

Understanding the Dynamics of the Fiscal Deficit and Economic Performance in Zimbabwe

By

William Kavila

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Contents

List of tables	iv
List of figures	v
List of Abbreviations and Acronyms	viii
Abstract	x
Acknowledgements.....	xi
1.0 Introduction and background	1
2.0 Literature review	3
3.0 Fiscal policy transmission channels in Zimbabwe	5
4.0 Analysis of fiscal deficits and economic performance	7
5.0 Fiscal deficits and public debt	27
6.0 Exogenous shocks and growth.....	34
7.0 Summary and conclusion.....	45
References.....	47
Appendix.....	53

List of tables

Table 1: Government expenditure components (% of total expenditure)	9
Table 2: Government expenditure (% of GDP)	10
Table 3: Zimbabwe: Selected economic indicators (1980–1990)	13
Table 4: Zimbabwe: Selected economic indicators (1991–1996)	14

List of figures

Figure 1: Crowding out effect of government borrowing (ZW\$ billion)	5
Figure 2: Macroeconomic phases.	8
Figure 3: Government revenue, expenditure, and fiscal balance	11
Figure 4: Reserve money and consumer price index.	18
Figure 5: Month-on-month inflation	18
Figure 6: Real GDP growth (%)	20
Figure 7: Annual inflation	21
Figure 8: Official exchange rate, parallel rate, and premium (ZW\$/US\$).	23
Figure 9: Inflation and parallel exchange rate	24
Figure 10: Inflation and money supply growth	25
Figure 11: Zimbabwe FDI inflows (US\$ millions)	26
Figure 12: Zimbabwe public debt (US\$ million)	28
Figure 13: Trends in Zimbabwe debt service ratios	29
Figure 14: Evolution of external payment arrears (US\$ millions)	29
Figure 15: Trends in debt composition (% share).	30
Figure 16: Domestic and external debt as % of GDP	31
Figure 17: Primary balance (US\$ millions).	32
Figure 18: Budget and account balance	33
Figure 19: Annual real GDP growth	34
Figure 20: Sectoral contributions to GDP (%)	35
Figure 21: Gold and platinum price developments (1980–2018)	37

Figure 22: Copper and nickel price developments (1980–2018)	37
Figure 23: Tobacco price developments (US\$ per kg)	38
Figure 24: Gold output (kg)	39
Figure 25: Total export earnings (US\$ millions)	40
Figure 26: Zimbabwe FDI inflows (US\$ millions)	41
Figure 27: Grant inflows to Zimbabwe (US\$ millions)	42
Figure 28: FDI inflows (1990-1999)	43
Figure 29: FDI inflows (2000-2008)	43
Figure A1: Sources of government revenue, 1980–2018	53

List of Abbreviations and Acronyms

AERC	African Economic Research Consortium
AfDB	African Development Bank
AGOA	African Growth and Opportunities Act
AIPPA	Access to Information and Protection of Privacy Act
BADEA	Arab Bank for Economic Development in Africa
BRICS	Brazil, Russia, India, China, and South Africa
CZI	Confederation of Zimbabwe Industries
DRC	Democratic Republic of Congo
ESAP	Economic and Structural Adjustment Programme
EU	European Union
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
GMB	Grain Marketing Board
GNU	Government of National Unity
GoZ	Government of Zimbabwe
IFAD	International Fund for Agricultural Development
IFI	International Financial Institution
IMF	International Monetary Fund
MDB	Multilateral Development Bank
MDC	Movement for Democratic Change
MoFED	Ministry of Finance and Economic Development
QFAs	Quasi-fiscal Activities
RBZ	Reserve Bank of Zimbabwe
SADC	Southern African Development Community
SMP	Staff-Monitored Programme
STERP	Short-Term Economic Recovery Programme
TSP	Transitional Stabilization Plan
TDH	Twin Deficit Hypothesis
UNCTAD	United Nations Conference on Trade and Development

ZANU PF
ZIDERA

ZIMPREST

ZIMSTAT

Zimbabwe National Union Patriotic Front
Zimbabwe Democracy and Economic
Recovery Act

Zimbabwe Programme for Economic and
Social Transformation

Zimbabwe Statistical Agency

Abstract

The Government of Zimbabwe's desire to meet the country's development expenditure needs, following the attainment of independence in 1980, resulted in high fiscal expenditures which were not supported by adequate fiscal revenue inflows and this resulted in high and persistent fiscal deficits, with a negative impact on the growth of the economy. This paper uses a descriptive approach to analyse developments in the Zimbabwean economy over the period 1980–2018, with emphasis on the relationship between fiscal deficits and economic growth. The paper also provides a descriptive analysis of the impact of external shocks, structural breaks, and policy shifts on the Zimbabwean economy and their influence on the relationship between fiscal deficits, inflation, and economic growth. The analysis indicates that there could be a two-way relationship between fiscal deficits and real GDP growth, with one possibly causing the other. High fiscal deficits, largely financed through borrowing from the central bank, resulted in high money supply growth, leading to high inflation and a negative impact on economic growth. Conversely, low economic growth resulted in low fiscal revenue inflows, against high government expenditure, leading to high fiscal deficits. External shocks, such as droughts and the decline in international commodity prices of Zimbabwe's export products, negatively affected fiscal revenue inflows and economic growth. Developments in the country's political economy also had an influence on economic growth.

Key words: fiscal deficit; economic growth; inflation, Zimbabwe
JEL classification codes: E31, H62, O4

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1.0 Introduction and background

Zimbabwe has been running large and persistent fiscal deficits since the attainment of independence in 1980. The persistent incurrence of budget deficits was a result of the need to meet development expenditure requirements, critical to foster economic growth and development. The country made substantial social progress during the first ten years of independence, but real growth in the economy was erratic (Government of Zimbabwe [GoZ], 1998). According to the GoZ (1998), a combination of structural bottlenecks, poor weather conditions, low investment levels, and low international commodity prices militated against the attainment of sustained economic growth.

Due to high spending against low revenue inflows, the GoZ monetized fiscal deficits as it embarked on a programme of wealth redistribution and infrastructure development. Its main concern was to address equity considerations through expanded social services, especially in health, education, and social development (GoZ, 1983). These programmes implied an increase in recurrent expenditure, which mainly consisted of wages and salaries, interest on debt and transfer payments, and made up over 90% of total government expenditure. The monetization of fiscal deficits resulted in high money supply growth, leading to high inflation, which created internal macroeconomic imbalances.

While economic growth averaged about 3% during the first decade of independence, fiscal deficits were higher, averaging 7.4% during the same period. Fiscal deficits have carried the blame for adversely affecting economic growth since 1980, and causing economic crises, starting with the hyperinflation of 2007/08 and cash and foreign currency shortages during the period of relapse into economic crisis (2013–2018). Notwithstanding this, the literature asserts that a budget deficit is not necessarily a problem if it is within manageable levels. Moreover, the literature also postulates that the impact of a budget deficit on the economy depends on its financing.

This study uses a descriptive approach to analyse the relationship between fiscal deficits, inflation, and the economic performance of the Zimbabwean economy for the period 1980–2018 and, in the process, makes an assessment of whether fiscal deficits were a consequence of either deliberate policy shifts or exogenous shocks the economy experienced. The study tells the story about the Zimbabwean economy by analysing what went wrong with an economy that was doing relatively well in the 1980s. In terms of industrialization, the Zimbabwean economy was second to South Africa in Southern Africa and was once the “bread basket” of the Southern

African Development Community (SADC) region. However, the country has recently been moving from one economic crisis to another, and has had to rely on imports for basic needs such as food items, let alone raw materials for use by its agro-processing industry. The study seeks to answer questions such as: have high fiscal deficits had an influence on growth and macroeconomic stability; why economic growth had been so erratic; why the Government of Zimbabwe moved away from good economic management practices; and why inflation was going up again.

The main finding of this study is that high fiscal deficits, which were mainly a result of poor economic management and bad policies, had a negative impact on inflation and the country's economic performance. On one hand, the monetization of fiscal deficits led to high money supply growth and inflation. On the other hand, high inflation eroded the real value of fiscal revenues resulting in even higher fiscal deficits, which were also monetized, thus creating a vicious cycle. Ancillary and exogenous factors such as sanctions, droughts, and international commodity price shocks also had a negative impact on the country's economic performance.

The study contributes to the existing literature on the impact of high fiscal deficits on inflation and economic performance. As Ndlela (1987) observes, the GoZ inherited a well-diversified and sophisticated economy. Notwithstanding this, decades of poor economic management and bad governance constrained economic growth and development (Dansereau et al., 2005). The huge role government played in economic activity, particularly through state investments in public enterprises and shareholding in some private enterprises in both the financial and non-financial sectors, created huge inefficiencies, which resulted in high fiscal expenditures as government supported the loss-making enterprises. The high fiscal expenditures, not matched by fiscal revenue inflows, resulted in high fiscal deficits mainly financed through borrowing from the central bank.

The rest of this paper is organized as follows: Section 2 provides a summary of the literature review. Section 3 covers the fiscal policy transmission mechanism. An analysis of the fiscal deficit and economic performance in Zimbabwe is in Section 4. Section 5 discusses the relationship between fiscal deficits and public debt. Section 6 covers exogenous shocks and growth; and Section 7 provides a summary and concluding remarks.

2.0 Literature review

Fiscal deficits have an impact on inflation as Chhibber et al. (1989) find in their investigation of the impact of government policies on inflation and price changes in Zimbabwe. Excess money supply, emanating from the monetization of fiscal deficits, influenced price formation in Zimbabwe, together with changes in import prices, administered prices, unit labour costs, and output (Chhibber et al., 1989). Hanke (2008) points out that the source of Zimbabwe's hyperinflation was the printing of money by the country's central bank to finance excessive government spending. According to the author, during the period January 2005–May 2007, the rate of currency issuance by the Reserve Bank of Zimbabwe (RBZ) exceeded that of Germany's central bank over the period January 1921–May 1923, the peak of the famous German hyperinflation. Robinson (2006) and Muñoz (2007) supported this view when they found that the monetization of fiscal deficits, coupled with quasi-fiscal activities (QFAs) of the RBZ, caused excessive money supply growth, fuelling hyperinflation in Zimbabwe. As the European Union (EU) (2020), Moretti (2017), Portela (2014), US Congress (2001), and Bigsten and Durevall (2003) posit, the implementation of bad economic policies by the Zimbabwean Government resulted in the incurrence of high fiscal deficits, with a negative impact on inflation and economic activity. The positive relationship between money supply growth and inflation is also supported in studies by Kuijs (1998), Durevall and Ndungu (1999) and Sacerdoti and Xiao (2001).

In a qualitative analysis of fiscal deficits, stability and the monetary dynamics of hyperinflation, Kiguel (1989) concluded that hyperinflation is a result of unsustainably large government budget deficits and, in this regard, the elimination of fiscal deficits would stop hyperinflation episodes. The researcher also notes that hyperinflation is 'inherently unstable' and is characterized by an accelerating rate of inflation over time. Increases in the fiscal deficit, though small, can trigger a hyperinflationary process, with real money balances falling as inflation increases, leading to higher demand for inflationary financing (Kiguel, 1989). De Haan and Zelhorst (1990) find that during high inflation periods, fiscal deficits have a positive relationship with inflation. Shallow domestic markets, which cannot take all newly issued government paper, coupled with fiscal dominance, where fiscal deficits are monetized, have resulted in inflation in most developing countries (De Haan and Zelhorst, 1990). Catao and Terrones (2003), find a strong deficit–inflation relationship for a wide range of high inflation developing countries in a panel data analysis of fiscal deficits and inflation for 107

countries. In Mexico, the use of inflation tax to finance fiscal deficits resulted in high inflation, an increase in government debt and, in some cases, fiscal imbalances, leading to economic crises (Ramos-Francia et al., 2018).

The monetization of persistent fiscal deficits by governments, which are fiscally dominant, results in inflation (Sargent and Wallace, 1981). Sargent (1981) confirms this assertion in a study of hyperinflation for four countries, namely, Germany, Austria, Hungary, and Poland, and notes that persistently large fiscal deficits, coupled with rapid monetary expansion, had resulted in inflation spirals, which only abruptly stopped through a change in government policy. The new fiscal policy would only be effective if it advocated for a framework that would contain fiscal deficits for the short, medium, and long term. The increase in unbacked fiat money resulting from the monetization of fiscal deficits accounted for the big inflation episodes in the four countries, with inflation ending in each country only when it became clear that the monetization of fiscal deficits had ended and the countries had restored their currency convertibility to the US dollar or to gold (Sargent, 1981). Indeed, this happened in Zimbabwe in 2009 when the Government of National Unity (GNU) adopted a multi-currency form of dollarization and the central bank stopped lending to the government, following the hyperinflation episode of 2007/08.

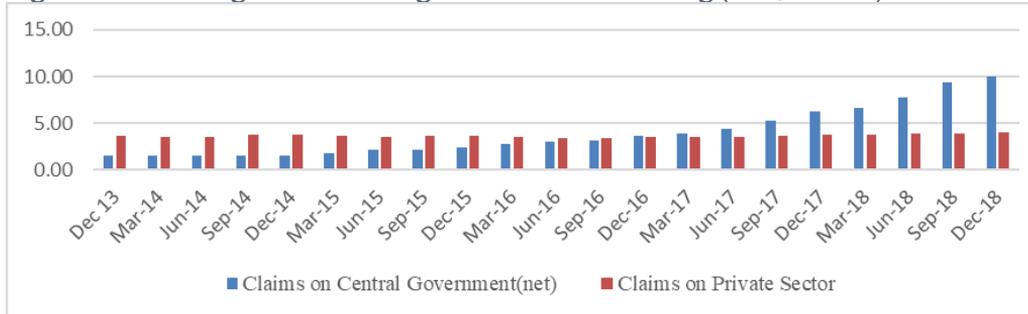
Inflation may affect fiscal deficits through lags in tax collection that reduce the real value of revenues collected, thereby worsening the fiscal deficit, as well as through the deterioration in tax compliance (Dornbusch et al., 1990). In this regard, a higher fiscal deficit caused by reduced real fiscal revenues is likely to result in the demand for more financing through borrowing from the central bank, thus influencing inflation dynamics. This postulation by Dornbusch et al. (1990) suggests a two-way causality between high inflation and fiscal deficits.

3.0 Fiscal policy transmission channels in Zimbabwe

Fiscal policy maintains a prominent role in engendering sustainable and inclusive growth. Notwithstanding, the increase in public debt has created a constraining environment for fiscal policy to smooth short-term economic cycles through automatic stabilization or discretionary fiscal policy measures (International Monetary Fund [IMF], 2017). The channels for the transmission of fiscal policy vary across countries, with the most prominent channels being the interest rate and central bank financing of the deficit. However, the monetization of fiscal deficits causes inflation and macroeconomic instability, which negatively affects real private-sector investment.

In Zimbabwe, high fiscal deficits, predominantly financed through domestic borrowing, resulted in government obtaining a bigger share of funds from the banking system from December 2016 to December 2018. This was tantamount to a crowding out of the private sector, which evidently received less credit compared to the government, as shown in Figure 1.

