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Zimbabwe Coalition on Debt and Development
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Annual Debt Management Report for Zimbabwe 2020

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Acronyms

AfDB	African Development Bank
ASPEF	Agricultural Sector Productivity Enhancement Facility
BACCOSSI	Basic Commodities Supply-Side Intervention Facility
BADEA	Arab Bank for Economic Development in Africa
BWP	Botswana Pula
CBZ	Commercial Bank of Zimbabwe
CFU	Commercial Farmers Union
CHF	Swiss Franc
CNY	Chinese Yuan
CPI	Consumer Price Index
DeMPA	Debt Management Performance Assessment
DMO	Debt Management Office
DSA	Debt Sustainability Analysis
EDDC	External and Domestic Debt Committee
GBP	The British Pound
GDP	Gross Domestic Product
GFSM	Government Financial Statistics Manual
GNU	Government of National Unity
HIPC	Heavily Indebted Poor countries
IBRD	International Bank of Reconstruction and Development
ICSID	International Centre for Settlement of Investment Disputes
IDA	International Development Association
IFAD	International Fund for Agricultural Development
IFIs	International Financial Institutions
IMF	International Monetary Fund
JPY	Japanese Yen
KWD	Kuwaiti Dinar
MEFMI	Macroeconomic and Financial Management Institute of Eastern and Southern Africa
MOFED	Ministry of Finance and Economic Development
MTDS	Medium Term Debt Management Strategies
NOK	Norwegian Krone
ODA	Official Development Assistance
OFID	Opec Fund for International Development
OPEC	Organisation of the Oil Exporting Countries
PDMA	Public Debt Management Act
PLARP	Parastatals and Local Authorities Reorientation Programme
PPG	Public and Publicly Guaranteed
PRGT	Poverty Reduction and Growth Trust
RBZ	Reserve Bank of Zimbabwe
RTGS	Real-Time Gross Settlement
SADC	Southern African Development Community
SDR	Special Drawing Rights
SEK	Swedish Krone
SMP	Staff Monitored Project
SOEs	State Owned Enterprises
SSA	Sub-Saharan Africa

TBS	Treasury Bills
TSP	Transitional Stabilisation Plan
UNCTAD	United Nations Conference on Trade and Development
UNICEF	United Nations Children's Fund
US$	United States Dollar
WHO	World Health Organisation
ZAADDS	Zimbabwe Accelerated Arrears Clearance, Debt and Development Strategy
ZAMCO	Zimbabwe Asset Management Corporation
ZAREP	Zimbabwe Accelerated Re-engagement Programme
ZETDC	Zimbabwe Electricity Transmission and Distribution Company
ZIMSTAT	Zimbabwe Statistics Agency
ZWL	Zimbabwe Local Currency

Executive Summary

The country's public debt has also been increasing due to large fiscal deficits and quasi-fiscal activities conducted by the Reserve Bank of Zimbabwe (RBZ). Budget deficits increased from US$185 million (0.9 % of GDP) in 2014 to US$2,7 billion in 2018 (11.8% of GDP).

Zimbabwe has been in arrears since early 2000 and has been unable to access funding from external creditors owing to the country's failure to meet its debt service obligations. This has resulted in the accumulation of arrears on external debt obligations. A weak economy, coupled with a lack of robust mechanisms for resolving the accumulation of external arrears, has made Zimbabwe to remain in a debt distress situation for a very long time. As at end-2019, total public and publicly guaranteed external debt was estimated at US$10.6 billion (49% of GDP). About 57% (US$6 billion) of the outstanding external debt was external payment arrears (Ministry of Finance and Economic Development (MOFED), 2020). The government is still accessing funding from commercial sources (such as China Exim Bank), in some cases collateralized against future commodity exports. External debt will increase by an additional US$3.5 billion that the Government of Zimbabwe committed to pay as compensation to former white commercial farmers displaced during the fast-track land re-distribution programme. According to the Global Compensation Agreement of 2020, the Government of Zimbabwe is expected to borrow the US$3.5 billion by issuing a long-term debt instrument of 30 years maturity in the international capital markets (Government of Zimbabwe, 2020). This will further worsen debt sustainability indicators and potentially complicate negotiations with external creditors to restore debt sustainability.

The constrained access to external financial resources has contributed to the deteriorating economic environment characterised by low economic growth, high inflation rates, worsening terms of trade, among other economic indicators. In addition, these developments have negatively impacted social service delivery due to inadequacy of resources. In the absence of a comprehensive resolution of the on-going debt crisis, the debt situation will continue to worsen and will inhibit the achievement of the country's development aspirations and the Sustainable Development Goals. With limited access to external financing and hence limited fiscal space, government's capacity to respond to shocks is also reduced. For example, in response to the materialization of three external shocks, namely the El Niño related drought in 2019, the extensive damage inflicted by Cyclone Idai in 2019 and COVID-19 pandemic in 2020, government resorted to commercial borrowing, collateralized against future commodity exports. While the debt is necessary to assist in the country's response to the economic and humanitarian crisis, it has the potential to further complicate negotiations with external creditors to restore debt sustainability.

