	29.8	30.9
Of which : interest on central government debt	11.8	12.3	9.2	7.8	6.5	5.4
Overall balance, excluding grants and arrears	-12.9	-11.9	-6.7	-4.1	-2.8	-3.7
Primary balance, excluding grants	-1.2	0.4	2.5	3.7	3.7	1.7
Overall balance, including grants and interest arrears	-9.5	-8.8	-4.5	-2.1	-0.9	-2.3
Domestic financing (including privatization)	9.5	3.0	1.1	-0.2	-1.0	0.3
External financing (including principal arrears)	0.0	5.8	3.4	2.3	1.9	2.0
Total public debt (percent of GDP; end of period)	78.0	86.9	77.5	78.9	74.0	76.3
Domestic debt	37.6	34.3	24.4	25.6	20.5	22.7
External debt (public and publicly guaranteed)	40.4	52.6	53.1	53.3	53.5	53.6
Money and credit (percentage change; end of period)						
Broad money (M3)	67.0	34.6	23.0	19.7	13.8	11.0
Domestic credit	39.4	30.8	19.0	15.9	9.7	10.7
Credit to the private sector	48.5	53.7	41.2	31.3	23.8	18.2
External trade (percentage change)						
Export volume	0.1	7.9	9.8	6.2	7.5	7.5
Import volume	-6.4	21.2	23.5	7.5	8.3	6.7
Terms of trade	-3.0	-1.6	1.7	-0.6	1.1	1.1
Balance of payments (billions of U.S. dollars; unless otherwise indicated)						
Exports	1.73	1.94	2.21	2.42	2.68	2.96
Imports	-1.41	-1.81	-2.28	-2.55	-2.81	-3.04
Current account balance (excluding official transfers)	-0.09	-0.35	-0.61	-0.66	-0.66	-0.60
(in percent of GDP)	-1.0	-4.9	-7.9	-7.9	-7.3	-6.1
Overall balance	-0.16	0.01	0.07	0.15	0.13	0.22
Official reserves (gold valued at market price)						
Usable reserves (millions of U.S. dollars; end of period)	272.0	365.9	931.0	1,175.2	1,268.9	1,450.4
(months of imports of goods and services)	1.4	1.6	3.4	3.8	3.8	4.0
(percent of short-term debt)	61.4	67.7	140.3	147.7	215.4	219.4
(percent of reserve money)	49.1	93.1	226.1	268.9	275.2	301.1
External debt and arrears (including private debt)						
Total external debt (percent of GDP; end of period)	44.3	57.6	59.4	61.3	62.5	63.5
Debt service (percent of exports of goods and services)	25.1	23.6	21.6	20.3	18.2	17.2
Total external arrears (percent of GDP; end of period)	26.8	0.0	0.0	0.0	0.0	0.0

Sources: Zimbabwean authorities; and staff estimates and projections.

1/ Staff projections represent the baseline scenario discussed in Section III.

2/ Negative gross investment in 2002 represents destruction of productive capital.

Table 6. Zimbabwe: Indicators of Debt-Servicing Capacity, 1998-2002 1/

	1998	1999 Est.	2000 Est.	2001 Proj.	2002 Proj. 2/
			(In percent of GDP)		
External debt outstanding	82.1	91.3	69.6	46.4	44.3
Medium- and long-term debt	66.8	76.3	61.3	42.9	42.9
Of which : Fund	6.2	6.5	4.1	2.2	1.6
other multilaterals	28.2	32.8	28.8	21.5	23.2
Short-term debt	15.3	15.0	8.3	3.5	1.4
Of which : non-trade related	5.3	4.1	1.5	0.0	0.0
Debt service 3/	9.1	10.5	9.0	6.5	6.5
Of which : Fund	0.9	1.2	1.2	0.9	0.8
other multilaterals	1.9	2.7	2.1	1.3	1.3
			(In percent of exports of goods and services)		
External debt outstanding	191.9	190.0	211.8	193.2	172.4
Medium- and long-term debt	156.1	158.8	186.5	178.6	167.0
Of which : Fund	14.5	13.5	12.5	9.1	6.3
other multilaterals	65.9	68.2	87.5	89.5	90.2
Short-term debt	35.9	31.2	25.2	14.6	5.4
Of which : non-trade related	12.4	8.5	4.4	0.0	0.0
Debt service 3/	21.2	21.8	27.4	27.0	25.1
Of which : Fund	2.1	2.6	3.6	3.8	3.3
other multilaterals	4.4	5.7	6.4	5.4	5.0
			(In millions of SDRs)		
Debt service due to Fund	42.9	51.5	61.0	64.7	54.4
Principal	35.6	45.1	53.4	60.2	50.8
Interest and charges	7.3	6.4	7.6	4.5	3.6
			(In percent)		
Ratio of outstanding Fund credit to:					
Quota	110.7	76.1	61.0	43.9	29.5
Total debt	7.5	7.1	5.9	4.7	3.7
Ratio of debt service due to Fund to:					
Quota 4/	16.4	14.6	17.3	18.3	15.4
Total debt service	10.1	11.9	13.0	14.1	13.1
Gross official reserves 5/	106.6	149.5	364.0	409.4	25.8
Memorandum items:					
Ratio of short-term debt to gross reserves 6/	415.2	427.9	307.9	172.0	25.5
Of which : non-trade related	143.8	116.9	53.9	-0.5	-0.2

Sources: Zimbawean authorities; and staff estimates and projections.

1/ On accrual basis.

2/ Staff projections for 2002 represent the baseline scenario discussed in Section III.

