AFRICAN DEVELOPMENT BANK

Zimbabwe Short-Term Strategy: Concept Note

REGIONAL DEPARTMENT

South Region A

April 2009

I Context

1.1 Zimbabwe, once the breadbasket of the region is now a net importer of food. It remains in crisis, with serious economic and social consequences. Hyperinflation, peaking at some 500 billion percent in September 2008 effectively destroyed the Zimbabwe dollar; the country now operates with the US dollar and SA Rand. This was fuelled by the Reserve Bank's quasi-fiscal activities including election related expenses, transfers to parastatals, subsidised directed lending and forex allocations, were estimated at some 46% of GDP in 2008. At end 2008, there was a current account deficit of 28% of GDP and gross international reserves of only $6million (equivalent to 0.2 months of imports of goods and services).

1.2 The impact is evident. The private sector is operating at some 10% of capacity. There are major shortages of investment, raw materials and energy, and the physical infrastructure has fallen into disrepair. The financial system is paralyzed; there is no lender of last resort facility and no payments system in dollars or Rand. Although there has been a recent fall in consumer prices, there has been a significant deterioration in the humanitarian situation: formerly good education and health services have collapsed, and HIV AIDS is rampant. The poor state of infrastructure and related facilities such as water supply and sanitation systems, transport and energy and the deterioration of institutional capacity to manage them has impacted negatively on the provision of social and economic services for the whole population, and the more vulnerable population is particularly hit hard with increase in disease and rising poverty levels.

1.3 The impact is felt beyond Zimbabwe's borders. The deterioration has negatively impacted on investor perception of the region and trade has diminished. An estimated 2 million Zimbabweans have left the country recently, including many skilled personnel. Unskilled labor has flooded into Botswana and South Africa, imposing a burden on those countries and raising political tensions. SADC, mandated by the AU, has brokered a political solution (the Global Political Agreement – GPA), leading to the formation of an Inclusive Government (IG) in February 2009. The political situation remains fragile; much will depend on the ability of the IG to engineer economic recovery. The massive reform and adjustment effort required takes place at a time when the global recession is dampening the prospects for export led recovery.

1.4 The country has been isolated from much of the international community and International Financial Institutions, and will need support on reengagement. Consistent with the wish to see an African led solution, the African Development Bank (ADB) has been asked to take a lead role. This note sets out a strategy for the ADB from May 2009 to December 2010, anchored in support to the IG and with the aim of full reengagement with Zimbabwe by that time. It is focused on the short-term goal of unlocking resources to develop and support a recovery and reform programme, and at the same time to collect data on infrastructure needs and formulate immediate and medium term action plans. The longer-term aim is for revival of a strong private sector-led economy through amongst other means, strategic investment in selected infrastructure, and capacity building. These are key in supporting social and economic activities, and thereby to realizing Zimbabwe's full potential: a self-sustaining country that is not aid dependent.

II Policy Framework

2.1 The IG has moved swiftly to produce a Short Term Emergency Recovery Program (STERP). STERP emphasizes political stability, good governance, social protection, sound macro-economic management and growth. It has eliminated the quasi-fiscal activities of the Reserve Bank of Zimbabwe and introduced cash budgeting-spending only what it receives in revenue. STERP identifies the revival of manufacturing, agriculture and tourism as key to a quick economic turnaround. The IMF Article 4 mission has underlined that an economic recovery will not be possible without foreign assistance and private capital. Therefore immediate steps have to be taken to stimulate private sector activity, promote investor confidence, restore protection of property rights, and to reduce the cost of doing business.

2.2 The Government has created a STERP steering committee with key ministries and donors, including the Bank, as members. The IG needs now to move quickly to develop and implement specific, prioritized, programs of action. The IMF have made a number of policy recommendations for reforms and to ensure a balanced budget. Steps are being taken to ensure the Reserve Bank does not again exceed its mandate, and to introduce new governance arrangements. Following an IG ministerial retreat in April 2009, leaner policy procedures have been introduced. Even though the initial budget for the current year has been cut in half; payments of a flat rate to civil servants pegged at $100 per month; and no provision made for investment; STERP is underfinanced. There is an estimated budget gap of some $200million for the remainder of 2009. Implementation will therefore need immediate support from the international community and sustained assistance in the medium term.