Figure 1: Crowding out effect of government borrowing (ZW\$ billion)



Source: Author construct with data extracted from Reserve Bank of Zimbabwe Monthly Reviews, 2013 through 2018.

The reduced availability of loanable funds to the private sector is likely to have negatively affected private investment, leading to a negative impact on output. The structure of government expenditure, skewed towards recurrent expenditures, largely employment costs, worsened the situation. Expenditure on capital projects averaged less than 10% of GDP over the period 1980–2018. As Morande and Schmidt-Hebbel

(1991) observe, high government expenditure financed through borrowing from the domestic banking sector resulted in the crowding out of private investment. This, coupled with the foreign currency allocation system used by Zimbabwean authorities, constrained imports for both private consumption and investment during the period 1980–1989, with a negative impact on import substitution by firms (Morande and Schmidt-Hebbel, 1991).

The transmission of fiscal policy through the interest rate channel, in the case of a fiscal expansion, may have an adverse impact on growth if financial market players respond by increasing interest rates. This is because financial market participants will be expecting an increase in inflation and the possibility of financial instability following fiscal expansion. High interest rates may consequently lead to the crowding out of private investment and a contraction in output. However, the interest rate transmission channel for fiscal policy is not very pronounced in Zimbabwe because the country has a relatively underdeveloped financial market.

The monetization of fiscal deficits resulted in an increase in money supply, and hence inflation, causing macroeconomic instability, with devastating effects on economic growth. Excessive money supply growth largely accounted for Zimbabwe's hyperinflation episode of 2007/08 (Coorey et al., 2007; Hanke, 2008).

4.0 Analysis of fiscal deficits and economic performance

Zimbabwe was under international sanctions for a period of 14 years, including seven years of a protracted war of liberation, before attaining independence in 1980. The new government took over a highly diversified economy, which registered impressive growth during the first two years of independence. While the country experienced substantial social progress during the first ten years of independence, economic growth was erratic (GoZ, 2003). This was the result of a combination of structural bottlenecks, poor weather conditions, low investment levels, and low international commodity prices (GoZ, 2003). The growth of the economy was constrained by fiscal imbalances, which reflected the desire of the GoZ to improve social services and fulfil the aspirations of the general populace created during the war of liberation (GoZ, 2003).

The GoZ opened up the economy in 1991, through the adoption of an International Monetary Fund (IMF) and World Bank-supported Economic Structural Adjustment Programme (ESAP), aimed at addressing the poor economic performance. The liberalization of the economy through the implementation of economic reforms was largely successful, but did not deliver the expected sustained high real GDP growth rates because of persistent fiscal imbalances (IMF, 2001). Additional economic reform programmes the country adopted after the ESAP failed to bring any tangible benefits to the economy due to partial implementation and, in some cases, outright lack of commitment to their implementation (IMF, 2001).

An economic crisis manifested itself in Zimbabwe in 1997, leading to an estimated cumulative 45% contraction in the economy over the period 2000–2008 (IMF, 2009). The economy experienced an exponential growth in inflation, endemic rent-seeking and speculative activities, and persistent shortages of fuel, cash, basic commodities, and foreign exchange. Major declines occurred in the social services and utility sectors such as education, health, electricity and water, and in public services.

As domestic macroeconomic conditions deteriorated, deindustrialization increased, leading to a swift growth in the informalization of the economy, following the decline in employment opportunities. Moreover, the local currency lost its value drastically and, consequently, lost its basic functions as an acceptable store of value, medium of exchange, and standard for deferred payments (Tsumba, 2009). The informal use of stable foreign currencies, such as the US dollar, British pound, South African rand, and the Botswana pula, increased significantly in the third quarter of

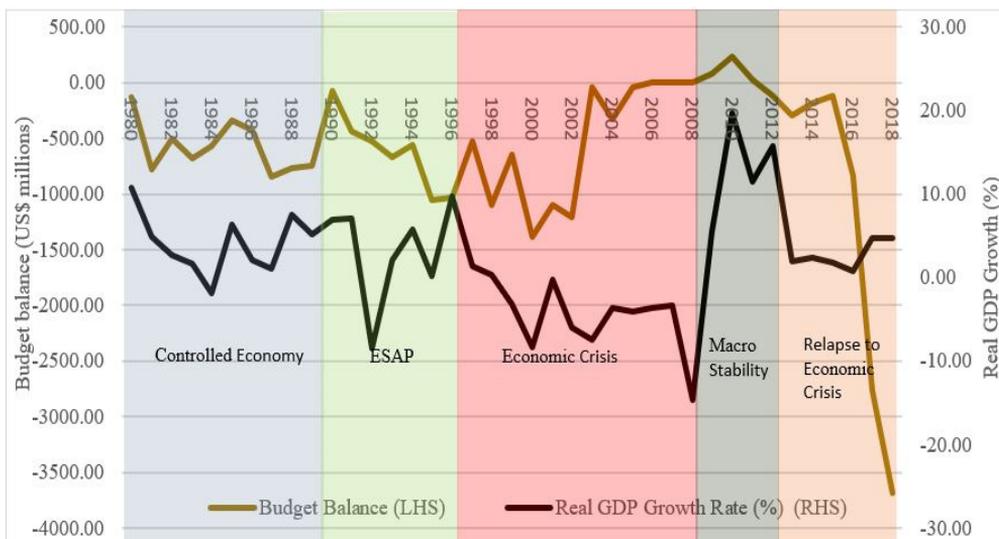
2008, a consequence of the loss in value of the local currency. The GoZ responded to increased informal dollarization of the economy by formally adopting a multiple-currency system in January 2009. This reduced speculative activities and brought about macroeconomic stability characterized by low and stable inflation and high economic growth rates.

The nascent recovery of the economy was short-lived, as economic activity decelerated during the period 2013–2018, due to emerging vulnerabilities and structural bottlenecks, which had a dampening effect on the momentum of the economic recovery. Real GDP growth decelerated to 2.0% in 2013, before registering a marginal increase to 2.4% in 2014, and posted lower growth rates of 1.8% in 2015 and 0.8% in 2016 (ZIMSTAT, 2018). The economy, however, rebounded to 4.7%, in 2017 and 4.8% in 2018 (ZIMSTAT, 2019). This was a clear indication of the volatility of real economic growth in Zimbabwe during the study period.

Macroeconomic episodes

Macroeconomic developments in Zimbabwe can be divided into five distinct phases, namely: decade of controls (1980–1990); the first and part of the second phase of economic reforms (1991–1996); economic crisis (1997–2008); return to macroeconomic stability or the multi-currency era (2009–2012); and relapse into macroeconomic instability (2013–2018). Figure 2 provides a snapshot of the phases of macroeconomic development in Zimbabwe, and trends in the budget balance and real GDP growth for the period 1980–2018.

Figure 2: Macroeconomic phases, GDP growth, and budget balance (1980–2018)



Source: Author computations and construct with data extracted from Ministry of Finance and Economic Development, Zimbabwe, Budget Estimates; and ZIMSTAT, Quarterly Digest of Statistics, 1980 through 2018.

The major decline in real GDP growth during the period of the controlled economy and ESAP could be partly explained by drought, which had a negative impact on growth, especially for the years 1983, 1984, and 1992. The economic crisis period was also characterized by high negative real GDP growth rates, with 2008 being the year the crisis reached a climax. High real GDP growth rates and budget surpluses were only realized during the period the country was under a Government of National Unity. However, the economy registered low real GDP growth rates and high fiscal deficits when it relapsed into the economic crisis.

The two major sources of fiscal revenue during the study period were tax and non-tax revenue. Tax revenue consisted of income and profit tax, value added tax, customs duties, excise duties, and other indirect taxes, as shown in Figure A1 (in the appendix). During the period 1980–1990, government revenues were dominated by income and tax profits at an average of 11.0% of GDP, followed by value added tax at 6.0%, customs duties at 3.6%, excise duties at 2.5%, and other indirect taxes at 0.3%. The scope to increase government revenue under this scenario was dependent on the level of economic activity, which was sluggish during this period. Conversely, government had to deliberately increase expenditures, especially in social sectors such as education and health, which resulted in fiscal deficits given the constrained fiscal space. Moreover, there were expectations from the populace pertaining to an improvement in their livelihoods, given that the country had just gained political independence.

As shown in tables 1 and 2, the GoZ has been allocating and spending inadequate amounts of capital expenditure, critical for fostering long-term economic growth. This was the case for capital expenditure both as a proportion of total expenditure and as a proportion of GDP. The employment costs component of current expenditure was generally above 60% of total costs during the period 2009–2018. In addition, while capital expenditure increased between 2016 and 2018, it largely consisted of unproductive capital transfers to state-owned enterprises.

Table 1: Government expenditure components (% of total expenditure)

	1980–1990	1991–1996	1997–2008	2009–2012	2013–2018
Current expenditure	87.4	81.8	87.1	86.4	79.1
Capital expenditure	12.6	18.2	12.9	13.6	21.8

Source: Ministry of Finance and Economic Development, Zimbabwe (2018), and author computations.

Table 2: Government expenditure (% of GDP)

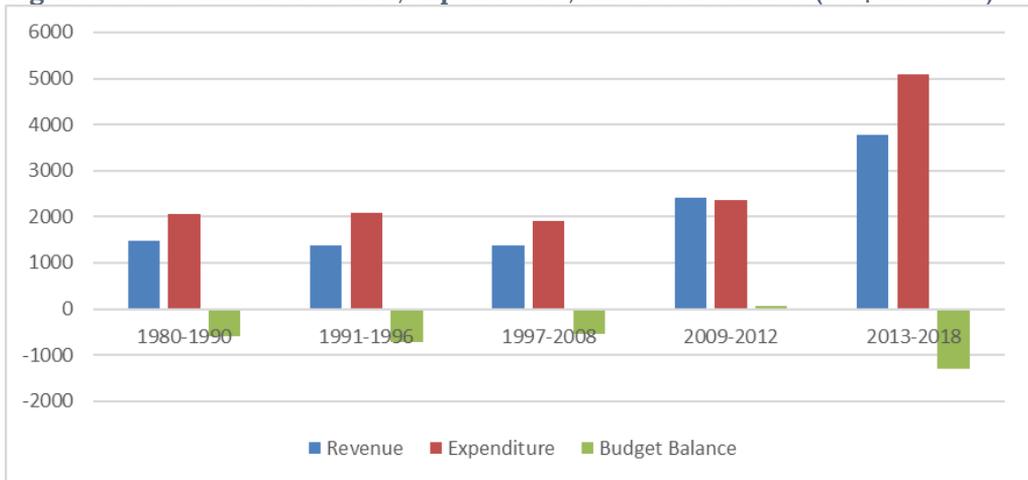
	1980–1990	1991–1996	1997–2008	2009–2012	2013–2018
Total expenditure	32.8	31.4	41.8	16.6	20.4
Current expenditure	28.8	25.6	36.3	14.5	17.0
Capital expenditure	4.0	5.8	5.5	2.1	3.4

Source: Ministry of Finance and Economic Development, Zimbabwe (2018), and author computations.

Public expenditure largely consisted of employment costs and transfers to state-owned enterprises such as the Grain Marketing Board (GMB) for grain purchases (GoZ, 2019). Grant-aided tertiary institutions and hospitals run by religious organizations also accounted for a substantial amount of current expenditures incurred by government. Grants and capital transfers largely exceeded budgets because of high inflation.

The key drivers of fiscal deficits in Zimbabwe have been expenditure overruns, arising from costly political decisions in most cases. The involvement of the country in the Democratic Republic of the Congo (DRC) conflict and the payment of gratuities to the veterans of the war of liberation, for example, were purely political decisions that increased fiscal expenditures. The land resettlement programme itself and agriculture support schemes such as Command Agriculture came at a huge cost to the fiscus. In addition, Zimbabwe has been on its own due to limited sources of external financing, following the suspension of budget support by bilateral donor countries. While fiscal revenues performed fairly well over the years, high levels of inflation severely reduced them in real terms. The statutory limit of government borrowing from the central bank was 20% of the total fiscal revenue of the previous year, but was not adhered to in many instances.

Figure 3 depicts developments in government revenues, expenditure, and budget balance during the study period. The graph shows that, the GoZ posted budget deficits in four of the five economic episodes. The exception was the period 2009–2012, when fiscal prudence fostered macroeconomic stability. Larger deficits characterized the period of relapse into economic crisis (2013–2018).

Figure 3: Government revenue, expenditure, and fiscal balance (US\$ millions)

Source: Ministry of Finance and Economic Development, Zimbabwe (2018), and author computations.

The next sections provide a detailed analysis of economic developments during each of the five distinct economic episodes.

Decade of controls (1980–1990)

Zimbabwe's economic policy thrust during the decade of controls was that of heavy reliance on government intervention in the management of the economy, in pursuit of its declared 'socialistic' welfare responsibilities. The socioeconomic policy of the government had a dual role, namely, to redress the socioeconomic inequalities inherited at independence in 1980 and to promote economic growth with equity. This resulted in the posting of significant fiscal deficits during the entire period from 1980 to 1990. There was some marked level of correlation between the budget deficit and economic growth during the period 1980–1990.

The Government of Zimbabwe (GoZ) adopted the growth-with-equity model as its economic blueprint at independence (Khadhani, 1986; Sibanda and Makwata, 2017). This appeared logical post-independence, as the economic management system used by colonial rulers had created two distinct classes of people, the rich white minority and a poor black majority. The growth-with-equity model was aimed at addressing the colonial injustices created by the apartheid regime of Ian Douglas Smith, who was Prime Minister of the then Rhodesia from 1964 to 1979. Moreover, during the war of liberation, the black majority was given the assurance that the inequalities, which they had endured during the colonial rule, would be addressed if the country attained political independence.

The Zimbabwean economy posted high real growth rates in 1980 and 1981 (GoZ, 1986). This followed the improved security situation when the war ended in 1979, with the country attaining independence in 1980. In addition, the economy was opened up and this, coupled with the good 1980/81 agricultural season, also supported the high real growth rates. Economic activity was further enhanced by increased domestic demand, coupled with the lifting of international sanctions against the country. Real GDP grew by 7.9% and 11.5% in 1980 and 1981, respectively.

In 1982, the economy registered lower growth of 0.6% and a fiscal deficit of 8.96% of GDP, largely financed through borrowing from the central bank. High government expenditure, against low revenue inflows as government embarked on a programme of infrastructural development and wealth redistribution, led to the monetization of fiscal deficits. The GoZ's main thrust was to address equity considerations through expanded social services, such as education and health (GoZ, 1983; Kadhani, 1986) and this implied increased recurrent expenditure.

The country experienced a severe drought in the 1983/84 agricultural season, resulting in a decline in agricultural output (GoZ, 1986). Real GDP growth registered a 15.0% decline in 1984, with the fiscal deficit standing at 11.11% of GDP. Inflation remained high at 16.3% in 1984, down from 19.6% in 1983, partly attributable to the decline in output coupled with the monetization of fiscal deficits.