During 2017 - 2019, the government contracted external loans amounting to US$572.5 million. Of this amount, US$113.5 million was contracted from India and China in 2019. The other creditors that have lent to Zimbabwe since 2017 are Kuwait Fund, BADEA, OFID and GEMCORP CAPITAL LLP. Zimbabwe contracted loans amounting to US$3,202.63 million during the period 2010 to 2019. Of the total borrowed funds in the period, the largest amount was allocated to the Fuel and Power sectors (53%), corresponding to a total amount of US$1,697.00 million, of which US$250 million was a guarantee issued by the Government in 2018 to finance the price differential between the purchase price of commodities by the importers from the sellers. The country is likely to accumulate domestic arrears and contingent liabilities (related to additional fiscal costs from debt assumptions for losses following the currency conversion), some of which would migrate to the central government balance sheet and sharply increase domestic debt.

Zimbabwe's debt build-up during 2014 - 2019 was driven by arrears, primary deficit, real GDP growth and real exchange rate depreciation. External payment arrears increased from US$109 million in 1999 to about US$6.4 billion in 2019, which were partially reduced by the cancellation of arrears to the IMF of US$107.8 million and token payments to other multilaterals. The country's public debt has also been increasing due to large fiscal deficits and quasi-fiscal activities conducted by the Reserve Bank of Zimbabwe (RBZ). Budget deficits increased from US$185 million (0.9 % of GDP) in 2014 to US$2,7 billion in 2018 (11.8% of GDP). The RBZ has over the years been involved in public sector expenditure programmes such as the procurement of farming inputs, petroleum, medicines, grain and processed food, farm implements and electricity, among others. The widening fiscal gap has been financed through the central bank overdraft facility and domestic borrowing through issuance of Treasury Bills. Despite having provision for the issuance of guarantees in the Public Debt Management Act (PDMA), currently there is no framework in place for issuance of guarantees to provide a clear process on how the above operations should be undertaken. This exposes the country to risk of accumulating unsustainable levels of contingent liabilities emanating from government guarantees. Some of the provisions of the PDMA on management of guarantees which the government has not adhered to include the following:

- The Minister of MOFED levying a fee on guarantees
- The Parliament of Zimbabwe setting the limit of the guarantees to be issued in any financial year.

To address the above-mentioned challenges, the Government of Zimbabwe has over the years implemented several measures to strengthen public finance management. Some specific interventions in strengthening public debt included the enactment of the PDMA (2015), the establishment of the Public Debt Management Office (PDMO), the IMF Staff Monitored Programme (SMP) which set limits on non-concessional borrowing, among others. Furthermore, efforts have been made to enhance domestic resource mobilisation through the re-introduction of the auction system for government securities. Government has also taken a step to enhance transparency through the publication of the maiden Public Debt Bulletin in March 2020. The bulletin, which is comprehensive as set out recommended sound practice, however, it excludes information on the cost and risk indicators of the current country's debt portfolio and lacks an analysis of loan guarantees. In addition, another key deficiency is that the data provided was outdated as it reported developments as at December 2018. Sound practice requires that information published should not be more than 6 months old as at the date of publication. Gaps remain in terms of data coverage and analytical rigour. There has been no detailed reporting of debt operations in Zimbabwe. Information on the public debt is sparse with very limited data provided on portfolio costs and risk exposures.

Debt resolution remains central to supporting the achievement of the government's development objectives going forward as this will unlock the much-needed resources to address the huge infrastructure needs. This involves a multi-stakeholder approach in designing realistic and implementable strategies on how to address the current debt challenges while learning from experiences of other countries that faced similar situations. For the international community, reengagement has become tied to improvements needed in governance, human rights, land tenure security, and electoral reforms. The process of reaching political agreement on normalization will require the country, and the international community, to confront and reconcile the existing disconnect and many of the predetermined narratives that have been forged over the years.

Government borrowing on the domestic market has been conducted through private placement from 2012-2019.This method of issuing government securities inhibits transparency in government's domestic debt market operations and does not support the growth of domestic securities market. Sound practice in public debt management requires that domestic debt instruments are issued through market based instruments, i.e. through the auction system. Currently government domestic borrowing is determined on a monthly basis through the Cash Flow Committee. The absence of a borrowing plan restricts government from undertaking structured borrowing operations in any given year. Short-term debt instruments, particularly arrears, central bank advances and Treasury bill issuance were used to finance the government programs. This created a huge refinancing risk in the near term, exacerbating uncertainty in government's capacity to service its debt Comprehensive reforms remain pivotal to the implementation of the government's arrears clearance and re-engagement initiatives. Continuous re-engagement with development partners is important in resolving the country's public debt challenges. Government needs to ensure policy consistency as this is an important aspect to communicating its commitment to reforms and effort to enhance economic stability and growth. In addition, borrowing should be guided by a Medium-Term Debt Management Strategy and government should avoid ad-hoc borrowing as this may further worsen the country's debt sustainability. In addition, the Government should limit collateralised external borrowing to preserve these resources for future generations. Furthermore, there is need for the national assembly to enhance its oversight role on Government as stated in the Constitution to ensure accountability and transparency on the use of borrowed resources.

