1.1 PATTERNS OF GROWTH AND DEVELOPMENT SINCE 1960

1.1.1 Overview

Prior to 1990, Zimbabwe experienced periods of strong and weak economic performance. Real GDP growth rates averaged nearly 4.5 percent a year during 1960-80, reflecting deliberate policies that promoted large-scale investment in domestic manufacturing and agriculture. The latter policies were motivated in large part by a need to achieve self-sufficiency following international sanctions against the Unilateral Declaration of Independence (UDI) Government. Since 1980, Zimbabwe’s performance has been mixed, reflecting policy lapses and adverse weather conditions that affected agricultural output. The country recorded its strongest post-independence growth performance during 1980-90 with gross domestic product (GDP) growing by an average of around 5.5 percent, higher than the average for Sub-Saharan African (SSA) countries, while the population grew at about 3 percent. Real GDP growth was, however, characterized by considerable volatility influenced by weather conditions and high levels of foreign capital inflows at independence in 1980. It was also driven by redistributive fiscal policies that focused on increased Government spending on health, education, and other social welfare programs within the framework of a command economy. Since 1990, the poor policy environment, government controls, droughts, and measures to address social inequalities via the provision of basic and social services at the expense of production, combined to cause the poor performance of the economy.

1.1.2 From Strong Growth to Economic Decline

The above summary of Zimbabwe’s recent economic history is reflected in Figure 1.1, which highlights the evolution of GDP during the post-independence period and shows the growth rates for different sub-periods. Four distinct episodes can be distinguished during the 1960-2008 period: two pre-independence sub-periods covering 1960-72 and 1973-79, and two post-independence sub-periods covering 1980-97 and 1998-2008.

![Figure 1.1: Zimbabwe: Annual and Tread GDP Growth, 1962-2007 (Natural Log Levels)](image-url)

Source: World Development Indicators, 2010
(B-K): Baxter & King Filter
**Episode 1:** Gross domestic product (GDP) increased at an average of 4.5 percent a year during 1960–70, reflecting interventionist and protectionist policies designed to propel the manufacturing sector. These succeeded in promoting domestic manufacturing and self-sufficiency in consumer goods, while investment increased significantly, as reflected in the steady increase in gross capital formation throughout this period.
• **Episode 2:** Growth slowed to 3.8 percent a year during 1970-79, reflecting the war of independence and economic sanctions against the UDI government of Rhodesia at the time.

• **Episode 3:** Independence brought resurgence in economic activity, with GDP growth averaging about 5.5 percent during 1980-1990. Economic growth in Zimbabwe surpassed the average for Sub-Saharan Africa during this period. The economy rebounded significantly in the early years of independence averaging 10 percent growth during 1980-82. This was influenced by favorable domestic and external conditions, including the lifting of economic sanctions, stimulation of overall demand in the economy with redistributive fiscal policies, and the opening up of external markets, fuelled activity. Thereafter, until towards the end of 1990s, growth was, characterized by periods of economic booms and busts corresponding essentially to periods of good weather or severe drought. The general trend of the 1990s is that the economy showed signs of weakening on account of low investment, an adverse internal environment and cutback in production by manufacturing industries due to foreign exchange shortages.

• **Episode 4—the Lost Decade:** Between 2000 and 2008, a sustained and broad-based decline in economic activities led to a cumulative decline of nearly 50 percent in real GDP growth. The crisis can be attributed largely to a combination of factors, including economic mismanagement, poor governance mainly arising from weaknesses in the rule of law in the context of the Government’s fast-tracked land reform program, the concomitant loss of support from the international community, capital flight, and low investment. The inflation rate increased substantially from 2000, reaching triple figures in 2006. It then moved to severe hyperinflation in 2007 before peaking at five hundred billion percent at end-2008. It was fueled by years of money creation to finance public expenditures and quasi-fiscal spending by the Reserve Bank of Zimbabwe (RBZ). Sustained high inflation contributed to real output contraction, while widespread controls of producer and retail prices accentuated shortages of most consumer items. Expropriation of farm land and resettlement in communal and commercial agriculture exacerbated the decline in food output.