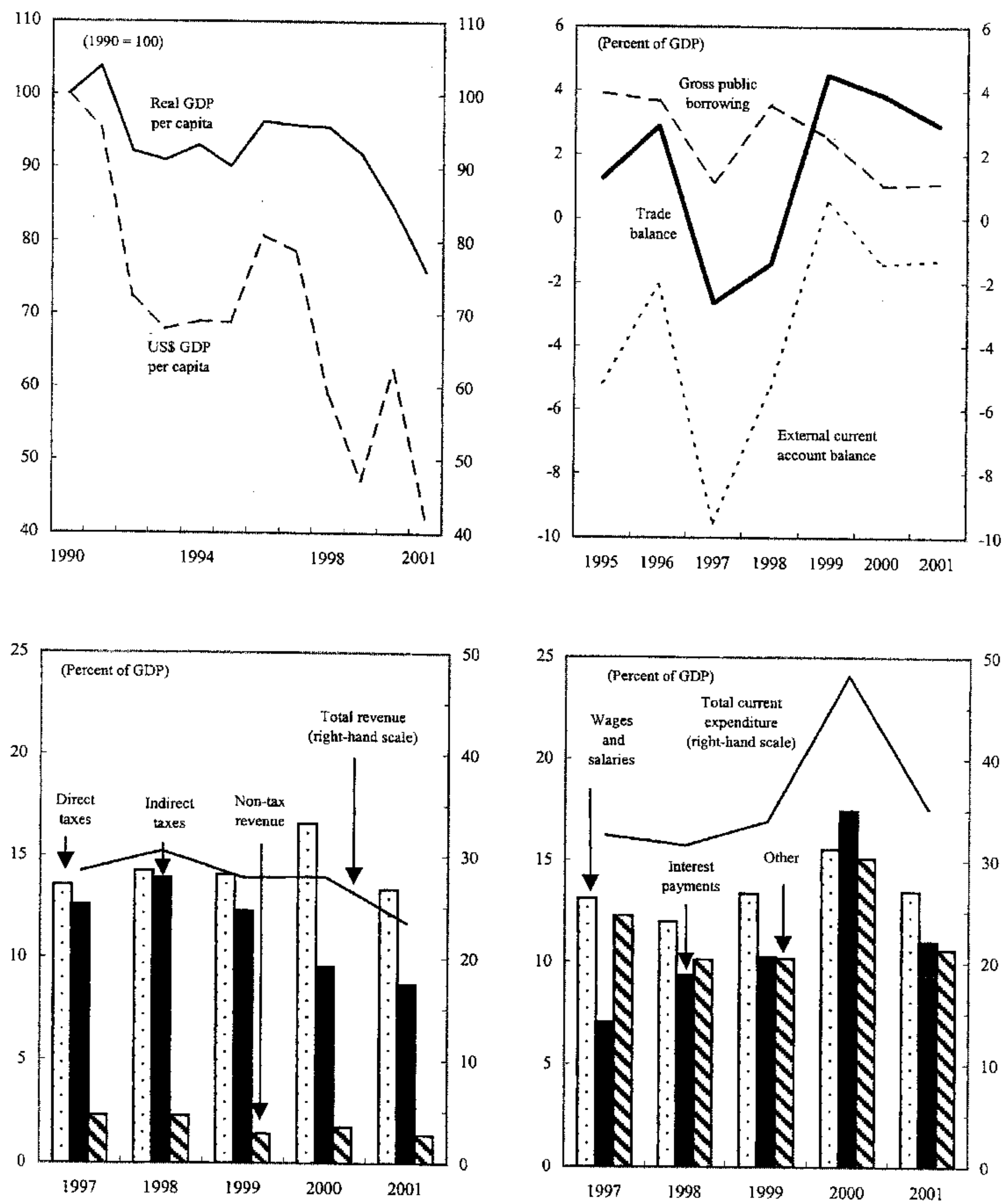
3/ Principal on medium- and long-term debt plus interest payments on all debts.

4/ Zimbabwe's quota was raised from SDR 261.3 million to SDR 353.4 million in February 1999.

5/ Gold valued at full market prices.

6/ Official reserves plus reserves of deposit money banks.

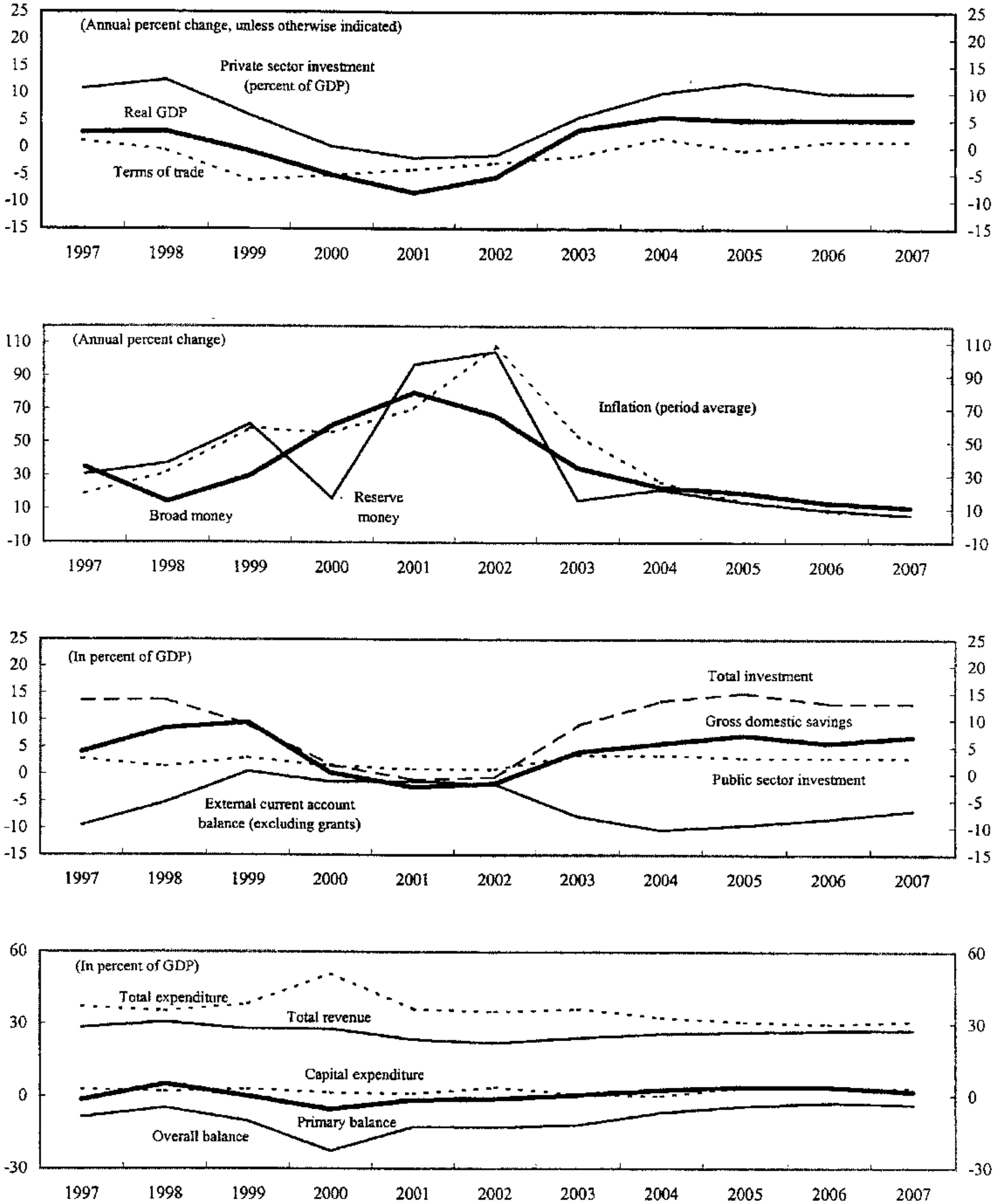
Figure 1. Zimbabwe: Selected Indicators 1/