The GoZ introduced an economy-wide wage and price freeze in June 1987 in an endeavour to contain inflation, which it managed to do, albeit with adverse effects on the supply of goods. Inflation ended the year 1987 at 11.9%, before falling to 7.1% in 1988. However, inflation accelerated to 15.5% in 1990, from 11.6% in 1989, due to the June 1989 partial relaxation of the price-wage freeze, an increase in the price of fuel and a significant expansion in money supply. The fiscal deficit remained high, ending the year 1990 at 5.29% of GDP, as shown in Table 3.

Table 3: Zimbabwe: Selected economic indicators (1980–1990)

Year	Real GDP growth rate (%)	Inflation rate (%)	Budget deficit (% of GDP)	Money supply growth (%)	External debt service ratio (%)	Current account deficit (% of GDP)
1980	7.9	7.3	-2.77	21.5	9.0	-4.9
1981	11.5	13.8	-7.16	13.1	10.0	-10.9
1982	0.6	14.6	-8.96	13.6	16.0	-11.6
1983	10.6	19.6	-9.98	11.7	25.0	-8.9
1984	-15.0	16.3	-11.11	10.5	27.0	-1.8
1985	0.3	9.2	-7.61	17.7	29.0	-1.9
1986	1.7	14.2	-6.53	12.2	29.0	0.2
1987	-2.2	11.9	-8.84	17.0	33.0	0.8
1988	15.5	7.1	-6.34	25.0	28.0	1.6
1989	10.6	11.6	-6.31	20.8	21.0	-0.5
1990	7.0	15.5	-5.29	20.9	25.0	-4.0

Source: Author computations with data extracted from Reserve Bank of Zimbabwe Quarterly Economic and Statistical Review; and ZIMSTAT Quarterly Digest of Statistics, 1980 through 2018.

The erratic growth in the economy during the first decade of independence bore testimony to the failure of the use of controls in economic management. In this regard, the GoZ embarked on an IMF-supported Economic and Structural Adjustment Programme (ESAP) whose general thrust was to deregulate the economy and put it back onto a sustainable growth path.

First phase of the Economic Structural Adjustment Programme (1991–1995)

Zimbabwean authorities instituted a wide range of economic reforms under the ESAP in 1991, whose main objective was to stabilize the economy, which was facing severe internal and external imbalances (GoZ, 1991). The first phase of the reform programme was generally successful, notwithstanding the negative impact of a severe drought in the country in the 1991/92 agricultural season (GoZ, 1998). Substantial progress was made in the liberalization of the foreign exchange, labour and product markets, as well as the deregulation of foreign investment. However, the economy did not register substantial growth due to macroeconomic imbalances, as shown in Table 4.

Table 4: Zimbabwe: Selected economic indicators (1991-1996)

Year	Real GDP growth rate (%)	End period inflation rate (%)	Lending rate (%)	Budget deficit (% of GDP)	Broad money growth (%)	External debt service ratio (%)	Current account deficit (% of GDP)
1991	7.1	30.2	14.6	-5.39	20.4	24.0	-5.3
1992	-8.4	46.4	34.6	-4.97	22.1	30.0	-8.9
1993	2.1	18.6	37.9	-6.23	43.8	30.0	-2.1
1994	5.8	21.1	36.4	-3.8	33.8	25.0	-2.0
1995	-0.2	25.8	35.1	-9.36	30.0	20.0	-5.0
1996	9.7	16.4	33.6	-5.92	27.7	18.0	-0.2

Source: Author computations with data extracted from Reserve Bank of Zimbabwe Quarterly Economic and Statistical Review; and ZIMSTAT Quarterly Digest of Statistics, 1980 through 2018.

High fiscal deficits were a major source of macroeconomic imbalance that affected the Zimbabwean economy during the first phase of the reforms (IMF, 1997). Budget outturns were higher than initially planned and what the economy could sustain. Slippages in fiscal policy occurred because of a lack of control in government expenditure: slower than planned progress in civil service rationalization and reform, larger than budgeted for public enterprise losses, and slower disbursement of foreign inflows (African Development Bank [AfDB], 1997; IMF, 1997). Consequently, government absorbed more resources from the domestic banking sector, thereby reducing the amount available for investment by the private sector.

Under the economic reform programme, the fiscal deficit was to be reduced to 5% of GDP by the end of the fiscal year 1993/94. However, the fiscal deficit turned out to be 7.9% of GDP. Similarly, the fiscal deficit for the 1994/95 fiscal year was 9.36% of GDP, compared to the target of 5%. Trends in the fiscal balance and GDP growth rates during the period 1991–1997 also exhibited some degree of correlation whereby higher growth rates were associated with lower fiscal deficits, as shown in Figure 2.

The first phase of ESAP succeeded in liberalizing the economy and attracting investment as investment regulations were more conducive. However, the economic reforms lacked a comprehensive social protection programme and led to an increase in poverty and unemployment. Furthermore, the ESAP became unpopular with trade unions, as it had also led to the laying-off of many workers and became a threat to state security. In this regard, the planned second phase of economic reforms code-named the Zimbabwe Programme for Economic and Social Transformation (ZIMPREST), scheduled for implementation over the period 1996–2000 was abandoned. The abandonment of economic reforms constituted a major drawback for the country's

economic performance by having a negative impact on both domestic and foreign investment, which had responded positively to domestic deregulation.

Opposition to the rule of the then President of the country, Robert Gabriel Mugabe, emerged, stemming from the adverse impact of the ESAP as well as the populace's general disgruntlement over government's delay in addressing the land issue. The land issue was on hold for a period of ten years, from 1980 to 1990, in line with the Lancaster House agreement (Jansen and Rukovo, 1992; Moyo, 1986), which ended the white minority rule. There was a build-up of pressure on government to redistribute land. In addition, there was pressure from veterans of the liberation struggle who demanded some form of compensation for their participation in the liberation of the country. The veterans of the war of liberation threatened to march to State House to demonstrate against the government, which subsequently gave in to their demands and compensated them through pay-outs in 1997. The pay-outs constituted unbudgeted expenditure, financed by the central bank, marking the beginning of an economic crisis in the last quarter of 1997.

The economic crisis (1997–2008)

The economic crisis which manifested itself in Zimbabwe during the last quarter of 1997 was a result of weaknesses in macroeconomic management, particularly in the fiscal area, governance challenges, and the involvement of the country in the Democratic Republic of Congo conflict, which undermined economic performance and investor confidence (IMF, 2001; Kairiza, 2012). In addition, the GoZ made unbudgeted pay-outs to the veterans of the country's war of liberation to the tune of ZW\$2 billion or about US\$180 million through borrowing from the central bank. This huge injection of liquidity into the economy put the local currency under severe pressure in late 1997 (IMF, 2001; Kovanen, 2004). The economic crisis was worsened by the country's fallout with the international community following the implementation of the fast-track land reform programme.

The main objective of the land reform programme was to address the historical imbalance in land ownership, where the minority white commercial farmers owned large tracts of productive land, while the indigenous black majority were largely peasant farmers who owned small and unproductive pieces of land (GoZ, 1983, 1986; Moyo and Skalness, 1990; Chitiyo, 2000). To get buy-in from the international community on the implementation of the land reform programme, the GoZ and international donors convened a Land Donor Conference on land reform in Zimbabwe in September 1998. The GoZ then undertook to implement an orderly land reform programme, to be partly financed by international donors (IMF, 2001).

However, in a move against the undertaking it had made at the Land Donor Conference, the GoZ implemented a fast-track land reform programme in 2000 that was often characterized by violence against white commercial farmers and their workers (Sachikonye, 2002; Dansereau et al., 2005; Besada & Moyo, 2008; Munangagwa, 2011). The veterans of the war of liberation invaded white-owned commercial farms

in April 2000, with the tacit support of the GoZ and the ruling party (Raftopoulos and Phimister, 2003). Western donor nations and organizations reacted to the way in which the land reform programme was implemented by suspending aid to the country (IMF, 2001; Besada and Moyo, 2008). The suspension of budget support by the donor community could also partly explain the huge fiscal imbalances the country suffered during the economic crisis.

The disruption of production on commercial farms adversely affected agricultural output and other sectors of the economy, including manufacturing, mining, and tourism. Zimbabwe's annual GDP fell by an average of 12.5% between 2000 and 2003, following the implementation of the land reform programme (Richardson, 2005). Estimates by Montier (2013) put the decline in agriculture output at more than 50% between 2000 and 2008.

The huge knock which the agro-processing subsector of the manufacturing sector took as a result of low agriculture output led to shortages of food and other basic commodities. Moreover, the lower output from farming and manufacturing exerted upward pressure on inflation, as the country had to rely on imports to feed itself. The collapse of the agriculture industry had negative ripple effects on foreign currency generation, consequently causing an external debt overhang, as the country failed to honour principal and interest payments on external debt as they became due.

The economic fall-out from the unbudgeted pay-outs to war veterans included a weak local currency, very low levels of international reserves, an uncompetitive external sector, and intense balance of payments pressures (IMF, 1999). This called for remedial action on the part of the GoZ; it adopted a package of corrective economic reforms towards the end of 1997 and negotiated for an IMF stand-by credit facility, which was approved in June 1998. However, the country managed to make only one draw-down as further disbursements were suspended, following the GoZ's failure to meet the agreed performance benchmarks (IMF, 1999). This put the Zimbabwe dollar under more pressure, which was worsened by the fall in prices of major export commodities such as tobacco.

The period October 1997 to end December 1997 saw the local currency lose 33% of its value against the US dollar (IMF, 1999), with the economic crisis deepening through 1998 and 1999, adversely affecting livelihoods. The populace became increasingly agitated and angry with the ruling elite to such an extent that political activism began in earnest. The local currency depreciated by more than 50% during the six-month period April 1998–October 1998, falling from ZW\$17 per US\$1 to ZW\$38 per US\$1 (Besada and Moyo, 2008). The local currency was market determined up to January 2001, before the GoZ fixed it at ZW\$55 per US\$1, effectively widening parallel market activity.

Broad money supply growth was on an upward trend during the economic crisis, rising from 34.9% in December 1997 to 431 quintillion per cent in December 2008, largely due to domestic credit expansion. Annual domestic credit increased by 6.2 sextillion per cent by the end of 2008. Money supply expansion, against an environment of declining real economic activity directly fed into inflation, which

increased sharply from 20.1% by end of 1997 to 231 million per cent by end July of 2008. The GoZ responded to the exponential increase in inflation by ordering the Zimbabwe Statistical Agency (ZIMSTAT), the institution responsible for producing and disseminating statistical information, to stop publishing inflation numbers.

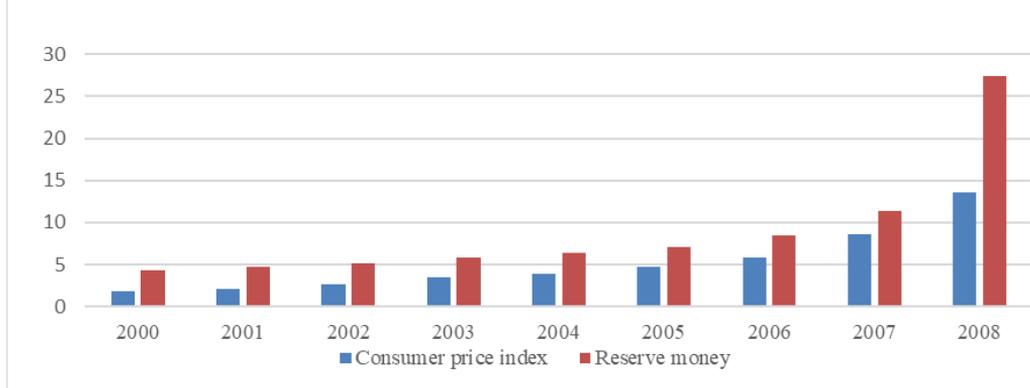
On the fiscal front, the deficit peaked at 22.5% of GDP in 2000, before falling to about 0.4% of GDP in 2003 and increasing to 4.5% of GDP in 2006. Diminished external sources of budget financing, coupled with the low capacity of the non-bank sector to finance fiscal deficits, resulted in more than 50% of fiscal deficits being monetized. In addition, the rollover of amounts owed to the banking sector over the years led to a significant build-up of government domestic debt, from ZW\$31.4 billion in 1997 to ZW\$590.7 billion or 42% of GDP by end December 2008. Cumulative past borrowings and increased new borrowing placed government in a domestic debt trap.

Output declined, resulting in a drastic fall in fiscal revenues, as the country traditionally relied heavily on taxes on income and profits of corporate entities and value added tax. The real value of tax revenue also declined due to high inflation levels. The deepening economic crisis saw the country's central bank endeavour to revive the economy by engaging in quasi-fiscal activities (QFAs) at the beginning of 2004. Quasi-fiscal activities of the RBZ included the provision of free foreign exchange to public enterprises, price support to exporters, and subsidized credit to troubled banks, farmers and public enterprises. Muñoz (2007) estimated the consolidated quasi-fiscal activities of the central bank at above 90% of GDP in 2007.

It was the belief of the then Central Bank Governor, Gideon Gono, that the QFAs would stop further economic decline and steer the economy onto a sustainable growth and development path (RBZ, 2004, 2008). However, the QFAs were outside the conventional mandate of the central bank, which became the de facto treasury of the country by usurping the powers of the Ministry of Finance and Economic Development (MoFED), with dire consequences for money supply growth and inflation.

The quasi-fiscal expenditures of the central bank resulted in an increase in reserve money growth, triggering Zimbabwe's hyperinflation episode which began when month-on-month inflation reached 50.5% in March 2007, conforming with the Cagan (1956) definition of hyperinflation. Reserve money growth rose from 217.6% in December 2004 to 460.8% in December 2005; 2,220.4% in December 2006; 78,146% in December 2007, and 53,206,461% by the end of July 2008. Concomitantly, annual inflation rose from 132.8% in December 2004 to 585.8%, 1,281.1%, 66,212.3%, and 231.1 million per cent in December 2005, December 2006, December 2007, and end July 2008, respectively. As shown in Figure 4, there was a close correlation between reserve money growth and inflation over the period 2000–2008.

Figure 4: Reserve money and consumer price index

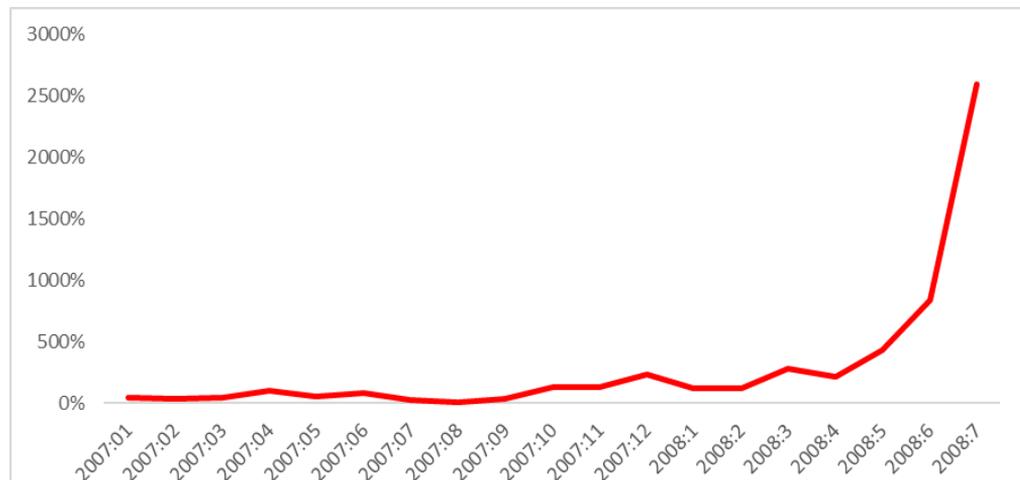


Source: Author construct with data extracted from RBZ database; and ZIMSTAT Quarterly Digest of Statistics, 2000 through 2008.