### 1.1.3 A Weak Investment Performance

Zimbabwe’s poor growth performance also reflects a low rate of investment. Gross domestic investment averaged about 18 percent of GDP during 1980-89 and 19 percent during 1990-1999, respectively. It fell drastically to about 3 percent of GDP in 2000-06. The investment rates in recent years are below the average for low income Sub-Saharan Africa of about 19 percent of GDP. The level of investment since 2000 has therefore been inadequate for the maintenance of the existing stock of capital, let alone for the expansion of the productive base.

### 1.1.4 The Incidence of Poverty has increased

As a result of the drastic decline in economic performance in the past decade, Zimbabwe experienced a rapid increase in poverty, and real per capita income fell sharply from about US$644 in 1990 to $433 in 2006 and to an estimated $338 in 2008 (Figure 1.2). The poverty rate has increased from 42 percent in 1995 to 63 percent in 2003 and is currently estimated to be over 70 percent. Inequality is very high, with the Gini coefficient estimated at 57 percent in 2003, one of the highest in the world. Some estimates put unemployment at 80 percent. An estimated 1.2 million people, nearly 10 percent of the population, live with HIV/AIDS in Zimbabwe. In 1980, Zimbabwe had the tenth highest gross national income (GNI) per capita in Sub-Saharan Africa, but by 2005 it ranked 34th out of the 48 Sub-Saharan countries. An extended period of strong economic growth will therefore be required to raise incomes to the levels prevailing in the 1980s and early 1990s.
1.2 THE CHANGING ECONOMIC STRUCTURE

1.2.1 Overview

Whether Zimbabwe’s economic growth was balanced across productive sectors and especially whether the slowdown affected equally all areas of the Zimbabwe economy are interesting questions that provide important insights into the nature of the development process over the past half century.

The following sectoral analysis sheds some light on the long-term evolution of Zimbabwe’s economy, and gives insights into changes arising from economic crises, macroeconomic adjustment, and reform. From 1999 to 2008, the country’s key sectors (agriculture, manufacturing, mining, and services) shrunk significantly as a result of shifting government policies that weakened the economy’s ability to weather external shocks (Figures 1.3 and 1.4).

1.2.2 Primary Production

Agriculture is the key sector of the Zimbabwe economy. Although its share in GDP is now lower than that of the manufacturing sector, it is
the most important sector in terms of contribution to exports, provision of livelihood for many Zimbabweans, particularly in the rural areas, production of the bulk of the country’s food requirement. The agricultural sector also has linkages with the manufacturing sector as a supplier of a sizeable proportion of the raw materials required in the industrial sector, as well as a consumer of a large portion of industrial sector output (fertilizer, chemicals, stock feed, machinery, spare parts, and liquid fuels). Agricultural production has declined steadily and drastically over the years. While the share of agriculture in GDP was about 22 percent in 2001, it fell to about 10 percent in 2008. The sector’s value added contracted by 66 percent during 1999-2008, with most of the contraction occurring in commercial and communal farming. The contraction was triggered mainly by the fast track land reform program, erratic weather, limited access to finance, infrastructure bottlenecks, control of producer and food prices, and large-scale underutilization of land. Lack of security of tenure adversely affected investment in agriculture.

The mining sector remains small and largely underdeveloped. It contributed less than 3 percent of GDP in 2008, down from a peak of over 8 percent at independence. This is in spite of the fact that Zimbabwe is rich in mineral resources. Major resources of the sector include gold, diamonds, coal, iron ore, chrome ore, nickel, and platinum. Others, such as silver, cobalt, tin metal, limestone, phosphate, and lithium, also exist, but only in small quantities. The mining sector contracted by a cumulative of 81 percent during 1999-2008. In addition to an uncertain investment climate, performance of the mining sector has been hindered by the stiff foreign currency surrender requirements of the Reserve Bank of Zimbabwe, increased government control of the sector, and lack of clarity over the royalty and tax regime. Consequently, the production of all minerals has fallen well below their peak levels. Gold production dropped from 27 tons in 1999 to 3.6 tons in 2008, with similar trends in the output of all other minerals. In this regard, Zimbabwe lost a golden opportunity to take advantage of the lengthy sustained worldwide commodity price boom during 2003-08. Despite these challenges, the sector is also expected to be the primary driver of growth in the near term and will attract the most foreign direct investment (FDI), assuming uncertainty over the controversial Indigenization Law (which is discussed in Chapter 5) and structural constraints, such as a lack of electricity, a shortage of skills, and limited access to domestic capital, are addressed.