Sources: Zimbabwean authorities; and staff estimates.

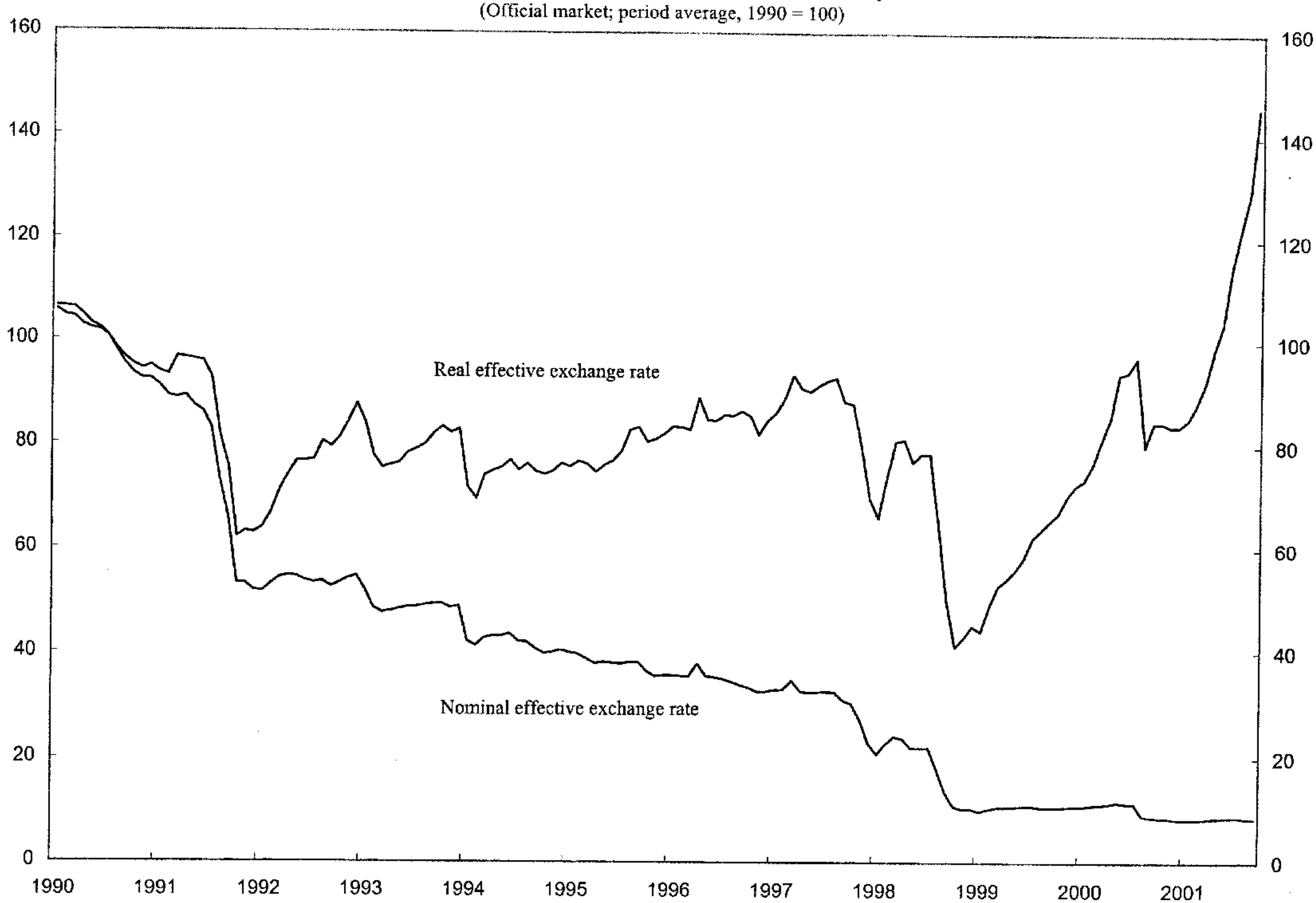
1/ Foreign currency units are converted into Zimbabwe dollars at the official exchange rate.

Figure 2. Zimbabwe: Macroeconomic Indicators, 1997-2007



Sources: Zimbabwean authorities; and staff estimates and projections.

Figure 3. Zimbabwe: Effective Exchange Rates, January 1990 to September 2001
(Official market; period average, 1990 = 100)



Source: IMF, *Information Notice System* .