1. Introduction

Hyperinflation took a heavy toll on the financial sector, wiping their assets, and affecting savings mobilization due to negative real interest rates

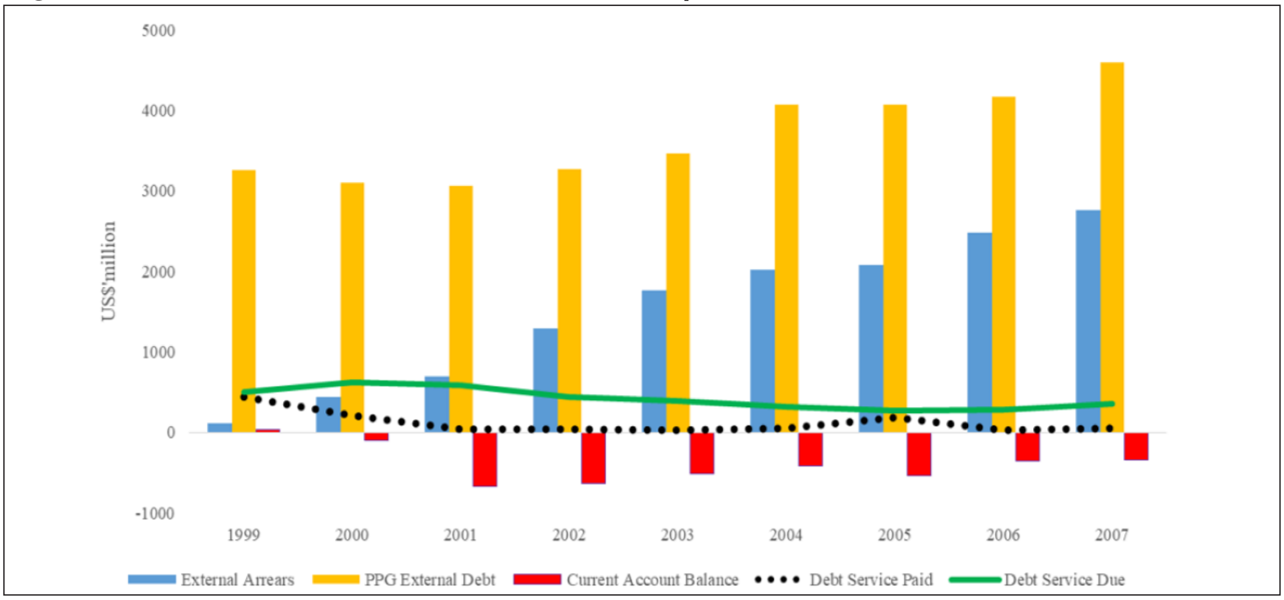
The Zimbabwean economy, once among the most advanced in Sub-Saharan Africa (SSA), has become one of the region's most vulnerable economies. In 1980, gross domestic product (GDP) per capita in Zimbabwe was higher than that of most of its neighbours; manufacturing accounted for a large share of GDP (about 20%); the quality of health and education services was high. The country recorded its strongest post-independence growth performance during 1980-90, with GDP growing by an average of around 5.5%, higher than the average for SSA countries, while the population grew at about 3%. Hence, the country was on the path to middle-income status in the 1980s and much of the 1990s (ZIMSTAT, 2020).

However, the above trajectory reversed due to protracted fragility induced by recurrent cycles of political crises, which drained the country's institutional capacity, especially in core governance functions, service delivery to citizens, and systems to resolve economic and external stresses. Between 1999 and 2008, a sustained and broad-based decline in economic activities led to a cumulative decline of nearly 50% in real GDP growth(AfDB, 2011).

The decline in economic activities was due to a combination of factors, including economic mismanagement, poor governance, and the concomitant loss of support from the international community, capital flight, and low investment.

High fiscal deficits (averaging 8% of GDP) financed by printing money by the Reserve Bank of Zimbabwe (RBZ) led to high inflation, which spiralled out of control in 2006, moved to hyperinflationary levels in 2007 and reached 500 hundred billion percent by end-September 2008 (IMF, 2009). The runaway inflation progressively debased the (original) Zimbabwe dollar, which subsequently caused its demise by year-end 2008. Hyperinflation took a heavy toll on the financial sector, wiping their assets, and affecting savings mobilization due to negative real interest rates. The negative real interest rates, while benefiting the government through reducing the cost of financing the budget deficit and reducing the stock of the domestic debt, came at the expense of the private sector more generally and the vulnerable groups in society such as pensioners more specifically.