1 Mining’s value-added processes fall under manufacturing.
2 Recently, the business climate for mining companies has been adversely affected by the uncertainties regarding the implementation of the Indigenization and Empowerment Act passed in 2010.
1.2.3 The Industrial Sector

Under heavy protection, the manufacturing sector grew rapidly in the 1960s. However, since independence in 1980, manufacturing output has grown very slowly. In the 1980s it grew at an average of only 2.7 percent.
compared with the rapid growth of 11 percent per annum during 1965-75. Growth was constrained by scarce foreign exchange and an overvalued exchange rate. Manufacturing value added grew even more sluggishly in the 1990s at the time when the authorities undertook a series of partial reforms aimed at liberalization of the economy and removal of restrictions to import. Manufacturing was the leading sector until late 1990s despite its share of GDP having declined significantly to about 18 percent in 2000 from 23 percent in the 1980s.\(^3\) The declining trend in manufacturing can be attributed to a combination of challenges stemming from unstable and unpredictable policies that had led to high and unpredictable inflation, acute shortages of foreign exchange, an overvalued exchange rate, persistent fuel shortages, inadequate and costly infrastructure services (particularly power and water), inefficient transport, as well as price controls and shortage of skilled labor associated with brain drain and tough labor regulations.

1.2.4 The Services Sector

Services accounted for an average of about 48 percent of GDP during the 1980s and 49 percent during the 1990s. Although the service sectors value added contracted by a cumulative of nearly 18 percent during 2000-08, the share of the sectors’ in GDP increased to an average of over 54 percent during the same period due to the fact that the other key sectors (mainly agriculture and manufacturing) shrunk relatively more rapidly during the economic crisis. The services sector comprise economic activities including transportation and communications, tourism, financial services, and electricity that have sharply deteriorated over time, as well as community and personal services, which are sensitive to weaknesses in law and order and in governance.

The services sector is likely to continue to dominate the Zimbabwean economy. The recovery of infrastructure services along the lines discussed in this Report, financial services, tourism, and community services, would ensure that the sector continues to be an important source of growth and employment creation in Zimbabwe going forward. Strong backward linkages with the agricultural and manufacturing sectors and the potential for developing the Victoria Falls, water-sport on Lake Kariba and the Zambezi River, game reserves, hunting and photographic safaris, and proximity to South Africa are major assets in this regard.

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\(^3\) Still, roughly three times as large as the average for Sub-Saharan Africa. In fact, Zimbabwe was SSA’s second most industrialized country after South Africa in the 1990s.
Figure 1.4: Zimbabwe: Sectoral Growth Trends
(annual growth rates in percent)

Source: Government Data, 2010
1.3 SOURCES OF ECONOMIC GROWTH SINCE 1960

1.3.1 Evolution of Sources of Zimbabwe’s Economic Growth

For Zimbabwe, an important question is whether its growth has been driven by labor and capital accumulation or by productivity growth. The aggregate output of an economy may be characterized as the product of all employed inputs, usually categorized as capital and labor (Solow 1957). The growth accounting procedure breaks down output growth into shares accruing to the growth of capital and labor and to a portion that is not accounted for by increases in the use of these inputs. This unexplained part of output growth is usually considered as the growth in total factor productivity (TFP), and is taken to represent productivity improvements or to be a measure of broadly defined technological progress that explains the growth in output over time, while holding input levels fixed. The vague nature of TFP has provoked long debate on the role that it plays in promoting overall economic growth. It is a residual that drops out of the growth accounting procedure, representing the difference between overall economic growth and the sum of the contributions of growth of the input factors. Nevertheless, empirical evidence indicates that it accounts for an increasingly large share of output growth in countries that have been able to sustain their economic growth rates over time. Efforts to better explain what TFP is and the role that it plays in economic growth have thus become important exercises in growth theory and development economics. On the one hand, endogenous growth models point to improvements in, say, the quality of physical infrastructure and human capital stock as well as broader and deeper financial development as possible ways by which the rate of innovation (or TFP growth) can be accelerated. Conversely, accounts in the new institutional economics literature suggest that institutional change that promotes broad-based property rights or solves coordination failures in an economy enhances the economy’s overall efficiency and its growth prospects. From both interpretations of TFP, however, the message is clear: A better understanding of the determinants of TFP growth is important for designing better policies to strengthen and sustain future economic growth.