Note: Graph plotted on a log scale because of the magnitude of the figures involved.

Monthly inflation increased exponentially, from 45.5% in January 2007 to 240.1% in December 2007, before slowing down to 120.8% in January 2008. The slowdown in monthly inflation was short-lived as it increased by 312.6 percentage points to 433.4% in May 2008 and further to 839.3% in June 2008 and 2,600.2% by the end of July 2008. Figure 5 depicts the trends in monthly inflation for the period January 2007–July 2008.

Figure 5: Month-on-month inflation



Source: ZIMSTAT.

Zimbabwe's fiscal deficit averaged 9.2% of GDP during the economic crisis, while annual real GDP growth averaged -5% and bottomed out at -14.7% in 2008. High inflation resulted in a fall in real fiscal revenue inflows, further increasing fiscal deficits. Sustained fiscal deficits result in an increase in inflation which, in turn, lowers real tax revenues. As real tax revenue falls, the fiscal deficit might further increase. This is in line with Montiel (1989) and Agenor and Montiel (2008) who posit that the real value of government revenue is eroded by higher rates of inflation, thus increasing the size or real value of the budget deficit.¹

The economic crisis period saw the country maintain a fixed official exchange rate regime. The fixed exchange rate regime, coupled with low foreign currency inflows, led to the emergence of a thriving parallel market for foreign exchange. The activities of the parallel market were further heightened by the injections of liquidity into the market through the QFAs of the central bank. As a result, the parallel market exchange rate continued to depreciate, creating a vicious cycle of exchange rate depreciation and increase in inflation.

Hyperinflation severely undermined the value of the Zimbabwe dollar, leading to the informal dollarization of the economy during the second half of 2008 (IMF, 2009; Coomer and Gstraunthaler, 2011; Kairiza, 2012). Business transactions were secretly settled in foreign currency, which prompted the authorities to formalize the use of foreign currency by the transacting public. The Minister of Finance and Economic Development announced the adoption of the multi-currency system in the 2009 National Budget Statement, which was presented in US dollar. The abandonment of the use of the Zimbabwe dollar as legal tender and adoption of the multi-currency system was a major policy regime shift that brought stability to the Zimbabwean economy. This major policy shift provided an anchor for inflation expectations, a major factor that influenced price formation in Zimbabwe, more prominently during the hyperinflation episode. The multi-currency system restored financial intermediation, engendered fiscal austerity by ending the monetization of fiscal deficits, and fostering pricing and accounting stability (Kramarenko et al., 2010).

Return to macroeconomic stability (2009–2012)

The adoption of the multi-currency system by the country abruptly put an end to the hyperinflation episode and ushered in an era of price stability. Parallel market activities and arbitrage opportunities were reduced, with goods becoming available in the formal market.

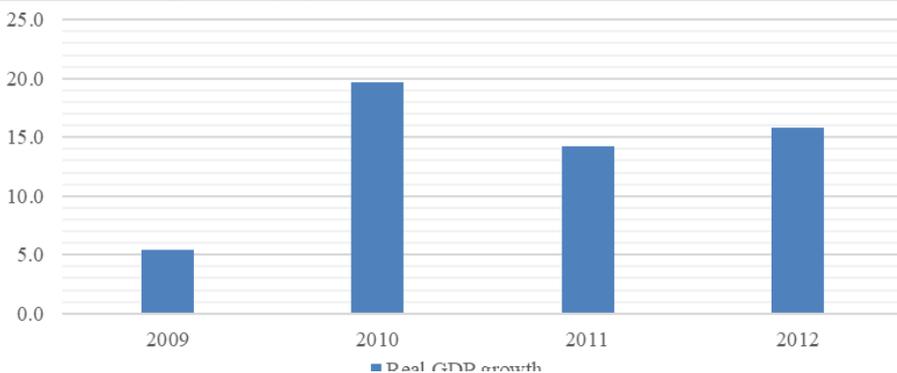
On the political front, the ruling party and the opposition Movement for Democratic Change (MDC) signed a Global Political Agreement on 1 September 2008, following negotiations after a political stalemate that had been caused by the disputed March 2008 presidential elections and the June 2008 run-off. The formation of the Government of National Unity (GNU) was a significant institutional change that would

¹ This is the Olivera-Tanzi effect (Olivera, 1967; Tanzi, 1977).

see an improvement in economic activity in Zimbabwe during the four-year period of its existence.

The GNU adopted the Short-Term Emergency Recovery Programme (STERP) as its economic blueprint at inception in March 2009. The STERP was implemented over a nine-month period from March 2009 to December 2009. The main areas of focus for STERP were social protection; macroeconomic reform, with an emphasis on the elimination of structural bottlenecks; and political and governance issues (GoZ, 2009). Significant positive spin-offs, including inflation reduction and high real GDP growth rates, were realized through the implementation of the STERP. Real GDP growth increased from 5.4% in 2009 to 19.7% in 2010, 14.2% in 2011, and 15.8% in 2012, as shown in Figure 6.

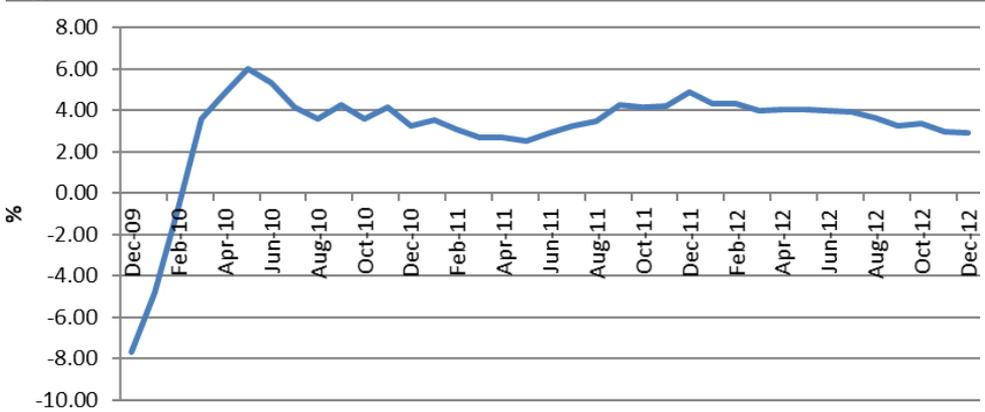
Figure 6: Real GDP growth (%)



Source: ZIMSTAT.

The emergency recovery programme was buttressed by the adoption of a cash budgeting system, aimed at efficiently allocating fiscal revenues (GoZ, 2009). In addition, the central bank was ordered to discontinue quasi-fiscal activities, which resulted in minimal expenditure overruns and the promotion of fiscal austerity (IMF, 2012a). The adoption of a cash budgeting system by the GoZ and the discontinuation of quasi-fiscal operations by the central bank were major policy shifts that brought about, as well as sustained, price stability during the multi-currency era.

Year-on-year inflation stood at -7.7% by the end of December 2009, reflecting higher US dollar prices that existed during the unofficial use of the multi-currency system in 2008. Annual inflation, however, moved into positive territory and stood at 3.2% in 2010, 4.9% in 2011 and 2.9% in 2012. However, inflation was below 5%, on average, during the multi-currency era, as shown in Figure 7.

Figure 7: Annual inflation

Source: ZIMSTAT.

The budget deficit improved significantly during the early stages of dollarization, reflecting the initial fiscal policy stance that was based on a balanced budget. The fiscal policy stance was anchored on the ‘we eat what we kill’ principle, which ensured government followed a strict budget balance. In line with the argument by Eichengreen (2001), dollarization enhanced the country’s fiscal discipline by eliminating the possibility of printing money to finance fiscal deficits. High economic growth rates were associated with lower fiscal deficits during the period 2009–2012, as shown in Figure 2.

Notwithstanding this, the fiscal reforms instituted during the multi-currency era were not sufficient to anchor Zimbabwe's inflation and inflation expectations, as was the case in Mexico, as posited by Ramos-Francia et al. (2018). The cash budgeting framework was operational until 2013, albeit with its own challenges such as lack of fiscal space. Moreover, the civil service wage bill dominated government expenditures leaving little for social and capital expenditures. Consequently, employment costs crowded out investment by the public sector and general service provision by government. The reduced fiscal space during the multi-currency era also resulted in significant government payment arrears to public enterprises and providers of critical government services. Total domestic payment arrears amounted to US\$175 million at the end of December 2012. Fiscal sustainability was also negatively impacted by a huge external debt overhang, which stood at US\$8.3 billion at the end of 2012.

Cosmetic fiscal reforms can temporarily reduce inflation, as was the case in Brazil and Argentina (Sargent et al., 2009), with comprehensive reforms following. The GoZ implemented nominal fiscal adjustments and these, coupled with the adoption of the multi-currency system, ended hyperinflation but they were not followed by fundamental reforms. The change of government following the 2013 general and presidential elections signalled the GoZ's shift from fiscal austerity to loosened fiscal policy as it immediately abandoned the rather restraining cash budgeting system. This obviously came at a very high cost of increasing inflation, and the relapse of the economy into another crisis. In this regard, low and stable inflation could not be sustained during the period 2013–2018.

Relapse into economic crisis (2013–2018)

The Zimbabwean economy relapsed into another crisis in 2013, with the GoZ abandoning the cash budgeting system, creating huge fiscal imbalances financed through borrowing from the central bank. Partly reflecting subdued fiscal revenues, a result of low real GDP growth and decline in international commodity prices, the country started to incur budget deficits during the period 2014–2018. Government expenditure also increased due to public support of agriculture and the deliberate policy to extinguish previously accumulated domestic arrears on public debt, pushing the budget deficit upwards.

Real growth in the economy slowed to 3.4% in 2013, from growth of 10.6% registered in 2012, and declined further to 2.4% in 2014, 1.8% in 2015, and 0.8% in 2016, before increasing to 4.7% in 2017 and 4.8% in 2018 (ZIMSTAT, 2019). In large part, the volatility in economic growth reflected underlying challenges in the economy, which included liquidity shortages, power outages, weak domestic demand, infrastructural bottlenecks, and low foreign direct investment (FDI) inflows. Low FDI inflows were a direct consequence of perceived high country risk and diminished international goodwill following alleged human rights abuses by the GoZ and the lack of rule of law.

The country embraced the use of electronic money, with members of the public initially being able to access real US dollars against electronic balances in their banks. This resulted in the depletion of nostro balances of commercial banks, ushering in a cash crisis that began in the third quarter of 2016.

An agriculture financing support scheme, code named Command Agriculture, was put in place by the GoZ in 2016. The scheme entailed the procurement of agricultural inputs such as seed, fertilizer, fuel, and chemicals for distribution to farmers enlisted in the programme. This resulted in a huge increase in government expenditure against subdued revenue inflows, culminating in huge fiscal deficits, especially for 2016 and 2017, as shown in Figure 16. Fiscal deficits ballooned as government also procured grain from local farmers at an inflated price of US\$390 per tonne for maize, against an international price of US\$150–180 per tonne. Financing of the deficit was through the issuance of Treasury bills.

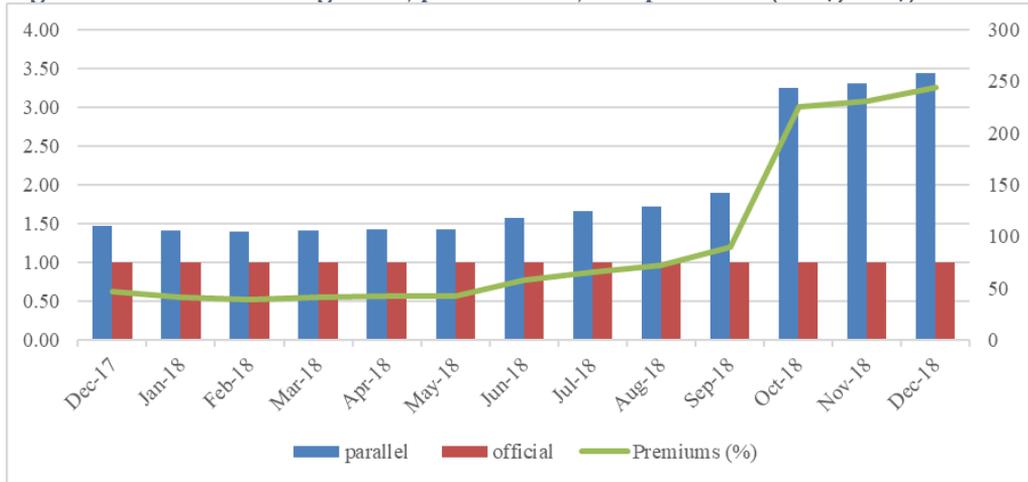
The fiscal deficit worsened to 13.4% of GDP in 2017, from 7.8% of GDP in 2016, before slightly improving to a deficit of 7.7% of GDP in 2018. Expenditure for the Command Agriculture scheme was financed off budget by the central bank and if it had been incorporated into the budget, the result would have been much bigger fiscal deficits for 2017 and 2018.

On the exchange rate front, a parallel market exchange rate emerged as a major determinant of price formation in Zimbabwe, especially between 2016 and 2018. High fiscal deficits predominantly financed through borrowing from the central bank resulted in excessive money supply growth, which created high demand for foreign exchange in a market with inadequate supply. A study by Nyarota, et al (2016) found that domestic money supply growth drove the parallel exchange rate premium. In

this regard, a 1% increase in broad money supply increased the parallel exchange rate premium by about 2% in the long run and 0.22% in the short run.