2.3 Recent meetings in Tunis and in Washington between the Minister of Finance and the donors have indicated broad agreement that technical assistance should be provided to the IG, including by the IFIs. At present, the $500m aid provided annually to Zimbabwe is almost entirely humanitarian, with half the population receiving food aid. Humanitarian needs are estimated to increase to $800million this year. Whilst some donors are willing to consider “humanitarian plus” assistance (for instance supplementing salaries for health workers and providing drugs), there is reluctance to provide any resources direct to Government given concerns about financial control and accountability, and uncertainty about the level of commitment to reform. Only South Africa (with an offer of R300m) has so far been prepared to assist directly. However as a signal of support for the process, other SADC countries are also considering providing assistance.

2.4 The meetings showed a consensus that the ADB should have a presence in Harare, as indeed the World Bank maintained throughout, notwithstanding Zimbabwe’s arrears. Whilst Zimbabwe remains in arrears there are limited resources the ADB can provide. This strategy is based therefore as much on the non-financing role for the ADB, situating our contribution within the broader donor effort, with a premium on speed and flexibility. The Bank will help kick-start financial sector operations, identify specific sectors especially those covering physical infrastructure development where the Bank can leverage its resources with those of other donors, assist the IG with policy development and implementation, and help interface with the international community.

There is agreement that scarce donor funding must be effectively coordinated and prioritised, including through multi-donor trust funds. The Fragile States Facility (FSF) provides an appropriate channel.

III The Strategy

3.1 As stated, the Bank's Strategy for Zimbabwe, over the next 19 months (May 2009-December 2010) will help address the challenges facing the country and will be anchored on supporting the IG in the implementation of STERP. The broad outcomes to which this strategy will contribute include: improved macro-economic stability and public financial management; greater private sector and donor confidence; improved financial intermediation; policy development and implementation in key strategic areas especially in rehabilitation of infrastructure; arrears clearance; Zimbabwe's eligibility under the HIPC initiative; enhanced confidence in the private sector activities; and the resumption of full development partnerships with the international community. For the ADB itself the outcomes will include, a full Bank Country Strategy Paper based on a medium-term strategy developed by Government, and the resumption of normal lending operations. The key elements are set out below.

Establishing Effective Partnerships with Other Donors

3.2 The Bank's leverage in Zimbabwe will not only be financial, but will also include provision of advice and technical support to assist the IG move its agenda forward. A major task of the extended mission and the Bank strategy in this regard would be to work with the Government to convene and coordinate support from donors. The Bank will be selective and focused in its assistance, and as a matter of principle will seek to leverage its operations by coordinating and co-financing with other partners, including in particular SADC countries. It is currently participating in a Needs Assessment Mission together with the WB and UN which exercise will map out the needs in all sectors of the economy. In this respect the Bank, while participating in all other sectors, has been given the lead role in the sectors within infrastructure cluster.

Extended Bank Presence in Country

3.3 In order to play the role expected, it is imperative that the Bank has an appropriate presence in Harare. The Bank has had staff on mission in Harare for the last two months, co-located with UNDP. This has enabled the Bank to participate in donor coordination meetings, a joint scoping mission (where the Bank is coordinating infrastructure issues), and to work closely with the incoming Finance Minister. There has been regular in-country donor coordination meeting through the "Fishmongers Group", and there is a strong demand by both the government and the donors for an extended ADB presence.

3.4 A team of three (3) Bank staff has been put in place immediately, comprising a Lead Economist from the FSF (Head of Mission), Senior Country Economist; and Principal Engineer from the OINF as the infrastructure expert. The team's role will be to work in concert with other donors to develop an actionable Needs Assessment of the keys sectors of the economy. In addition consultancy services will be made available (provided from the Fragile States Facility (FSF)). The Bank will seek urgently secondments from other bilateral or multilateral institutions to supplement its own resources. (The World Bank office already has such supplements.) Regular high level supervision and support will be provided to the mission to enable it conduct as much of our work as possible in Harare.