A growth accounting exercise has therefore been undertaken to provide insights about the historical growth trends and medium-term growth prospects for Zimbabwe. Assumptions of constant returns to scale and competitive factor markets make it possible to calculate the growth rate of output implied by the growth of physical and human capital. The analysis below estimates how much of the growth in output in Zimbabwe is associated with increases in physical capital and labor inputs, and how much is due to technology, institutional change, and other factors. The growth accounting exercise was performed for the 1960–2007 period.

Table 1.3 shows the contributions of the three factor inputs to GDP growth from 1960 to 2007. The analysis indicates that the growth in labor and capital were the main sources of GDP growth in this period. The first decade marks the strongest growth in real GDP for Zimbabwe, Total factor productivity (TFP) contributed significantly to output growth in this period increasing by 2.7 percent year for the decade.

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4 The framework used for the growth accounting analysis assumes that output (Y) follows a Cobb-Douglas production function and is measured as deflated value added. The Cobb-Douglas function was assumed to have output elasticities of capital and labor of 0.33 and 0.67 respectively. Capital stock is derived from data on gross fixed investment using the perpetual inventory method, with an assumed depreciation rate of 5 percent. The derived capital-output ratio in 1960 is 3.1. The labor input is the labor force proxied by data on the economically active population. All data except for capital, which are derived, are from the AfDB Data Platform and the World Bank Development Indicators Report. Total factor productivity is derived as a residual.
as a whole. In the subsequent decades, the growth in the labor force made an increasingly significant contribution to real GDP growth. In other words, Zimbabwe’s GDP growth during this period has been achieved largely by adding labor to production. The decline in the contribution of capital in the post-independence period reflected the earlier-mentioned declining levels of investment that stemmed from the generally poor investment climate, consecutive droughts, and weak demand for Zimbabwean exports. During the 1990s, the small increase in capital’s contribution to growth in the 1990s was most likely the result of policy reforms at that time which were aimed at increasing private investment.

Table 1.3: Zimbabwe: Sources of Growth, 1960-2007 (In % p.a.)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Real GDP growth</td>
<td>6.1</td>
<td>3.1</td>
<td>4.3</td>
<td>0.9</td>
<td>-5.0</td>
</tr>
<tr>
<td>Capital</td>
<td>4.7</td>
<td>4.9</td>
<td>0.4</td>
<td>1.5</td>
<td>0.4</td>
</tr>
<tr>
<td>Labor</td>
<td>2.7</td>
<td>3.2</td>
<td>4.2</td>
<td>2.4</td>
<td>2.3</td>
</tr>
<tr>
<td>TFP</td>
<td>2.7</td>
<td>-0.7</td>
<td>1.4</td>
<td>-1.1</td>
<td>-6.6</td>
</tr>
<tr>
<td>Trend TFP growth</td>
<td>0.9</td>
<td>-0.2</td>
<td>-0.5</td>
<td>-0.9</td>
<td>-1.8</td>
</tr>
</tbody>
</table>

Source: WEO, WDI, and authors’ estimates

The most striking result from the Figure 1.6 is that the estimated size of TFP growth and its relative contribution to Zimbabwe’s economic growth fell markedly after 1990. This implies a shift in the sources of the Zimbabwe’s growth from capital accumulation to sharp declines in TFP growth. Prior to 2000, expansion of the capital stock and labor were the main sources of output growth in Zimbabwe; after 2000, the contribution of capital accumulation was negligible and the negative impact of TFP growth offset the effects of the growth in the labor force and dragged down the overall economic growth rate. However, the sharp drop in GDP during this period may be distorting the results. Essentially, because TFP is measured as a residual, business cycle effects (that is, the economy’s move below potential growth during the recession) may be mixed with productivity growth effects. The business-
cycle adjusted TFP, however, supports the view that a decline in the productivity of labor and capital accounted for most of the decline in economic growth during this period.