Figure 1: External Debt Service and Arrears Developments (1999 – 2007)



Source: RBZ and Ministry of Finance (Various Publications)

The external position remained precarious, as exports continued to decline, from US$2.2 billion in 2000 to US$1.7 billion in 2008 (RBZ, 2008), on account of the disruptive domestic economic environment. The ensuing current account deficit was mainly financed by accumulation of external payments arrears, a decline in net international reserves, large RBZ external borrowing, a sizable decline in banks' foreign assets, and modest private capital inflows (foreign direct investment and short-term suppliers' credits). This severely constrained the country's capacity to service its external debt obligations, reflected by the accumulation of external payment arrears from US$109 million in 2000 to above US$3 billion by 31 December 2008 (Figure 1). The stock of external debt also increased from US$3.1 billion to US$4.6 billion during the same period, reflecting debt contracted by the Government from China and other non-traditional lenders, and the capitalization of penalty interest on arrears(RBZ, 2009).

The formation of the Government of National Unity (GNU) in 2009, and the subsequent adoption of the multi-currency regime in the same year opened the door for tackling the difficult economic and humanitarian crisis facing the country. The economy recovered strongly, with GDP growth rate averaging 10% during the period 2009 – 2013, while inflation was brought to single digits, a remarkable turnaround for a country that was in crisis never seen before across the globe. However, the country's public and publicly guaranteed external debt, estimated at USD$7 billion or 39% of GDP in 2013, was unsustainable as government continued accumulating external debt service arrears. On the other hand, domestic debt began accumulating largely due to the limited external financing options owing to continued arrears accumulation. Domestic debt was estimated at USD$0.3 billion as at end 2013, representing 2% of GDP (Ministry of Finance and Economic Development, 2020).

After a period of relative macroeconomic stability, the economy deteriorated sharply after 2015, following government's resumption of expansionary fiscal policy, which led to burgeoning fiscal deficits. Fiscal deficit increased to 9.9% of GDP in 2017, from less than 3% of GDP between 2008 and 2015, driven by off-budget quasi-fiscal activities, unbudgeted agricultural programs, and proliferation of wage bill overruns. The financing of large fiscal deficits by issuance of quasi-currency instruments built up pressure in the dollarized economy. For example, the overdraft facility created electronic deposits or Real-Time Gross Settlement (RTGS) in the banking system, which was not convertible to actual US dollars. This created substantial economic distortions, which manifested through shortage of foreign currency. The unemployment rate has continued to rise, undermining the livelihoods of the population. The shortage of foreign currency and severe drought limited the productive sectors' ability to trade and invest, while also having a dampening impact on household consumption. Average Consumer Price Index (CPI) rose by 10.6% in 2018 from less than 1% per year in 2014-17 while year-on-year inflation ended the year 2019 at 551.6% (ZIMSTAT, 2020). Government subsequently abandoned the dollarized system and adopted a new domestic currency in 2019.

The policy uncertainty and missteps, weak institutions, policy inconsistencies, and fiscal indiscipline eroded investors' confidence and limited the development of the economy. Between 2014 and 2018, the country's GDP growth averaged 2.7%, which is only marginally above population growth and insufficient to improve average per capita income. In 2019, GDP contracted by 8.1% (IMF, 2020).

A weak economy, coupled with lack of robust mechanisms for resolving the accumulation of external arrears, has made Zimbabwe to remain in a debt distress situation for a very long time. As at end-2019, total public and publicly guaranteed external debt was estimated at US$10.6 billion (49% of GDP). About 57% (or US$6 billion) of the outstanding external debt was external payment arrears (Ministry of Finance and Economic Development, 2020). On the other hand, domestic debt stock declined from USD8.4 billion in 2018 to US$525 million (or 3% of GDP) in 2019 following the introduction of the Zimbabwe dollar and the redenomination of domestic debt into the new currency earlier in the year. The recent sharp increase in inflation together with the 1:1 conversion from US$ to $RTGS has inflated away a sizable portion of the real value of domestic public debt. Nevertheless, it is still a source of vulnerability, given that it constitutes a major source of funding for the government as external financing continues to be limited.

In addition, the country is likely to accumulate domestic arrears and contingent liabilities (related to additional fiscal costs from debt assumptions for losses following the currency conversion), some of which would migrate to the central government balance sheet and sharply increase domestic debt. This is in addition to US$3.5 billion that the Government of Zimbabwe committed to pay as compensation to former white commercial farmers displaced during the fast-track land re-distribution programme. According to the Global Compensation Agreement of 2020, the Government of Zimbabwe is expected to borrow the US$3.5 billion by issuing a long-term debt instrument of 30 years maturity in the international capital markets (Government of Zimbabwe, 2020). However, accessing the international capital markets may be a challenge particularly considering the country's negative perception and poor credit profile. Moreover, the terms of borrowing will be unfavourable, and this will further aggravate the country's debt overhang situation.