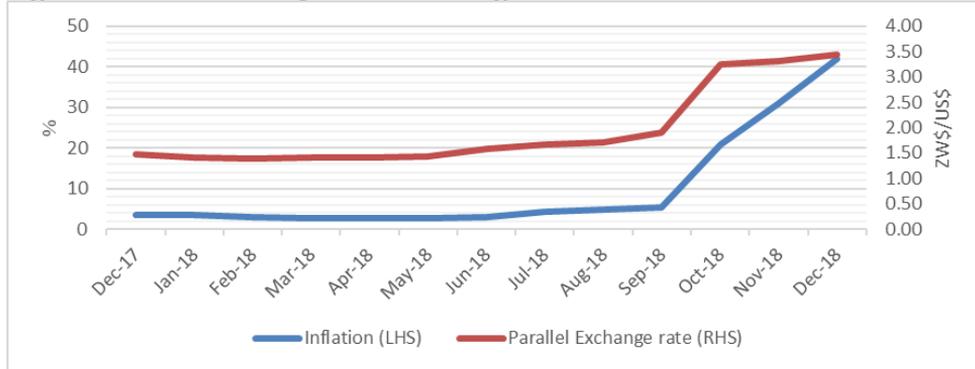
The increase in the demand for foreign exchange, following the increase in money supply, led to high parallel market premiums that resulted in an increase in inflation, as firms factored in the exchange rate premiums in their pricing. High parallel market premiums also influenced price formation through high import prices, benchmarking of local prices in US dollar, and outright speculation by sellers of goods and services. High inflation, in turn, created an unstable macroeconomic environment with adverse effects on the country's economic performance. Premiums on the parallel market exchange rate increased from 47% in December 2017 to 245% in December 2018. The continuous increase in parallel market premiums sustained the upward inflation spiral. Figure 8 and Figure 9 shows the movement in the parallel market exchange rate premium and the relationship between inflation and the parallel market exchange rate, respectively.

Figure 8: Official exchange rate, parallel rate, and premium (ZW\$/US\$)



Source: Author computations and construct with data extracted from Reserve Bank of Zimbabwe database, and January 2019 Monthly Review.

Figure 9: Inflation and parallel exchange rate



Source: Author computations and construct with data extracted from Reserve Bank of Zimbabwe database; and ZIMSTAT Quarterly Digest of Statistics, Fourth Quarter 2018.

As shown in Figure 10, there was a close correlation between money supply growth and inflation in Zimbabwe during the period the economy relapsed into an economic crisis. Changes in money supply influenced inflation through their impact on the parallel market exchange rate, where an increase in money supply resulted in the depreciation of the parallel market exchange rate which, in turn, led to an increase in the general price level in the economy. The depreciation of the parallel market exchange rate against the background of a more-or-less fixed official exchange rate resulted in an increase in premiums on the parallel market, which were passed on to consumers in the form of higher prices, as most producers of goods sourced foreign exchange from the parallel market to import raw materials. Despite the apparent slowdown in money supply growth between October 2017 and April 2018, inflation was on an upward trend as parallel market premiums increased. While another slowdown in money supply growth was experienced between July 2018 and November 2018, inflation continued to increase, a result of a combination of adverse inflationary expectations and soaring parallel market premiums.

Figure 10: Inflation and money supply growth



Source: Author computations and construct with data extracted from Reserve Bank of Zimbabwe Monthly Review, December 2014 through December 2018; and ZIMSTAT Quarterly Digest of Statistics, Q4 2014 through Q4 2018.

The Transitional Stabilization Plan (TSP)

A “new dispensation” took power in Zimbabwe in November 2017 through a military intervention. This resulted in the removal of the long-serving President of the country, Robert Gabriel Mugabe. The mantra of the new administration was “Zimbabwe is open for business”, which implied that the administration committed to swiftly embark on economic reforms and “easing the doing business environment” to attract both the much-needed FDI inflows as well as domestic investment. In this regard, the country, through the Ministry of Finance and Economic Development, introduced the Transitional Stabilization Programme (TSP), which was to be implemented over the period October 2018–December 2020. The TSP was aligned to the country's Vision 2030, whose main objectives would be achieved through good governance, achievement of macroeconomic stability, re-engagement with the international community, inclusive growth, rehabilitation of infrastructure and provision of utilities, and social development (GoZ, 2018).

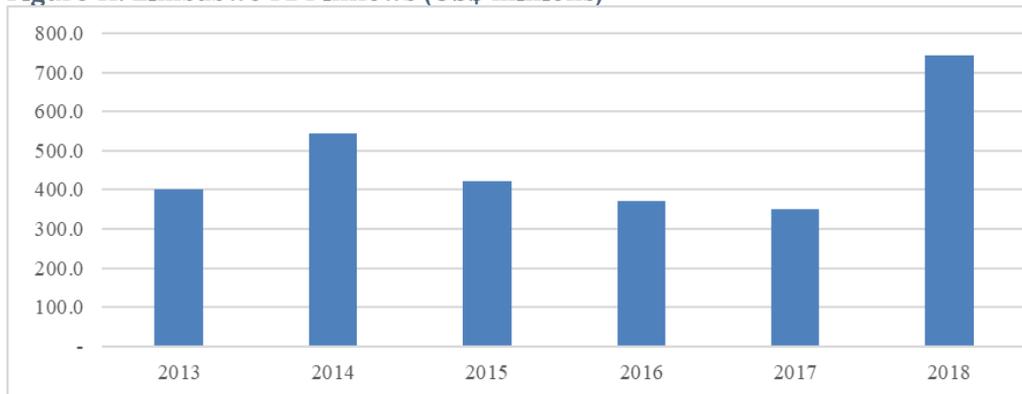
The TSP also focussed on stabilizing the financial sector and macro-economy at large by creating private sector-led growth through institutional reforms, fixing infrastructure challenges, and implementing quick-win projects to stimulate growth. The main agenda of the TSP was essentially to transform the Zimbabwean economy to upper middle-income status by 2030. This would be achieved through the implementation of policies to deal with macroeconomic imbalances as well as creating a stable economic environment. A major policy adjustment under the TSP was fiscal consolidation, entailing the abolishment of the unsustainable financing of fiscal deficits, which had created financial sector vulnerabilities. Government stopped

financing its deficits through borrowing from the central bank. In addition, various initiatives were also undertaken to promote the mobilization of domestic savings and enhance export competitiveness. Monetary and institutional reforms were also implemented in an endeavour to foster economic growth and development.

The ushering in of the new dispensation was warmly received by the international community, prompting the GoZ to start the re-engagement process to deal with the external debt overhang. As part of the re-engagement process, the authorities successfully negotiated for a new IMF Staff-Monitored Programme (SMP), following the successful completion of another SMP during the period 2013–2015. The SMP was implemented in conjunction with comprehensive economic reforms and complemented the TSP by assisting the country in building a track-record of sound economic policies. The emphasis of the SMP was on fiscal consolidation and elimination of the financing of the fiscal deficit by the central bank, as well as the adoption of reforms that promote the free interplay of market forces.

Indeed, the ushering in of the new dispensation attracted the much-needed international goodwill, leading to an increase in FDI inflows, which had risen from US\$400 million in 2013 to US\$544 million in 2014, before declining to US\$349.4 million in 2017. As shown in Figure 11, FDI inflows increased to US\$744.6 million in 2018, as the relaxation of the Indigenization and Economic Empowerment regulations and undertaking by the new government to implement fiscal reforms under the TSP boosted investor confidence.

Figure 11: Zimbabwe FDI inflows (US\$ millions)



Source: Author construct with data extracted from Reserve Bank of Zimbabwe database.

5.0 Fiscal deficits and public debt

Evolution of Zimbabwe's public debt

The GoZ inherited public debt to the tune of about US\$786 million, when the country attained political independence in 1980 from the then colonial Rhodesian Government (Dashwood, 2000). The debt largely emanated from loans the colonial regime contracted to buy arms of war and fund military operations to fight the black majority, which had taken up arms of war to gain political independence from colonial rule. Jones (2011) posits that military spending by the Rhodesian Government increased from 20% of the national budget in the fiscal year 1975/76 to almost 50% in the fiscal year 1978/79.

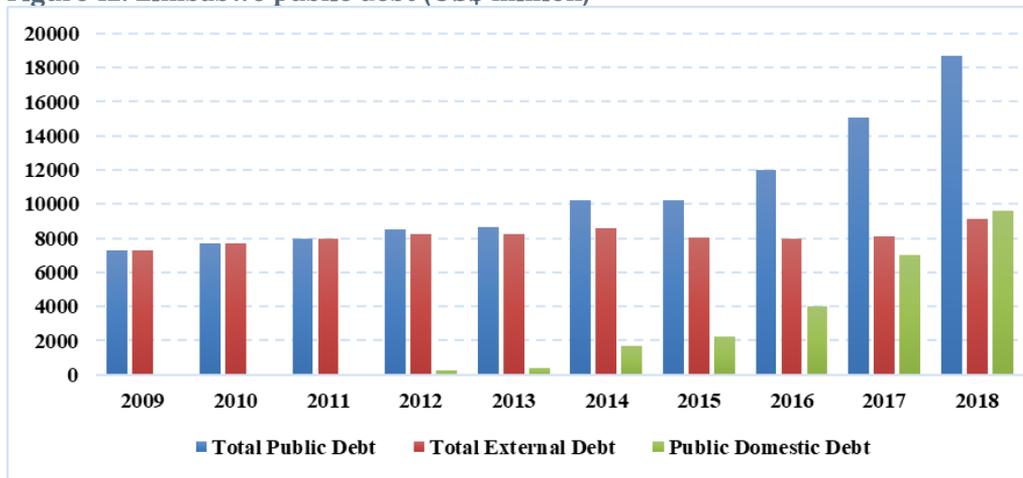
After the country attained political independence, the GoZ had the responsibility to restore infrastructure that had been destroyed during the war of liberation and build a new nation, as well as address the social imbalances inherited from the colonial past. However, the country registered erratic real GDP growth due to acute droughts experienced in some agricultural seasons. The resultant food deficit compelled the government to import substantial amounts of grain, increasing the outlay of resources required. The available resources to import food were augmented by loans from both multilateral and bilateral creditors and grants, following the flow of goodwill to the newly independent country. The resources were utilized in various sectors of the economy, mainly energy², road and housing construction, communication, water and sanitation, education, agriculture, and public administration projects.

The other share of loans came from international financial institutions (IFIs) such as the World Bank, IMF, European Investment Bank, and African Development Bank Group. Loans were also sourced from the International Fund for Agricultural Development (IFAD), Kuwait Fund, and Arab Bank for Economic Development in Africa (BADEA). The loans were largely concessional and earmarked for economic development purposes with maturities ranging from 10 to 40 years.

² Zimbabwe's Hwange Thermal Power Station was built through funding from external lenders including the World Bank, European Investment Bank, and the UK government.

Prior to 1999, the GoZ had an impeccable record of timely external debt servicing to its foreign creditors, who included bilateral creditors, most of whom were members of the Paris and non-Paris Clubs. However, the country's inability to fully service its external payment obligations started worsening in 2000 following the country's poor external sector performance as a result of the fall in international commodity prices. This led to a significant scaling down, and in some cases outright suspension, of disbursements to the country. The public sector external debt arrears have grown persistently since 2000 with no meaningful fresh financing from traditional bilateral sources, except for small disbursements from countries such as China and India. Figure 12 shows the evolution of Zimbabwe's public debt since 2000. The ratio of domestic and external debt to GDP is shown in Figure 13.

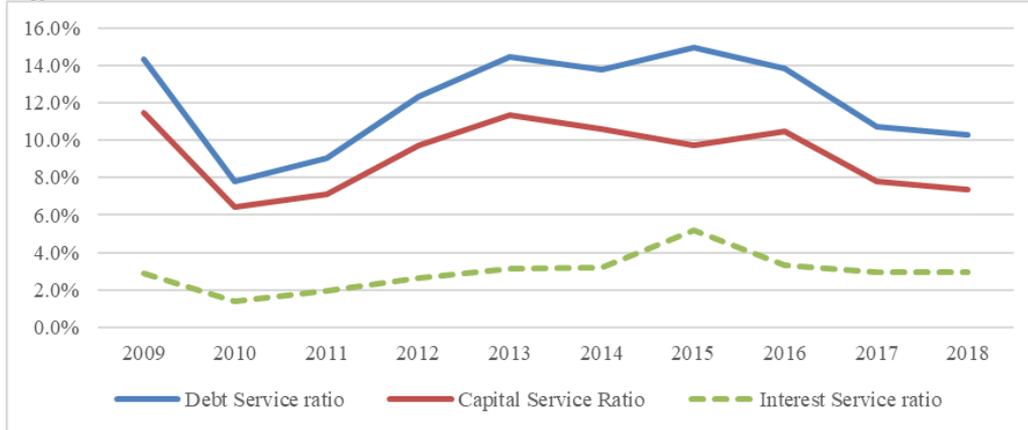
Figure 12: Zimbabwe public debt (US\$ million)



Source: Ministry of Finance and Economic Development, Zimbabwe (2018).

Zimbabwe's external debt service ratio has been low as the bulk of the country's debt has been in arrears and the country was not in a position to borrow from external sources. As shown in Figure 13, despite a gradual increase in debt service ratios between 2010 and 2013, a result of moderate external borrowing, the overall debt service ratio has been contained below 15%, much lower than the average debt service ratios of peer countries, which are in excess of 20%. In addition, the country's principal or capital service ratio has consistently been higher, reflecting the short-term nature of external loans based on a remaining maturity basis.

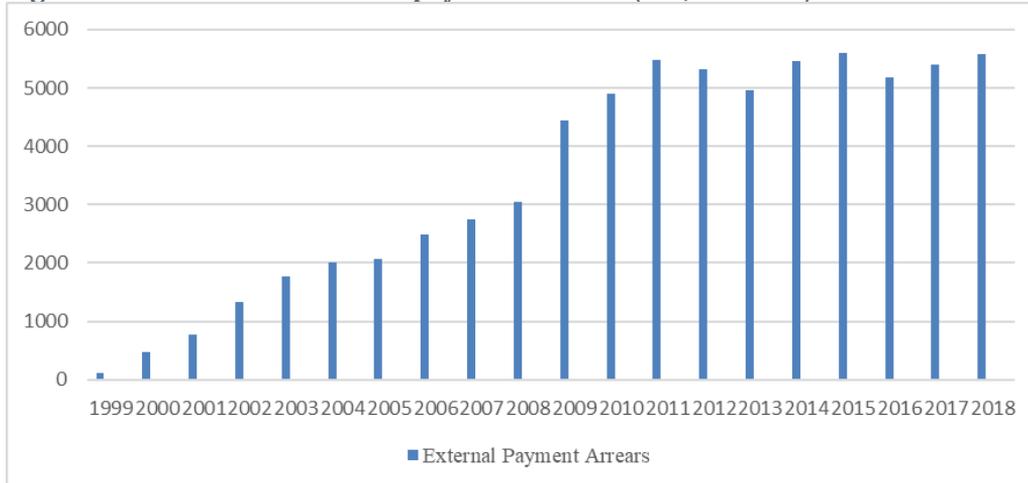
Figure 13: Trends in Zimbabwe debt service ratios



Source: Author computations and construct with data extracted from Reserve Bank of Zimbabwe and Ministry of Finance and Economic Development databases.

The country started accumulating external payment arrears in 1999, which stood at US\$109 million, before increasing to US\$5.6 billion in 2018. External payment arrears represented about 77% of the public and publicly guaranteed external debt by the end of 2018. Multilateral development banks (MDBs) and some bilateral creditors responded to the increase in arrears by imposing remedial measures on the country to compel it to pay its overdue debt. Figure 14 shows the evolution of the country's external payment arrears for the period 1999–2018.