1.4 ECONOMIC RECOVERY AND MACROECONOMIC STABILITY

1.4.1 Economic Recovery in 2009

The reforms, in particular the multi-currency regime and the cash budget system, adopted by the Inclusive Government (IG) in March 2009 have helped to restore macroeconomic stability and support an emerging economic recovery. In response to the more stable and liberalized economic environment under the Short-Term Emergency Recovery Program (STERP), real GDP grew by 5.7 percent in 2009 and is estimated to have risen strongly by about 8 percent 2010, compared with a decline of about 14 percent in 2008.

The economic expansion is broad-based, with agriculture estimated to have grown by 14.9 percent in 2009 on a strong maize crop yield. The liberalized grain market environment, improved support and timely availability of inputs through the open market contributed to the improved production of maize in 2009. However, although at 1.2 million tons maize crop doubled in 2009, it still fell far short of the national cereal requirement of 1.95 million tons. In 2010, agriculture is expected to register a strong growth of about 34 percent, mainly driven by a strong production of tobacco, sugar, maize and cotton by 110 percent, 35 percent, 34 percent and 23 percent, respectively, underpinned by higher hectarage.

Manufacturing grew by 10 percent in 2009 after capacity utilization rose from less than 10 percent in 2008 to levels in the range of 30-50 percent. Manufacturing activity benefited from the removal of price controls on basic commodities, the ability to earn revenue streams in foreign currency and the possibility of using foreign currency for the purchase of inputs on liberalized markets. The sector’s recovery momentum has, however, not been sustained and manufacturing is estimated to have posted a modest growth rate of only 2.7 percent in 2010, reflecting competitive hurdles the sector is still facing, including liquidity constraints, competition from imports, high costs of borrowing, and infrastructure bottlenecks (in particular erratic power and water supplies). Mining rose by 8.5 percent in 2009, taking advantage of the removal of forced foreign exchange surrender requirements and full retention of market proceeds. It is estimated to have registered a very high growth rate of 47 percent in the 2010, in spite of investor concerns over the Indigenization and Empowerment Regulations and liquidity constraints which made medium-to long-term finance for plant refurbishment largely inaccessible. The sector’s strong performance was influenced by continued bullish mineral and metal prices.

The tourism industry also registered its first growth in a decade, thanks to current political stability. It grew by an estimated 6.5 percent in 2009 and growth is expected to be subdued in 2010 estimated at only 0.5 percent reflecting capitalization constraints facing the sector and slow recovery in the global economy. Since the onset of the economic crisis, the performance of the sector has been adversely affected by the country’s image internationally and the increase in the number of travel warnings issues against Zimbabwe.

The financial turmoil of recent years had resulted in sharp curtailment of banking activities, and financial intermediation started to recover only in 2009. Total bank industry dollar deposits grew very rapidly reaching US$1.35 billion by 31 December 2009 and US$2.3 billion by September 2010 from US$297.6 million as at 31 January 2009, reflecting increased confidence in the banking system, the elimination of surrender requirements, and short-term private inflows. The increase in deposits, together with foreign credit lines, allowed the commercial banks to
expand their portfolios. As a result, total loans and advances grew from US$79.6 million in January 2009 to US$738.9 million in December 2009 and US$1.42 billion by September 2010. This, however, is not sufficient to fund lending requirements to restart the economy. Although the loan-to-deposit ratio of about 63 percent in September June 2010 compares favorably with the levels obtaining in the neighboring countries, the financial turmoil of recent years has resulted in sharp curtailment of business sector access to conventional 90 and 180 day external trade financing facilities with longer-term loans accounting for only less than 3 percent of overall loans. Lending rates of as high as 30 percent are extremely prohibitive against deposit rates of as low as 2 percent, which tend to discourage saving. This cautious approach by banks reflects high credit risks and the liquidity crunch in the economy, as well as the absence of overnight central bank facilities and an interbank market.