Zimbabwe: Relations with the Fund
(as of October 31, 2001)

I. Membership Status: Joined: 09/29/1980; Article VIII

II. General Resources Account:	SDR Million	% Quota
Quota	353.40	100.0
Fund holdings of currency	472.03	133.6
Reserve position in Fund	0.33	0.1

III. SDR Department:	SDR Million	% Allocation
Net cumulative allocation	10.20	100.0
Holdings	0.09	0.9

IV. Outstanding Purchases and Loans:	SDR Million	% Quota
Stand-By Arrangements	63.94	18.1
Extended Arrangements	55.01	15.6
Poverty Reduction Growth Facility (PRGF) Arrangements	90.07	25.5

V. Financial Arrangements:

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
Stand-By Arrangement	08/02/1999	10/01/2000	141.36	24.74
Stand-By Arrangement	06/01/1998	06/30/1999	130.65	39.20
Extended Fund Facility (EFF)	09/11/1992	09/10/1995	114.60	86.90

VI. Projected Obligations to Fund:(SDR Million; based on existing use of resources and present holdings of SDRs):

	Overdue	Forthcoming				
	09/30/2001	2001	2002	2003	2004	2005
Principal	50.8	9.4	73.5	46.4	24.1	4.9
Charges/interest	3.0	1.6	3.6	2.3	1.4	1.1
Total	53.8	11.0	77.1	48.7	25.5	6.0

VII. Exchange Rate Arrangement

From January 1999 to July 2000, the exchange rate was fixed de facto by the Reserve Bank of Zimbabwe (RBZ) at US$1=Z$38. On August 1, 2000 the exchange rate was allowed to fluctuate in a range of +/- 5 percent around the central rate set by the RBZ, to be adjusted periodically in light of inflation differentials with trading partners. However, since mid-October 2000, the central rate has remained unchanged at US$1=Z$55.

Zimbabwe accepted the obligations of Article VIII, Sections 2, 3, and 4 of the Fund's Articles of Agreement on February 3, 1995. The RBZ maintains a multiple currency practice arising from outstanding contracts under a discontinued RBZ scheme for forward foreign exchange cover (to be cleared by end-2001). Fund approval of this measure, pursuant to Article VIII, Section 2 *(a)* and Section 3, lapsed in March 2000. Moreover, limitation on the availability of foreign exchange from the RBZ (as evidenced by the accumulation of external payments arrears by the private sector), gives rise to an exchange restriction subject to Fund approval under Article VIII, Section 2(*a*) and Article XIX, Section 7(a).

VIII. Article IV Consultations

Zimbabwe is on the standard 12-month consultation cycle. The last Article IV consultation was concluded on December 6, 2000 (EBM/00/120).

IX. Technical Assistance

Fund technical assistance to Zimbabwe has been limited during the past 12 months. An MAE-sponsored long-term advisor arrived in Zimbabwe in August 1996 to assist in the area of banking supervision; his appointment was not extended beyond October 1999. Another MAE expert on monetary operations provided advice and trained staff in the implementation of open market operations and the use of repurchase agreements from October 1998 until October 2000. A third MAE expert on the payments system, who also advised the RBZ on the array of monetary instruments to be used to monitor and manage liquidity in the financial sector, completed a one-year assignment in October 1999.

Technical assistance is summarized in the attached table.

X. Resident Representative

A resident representative office was opened in July 1993. Mr. G. G. Johnson has been the Senior Resident Representative since January 2001.

Zimbabwe: Technical Assistance from the Fund (Since the Inception of the PRGF/EFF Arrangements in September 1992)

Date	Department	Purpose	Result
November 1992	STA	Revise monetary statistics.	Revision initiated.
April 1993	MAE	Liberalize foreign exchange system.	Comprehensive reforms launched; completed in July 1994.
Spring 1994	LEG	Revise the Reserve Bank Act and the Banking Act.	Completed.
Spring 1995	FAD	Improve the system of budgeting and public expenditure control.	Initial steps taken.
Spring 1995	STA	Harmonize the reporting system for monetary statistics.	Harmonization completed.
Winter 1995	STA	Provide training in balance of payments methodology.	Seminar provided.
January 1996	STA	Improve foreign trade statistics.	Advice being implemented.
August 1996	MAE (long term)	Strengthen banking supervision.	Some of the advice being implemented.
October 1996	STA	Improve national accounts.	Some of the advice being implemented.
January 1996, November 1996	MAE	Improve monetary and foreign exchange operations.	Some of the advice being implemented.
November 1997	MAE	Improve monetary operations.	Some of the advice being implemented.
May 1999	MAE	Review and advise on monetary operations, the payments system, and supervision; assess vulnerability of the financial sector.	Report recommendations being reviewed.
July 2001	MAE	Deposit insurance scheme.	Report recommendations being reviewed.

Zimbabwe: Relations with the World Bank Group

Arrears to the Bank, which were US$27 million as of end-October 2000, expanded to US$82 million by end-October 2001 and are expected to accumulate further in the next several months. Due to the accumulation of arrears, disbursements were suspended on May 15, 2000. A resumption of disbursements would be contingent upon clearance of arrears, and the scale of the Bank's subsequent reengagement will depend on progress in the following issues: (a) governance, (b) land reform, and (c) macroeconomic stability. In the absence of adequate progress on these fronts, Bank support to Zimbabwe will be limited primarily to social protection and AIDS-related activities, as well as the dialogue on land reform.

The second structural adjustment loan was closed on December 31, 1997 after release of the third tranche earlier in the month. A third structural adjustment credit has been prepared but put on hold, owing to the weakening in economic performance and governance.

There are three ongoing IDA investment projects in Zimbabwe, covering (a) Agricultural Services and Management, providing for improved extension services; (b) Sexually Transmitted Infections, aimed at arresting the spread of STDs and HIV/AIDS and providing care for those already infected; (c) Enterprise Development, to promote exports and industrial growth; (d) Community Action, aimed at alleviating structural causes of poverty in rural areas; (e) Park Rehabilitation and Conservation, focused on transforming the management of national parks, and recently amended to support rehabilitation of infrastructure in flood- affected areas; and (f) the Land Reform Project, already approved but not yet effective, to support pilot land improvement interventions (physical and social infrastructure) on already-acquired lands, which would then be distributed to landless farmers. Moreover, an Enhanced Social Protection Project is under preparation.

The IFC's investment portfolio in Zimbabwe represents one of its largest exposures in Africa, with commitments (as of October 2000) of US$70 million (loans of US$54 million and equity of US$16 million) and an outstanding portfolio of US$48 million (loans of US$33 million and equity of US$15 million). These IFC investments cover over 25 companies in a wide range of sectors. The IFC's specific strategy for Zimbabwe is to assist private sector development by (a) helping to enhance export-generating activities; (b) assisting in corporate restructuring, privatization (subject to the government's majority divestiture, the IFC would consider participating in the privatization of the insurance company, ZIMRE), and modernization; (c) strengthening the financial sector; and (d) supporting small and medium-sized enterprises.