> .....accessing the international capital markets may be a challenge particularly considering the country's negative perception and poor credit profile

To restore debt sustainability, there is need for the government to adopt a comprehensive arrears clearance and debt relief strategy. To this end, the Government has over the years adopted a series of debt resolution strategies, including reengaging the international community and negotiating a comprehensive package for arrears clearance and debt relief. These strategies include the Zimbabwe Accelerated Arrears Clearance, Debt and Development Strategy (ZAADS) of 2012 and the Lima Strategy of 2015. There is also a Parliament Portfolio Committee on Foreign Affairs which is complementing the re-engagement efforts of the Government. However, reengagement with the international community continues to face delays, as government has yet to identify financing to clear arrears to multilateral institutions, and to undertake reforms that would facilitate resolution of arrears with bilateral creditors.

Lack of external support continues to constrain government's capacity to resolve the ongoing macroeconomic crisis, which is directly impacting the poor and vulnerable groups in society, particularly children and women. Cyclone Idai and COVID-19 have compounded the situation, and those in extreme poverty are most affected by these shocks and the worsening economic crisis. About 29% (or 4.6 million people) of the population was living under the extreme poverty line (US$1.9 a day) by end-2017, and this number was expected to rise further to 34% (or 5.7 million people) in 2019 (World Bank, 2019).
While Zimbabwe is unable to access long-term concessional financing from the traditional development partners, government is still accessing funding from commercial sources (such as China Exim Bank), in some cases collateralized against future commodity exports. Although this is necessary to assist in the country's response to humanitarian crises, it will further worsen debt sustainability indicators and potentially complicate negotiations with external creditors to restore debt sustainability.

All these issues highlight the importance of achieving debt sustainability and transparency in order to obtain long-term financing for development. While the annual financial statements are presented to Parliament and there is information on debt contained in the Annual Budget Statement, there has been no detailed reporting of debt operations in Zimbabwe. Information on the public debt is sparse with very limited data provided on portfolio costs and risk exposures. The publication of 2018 Debt Bulletin by the Government is a commendable initiative to promote transparency in managing public debt, however, gaps still remain in terms of data coverage and analytical rigour.

Public debt data and information is a key prerequisite for effective risk assessment in support of sustainable borrowing and lending practices. Where there is transparency, lenders and investors can accurately assess the country's debt position, borrowing capacity, and creditworthiness before extending new external and domestic financing. The public will be able to hold the government accountable for its fiscal management and debt management operations, and enable them to participate more actively in governance, potentially reducing corruption. While the government has the primary responsibility to report transparently on debt management issues, civil society organisations also have a role to play in supporting transparency and sustainable lending practices.

This Annual Debt Management Report aims at providing a comprehensive assessment of Zimbabwe's debt and debt management operations during 2014-2019. It is part of our efforts to promote transparency and accountability on management of public debt in Zimbabwe. The Report evaluates the current public debt management operations in Zimbabwe against sound practice and provides recommendations to the government. This information is useful for Zimbabweans to hold the government accountable on the management of public debt affairs. It also provides vital information to stakeholders such as local and international investors on the challenges and opportunities for investment in the country. Furthermore, it will also assist in evaluating how the government performs against any objectives that have been set by the legislature and with the debt management strategy approved by the executive.

1.1 Methodology

This report was compiled through a combination of desk research and a survey involving administration of questionnaires to relevant stakeholders, including government officials and civil society. The primary source of information was the Public Debt Management Office in Zimbabwe (PDMO). In light of the Covid-19 restrictions, information was gathered through the use of a questionnaire with information requirements on the existing debt management practices, particularly on issues relating to the loan procurement processes, utilisation of loan proceeds, the issuance of guarantees, and staffing levels. Discussions were also held with civil society organisations that focus on public debt.

The desk research involved review of the literature on public debt in Zimbabwe especially, the public debt trends, debt statistics and the legal and institutional framework for debt management. Zimbabwe's debt management performance was assessed in relation to sound practice using the World Bank's Debt Management Performance Assessment (DeMPA) framework. This report is also based on information and data from reports by other international institutions, particularly the joint IMF/World Bank debt sustainability analyses reports. Audit reports by the Auditor-General and the annual budget statements also provided useful information for this report.

After this introduction, the rest of this report is organised as follows: Section 2 provides data and information on the debt Portfolio review. Section 3 presents the legal and institutional framework guiding public debt management operations in Zimbabwe. This is followed by the summary of the borrowing process in Section 4 while Sections 5 and 6 discuss the challenges surrounding public debt management and conclusion, respectively.

2. Zimbabwe Debt Portfolio Review

The new currency and the subsequent depreciation led to a significant decline in domestic debt from US$8,398 million (37% of GDP) in 2018 to US$535 million (3% of GDP) in 2019.