1.4.2 Return to Macroeconomic Stability

The hyperinflation of 2008 was brought to a halt in 2009, reflecting the dollarization of the economy, the end of monetary injections by the authorities, and the increase in food crops and in the supply of goods in the shops. Year-on-year inflation fell to -7.7 percent in December 2009, but picked up during the first quarter of 2010 reaching -4.8 percent in January, -0.7 percent in February, and 6.1 percent in May 2010. The upward trend was being driven by rising prices of food and non-alcoholic beverages, a reflection of significant wage increases awarded to public and private sector employees in the first quarter of 2010 and the appreciation of the South African rand against the U.S. dollar. It also reflects tariff adjustments for public utilities. Annual inflation, however, registered a downward trend from June 2010, easing to 3.6 percent in October. It is estimated to remain within single digits in 2010, reflecting favorable developments in food, housing and utility prices.

Fiscal discipline was imposed in 2009 through strict adherence to a cash budget system and the halting of Reserve Bank’s quasi-fiscal activities by the authorities. Although the fiscal position was broadly balanced in 2009, difficult fiscal challenges remain. Revenue collection increased from less than 4 percent of GDP during hyperinflation in 2009 to US$973.0 million (about 19 percent of GDP) in 2009, but it fell short of the budgeted amount of US$1.9 billion. Value added tax (VAT) was the main source of revenue, contributing 39 percent of total collections in 2009. The improved revenue collection was boosted by the stabilization of prices and strong tax policy and administration. Total expenditure (and net lending) amounted to US$920.9 million in 2009, of which about 53 percent was spent on civil service wages, the highest in Sub-Saharan African countries. The wage bill is the single largest component in the Government budget and crowds out a significant portion of capital expenditures. As a result, capital expenditures accounted for only about 5 percent of the total budget (1 percent of GDP). Thus, the Government has little fiscal space to increase spending for infrastructure and for many socially oriented programs. The 2010 budget proposed total expenditure of US$2.25 billion against revenues of US$1.44 billion in 2010. The financing gap was expected to be financed by drawing down part of Zimbabwe’s SDR holdings and/or through donor loans and grants. While total revenue receipts for the period January-October 2010 were above target, amounting to US$1.79 billion, official inflows during the same period performed poorly with only US$360 million received, compared with US$810 million that was budget for 2010. Total expenditure during the period January-October 2010 amounted to US$81.46 billion, of which US$677.7 million represented employment costs (about 46 percent of actual total expenditures). Given that the authorities are operating a cash budget system, the ballooning wage bill will continue to crowd out budgeted capital expenditures,
particularly for financing urgent infrastructure maintenance and rehabilitation projects critical for economic recovery, as well as for essential social programs.

1.4.3 External Accounts continue to be a Major Concern

Zimbabwe’s external position remains precarious. In 2009, total exports amounted to about US$1,591 million, compared with US$1,657 million in 2008. The weak export performance is attributed to lower export prices as a result of the global economic downturn, decreased output volumes of selected agricultural and mining export products, as well as limited access by businesses to both domestic and offshore credit lines. Imports increased substantially by about 22 percent from US$2,630 million in 2008 to US$3,213 million in 2009, reflecting the need to compensate for shortfalls in domestic production of agricultural goods and raw materials and increased demand for rehabilitation or replacement of capital equipment. The current account deficit widened further to nearly 17 percent of GDP in 2009 from 16 percent in 2008. It was largely financed by short-term private inflows, SDR allocations, external payment arrears, and reduction in banks’ foreign assets. Developments in the capital and financial accounts continued to be dominated by the accumulation of arrears in 2009, increasing the balance of payments deficit in the absence of substantial inflows from disbursements of public sector loans/grants as well as from foreign direct and portfolio investments. In 2010, the current account deficit is estimated to remain high at almost the same level as in 2009 on account of increasing imports estimated at US$3.6 billion against exports of about US$2.0 billion and a slowdown in private transfers, such as remittances, to about US$660 million, compared with almost US$1.0 billion in 2009. The capital account is, nevertheless, expected to move to a surplus of US$578.5 million in 2010 from a deficit of about US$560 in 2009, on account of improved inflows in portfolio investment and short-term capital. Accordingly, the overall balance of payments deficit is projected to improve to a deficit of US$462 million from that of US$1.9 billion during the same period. Gross international reserves are projected to remain very low, estimated to equal less than 1.4 months of imports in 2010, compared with 1.2 months in 2009.