3.5 A more formal discussion will be conducted with UNDP Harare to assess the scope for temporary accommodation. The Bank presence in Harare will be reexamined after six months, and longer term options then considered in line with Bank policy on decentralization. This could include a proposal to the Board to establish a country office in Harare. An alternative might be to assess a more radical decentralization of the Department (ORSA) to the region given the increase in operations in other countries in response to the current financial crisis, the close inter-relationships within SADC, and the regional context within which engagement is being pursued.

Capacity Development in Key Ministries and Agencies

3.6 Rebuilding the institutional capacity of Government is essential if there is to be effective recovery. The ministries of Finance and Planning, Economic Development and Investment Promotion are in a pivotal position, particularly as Government takes back the functions assumed by the Reserve Bank. Early assessment missions have identified a range of requirements including: payroll census and reform; Government accounting and the operation of the Consolidated Revenue Fund; land audit; restructuring of the financial condition of parastatals; sector strategies in energy, water and sanitation; improved revenue operations; budget management; and the payments systems

3.7 Against this background, and in response to the Government's appeal to the Bank and other partners, a key element in the Bank short term strategy is to provide a channel for coordinated Technical Assistance (TA), the building of institutional and human capacity that could help the country to implement its programs. **Our own contribution will be focused on the priority areas of statistics, enhancing economic management skills and strengthening** oversight agencies, to be funded under the FSF and ESTA.

3.8 These will include:

(i) The *Ministry of Finance and the Ministry of Economic Planning and Investment Promotion* which are central in economic management in post-crisis Zimbabwe. The ministries are currently deeply involved in the implementation STERP, the preparation of Zimbabwe's Needs Assessment and the medium term recovery strategy. However, as is the case with other public sector ministries and institutions, the productive capacity of the two ministries is severely constrained by the lack of skilled manpower, resources, given the low budgetary allocations and working equipment and tools. To restore productive capacity in the two ministries, the Government of Zimbabwe has requested the Bank and other partners to provide capacity building and technical assistance support. The Bank will provide senior level staff to assist the Minister, to improve budget planning and execution, and public financial management. Advice will be provided also on cash budgeting. The Bank's program of assistance to the Ministries of Finance and Economic Planning and Investment Promotion will therefore be tailored to supporting specialized training and support on macroeconomic management to the staff in the ministries; and providing essential operational equipment, including computers, photocopies and Information Communication Technology (both software and hardware). The technical assistance support will draw where possible on highly skilled manpower drawn from the Zimbabwean in Diaspora or the neighboring countries, particularly South Africa. The Bank's capacity building and technical assistance support will be funded from the targeted support window of the FSF. To ensure maximum impact, the capacity building and technical assistance support from the Bank will be closely coordinated with that of other partners, including the World Bank and the IMF.

(ii) the Central Statistical Office which is critical for providing the information needed to facilitate the monitoring and evaluation of STERP implementation. Direct assistance will be provided in the form of technical and financial support for (i) short term training, including on-the-job training in real sector statistics; (ii) improving national accounts compilation including undertaking pertinent surveys such as the annual Census of Industrial Production, the Quarterly Employment Inquiry, Consumer Price surveys and the updating of the business register; (iii) processing and analysis of the Income, Consumption and Expenditure Survey data; (iv) updating the 2005 National Statistical Development Strategy; (v) processing and analysis of the Agriculture and Livestock Survey data; and (vi) data dissemination activities.These activities will be supplementary to the other statistical capacity building activities the Bank is currently implementing under its Phase 2 Statistical Capacity Building Program for RMCs which include support for infrastructure statistics, MDG monitoring, Gender statistics and preparations for the 2010 round of population census. Both the World Bank and IMF have expressed interest in partnering with the ADB.