2.1 Analysis of Total Public Debt

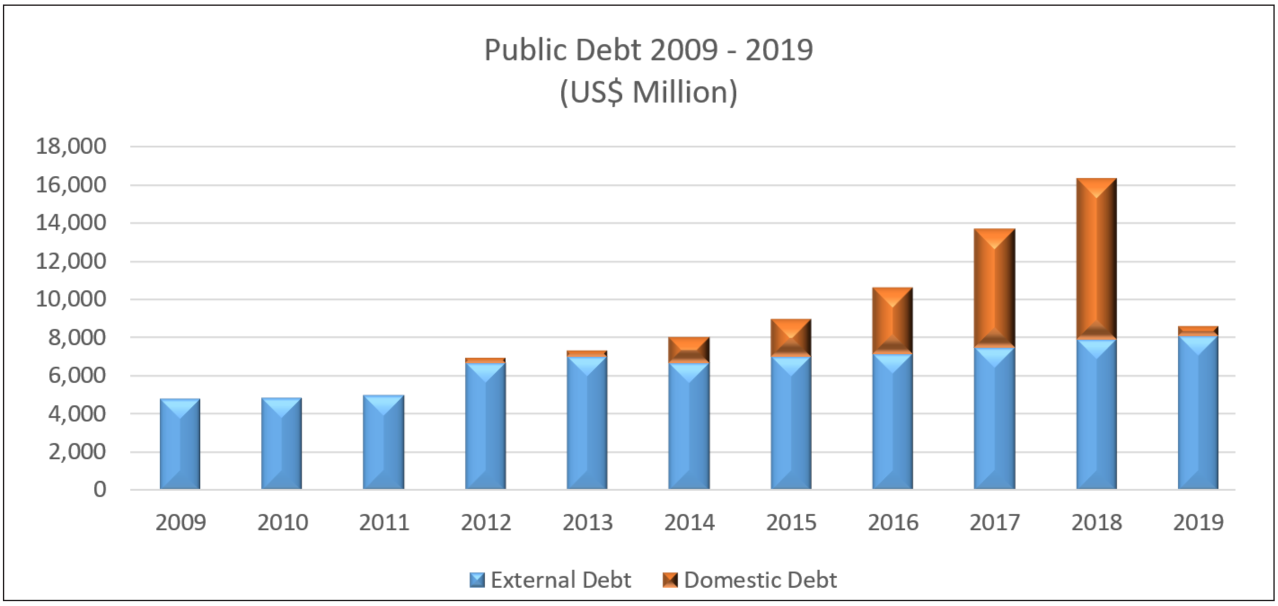
Zimbabwe's total public and publicly guaranteed (PPG) debt at end 2019 was estimated at US$11,091 million, representing 54% of GDP compared to US$17,880 million in 2018 (Table 1). The sharp decrease in the stock of total debt denominated in USD terms is explained by the revaluation of domestic debt following the adoption of a new local currency called the RTGS dollar. The new currency and the subsequent depreciation led to a significant decline in domestic debt from US$8,398 million (37% of GDP) in 2018 to US$535 million (3% of GDP) in 2019. Consequently, PPG external debt constituted 95 percent of total public debt in 2019 while domestic debt was 5 percent compared to 41 percent and 37 percent in 2018, respectively. Figure 2 shows the composition of public debt over the past decade.

Table 1: Zimbabwe's Total Public Publicly Guaranteed Debt (USD Million)

	2018	2019
Public Publicly Guaranteed Debt	**17,880**	**11,091**
External Debt (Inc. RBZ and External arrears)	9,482	10,556
Domestic Debt (Inc. Domestic arrears)	8,398	535