Zimbabwe’s external debt remains highly unsustainable and continues to grow owing to accrual of arrears and new payments of interest and penalty charges on existing payment arrears. The country has made only limited payments on its external debt since 2000 owing to the prolonged political and economic crisis. Its total external debt is estimated at about US$6.9 billion by October 2010, of which over two thirds are arrears to most of Zimbabwe’s creditors. The arrears to international financial institutions (IFIs) are estimated to reach US$1.5 billion (US$0.5 billion due to the AfDB, US$0.1 billion to the IMF and US$0.7 billion to the World Bank). The country is in debt distress.

Cognizant of the need urgently to resolve the debt overhang, the Government is considering adopting a comprehensive “hybrid” strategy, which will include a request for debt relief under the HIPC Initiative to resolve external payments arrears and the use of mineral resources to achieve sustainable development. The Government is also in the process of setting up a Debt Management Office, with AfDB support, which will be responsible for implementing the country’s arrears clearance and debt relief strategy, reviewing and strengthening the statutes and regulations, and giving advice to Government on public debt issues.

1.5 ECONOMIC OUTLOOK FOR THE SHORT- AND MEDIUM-TERM

1.5.1 The Challenges Ahead

Zimbabwe’s short- to medium-term economic growth outlook is subject to a variety of
threats. First, the fiscal scenario is likely to remain unsustainable if public sector wage costs are not contained and indeed reversed to create fiscal space for urgent growth-oriented investment programs and social projects. Second, the stability of the financial sector needs to be preserved through the intensification of measures to contain rapidly rising liquidity and credit risks to the banking system by stepping up supervisory efforts and addressing governance weaknesses at the RBZ. The increased vulnerabilities of banks emanate from the rapid growth of credit since the introduction of multi-currencies and the resultant balance of payments deficits, which can have serious consequences on Banks’ foreign assets. Third, measures to promote significant improvement in the business climate need to be pursued aggressively, especially with regard to property rights, the clarification of the regulations under the indigenization legislation, and security of land tenure. Fourth, the lack of access to medium- to long-term financing for critical investment in infrastructure rehabilitation and maintenance and upgrading of power generation capacity, as well as limited access by business to lines of credit, needs to be addressed.

The Government is acutely aware of these concerns and is drawing up a plan for the medium-term that aims to address these challenges.

1.5.2 Government’s Plan for the Medium-Term

The draft Medium Term Plan (MTP) for Zimbabwe sets out the national priorities and guidance for government policy documents and the national budgeting process for 2010-15. It responds to the mandate set out in Article III of the Global Political Agreement to support the restoration of economic stability and growth in Zimbabwe and builds on the foundations laid by the Short-Term Emergency Recovery Program (STERP) adopted by the Inclusive Government in March 2009. The MTP is guided by the Vision 2020 and linked to the Millennium Development Goals (MDGs). The theme of the MTP is the restoration and transformation of capacities for sustainable economic growth and development. Government anticipates that economic growth will be broad based and private sector driven, with strong performance in the four key sectors of agriculture, manufacturing, mining, and tourism. The MTP includes the following macroeconomic targets:

- A rise in GDP to US$ 9 billion by 2015;
- An average GDP growth rate of 15 percent per annum to achieve the targeted level of income by 2015;
- Revenue (including grants) and total expenditures of up to 30 percent of GDP;
- Savings and investment of up to 25 percent of GDP;
- Budget deficit of 5 percent of GDP by 2015;
- Single digit inflation figures; and
- Three months of import cover.

The Plan also gives particular emphasis to the following programs: (i) infrastructure development with emphasis on rehabilitation and completion of outstanding projects; (ii) implementation of pro-poor strategies as a fundamental factor for poverty reduction; and (iii) promotion of programs that endure gender parity in access to education, health, and other social services. The MTP recognizes that these issues should be complemented by distributive measures through special welfare programs that will be provided to meet the needs of the most disadvantage individuals and communities in the country in order to make them self-reliant.