Figure 14: Evolution of external payment arrears (US\$ millions)



Source: Author construct with data extracted from Reserve Bank of Zimbabwe and Ministry of Finance and Economic Development databases.

The accumulation of external payment arrears resulted in a shift of the composition of public external debt, characterized by declining concessional borrowing and increased borrowing from non-traditional official and private lenders. There was a

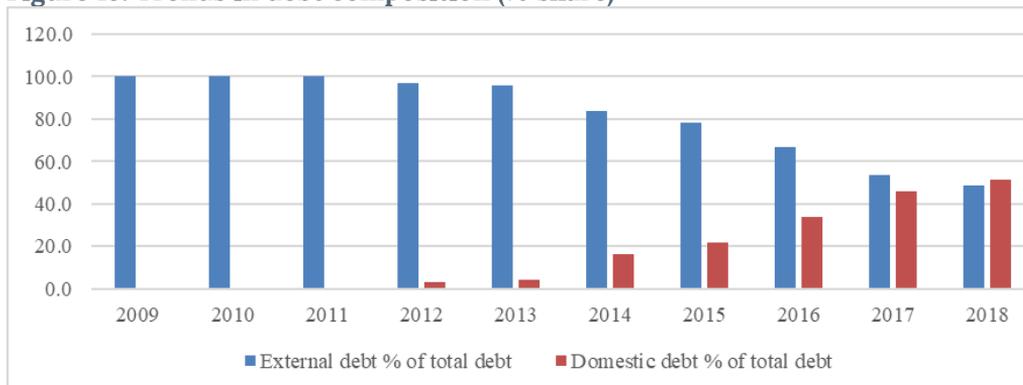
huge increase in loans from the non-Paris Club creditors, notably China and India, mainly to fund infrastructural projects, thereby replacing the traditional Paris Club creditors and the IFIs. Evidence shows that although the non-Paris Club debt started accumulating from 1986, it started growing faster from 2006 mainly due to the increase in Chinese debt, a result of government's failure to access credit from its traditional creditors.

Public domestic debt

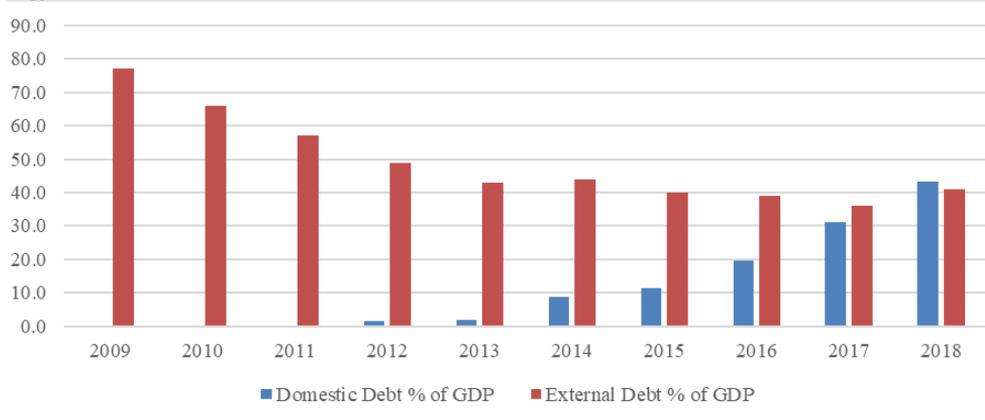
The hyperinflation experienced by the country in 2007/2008 wiped away all public domestic debt, which remained at zero during the greater part of the multi-currency era, as the GoZ had put in place a cash budgeting system when it adopted the multi-currency system in 2009. Under the cash budgeting system, the GoZ had no recourse to central bank financing and neither did it borrow from other entities in the local money market. The constrained fiscal space, coupled with the inability of the country to access external financing because of external payment arrears, compelled the GoZ to resort to domestic borrowing to finance the budget. The GoZ started borrowing from the domestic market from the second half of 2012 and domestic debt increased, peaking at US\$9.6 billion as at the end of December 2018 (Ministry of Finance and Economic Development, 2018). The sharp increase in domestic debt was attributed to the issuance of Treasury bills, following the take-over of central bank debt by the government and use of the overdraft facility at the central bank by the GoZ.

The high interest payment obligations that arose from the increasing public domestic debt exacerbated the fiscal deficit in a debt-deficit vicious cycle conundrum. According to Zimbabwe's Ministry of Finance and Economic Development (2018), the proportion of domestic debt to total public debt rose from 3.2% in 2012 to 51.4% by the end of 2018, as shown in Figure 15. Domestic debt as a proportion of GDP also increased from 2012, as shown in Figure 16.

Figure 15: Trends in debt composition (% share)



Source: Author computations and construct with data extracted from Reserve Bank of Zimbabwe and Ministry of Finance and Economic Development databases.

Figure 16: Domestic and external debt as % of GDP

Source: Author computations and construct with data extracted from Reserve Bank of Zimbabwe and Ministry of Finance and Economic Development databases.

From fiscal deficit to debt overhang and lower real growth

The financing of fiscal deficits through domestic and external borrowing led to the accumulation of public debt, taking into account the government's inter-temporal budget constraint. This had adverse consequences for the economy, which included high interest rates and crowding out of private investment, less flexibility to conduct countercyclical policy and external sector vulnerability due to a sudden stop in both official or private capital inflows, and a debt overhang. The debt overhang occurred because the expected tax burden to finance debt was so high that it became a disincentive to current investment/consumption and hence was a drag on domestic economic activity. The consequences of the country's debt overhang included lower growth, lower government revenues, insufficient funds for primary expenditures, and defaults on debt servicing.

Public debt and the primary balance

The GoZ incurred primary deficits from the early 1990s, a scenario that implied that it was not able to repay its debt obligations, which kept on accumulating. However, the government did not default on repaying its interest obligations on domestic debt, partly as a measure of preserving confidence in it as a borrower. Figure 17 shows that there was fiscal prudence during the period of the GNU, that is, from 2009 to 2012, as government incurred primary surpluses. Notwithstanding this, the country was not able to fulfil its debt obligations, except making token payments to multilateral financial institutions. A relapse occurred in 2013 when the new government loosened fiscal policy by abandoning cash budgeting, which resulted in the widening of primary deficits up to 2018. Total public debt also started increasing at an accelerated rate from

2013, largely due to the rise in the external payment arrears component of external debt as well as the increase in domestic debt.

Figure 17: Primary balance (US\$ millions)

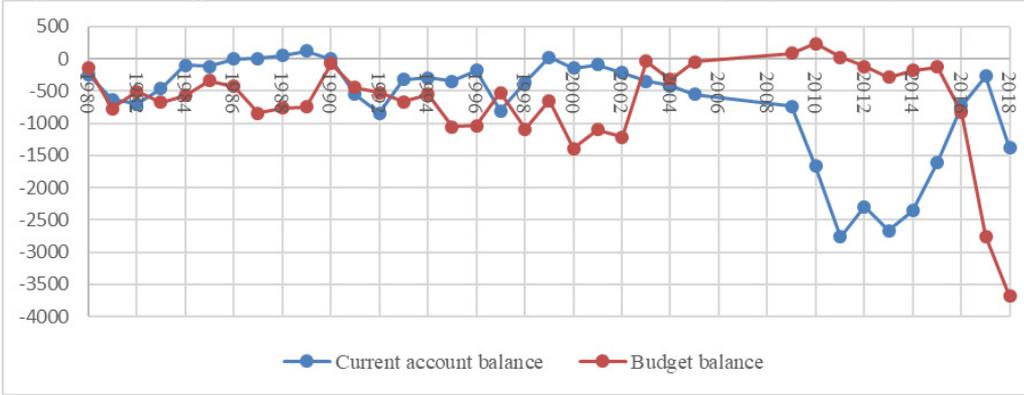


Source: Ministry of Finance and Economic Development, Zimbabwe (2018).

Twin deficits

Zimbabwe posted current account surpluses in only four of the 38 years of the study period. Similarly, fiscal surpluses were only realized in three of the four years the country experienced macroeconomic stability, that is, in 2009, 2010, and 2011. This scenario implies that the country largely experienced twin deficits during the study period, as shown in Figure 18. While the direction of causality remains an empirical question in Zimbabwe, the incurrence of budget deficits can result in an increase in interest rates, which in turn, attracts capital inflows, leading to exchange rate depreciation. A depreciation of the exchange rate renders a country's exports uncompetitive, while imports become cheaper. In this regard, a country ends up importing more merchandise, against low exports, resulting in a trade deficit. A study by Mandishekwa et al. (2014) supported the twin deficit hypothesis (TDH) for Zimbabwe, for the period 1980–2011.

Figure 18: Budget balance and current account balance (US\$ millions)



Source: Author computations and construct with data extracted from Reserve Bank of Zimbabwe database, and Ministry of Finance and Economic Development Budget Estimates, 1980 through 2018.

Fiscal and current account deficits are likely to have been the major cause of both internal and external imbalances that manifested in high inflation, high indebtedness, and accumulation of external payment arrears and foreign currency constraints in Zimbabwe during the study period.

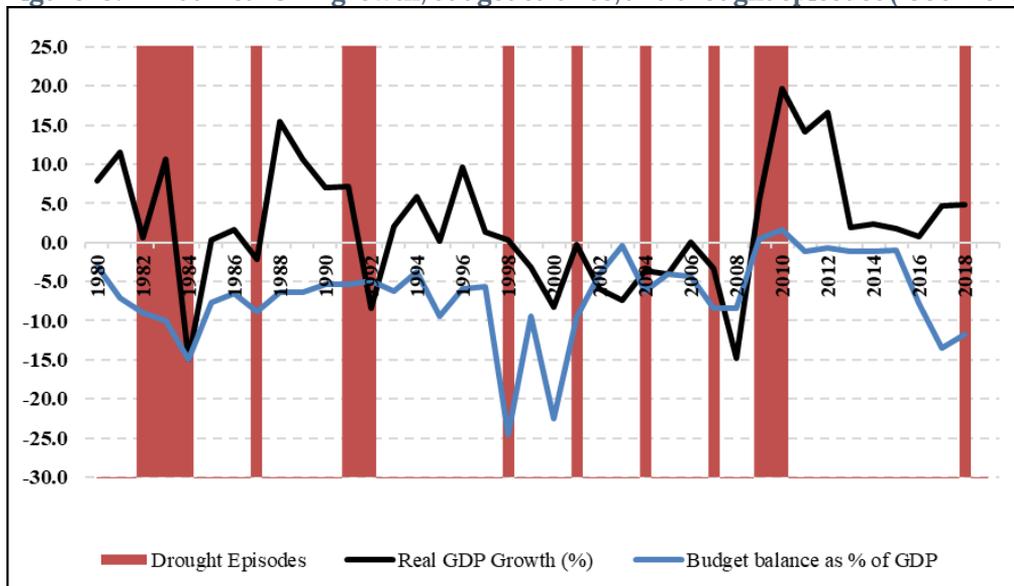
6.0 Exogenous shocks and growth

Drought

Drought shocks have an impact on agricultural output and, subsequently, on the economic performance of a country. The first-round effects of a drought would ordinarily include reduction in agricultural output, fall in the generation of hydroelectric power, as well as the curtailment of irrigation-related activities (Benson and Clay, 1998). This would result in a decline in overall real GDP growth.

The Zimbabwean economy experienced several structural changes and aggregate supply shocks since the 1980s, resulting in episodes of strong and weak economic performance. A combination of the 1992–1993 drought and a fall in the international commodity prices of major export commodities, for example, had a negative impact on the economy. The country has experienced mild droughts every three years and severe droughts every 10 years. In each of the drought years, the economy posted very low to negative real growth as shown in Figure 19.

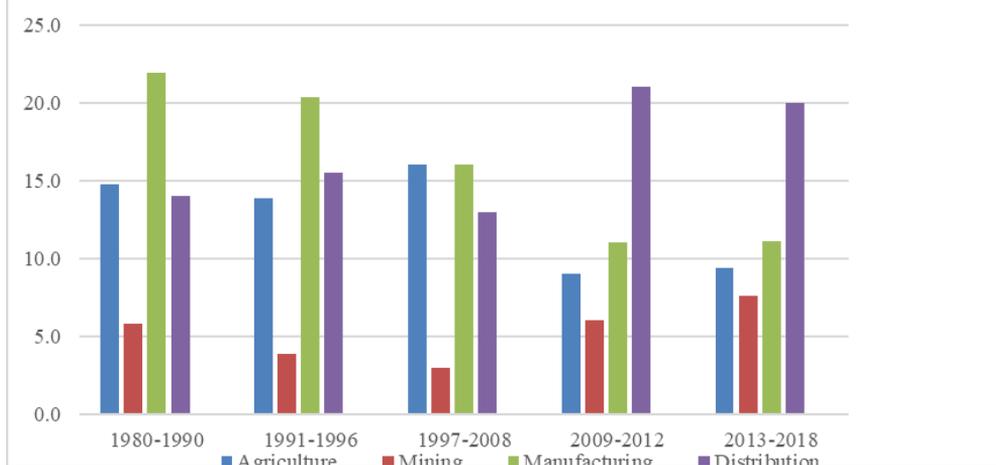
Figure 19: Annual real GDP growth, budget balance, and drought episodes (1980–2018)



Source: Author construct with data extracted from Ministry of Finance and Economic Development Budget Estimates; and ZIMSTAT Quarterly Digest of Statistics.

Agriculture is the backbone of the Zimbabwean economy through its forward and backward linkages with other sectors of the economy, especially the manufacturing sector. The agricultural sector is the major source of raw materials for the manufacturing sector, particularly the food processing subsectors. Agriculture was the second largest contributor to real GDP for the period 1980–2008, contributing an average of 14.8% to GDP in the period 1980–1990; 13.9% in the period 1991–1996, and 16.0% in the period 1997–2008. As shown in Figure 20, the contribution of agriculture to GDP was in third place for the periods 2009–2012 and 2013–2018, as the distribution sector, hotels and restaurants became the largest contributor to GDP, followed by the manufacturing sector.

Figure 20: Sectoral contributions to GDP (%)



Source: ZIMSTAT and author computations and construct.

The incidence of drought had a negative impact on the contribution of agriculture to overall output and hence on the manufacturing sector, with negative implications for food security, rural incomes, and price formation. Food contributes about 31.3% of the country's consumer basket (ZIMSTAT, 2018), which implies that food shortages exert upward pressure on inflation.

The years 1983 and 1984, for example, were negatively affected by droughts with negative spill-over effects on real economic growth as agricultural output declined. Real GDP growth declined from 13.5% in 1981 to 3.3% in 1982 and 1.3% in 1983, before posting a negative growth rate of -2.2% in 1984. A mild drought experienced in the 1986/87 agricultural season, was associated with a decline in real GDP growth, from 2.1% in 1986 to 1.1% in 1987.

The Zimbabwean economy also experienced a severe drought in the 1991/92 agricultural season with knock-on effects on agricultural output. The agriculture sector declined by more than 50% in 1992, with negative spill-over effects on the manufacturing sector, which declined by 9.2% (ZIMSTAT, 1998; Benson and Clay, 1998). Manufactured export earnings fell by 6%, translating to a 2% fall in total export receipts (Benson and Clay, 1998). Real GDP growth was negative at -4.8% in 1992.