IBRD/IDA Status of (Active) Operations in Zimbabwe
(in millions of SDRs; as of October 2, 2001)

Financier	Project name	Principal	Undisbursed	Disbursed	Closing Date
IDA	Enterprise Development	47.50	24.86	22.64	31-Dec-02
IDA	Community Action Project	45.00	42.27	2.73	31-Dec-03
IDA	Park Rehab. & Conservation	46.30	44.76	1.54	30-Sep-05
IDA	Land Reform	3.89	3.89	0.00	31-Dec-01

World Bank Loan/Credit Summary for Zimbabwe
(in millions of U.S. dollars; as of August 31, 2001)

	IBRD	IDA	TOTAL
Original principal	896.20	661.95	1558.15
Cancellations	52.07	28.17	80.25
Disbursed	842.99	459.71	1302.70
Undisbursed	1.14	163.29	164.43
Repaid:	412.81	5.31	418.12
Due:	430.18	428.57	858.75
Exchange adjustment	-23.64	0.00	-23.64
Borrowers' obligation	406.54	428.57	835.11

Zimbabwe: Statistical Issues

The statistical database in Zimbabwe is inadequate, and deficiencies have emerged in the timely provision of data to the Fund. While some monetary data are of high quality, the Reserve Bank of Zimbabwe (RBZ) does not report its foreign reserves in a meaningful fashion, data on external arrears are sketchy, budgetary data are reported to the staff with a substantial lag, and there is a significant discrepancy between above-the-line budgetary data and financing data compiled from other sources. The Central Statistical Office (CSO) conducts and updates regularly a wide array of sectoral surveys, but GDP data are reported with a substantial lag. There are shortcomings in external trade and finance data, and no information is available about unemployment.

Prices, production, labor

The CSO produces a monthly consumer price index. The base year was changed from 1990 to 1995, with new weights based on a 1995-96 survey. It also reports a monthly manufacturing index with a 1990 base, but with a long lag. Quarterly data on employment and wages are published with a substantial lag and limited coverage. A comprehensive labor market survey is long overdue.

National accounts

Having benefited from substantial technical assistance from the Fund, the World Bank, and the United Kingdom in 1996-97, the CSO published revised national accounts in late 1997, covering the period 1985-96, with 1990 as the base year for constant price estimates. While the revised national accounts are a significant improvement over the previous estimates, the coverage of economic activity in the informal sector remains inadequate. National accounts data for 1999 were not published until June 2001.

Public finance

Key weaknesses continue to impair the analysis of fiscal developments and the formulation of appropriate adjustment policies. Monthly revenue and expenditure data for the central government are available with a lag of four-six weeks. There are large discrepancies between the fiscal and monetary accounts, and a substantial unexplained discrepancy between the budget financing need (computed from the income expenditure side) and financing data from banking and other sources. In addition, a significant part of donor-financed development expenditure is off budget, the economic classification of expenditure is insufficiently disaggregated, and a functional classification of expenditure is not available.

The authorities do not provide Fund staff with budget data according to organizational classification on a regular basis, and they also provide limited access to source data, forcing staff to rely on aggregated data of unverifiable quality. Also, the operations of the social security fund and several self-financing funds under the purview of the central government are not included in reported data. Furthermore, although operating targets for public enterprises are provided regularly, it is still not possible to compile reliable consolidated accounts for the nonfinancial public sector, since financial operations of public enterprises are neither reported nor audited regularly, the accounts of local governments become available only with a lag of many years, and consolidated general government accounts are not compiled.

In 1999, the Ministry of Finance resumed reporting detailed data for publication in the *Government Finance Statistics (GFS) Yearbook*. However, no data have been reported since then, and the latest published data are for 1997. No more recent data are provided for publication in *International Financial Statistics (IFS)*.

External sector

Merchandise trade statistics are still being reported with a four- to five-month lag, even though, following installation of the new ASYCUDA computer system at the customs department, data are being provided by customs to the CSO within seven days of the end of each month.

Compilation of capital and financial account transactions suffers from a considerable delay, and there is a significant lag in reporting balance of payments data to the Fund. While the RBZ provides reasonably reliable estimates of the balance of payments for program and surveillance purposes, measures are needed to shorten the lag in the compilation and reporting of such data. Balance of payments data reported for publication in the *IFS* and *Balance of Payments Yearbook* are even less timely—the latest published data are for 1994.

Data on short-term external debt are reported to the Fund by the RBZ with a one- to two-month lag. Because of encumbrances on reserves, official reserve data are not reported to the Fund in a meaningful manner. Recently the RBZ has started to report "usable RBZ reserves" on a more timely basis. Comprehensive external debt data (including breakdowns of maturities, debtors, and creditors) are forthcoming only with a considerable lag. The authorities have provided staff only with partial information on the extent of their collateralized external borrowing, and they have not released comprehensive data on external arrears (including a detailed breakdown either by creditor and debtor or by principal and interest), which became significant in 1999 and have grown substantially since mid-2001. There is a pressing need for the authorities to provide comprehensive external sector data on a more timely basis.

Monetary accounts

Significant progress has been made in developing a unified system for reporting monetary statistics to the Fund based on international standards of data classification, and in improving the collection and reporting of financial data. However, there continues to be some difficulty in reconciling the balance sheet of the RBZ provided in the monetary control program, which is produced within two weeks of the end of each month, with the monetary survey, which is produced within six weeks of the end of each month.

Zimbabwe: Core Statistical Indicators
(as of October 31, 2001)

	Exchange Rates	International Reserves 1/	Central Bank Balance Sheet	Reserve/ Base Money	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	Overall Government Balance	GDP/ GNP	External Debt/ Debt Service 2/
Date of latest observation	10/31/01	10/05/01	09/01	10/05/01	08/01	10/31/01	09/01	12/00	12/00	09/01	1999	1999
Date received	10/31/01	10/22/01	10/05/01	10/22/01	10/01	10/31/01	10/01	09/01	09/01	10/01	09/01	09/01
Frequency of data 3/	D	W	M	W	M	D	M	Q	Q	M	Y	Y
Frequency of reporting 3/	D	W	M	W	M	W	M	V	V	M	V	V
Source of update 4/	C	A	A	A	A	A	A	A	A	A	A	A
Mode of reporting 5/	E	C	C	C	C	C	C	V	V	C	V	V
Confidentiality 4/	C	A	A	A	A	A	A	A	A	A	A	A
Frequency of publication 3/	D	W	M	W	M	W	M	V	V	M	V	V

1/ Data on reserves as reported by the authorities include substantial amounts of pledged or illiquid assets that are not identified clearly in official reports.
2/ The authorities do not provide comprehensive data on external arrears.
3/ D = daily; W = weekly; M = monthly; Q = quarterly; A = annual; V = on mission or staff visits.
4/ A = direct reporting by central bank or relevant ministry (including reports forwarded by World Bank); C = cable or fax (including reports forwarded by World Bank).
5/ C = unrestricted use; E = embargoed for a period of time.