The realization of this ambitious growth scenario is based on a number of key assumptions, including: political stability through successful implementation of GPA; continued implementation of a supportive monetary and fiscal policy framework; continuation of the present multi-currency regime; improved governance; creation of a
conducive business climate through strong policy and structural reforms covering areas such as tax, mining, land, property rights, public enterprise, and financial sector development; reversal of the brain drain; and successful re-engagement with the international community.

The implementation of the MTP will require a total of US$15.8 billion of recurrent and capital expenditures. Since this cannot be financed through public resources alone, donor inflows and private sector financing, especially through private-public partnerships (PPPs), will play a critical role.

1.6 POTENTIAL CONSTRAINTS TO LONG-TERM GROWTH

1.6.1 Challenges for the Longer-Term

Despite the nascent recovery since 2009, and the ambitious growth target set forth in the draft MTP, Zimbabwe faces many hurdles to sustain growth in the longer-term. The crisis of the past decade reversed the country’s progress in raising living standards and put at risk its achievements in poverty reduction. Deeply embedded structural constraints prevent it from reaching its full production potential and attaining the maximum possible outputs that its vast resources are capable of producing. The presence of structural constraints and the severe deterioration in the basic infrastructure of the country in the past decade has eroded Zimbabwe’s international competitiveness, an issue of major concern given the importance of export markets for sustained long-term growth.

Zimbabwe continues to be among the least competitive economies in the world. This is evidenced by the 2010-2011 Global Competitiveness Report by the World Economic Forum5, which ranked Zimbabwe 136th (out of 139 economies) in terms of the Global Competitiveness Index (GCI). The weak competitiveness of the Zimbabwe economy reflects several constraints that are critical to determining the level of productivity of the country, including inadequate supply of infrastructure facilities (which is ranked 129). The country also scores low on a number of other indicators, such as macroeconomic environment (ranked last at 139), technological readiness (135), market size (134), goods market efficiency (130) and labor market efficiency (129). Most of these issues have some linkages with the quality of infrastructure in the country (see Figure 1.6).

To accelerate growth and reduce poverty, Zimbabwe must address the limitations it faces in promoting the efficient use of resources and in raising productivity. Continued reliance on expanding the factors of production—that is, a growing labor force and capital stock—is essential for increasing long-term supply. But more than simple accumulation of factors, efforts to use these resources more efficiently and spur innovation hold the key to sustaining high growth over the longer term. Expanding trade would also allow Zimbabwe to transition away from labor-intensive to more capital- and knowledge-intensive manufacturing and put the country on a higher growth profile.

Zimbabwe supplies cheap labor to South Africa and other neighboring countries, but the sharp deterioration in the educational systems and inflexible labor laws are hurdles to further progress. Overhauling the educational system would contribute to the quality and quantity of its rich resource base of highly skilled professional and educated workforce. Poor infrastructure and high infrastructure costs present key binding constraints to sustained growth. By rehabilitating and strengthening its infrastructure, production and trade costs are reduced, which in turn attracts FDI and has a direct impact on productivity and trade. Another binding constraint arises from decades of bank-dominated financial intermediation.

and government-directed lending that have left domestic financial systems underdeveloped. Complex institutional and regulatory frameworks have further limited the scope for continually expanding growth. Modernizing the financial system would increase intermediation and lower lending rates and so allow it to launch Zimbabwe toward a higher-growth path as the future unfolds.

As Zimbabwe’s reform of institutions and economic policies and its resulting recovery gather momentum, medium- and long-run growth will reassert itself as the overriding concern of policy makers. Understandably, the policy makers were preoccupied with stabilizing short-run output during the depths of the crisis over the last decade, as exports plummeted and growth stagnated. Prudent fiscal and monetary policies have so far led to a resurgence of real GDP growth. Zimbabwe can now build on these gains and return to its growth agenda unfinished at the time of independence. While the short-term recovery measures can help revive the economy somewhat, they cannot sustain growth over a longer time horizon. While short-run output fluctuations are determined primarily by aggregate demand, long-run growth depends largely on supply-side factors, which augment an economy’s productive capacity. Long-run growth reflects the combined effects of the accumulation of factors of production—capital and labor—and productivity improvements, and involves structural supply-side strategies that enable individuals, firms, industries, and the entire economy to become more productive on a sustained basis. For Zimbabwe, this would require a major improvement in its infrastructure.