Notwithstanding, it is critical to note that drought could not have been the only factor that influenced the performance of the Zimbabwean economy during the period of analysis. The negative growth rates the economy posted for the years 2000 to 2008, for example, could also be partly attributed to the negative impact of the fast-track land reform programme, which disrupted commercial farming activities, as alluded to earlier. This was also the period the economy experienced a severe crisis.

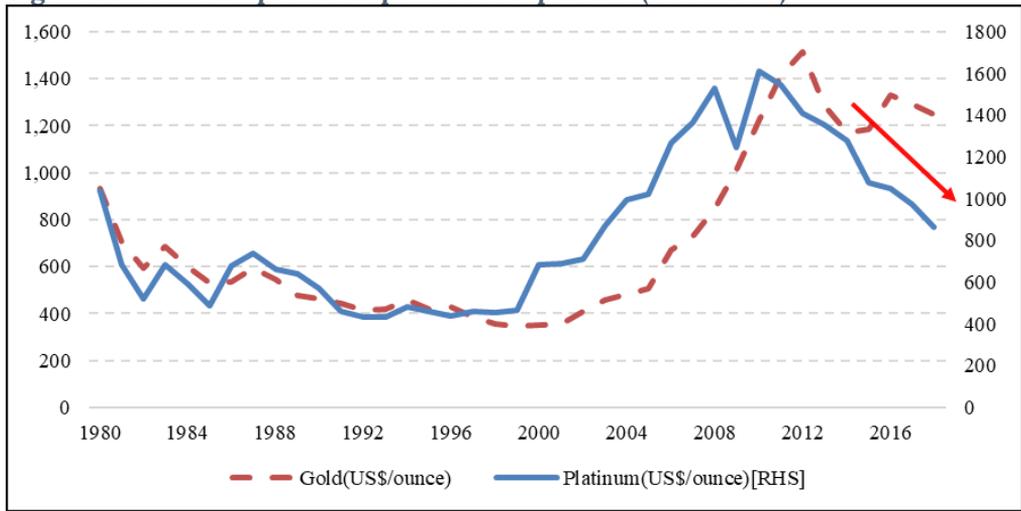
The impact of drought on fiscal policy in Zimbabwe during the period of analysis occurred through a reduction in tax revenue inflows and increased government expenditure. Additional expenditure on drought relief, other social spending and the bailout of public enterprises also affected by drought, exerted additional pressure on the fiscus resulting in the incurrence of high fiscal deficits. Figure 19 also shows that droughts were associated with fiscal deficits during the period under analysis.

International commodity price shocks

In the 1980s and 1990s, precious metal prices experienced a huge negative shock on account of robust growth in the U.S. economy, coupled with a strengthening US dollar. A commodity price shock hit the Zimbabwean economy hard in 1997, resulting in poor export performance (IMF, 1999). The main export commodities such as tobacco and gold performed badly, adversely affecting fiscal revenue inflows from international trade. As Spatafora and Samake (2012) observe, the instability of commodity prices raises fiscal budgeting uncertainty and is a threat to the sustainability of debt.

In the 2000s, confidence in the American economy and its currency slumped, boosting prices of precious metals, particularly gold, which reached an all-time high in 2011, as investors moved to precious metals as alternative investment assets. Since then, due to the economic recovery after the financial crisis, gold remained on a downward trend, although there has been a markedly mixed performance in the gold market in recent years. Figure 21 shows developments in commodity prices for precious metals for the period 1980–2018.

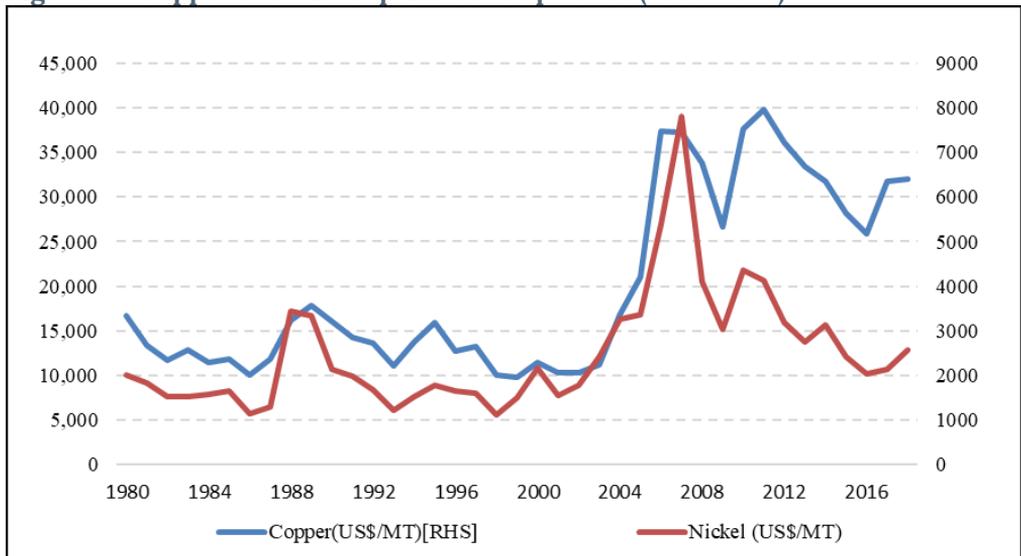
Figure 21: Gold and platinum price developments (1980–2018)



Source: World Bank, <http://worldbank.org/commodities>

Copper and nickel prices peaked between 2003 and 2011, a period also referred to as the Commodities Prices Boom, following the Great Commodities Depression of the 1980s and 1990s. The boom was largely due to the rising demand from emerging markets such as the BRICS, particularly China from 1992 to 2013, as well as concerns over long-term supply availability. There was a sharp downturn in prices during 2008 and early 2009, a result of the credit crunch and sovereign debt crisis. However, prices began to rise as demand recovered from late 2009 to mid-2010, as shown in Figure 22.

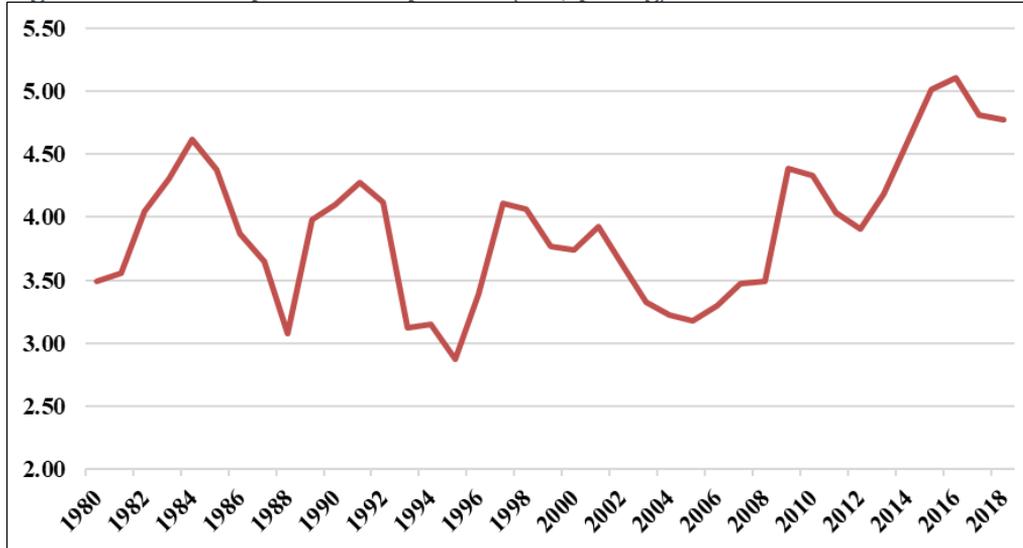
Figure 22: Copper and nickel price developments (1980–2018)



Source: World Bank, <http://worldbank.org/commodities>

Tobacco prices fluctuated widely during the period of analysis, with an adverse impact on fiscal revenues from international trade, during the years when prices declined. Figure 23 depicts developments in tobacco prices for the period 1980–2018.

Figure 23: Tobacco price developments (US\$ per kg)



Source: World Bank, <http://worldbank.org/commodities>

The decline in export prices of gold, nickel, and tobacco had a directly negative impact on fiscal revenues. In addition, the decline in commodity prices also affected real GDP growth through the reduction in investment capital flows. Commodity price fluctuations have an impact on the macroeconomic performance of commodity exporting economies, with declines in commodity prices weakening growth (IMF, 2012b; Christensen, 2016). This view is supported by UNCTAD (2012, 2019) which posits that commodity price shocks can have a negative impact on a country's long-term growth prospects as high price volatility raises uncertainty and risk, which undermines investment.

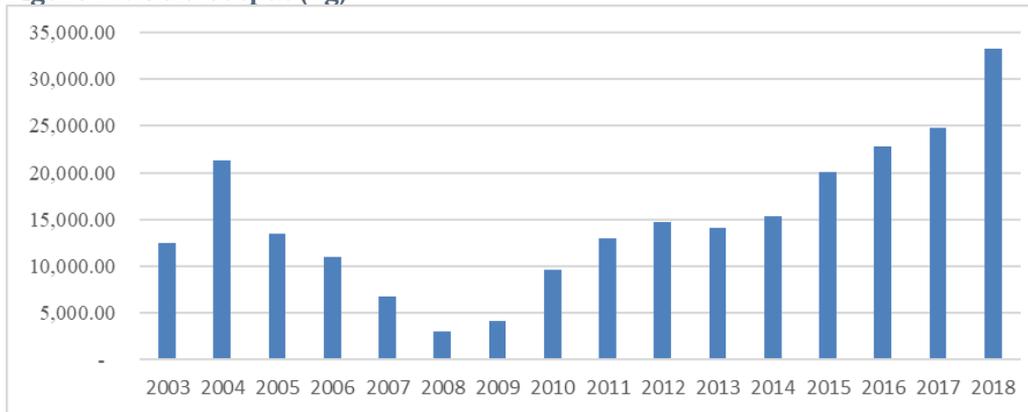
Export earnings and the 2003–2011 commodity price boom

The international commodity price boom from 2003 to 2011 benefited most commodity-exporting countries in sub-Saharan Africa through corresponding export growth and improvements in terms of trade. For Zimbabwe, however, many idiosyncratic factors militated against the country's possibility to increase its exports by taking advantage of the global commodity price boom. The country-specific factors included foreign currency constraints, electricity power constraints, and lack of access to external lines of credit for working capital purposes. In addition, there was general negative investor sentiment, driven by the country's fallout with the international

community and the promulgation of the Indigenization and Economic Empowerment Act (Chapter 14:33). These underlying constraints in the economic environment did not support the increased production of export commodities.

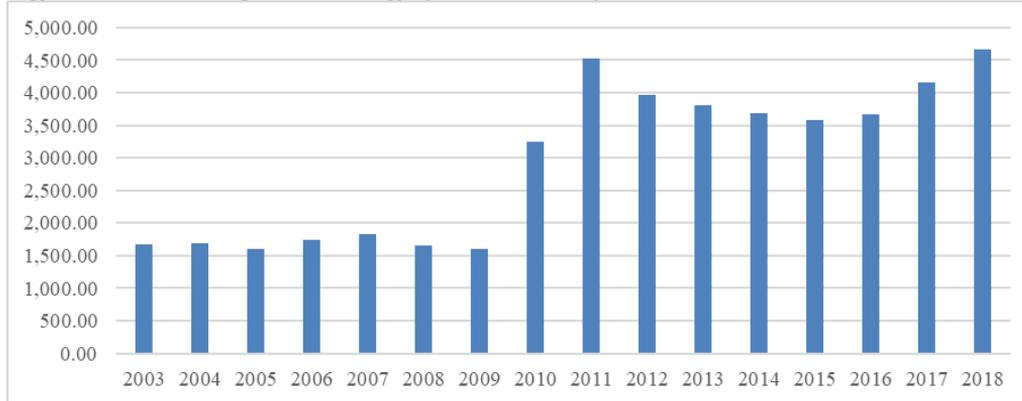
During the period of the international commodity price boom, the Zimbabwean economy was also characterized by high inflation on the back of a managed and strongly overvalued exchange rate. This situation naturally discouraged exports, irrespective of the incentive effect of the global commodity price boom. The adverse situation was further exacerbated by the country's exchange control regulations, which required that exporters surrender a significant portion of their export proceeds to the authorities at the overvalued and largely uncompetitive exchange rate. Surrender requirements on export proceeds were effectively an implicit and highly punitive tax on exporters and hence discouraged export performance despite the attractive global prices. As a result, the country's minerals, especially gold, were subjected to rampant smuggling, resulting in a substantial decline in gold deliveries to Fidelity Printers and Refiners, the entity authorized by the country's laws to purchase gold from local producers. The downward trend in gold output from 2004 to 2008 reflected the negative impact of an uncondusive economic policy environment on gold production. Figure 24 depicts the gold output for the period 2003–2018.

Figure 24: Gold output (kg)



Source: Reserve Bank of Zimbabwe Annual Reports, 2003 through 2018.

However, 2010 and 2011 were an exception, as there was a significant increase in exports of 102.3% and 39.5%, respectively, as shown in Figure 25. These two years were in the period of relative stability (2009–2012) when the country was under the GNU, enjoyed international goodwill and was also characterized by a more predictable macroeconomic environment. There was also minimal smuggling of minerals like gold as there was no incentive to do so.

Figure 25: Total export earnings (US\$ millions)

Source: Reserve Bank of Zimbabwe 2018 Annual Report.

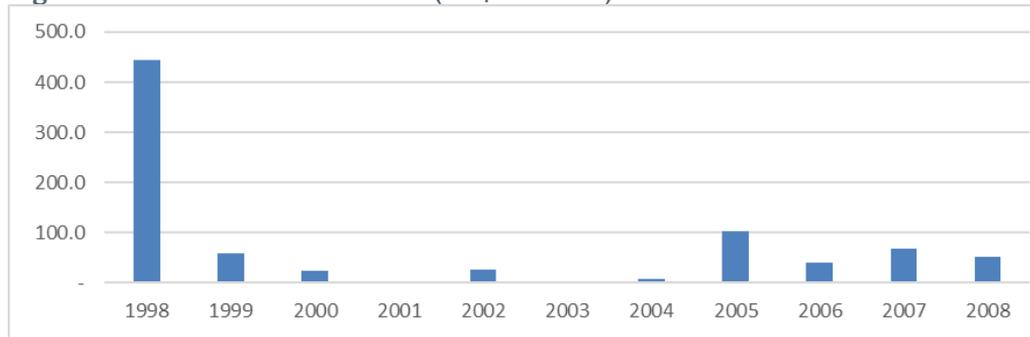
External shock from sanctions

The manner in which Zimbabwe's land reform programme was implemented angered the international community, particularly in relation to the perceived disregard for the rule of law and violation of human rights. This resulted in the imposition of sanctions on Zimbabwe by the US and the European Union (EU). In this regard, the US Congress enacted the Zimbabwe Democracy and Economic Recovery Act 2001 (ZIDERA) with the aim “to provide for a transition to democracy and to promote economic recovery in Zimbabwe” (US Congress, 2001). The US Congress (2001) cites “economic mismanagement, undemocratic practices and the costly deployment of troops into the DRC” as reasons why Zimbabwe could no longer be eligible for financial assistance from multilateral institutions such as the Bank for International Reconstruction and Development and the IMF. ZIDERA also directs all US executive directors of each of the multilateral institutions to vote against the extension of loans and cancellation or provision of debt relief to Zimbabwe, until such time as the country restores the rule of law, conducts free and fair elections, and commits to the implementation of “equitable and transparent land reform” (US Congress, 2001). The US Congress reviews ZIDERA every year and has continuously left it in place since its enactment in 2001. The imposition of sanctions on Zimbabwe exacerbated the economic crisis that started during the last quarter of 1997.