(iii) The Office of the Comptroller and Auditor General (OCAG) was established in 1924 and acts as a watchdog over the utilization of public resources in all government ministries, departments, parastatals, diplomatic missions, education institutions and others. The role and mandates of the OCAG are central in promoting good economic governance. However, the functions of the OCAG have been severely constrained by the inadequate budgetary allocations and poor staffing due to low salaries and poor working conditions. Despite the difficulties, the OCAG continues to periodically prepare the Annual Audit of Government Report, the last of which was done for the financial year ended December 2006. The reports have however been limited in scope, and cannot be relied upon to fully account for complicated public sector transactions such as those that were undertaken by the Reserve Bank of Zimbabwe. To restore the capacity of the OCAG to undertake its constitutional mandate and functions, the Bank, through the Targeted Support Window of the FSF will provide capacity building support aimed at training in accountancy and auditing of senior staff of the OCAG. Study tours and overseas training programs, particularly in South Africa, will also be provided focusing on acquainting auditors and the accountant staff with the new audit methodologies and techniques, including value for money auditing and the CIT auditing systems. The Bank will also provide office equipment and CIT. The training package proposed is justified on grounds that the professional staff (auditors and accountants) in the OCAG have never had any formal training since the early 1990s. The low budgetary allocations to the OCAG also make its difficult to purchase appropriate office equipment.

Fragile States Facility (FSF)[1]

3.9 The targeted support window (pillar III) of the FSF allows for the Bank to support countries in exceptional circumstances early in their post-crisis/conflict transition phase, even prior to the process of arrears clearance or debt regularization. Resources from Pillar III of the FSF will therefore be used to support the capacity building and technical assistance operations proposed in this Strategy Note for Zimbabwe. The Bank will initially utilize US$ 2 million towards financing these operations and will work closely with all other partners, particularly the World Bank and the IMF. This will be followed by two other separate capacity building and technical assistance support of US$ 2.0 million each that are being processed, based on request from the Government of Zimbabwe.

3.10 Voluntary Contributions from Donors: The FSF provides a suitable financing vehicle for donors to contribute to the recovery process of countries coming out of crisis or conflict. The resources could be earmarked for a specific country (e.g., Zimbabwe) and/or use (e.g., arrears clearance, supplemental funding or targeted support. Donated resources could also be used to support the recovery activities under any of the three windows of the FSF. The financial resources contributed in this manner to the FSF will be disclosed annually in the Financial Statements of the Bank Group, with the objective of ensuring transparency of the FSF. The operations procedures of the FSF and those of the African Development Bank Group will apply in the utilization of such donations.

Debt Management and Arrears Clearance[2]

3.11 Arrears clearance is a prerequisite to full engagement and ability to borrow from the IFIs. Zimbabwe is currently not classified as HIPC eligible, and as the list was closed in 2005 the process would have to be reopened for Zimbabwe to be included. The Bank has identified a consultant to be funded under Pillar III of the FSF, to assist Zimbabwe in dealing with its arrears clearance and to formulate a Debt Strategy. The consultancy will seek to:

- ascertain the full extent of the country's indebtedness, including to non-DAC donors, and the level of domestic debt
- if necessary, audit the obligations incurred by the Reserve Bank of Zimbabwe
- assess the country's capacity to pay for its debt (domestic and foreign) and arrears clearance;
- reclassify Zimbabwe from a blend country to IDA and ADF only (working with IMF and World Bank)
- identify the resources required to cover Zimbabwe's arrears and what track record has to be established
- produce a credible proposal for consideration by the international community, and

[1] See annex 1 on eligibility to FSF

[2] The criteria for reclassifying a country from blend to IDA-ADF only status are:

- the country must be relatively less developed- as evidenced by the level of GNI per capita;
- have limited or no creditworthiness for borrowing on market terms; and
- be in a position, as indicated by economic performance, to use IDA/ADF resources effectively.

- identify Zimbabwe as a fragile state in order to qualify for enhancement from the FSF. These steps can be taken by Management, but the opinion of the Boards would be sought.

All of these steps will be taken in close collaboration with the World Bank and IMF. ADB arrears clearance will require additional resources, which the Government with assistance from the Bank will solicit from the international community.

3.12 Clearance of arrears will take at least a year depending on the rate of progress made in the country itself. The ADB will work closely with the Minister of Finance and the Prime Minister on an eventual donor pledging conference. This will include providing advice on the requirements from the international community, monitoring and reporting progress in reforms, advocating on behalf of Zimbabwe, and working closely with a potential host country in preparation of a conference. Assuming effective implementation of the STERP, progress against the objectives set out in the GPA, and development of a medium term strategy, a preliminary target would be for such a conference to be held later in 2009. The aim would be to secure support for arrears clearance and also for longer term development needs.