Zimbabwe: Selected Social and Demographic Indicators
(1999, unless otherwise indicated)

Area	**Population**	**Density**
386,850 sq. km.	11,904 thousand	30.77 per sq. km.

Population characteristics	
Population growth rate	1.8
Life expectancy at birth	40.4
Infant mortality rate (per thousand)	70.1
Total fertility rate (births per woman)	3.6
Urban population (percent of total)	34.6
GNP per capita	US$ 652
Access to safe water (1996)	
Percent of population	77.0
Urban	99.0
Rural	64.0
Labor statistics	
Labor force (millions)	5.5
Of which: agriculture	1.3
(in percent)	25.5
Formal employment	
Private sector	
Informal sector	

Health	
Population per physician (1996)	8517
Public health expenditure (percent of GDP)	2.9
HIV-incidence (percent of population, age 15-49)	25
Education	
Adult literacy rate	88
Primary school enrollment rate (1997, percent of school-age group)	93
Poverty indicators (latest year)	
Poorest 40 percent	
Share of income	
Per adult equivalent consumption	

Sources: World Bank, *World Development Indicators, 2001.*

Statement by the IMF Staff Representative
December 14, 2001

This buff contains information that has become available since the staff report (SM/01/356; 11/30/01) was issued. Recent information does not modify the thrust of the staff appraisal.

Recent economic developments

- The parallel market exchange rate was trading at Z$300-350 per U.S. dollar in early December, depreciating from recent levels as low as Z$200 per U.S. dollar.

- After allowing nominal treasury bill yields to rise to about 25 percent in late November, the Reserve Bank of Zimbabwe has rejected all bids in recent treasury bill auctions that could have led to further rises in interest rates. Reserve money increased 138 percent in November 2000 from 12 months earlier, similar to the 135 percent rise in October.

- Privatization proceeds in 2001 are now expected to be Z$7-8 billion compared with Z$22 billion in the original budget and Z$10 billion in the supplementary budget.

Land reform

- The government has proposed to broaden the land acquisition program by limiting the maximum size of commercial farms to 250-2000 hectares, depending on the type and location of the property. Commercial farmers will be required to comply through subdivision by February 2002 or earlier. There are currently no limits on farm size.

- As part of the Abuja agreement, a UNDP team visited Zimbabwe for three weeks to assess the government's land reform program. The UNDP is preparing a report setting out proposals for a land reform program that could be acceptable to the Zimbabwean government and to the international community.

- On December 4, the recently reconstituted Supreme Court ruled that acquisitions of land by the government were lawful. This ruling followed the Supreme Court's December 2000 ruling ordering the government to develop a workable land reform program, to restore law and order in the commercial farms areas, and to remove or legalize illegal occupants of farms.

Political and other developments

- The government recently approved the UN's Humanitarian Assistance and Recovery Program for Zimbabwe, which is being considered as a basis for donor support. The World Food Programme is discussing with the government distribution mechanisms for a major food relief package.

- over -

- The Southern African Development Community, led by South African President Mbeki, is increasing pressure on Zimbabwe, reflecting concern that the deteriorating economic and political situation in Zimbabwe is increasingly spilling over to other countries in the region. Following a recent visit from SADC ministers, President Mugabe reportedly said that foreign observers will be allowed at the upcoming presidential election, reversing an earlier announcement prohibiting foreign observers.

- According to press reports, the presidential election will be held in March 2002, and the government will no longer allow NGOs to provide voter education. On December 3, the Zimbabwe High Court ordered the government to relax new voter registration requirements that would have made it difficult for many urban voters to register.

- The government has recently introduced a law that would effectively prohibit foreign journalists, requiring that correspondents for foreign media be Zimbabwean citizens.

- The European Union is reportedly considering "smart sanctions" targeted at travel by, and assets of, key ZANU-PF leaders and their families, following the EU's decision to invoke Article 96 of the Cotonou Agreement in October. On December11, the U.S. Congress passed the Zimbabwe Democracy and Recovery Act of 2001 restricting U.S. funding to Zimbabwe until the rule of law and democracy is restored.

INTERNATIONAL MONETARY FUND
Public Information Notice

EXTERNAL
RELATIONS
DEPARTMENT

Public Information Notice (PIN) No. 02/64
FOR IMMEDIATE RELEASE
June 19, 2002

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Concludes 2001 Article IV Consultation with Zimbabwe

On December 14, 2001, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Zimbabwe.[1]

Background

Zimbabwe's economic crisis has continued to deepen. The deterioration has mainly been the result of inappropriate macroeconomic policies and a general breakdown in the rule of law in the context of the government's fast-track land reform program launched in early 2000. This deterioration has undermined investor confidence, contributed to the rise in unemployment, destroyed capital, and eroded institutions important for economic development, thereby darkening the longer-term outlook. Real GDP is projected to contract by 8½ percent in 2001, bringing the cumulative decline in real per capita GDP since 1997 to 23 percent. Expansionary monetary policies have pushed inflation toward triple-digit levels and created an asset price bubble. Poverty and unemployment are rising, and food shortages—stemming from price controls on main commodities and foods, crop destruction, drought and floods, and the lack of foreign exchange—are becoming serious. Zimbabwe's economic and social problems are spilling over to other countries in the region in the form of increased illegal immigration, weakened investor confidence, and financial market turmoil.