Source: Ministry of Finance and Economic Development

Figure 2: Trends in Public Debt: 2009 to 2019

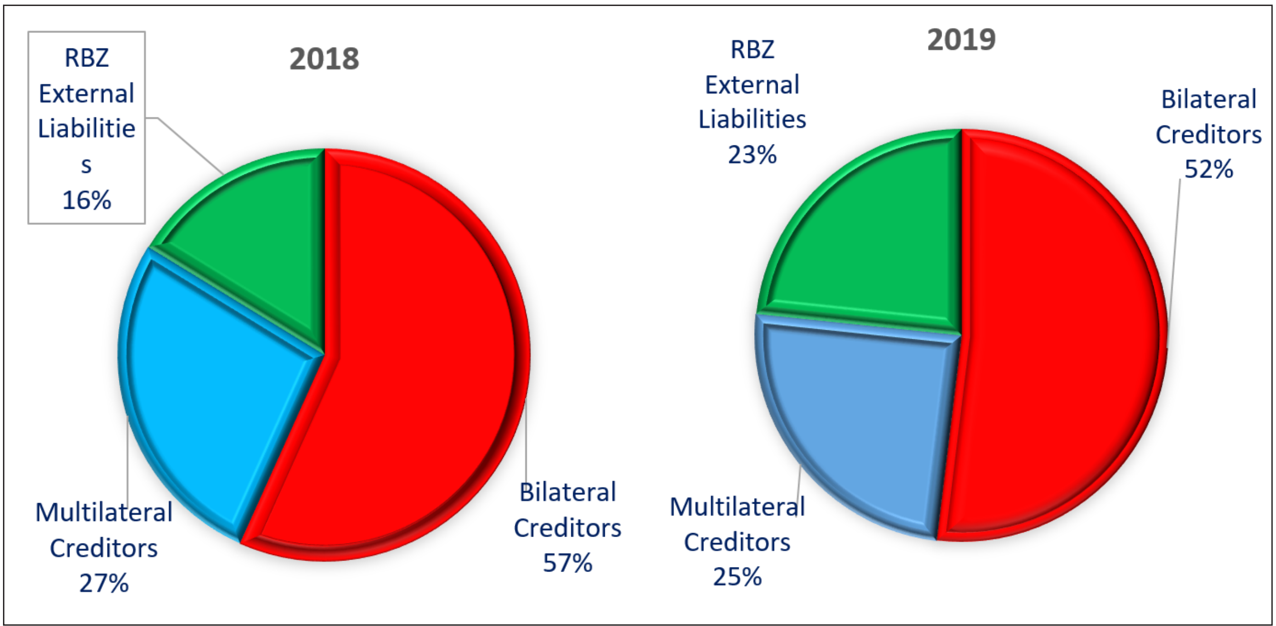


Source: Ministry of Finance and Economic Development

2.2 External Debt

Zimbabwe's PPG external debt amounted to US$10,556 million (51% of GDP) at the end of 2019, including quasi external debt liabilities undertaken by the RBZ on behalf of the Government of Zimbabwe amounting to USD 2.463 million. Compared to 2018, external debt increased by 11% in 2019. The debt portfolio is largely dominated by bilateral debt amounting to US$5,482 million, followed by multilateral debt at US$2,611 million while the remainder is debt on borrowing activities undertaken by the RBZ on behalf of the government. Figure 3 shows the composition of external debt in 2018 and 2019.

Figure 3: Composition of External Debt



Source: Ministry of Finance and Economic Development

The increase in external debt in 2019 is explained by the continued accumulation of arrears and the compounding effect of penalty charges on interest and principal arrears. Zimbabwe has been defaulting its debt service obligations since 2001. Of the total debt, 87.4% was central government external debt, while guaranteed external debt constituted 12.6 per cent (Table 2).

Table 2: Public Publicly Guaranteed External Debt 2018 and 2019

	2018							2019						
	Non-Guaranteed			**Guaranteed**			Grand	**Non-Guaranteed**			**Guaranteed**			Grand
	DOD	Arrears	Total	DOD	Arrears	Total	Total	DOD	Arrears	Total	DOD	Arrears	Total	Total
External Debt (Incl. RBZ)	3,586	4,470	8,056	52	1374	1426	9,482	4558	4671	9229	28	1299	1327	10,556
External Debt (Excl. RBZ	2046	4470	6516	52	1374	1426	7942	2095	4671	6766	28	1299	1327	8093
a. Bilateral Creditors	1733	2746	4479	52	847	899	5378	1815	2883	4698	28	756	784	5482
Paris Club	175	2441	2616	36	818	854	3470	157	2467	2624	24	740	764	3388
Non-Paris Club	1195	251	1446	16	29	45	1491	1223	339	1562	4	16	20	1582
RBZ Assumed Debt	363	54	417	0	0	0	417	435	77	512	0	0	0	512
b. Multilateral creditors	313	1724	2037	0	527	527	2564	280	1788	2068	0	543	543	2611
World Bank	219	980	1199	0	291	291	1490	193	1017	1210	0	301	301	1511
African Development Bank	35	577	612	0	80	80	692	33	592	625	0	80	80	705
European Investment bank	19	135	154	0	156	156	310	16	151	167	0	162	162	329
Others	40	32	72	0	0	0	72	38	28	66	0	0	-	66
c. RBZ External liabilities	1540	0	1540	0	0	0	1540	2463	0	2463	0	0	0	2463