Supporting private sector

3.13 Despite the recent decline, Zimbabwe remains potentially a MIC and its longer term development objectives are to move quickly away from reliance on non-concessional borrowing. It is crucial therefore for the private sector to be reinvigorated and to kick start the economy. A priority for the Bank strategy will be to provide a quick disbursing and self-liquidating line of credit, ideally in conjunction with South Africa. This is likely to be through commercial banks, not the Reserve Bank of Zimbabwe. The Bank will consider other technical assistance to enhance the impact of the resumption of credit.

Rehabilitation of infrastructure

3.14 Physical infrastructure (energy, water resources, water supply and sanitation, air, rail and road transport, communication) and the related soft infrastructure systems are the veins through which trade and other social – economic activities take place, and at the same time act as building blocks towards economic development. In this respect, Zimbabwe faces a number of structural issues. For instance energy supplies are only some 40% of installed capacity, and provide less than half of peak demand, even with the reduced economic activity. Similar conditions exist in relation to other infrastructures and utilities.. In the last decade there has been little investment and poor maintenance but it is vital to improve the position if private sector activity is to expand. Any economic recovery will amongst others depend on the extend of rehabilitation of infrastructure. A major programme of investment is therefore required over the medium term, and which cannot be funded entirely by the state. Early assistance will be needed to provide financial and technical advice on all issues related to rehabilitation of infrastructure including policy, legal, institutional and regulatory, restructuring, tariff, etc, and to explore the scope and conditions for private sector investment.

3.15 The Bank will use the maximum flexibility of other project preparation facilities (e.g. the NEPAD IPPF, the Infrastructure Consortium of Africa) and the scope for cooperation with bilateral donors will be explored.

Support from the African Water Facility

3.16 After years of neglect the water and sanitation infrastructure is in poor repair and is a major factor in the recent outbreak of cholera and other water borne diseases. Responsibility for water and sewerage has been recently passed to local governments, with uncertain results. Resources from the African Water Facility (AWF) will be made available. The Bank will work closely with UNICEF and NGOs who are also active. The AWF is appraising a water project for Chitungwiza, a high density suburb of Harare, which is seriously affected by inadequate sanitation and where access to safe water is sporadic. Subsequently AWF resources will be used to catalyze involvement of other donors in major sector investments and capacity building, for example in the development of a sector strategy and action plan.

Risks

3.17 There are evident risks to this strategy: potential political disagreements or lack of progress in constitutional reform leading to policy reversals within the IG. Revenue or budget shortfalls will have an immediate impact on expenditure, thus aggravating social and humanitarian problems. Inadequate support from the international community, and lack of visible improvement in day to day conditions for most Zimbabweans, could call into question the rigour needed for effective change and reform. Without progress on property rights and the rule of law, and the rehabilitation of physical infrastructure and the related systems, private sector confidence will not return. In short, there is no absolute certainty that the IG will succeed in turning round the country. But for the foreseeable future there is no better prospect, and the Bank will continue to take its cue from those in country who have committed themselves to the endeavour.

IV A Roadmap for the Implementation of the Strategy

4.1 The following roadmap will guide the Bank in implementing the elements of the strategy enunciated above. Some of the actions in the roadmap have already been initiated and some are close to fruition. The milestones and their indicative timing are summarized below:

i) Assemble and reinforce Zimbabwe Task Team in Tunis, composed of staff and consultants to work on aspects of the reengagement plan. This will be concluded by **April 30, 2009**.

ii) Identify Bank staff and consultants for longer presence in the country. Prepare TOR for the team and workout the logistics including discussions with the UNDP or other institutions resident in Harare to accommodate the office requirements of the team. Make a proposal for consideration by Senior Management by **May 5, 2009.**

iii) The Board has to be fully appraised of the situation of the country and more particularly the interventions of the Bank and its role in the process of reengagement. It would be ideal to convene an informal Board every 4-5 months, or as deemed necessary to share status and seek guidance. The first such informal meeting will provide general information on the current situation of the country and the Bank's Short-Term Strategy as outlined in this note. Subsequent Board meetings will inform on status of implementation of the strategy and the way forward. The note for the first Informal Board will be ready on **April 30, 2009**.