Unsustainable fiscal policies have been at the center of the deterioration in the economy. The overall budget deficit rose sharply to 23 percent of GDP in 2000, owing to large, unbudgeted increases in civil service wages, military spending, and domestic interest payments. Some progress has been made to return fiscal policy to a sustainable path in 2001, although the expected reduction in the overall deficit to about 12½ percent of GDP will be achieved mainly through a sharp fall in interest payments in the wake of the forced restructuring of domestic debt by the government. The recently announced budget for 2002

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. This PIN summarizes the views of the Executive Board as expressed during the Executive Board discussion based on the staff report.

proposes a deficit of 15 percent of GDP, well above the outcome for this year and the 8 percent of GDP target set last year in the context of the three-year rolling budget. Government borrowing is therefore expected to remain substantial in 2002.

Monetary policy was relaxed during the second half of 2000, as the government's domestic borrowing requirement rose rapidly, and has become highly expansionary in 2001. The restructuring of government debt and heavy borrowing from the Reserve Bank of Zimbabwe (RBZ) caused interest rates to collapse from 65 percent at end-2000 to 14 percent in January 2001. As inflation has accelerated after mid-2001 and government borrowing from the RBZ has approached the statutory limit of 20 percent of the previous year's revenue, yields on treasury bills have recently risen somewhat, although remaining highly negative in real terms. Reserve money growth increased sharply to 150 percent in the year to September 2001, compared with 22 percent in the same period in 2000. Asset substitution away from money market instruments has created bubbles in equity and residential real estate prices. Moreover, the deteriorating economic situation has increased vulnerabilities in the financial sector.

The real effective exchange rate in the official market has appreciated sharply since October 2000, when the RBZ effectively returned to a fixed exchange rate regime. The continued shortage of foreign exchange, lack of official reserves, and limited access to foreign financing, have led to widespread import scarcities that are crippling economic activity as well as to the accumulation of external payments arrears, which rose to about US$722 million at the end of October 2001. Zimbabwe has been in arrears to the Fund since February 2001; and these had accumulated to SDR 53.7 million at the end of October. On September 24, 2001, the Executive Board declared Zimbabwe ineligible to use the general resources of the Fund and removed it from the list of countries eligible to borrow resources under the Poverty Reduction and Growth Facility (PRGF) Trust.

Executive Board Assessment

Executive Directors expressed deep concern about the sharp decline in economic activity and per capita income, the rise in poverty and human suffering, the acceleration of inflation, and the accumulation of domestic and external payments arrears, all of which gathered pace in 2001. Directors noted that the deteriorating situation is the result of inappropriate economic policies aggravated by violence and disruptions to productive activity related to the government's fast-track land reform program. Directors expressed concern that Zimbabwe's economic and social problems are having adverse spillover effects on neighboring countries, which adds to the urgency of taking decisive corrective action.

Directors agreed that significant changes in the government's economic policies, together with improvements in governance and the adoption of a transparent and orderly land reform program, are urgently needed to prevent a worsening of the economic crisis. They stressed, in particular, that the land reform program should minimize disruptions to the productive sectors and to domestic food supply, and urged the authorities to honor commitments made in Abuja and to work closely with the United Nations Development Program in formulating a program that will receive broad domestic and international support.

Directors stressed that bringing the fiscal deficit under control will be crucial to restoring macroeconomic stability. They acknowledged the limited progress achieved in 2001 to reduce the fiscal deficit, but noted that the targeted reduction in noninterest expenditure has not been achieved, and that most of the budgetary savings are attributable to a decline in interest outlays due to the forced restructuring of the government's domestic debt. They welcomed the progress made in putting in place expenditure controls and in establishing the Zimbabwe Revenue Authority, and looked forward to prompt action to make the Authority fully operational.

Directors noted with concern that, in the run-up to the presidential election, a substantial rise in government expenditure is expected to result in a widening of the fiscal deficit in 2002 and will undermine the modest progress achieved thus far. They urged the authorities to redouble, without delay, their efforts toward fiscal consolidation and improving the efficiency of government operations. Directors stressed the need to retrench recurrent expenditures, in particular on wages and defense, and to shift government resources toward protecting health and addressing pressing social needs, especially the problems associated with the HIV/AIDS pandemic. They encouraged the authorities to accelerate the privatization of public enterprises, as this would improve efficiency and reduce the burden on the government's finances, and to eliminate price controls and supply monopolies that undermine food security and intensify economic imbalances.

Directors noted that loose monetary policy has aggravated economic imbalances and fueled inflation, and has increased the vulnerability of the banking system. They urged the authorities to take immediate corrective measures to mop up excess liquidity, allow interest rates to become positive in real terms, and dismantle the distortionary subsidized credit facilities. Directors also stressed the need to ensure the health of the banking system by dealing promptly with nonviable institutions, and to fully enforce prudential regulations and capital adequacy requirements.

Directors noted with concern that the overvaluation of the Zimbabwe dollar has seriously hampered the country's competitiveness, and has resulted in a shortage of foreign exchange, the exhaustion of usable foreign reserves, a large accumulation of external payment arrears, and a wide spread between the official and the parallel market exchange rates. They agreed that an adjustment in the official exchange rate to a more realistic level, supported by tight monetary and fiscal policies, is urgently needed to restore external viability and reduce the rent seeking associated with foreign exchange rationing. While this adjustment could be achieved by a substantial up-front devaluation, followed by a return to the previous crawling peg arrangement, several Directors considered that a unified, floating exchange rate should be the ultimate objective.

Directors underscored the importance of sustained structural reforms aimed at liberalizing the economy to improve Zimbabwe's competitiveness. In this connection, they regretted the recent changes in import tariffs, which have increased protection. Noting that Zimbabwe has much to gain from trade liberalization and closer economic ties with neighboring countries and the global trading system, they urged the authorities to take steps to fulfill Zimbabwe's trade liberalization commitments in the context of several regional arrangements. Directors called for early elimination of exchange restrictions.

Directors reviewed the status of Zimbabwe's overdue financial obligations to the Fund. While acknowledging the authorities' intention to make quarterly payments, they regretted that such payments would not be sufficient to eliminate, or even stabilize, Zimbabwe's arrears to the Fund. Directors observed that Zimbabwe's arrears to the PRGF Trust could reduce the availability of PRGF resources to other eligible countries. Directors urged the authorities to cooperate with the Fund on the preparation of appropriate economic policies and to promptly settle overdue financial obligations to the Fund.