Following the enactment of the Access to Information and Protection of Privacy Act (AIPPA) by the GoZ in 2003, the US President responded by issuing Executive Order Number 13288, which put more restrictions on individuals already under sanctions. AIPPA was deemed by the US to be a piece of legislation that limited the freedom of the press. In addition, Zimbabwe could not benefit from the African Growth and Opportunity Act (AGOA) because of the US sanctions. AGOA granted preferential access to US markets for export of apparel by some countries in sub-Saharan Africa.

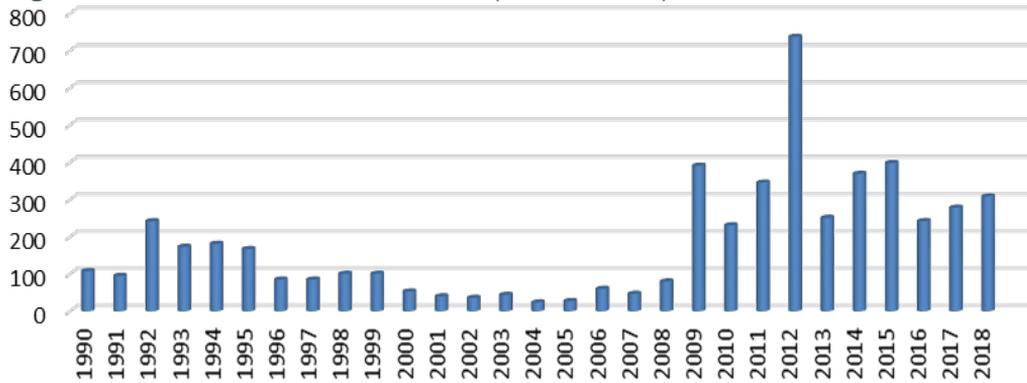
In concomitance with the action taken by the US, the EU Council suspended financial support to all projects in Zimbabwe on 18 February 2002, also as a reaction to the violence during the implementation of Zimbabwe's land reform programme and the crackdown on political opponents by government and the ruling party (Moretti, 2017). Development assistance to social sectors of the economy continued to be available to the country only through international and non-governmental organizations, but direct support for financing policy reforms and capacity building for the public sector was suspended. The EU also imposed travel bans on some members of the ruling party (Zimbabwe National Union Patriotic Front, [ZANU PF]) for allegedly participating in human rights abuses, and imposed a freeze on their assets in EU member states. As shown in Figure 26, FDI inflows took a huge knock in 1999 and further deteriorated from 2001 onwards, after the imposition of sanctions on the country.

Figure 26: Zimbabwe FDI inflows (US\$ millions)



Source: Author construct with data extracted from Reserve Bank of Zimbabwe database.

Bilateral donors withdrew budget support following the imposition of sanctions by the US and EU member states in 2001, with a negative impact on the capital account and fiscal budget. Grant inflows, which had averaged US\$90 million in the 1980s before increasing to an average of US\$135 million in the 1990s, declined to an average of US\$40 million between 2000 and 2007. Figure 27 shows that grants drastically fell from US\$53 million in 2000 to an all-time low of US\$24 million in 2004.

Figure 27: Grant inflows to Zimbabwe (US\$ millions)

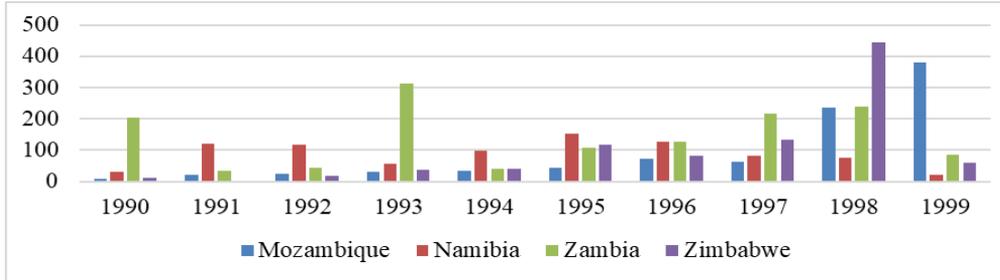
Source: Ministry of Finance and Economic Development, Zimbabwe (2018).

Another blow to Zimbabwe's ability to attract FDI was brought about by the promulgation of the Indigenization and Economic Empowerment Act (Chapter 14:33) by the GoZ, which became law effective from January 2008. The aim of the law was to ensure that indigenous and previously disadvantaged Zimbabweans hold at least 51% shareholding in all businesses with an asset value of at least US\$500,000 (GoZ, 2008). The requirement was that existing businesses had to achieve the 51% threshold within five years from 10 March 2010, while new businesses would have to comply within five years from the date they start business operations in Zimbabwe. However, the Act was at variance with Zimbabwe's call for FDI and had terms attached that discouraged investors, especially with respect to the issue of property rights. In addition, the country was already an unattractive investment destination and the promulgation of the Indigenization and Economic Empowerment Act exacerbated the situation. Another challenge with the Act was its lack of clarity and the frequent change in government ministers who were supposed to administer it. Each of the government ministers administering the Act at a particular time would interpret it differently, creating more confusion for potential investors.

While the sanctions imposed on Zimbabwe under ZIDERA and those imposed by the EU targeted the political elite for alleged economic mismanagement and the perceived suppression of basic human freedoms, they had a negative impact on productive and social sectors of the economy. The suspension of support for infrastructural projects, for example, had a huge and negative impact on economic growth and development as the country's infrastructure, such as power and transport services, were dilapidated and in need of replacement. As the African Development Bank (AfDB, 2019) posits, the medium- to long-term growth of an economy hinges on the extent and quality of its infrastructure. Moreover, there is a positive relationship between infrastructure and real GDP growth in sub-Saharan Africa (Kodongo and Ojah, 2016; Calderon and Servén, 2008).

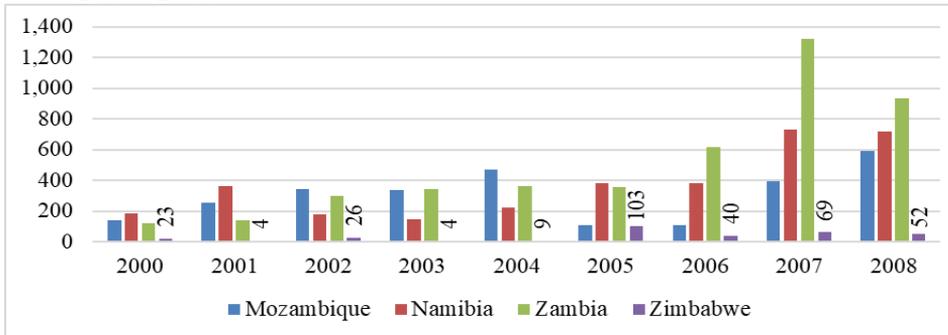
The perceived high country risk, an offshoot of the sanctions, resulted in a decline in FDI inflows. International investors naturally shunned Zimbabwe and put their funds in other countries in the region as shown in Figure 28. A comparison of figures 28 and 29 shows that Zimbabwe was relatively competitive in terms of FDI inflows in the 1990s, that is, before the imposition of sanctions.

Figure 28: FDI inflows into selected Southern African countries (US\$ millions), 1990-1999



Source: Author construct with data extracted from UNCTAD database, <http://www.unctad.org/fdistatistics>

Figure 29: FDI inflows into selected Southern African countries (US\$ millions), 2000-2008



Source: Author construct with data extracted from UNCTAD database, <http://www.unctad.org/fdistatistics>

The imposition of sanctions severely damaged the country's image because of the attendant negative perceptions. Consequently, private firms in the country found it extremely difficult to gain access to offshore lines of credit, particularly because of perceived country risk. Inflows of offshore loans rose from an average of US\$134.3 million in the 1980s to an average of US\$480.3 million in the 1990s, before declining to an average of US\$49.3 million during the period 2000–2007. Private firms that managed to secure offshore lines of credit accessed them at a very high premium. The difficulty in accessing offshore lines of credit for the procurement of raw materials, re-tooling and for working capital purposes was reflected in the decline in capacity

utilization levels in the manufacturing sector, from more than 80% in the 1990s to 48.2% in 2018 (CZI, 2020). Reduced industrial capacity utilization resulted in shortages of basic commodities with a negative impact on export earnings.

The most far-reaching of the consequences of the imposition of sanctions on Zimbabwe was the immediate drying-up of external budgetary support. Disbursements for ongoing infrastructure projects, including roads, telecommunications and water and sanitation were suspended, with ripple effects on economic activity. Support for projects in social sectors such as health and education was scaled down, with no new projects funded. The suspension of budgetary support forced the GoZ to resort to financing fiscal deficits through inflationary central bank borrowing.

7.0 Summary and conclusion

The economic history of Zimbabwe can be analysed in five distinct periods, namely, the period of controls, economic reforms, economic crisis, macroeconomic stability, and relapse into macroeconomic instability. Zimbabwe registered erratic growth during four of the five distinct economic phases, with high real growth rates and near-balanced budgets posted only during the period of macro-stability (2009–2013). A hyperinflation episode occurred in Zimbabwe during the economic crisis period, triggered by quasi-fiscal activities of the central bank. The quasi-fiscal activities of the central bank entailed the monetization of fiscal deficits as well as the financing of entities in both the public and private sectors.

However, macroeconomic stability was realized during the existence of the Government of National Unity, formed in 2009 following the disputed 2008 presidential election. This period saw the economy post high real GDP growth rates and fiscal budget surpluses or near-balanced budget outturns. Macroeconomic stability was realized largely because of the adoption of a multi-currency system, which restricted expenditure overruns as the GoZ had adopted a cash budgeting system. However, the end of the Government of National Unity in 2013 marked the end of fiscal austerity resulting in the incurrence of high fiscal deficits by the GoZ and the relapse of the economy into another crisis. This demonstrated, to some extent, that fiscal indiscipline could have been the major cause of macroeconomic instability and hence low real GDP growth rates in Zimbabwe, and that the political economy dynamics of the country had an impact on economic policy decisions made by the GoZ.

As in most sub-Saharan African countries, public debt negatively affected economic growth in Zimbabwe. This followed the accumulation of external payment arrears, which resulted in the suspension of further borrowing from both multilateral and bilateral sources. In cases where the country's private enterprises managed to access external lines of credit, they did so at a very high cost. Conversely, international commodity prices shocks resulted in a decline in revenue from export commodities, thus reducing the revenue inflows into the fiscus in the form of taxes on export earnings. Against the background of high government expenditure, a reduction in fiscal revenues resulted in the incurrence of high fiscal deficits.

High fiscal deficits, largely financed through borrowing from the central bank, crowded out private investment and had a negative impact on real economic growth. The monetization of fiscal deficits also led to excess growth in money supply, translating into higher demand for foreign exchange and increasing parallel market premiums. High parallel market premiums had a negative impact on price formation in Zimbabwe as firms passed on increases in costs to consumers in the form of higher prices, with negative effects on aggregate demand in the economy.

The analysis also showed that, for the years in which the country experienced drought, it posted low real growth rates and in other cases negative real growth rates. The drought years were also associated with high fiscal deficits, as droughts reduced tax revenues through their adverse impact on export earnings, income and employment, as was also observed by Benson and Clay (1998). In 1992, for example, a combination of drought and low international commodity prices adversely affected the economy through a decline in economic activity and low fiscal revenue inflows, respectively.

A combination of lack of access to external sources of financing and a reduction in inflows of foreign aid, a result of sanctions imposed on the country by the US and EU, had negative impact on real GDP growth in Zimbabwe. Moreover, the build-up of external payment arrears elevated country risk, which also led to the drying up of external financing and foreign direct investment. Foreign aid dried up, following the fallout with international donors because of the often-violent way in which the fast-track land reform programme was implemented.

The evolution of budget deficits and economic growth in Zimbabwe during the period of analysis show a close correlation between the two variables, with a possible two-way relationship. Notwithstanding this, the analysis also shows that other factors such as high public debt, droughts, a decline in export commodity prices, and high inflation caused by the monetization of fiscal deficits could also have influenced the country's economic performance. High inflation eroded the real value of government revenue, resultantly increasing the size or real value of the budget deficit, which had a negative impact on the country's economic performance.

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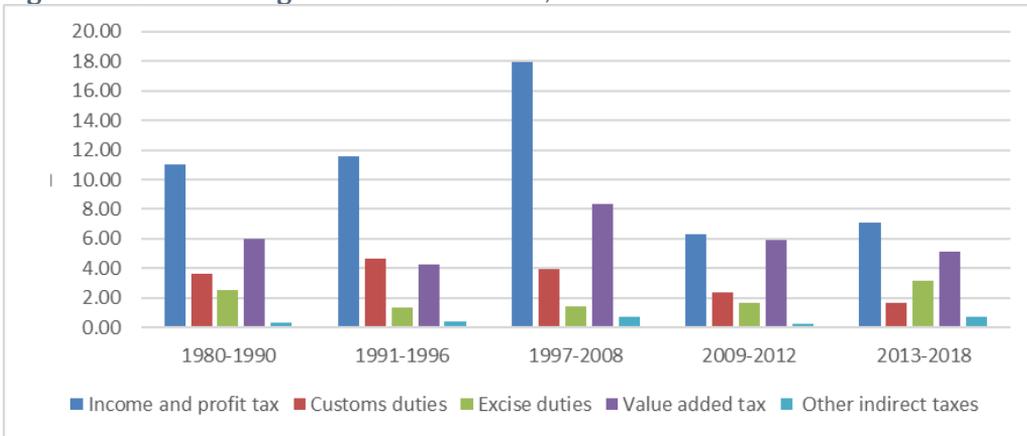
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Appendix

Figure A1: Sources of government revenue, 1980–2018



Source: Author computations and construct with data extracted from Ministry of Finance and Economic Development, Budget Estimates.



Mission

To strengthen local capacity for conducting independent, rigorous inquiry into the problems facing the management of economies in sub-Saharan Africa.

The mission rests on two basic premises: that development is more likely to occur where there is sustained sound management of the economy, and that such management is more likely to happen where there is an active, well-informed group of locally based professional economists to conduct policy-relevant research.

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