iv) Preliminary discussions have started (ADB/WB/IMF) to reclassify Zimbabwe as ADF/IDA-only country. This task is expected to be concluded during 4th quarter of the year.

v) A consultant with expertise in arrears clearance and debt management will be assigned to the office of the Minister of Finance immediately.

vi) Prepare papers for consideration by Senior Management and or Board on areas of intervention in capacity building and support to water and sanitation. Missions have been undertaken and documents are in advanced stage of preparation. The Capacity Building proposal will be finalized by **May 15, 2009.** The African Water Facility is currently mounting an appraisal mission for urgent water sector interventions in the country and to identify short to medium term requirements within its focal areas. The appraisal document for immediate action is scheduled for submission for approval by **June 24, 2009**.

vii) Establish partnership with regional financial institutions to provide support to the private sector through commercial Banks, AFREXIM Bank etc. Discussions are to be initiated in the course of **May 2009**.

viii) The Bank's core team in Zimbabwe will identify, prioritize and cost interventions that the Bank could undertake. In this respect, jointly with other donors the team will agree on the priority sectors to be included in the Needs Assessment; design the modus operandi for such assessment (including coordination and partnership arrangements, terms of reference, communication and outreach, and roles and responsibilities); identify required resources (in terms of both financing and expertise); and identify modalities and implications of other processes on when and how the needs assessment will take place (such as the ongoing dialogues between the government and international partners). This exercise will end in **May 2009**. A Needs Assessment report will be prepared by **December 2009.**

ix) Agree on the arrangements which would allow for the replenishment of the FSF facility to receive supplementary funding for Zimbabwe's reconstruction, capacity building and arrears clearance. This will entail the following:

- Consultations with the Zimbabwe Government to be completed by **end** June **2009;**
- Finalization of the financing requirements and justifications by **end** of **July, 2009 ; and**
- Depending on progress, undertaking the necessary preparations to allow a donors conference by the end of 2009.

Annex I: ASSESSING THE ELIGIBILITY OF ZIMBABWE TO THE FRAGILE STATES FACILITY (FSF)

1. A country qualifies for eligibility to the FSF if it has a composite (averaged) ADB and World Bank Country Policy and Institutional Assessment (CPIA) score of 3.2 or below. For 2008, Zimbabwe had a composite ADB/World Bank CPIA score of 1.77, therefore a fragile states

2. **Eligibility to the Supplemental Support Window of the FSF**: A country's eligibility to the supplemental support window of the FSF must be approved by the Boards of Directors. The country must meet a two-stage criteria:

❖ **First stage Criteria**

- Country must show commitment to consolidate peace and security – assessed through the signing of a peace agreement, forming an inclusive government or holding free and fair elections (Zimbabwe established an inclusive government in February 2009)
- Country must have demonstrated unmet social economic needs – assessed by having the real GDP per capita declining by more than 10% since 1990 (which is the base year of the MDGs). Information on Zimbabwe suggest that the real GDP per capita has declined by over 40% from the period 2000-2007. The decline from 1990 to 2007 is therefore more acute, and far beyond the threshold of 10%.

- The country must also be ranked at the bottom quintile of the UN Human Development Index

❖ **Second Stage criteria**

- Country must show improved macroeconomic conditions and pursuit of sound debt policy
- Country must show commitment to pursue sound public sector financial management policies and practices and reestablishing enabling environment for private sector activities
- Country must also show increased transparency and accountability in its public financial management
- The Country must have coordinated reengagement with Partners

❖ Countries meeting the two-stage criteria are eligible for grant resources calculated as an average of the best two ADF 10 allocations.

3. **Eligibility to the Arrears Clearance Window**

Eligibility to the arrears clearance window must be approved by the Board of Directors and meet the following conditions: The Country:

o should be an ADF-only country
o must have difficulties in servicing its external obligations
o must be potentially eligible for HIPC but not yet qualified for debt relief under the initiative

- o must have a coordinated re-egangement program with IMF and World Bank
- o must demonstrate maximum effort in repaying its share of Bank group arrears from internal sources[3].

4. **Eligibility to the Targeted Support Window**

- ❖ Country must be a fragile states, using the definition in paragraph 1 above

[3] Earlier beneficiaries were PCCF list of Countries.