Directors urged the authorities to improve the coverage and timeliness of economic data, which are needed to facilitate the implementation of economic policies and for purposes of Fund surveillance.

Public Information Notices (PINs) are issued, (i) at the request of a member country, following the conclusion of the Article IV consultation for countries seeking to make known the views of the IMF to the public. This action is intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies; and (ii) following policy discussions in the Executive Board at the decision of the Board.

Zimbabwe: Selected Economic Indicators, 1998-2001 1/

	1998	1999	2000 Est.	2001 Proj.
Real economy (percentage change)				
Real GDP (market prices)	2.9	-0.7	-5.1	-8.4
Consumer prices (end of period)	46.6	56.9	55.2	102.5
Government finances (percent of GDP)				
Revenue, excluding grants	30.5	27.8	27.9	23.5
Expenditure and net lending	35.2	38.1	50.8	36.1
Overall balance, excluding grants and arrears	-4.7	-10.3	-22.9	-12.6
Primary balance, excluding grants	4.9	0.0	-5.4	-1.6
Money and interest rates				
Broad money (M3, end of period; percentage change)	14.1	29.8	59.9	86.6
91-day treasury bills (annualized yield)	40.4	89.7	71.6	29.5
Balance of payments (billions of U.S. dollars; unless otherwise indicated)				
Exports	1.93	1.92	1.79	1.72
Imports	-2.02	-1.68	-1.52	-1.45
Current account balance (excluding official transfers)	-0.36	0.03	-0.10	-0.12
(in percent of GDP)	-5.30	0.49	-1.44	-1.32
Overall balance	-0.16	0.02	-0.19	-0.51
Usable reserves (millions of U.S. dollars; end of period)	54.5	46.7	22.1	20.0
(months of imports of goods and services)	0.2	0.2	0.1	0.1
Total external debt (percent of GDP; end of period)	77.8	92.5	68.0	46.4
Debt service (percent of exports of goods and services)	21.2	21.8	27.4	27.0

Sources: Zimbabwean authorities; and IMF staff estimates and projections.

1/ Foreign currency units are converted into Zimbabwe dollars at the official exchange rate.

Statement by Cyrus D.R. Rustomjee, Executive Director for Zimbabwe
December 14, 2001

The Authorities are thankful to the Fund for remaining engaged during these difficult times in Zimbabwe, providing valuable policy advice and technical assistance. The authorities acknowledge that economic performance in Zimbabwe has continued to deteriorate, reflecting the impact of both domestic and exogenous factors. They are aware that to salvage the situation, a comprehensive package of policies is required, involving land and other social reforms, monetary tightening, fiscal consolidation, exchange rate adjustment, privatisation, elimination of price controls and other structural distortions and the rescheduling of external debt. In this context, the scenarios explored by the staff for the post-election period are helpful, including the modalities for Fund involvement.

Domestic Factors: Land Reform

On the domestic front, the authorities have maintained that land reform is inevitable to address historical imbalances and deep-rooted poverty, considering that this was a key issue during the struggle for independence, but which has not been resolved for the past 21 years. In this context, their preferred pace is to speed-up land reform, contending that resolving the problem once and for all augurs well for the long-term stability of the country. The authorities will continue to explore all options to reach an amicable solution, including cooperation with regional and non-regional Heads of States and negotiations with farmers and other stakeholders.

External Factors

While acknowledging the foregoing, the impact of other factors that are exogenous should not be overlooked. These include both the droughts and floods which have contributed to food shortages; continuous terms of trade losses; the ongoing global slowdown, which has significantly compounded difficulties in the tourism sector and has also contributed to a further decline in the prices of Zimbabwe's major exports. The ensuing foreign exchange shortages have led to a curtailment of essential imports, while crippling the country's capacity to discharge its external obligations.

The Authorities' Policy Stance

The confluence of internal and exogenous factors as well as natural calamities has compounded the economic crisis in Zimbabwe, whose salient features have been spiralling inflation; nearing triple digits; acute shortage of foreign exchange and essential imports; company closures and increasing unemployment; rising tension in the country; and the spill-over of the crisis to countries in the region. This environment has made the authorities' policy response a daunting challenge. To worsen the situation, the pressures of an election cycle have tilted the focus of policy towards the short-term and as a result, the adopted policy measures have not been effective in addressing the fundamental causes of the crisis.

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.

Comment

Notwithstanding the positive effects of low interest rates such as saving highly geared businesses, which were on the verge of collapse, the policy also led to reduced savings and spawned high money supply growth and consequent speculative behaviour. Greater flexibility in interest rate determination is now allowing interest rates to adjust upwards in support of savings mobilization without undermining the recovery of investment.

3.3 High Inflation

The IMF expressed concern with the impact of government's domestic borrowing requirements and the accommodative monetary policy on inflation. Inflation remained high last year, against the background of significant slow down in economic activity, entrenched inflation expectations, supply bottlenecks, wage inflation spiral and the discretionary pricing by retailers. These factors, together with a sharp growth in monetary supply, have combined to contribute to the build up in underlying inflationary pressures.

Comment

The Reserve Bank of Zimbabwe will continue to pursue monetary policy measures designed to counter the inflationary surge in the economy. The surge in inflation, however, calls for concerted effort by all stakeholders in order to break the inflation spiral and further aggressively reduce inflation. In this regard, Government has engaged stakeholders in tripartite negotiations involving labour and employers. The objective of the negotiations is to agree on a social contract and adopt a stakeholder driven anti- inflation programme, necessary to end inflation spiral.

3.4 Banking Sector soundness

The IMF raises concern about the financial position of the banking system in light of the prevailing difficult economic conditions, low interest rates and the impact of the land reform.

Comment

Despite the low interest rate environment, financial institutions have generally maintained their spreads between deposit and lending rates. Hence, the financial sector has remained among those sectors

that have continued to post positive financial results.

Furthermore, the banks have increasingly been reducing reliance on interest income by diversifying into other sources of income

General Comment

Despite the country's problems in settling its obligations to the Fund in time, the Government of Zimbabwe continued to benefit from the Fund through the staff visits on Article IV Consultations as well as through Technical Assistance offered.

It is hoped that the continued assistance will enable the country to weather through the current crisis.

GOVERNMENT OF THE REPUBLIC OF ZIMBABWE.

June 4, 2002