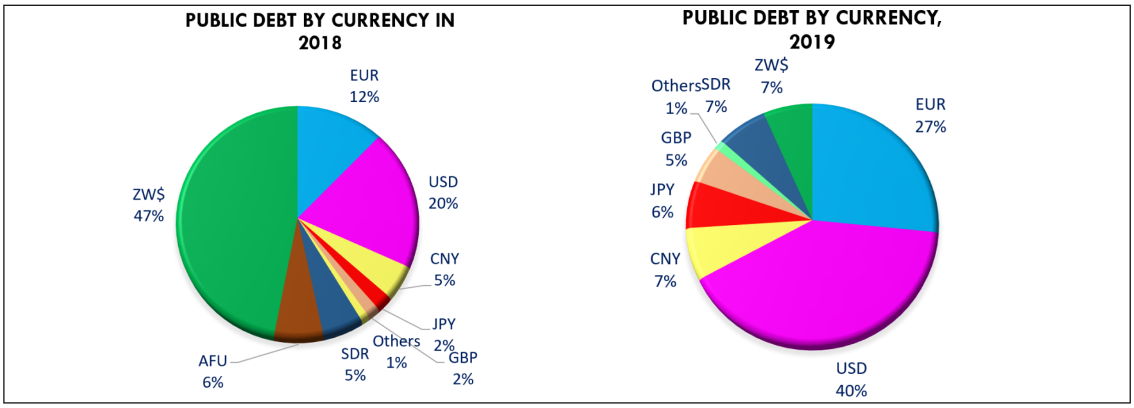
Source: Ministry of Finance and Economic Development

2.2.1 Currency Composition of Public Debt

Public debt is denominated in various currencies. The US dollar and EUR are the dominant currencies and account for 40% and 27% of external debt as at end-2019, respectively. The other currencies are Chinese Yuan (CNY), Japanese Yen (JPY) and Special Drawing Rights (SDR),[1] accounting for 7%, 6%, & 7%, respectively. The British Pound (GBP) accounted for 5% and other[2] currencies account for 1% of external debt. Debt denominated in domestic currency accounted for 7% of total debt.

The composition of public debt by currency in 2019 compared to 2018 changed significantly. Prior to 2019, Zimbabwe foreign currency market was not liberalized with a fixed exchange rate peg between the US$ and the Bond note currency of 1:1. Debt denominated in domestic currency was almost 50% of public debt as at end December 2018. However, the peg was abolished in 2019 and instead a market determined exchange rate regime was introduced. The local currency depreciated against the USD, which significantly reduced the value of domestic debt which was previously in USD. Figure 4 below shows the public debt composition by currency.

Figure 4: Public Debt by Currency Composition



Source: Ministry of Finance and Economic Development

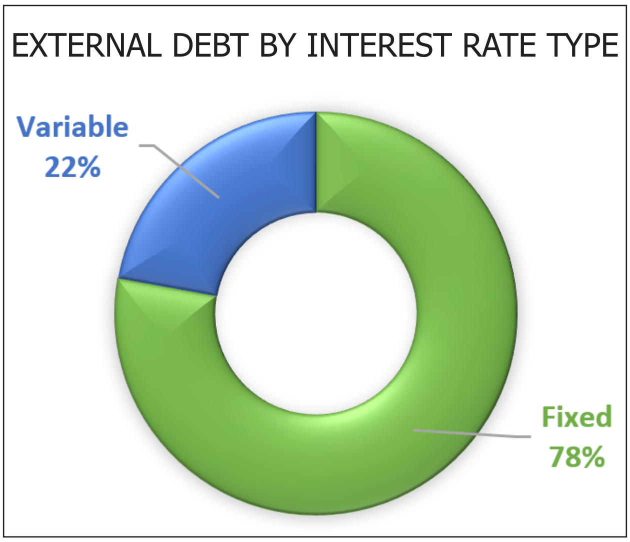
[1] The SDR is an international reserve asset, created by the IMF in 1969 to supplement its member countries' official reserves. The SDR serves as the unit of account of the IMF and some other international organizations.

The dominance of foreign currencies in the country's public debt in 2019, exposes the debt portfolio to exchange rate risks, whereby the adverse movements could lead to a sharp increase in external debt stock over time. It also implies higher costs of debt service in local currency terms.

2.2.2 Structure of External debt by Interest Rate Type

Zimbabwe's external debt was largely contracted under fixed interest rates, accounting for 78% of total debt, while the variable interest rate debt accounts for 22%.

Figure 5: PPG External Debt by Interest Rate Type



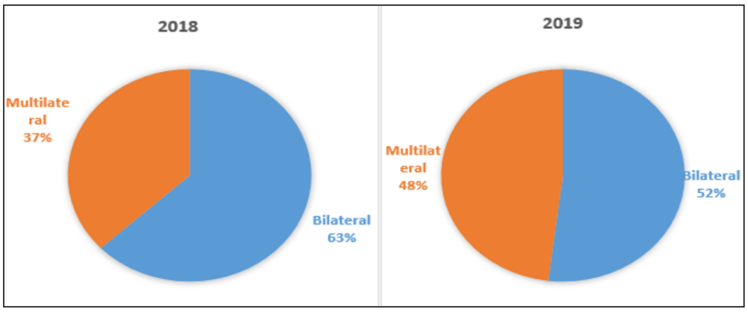
Source: Ministry of Finance and Economic Development

The average interest rates were about 5% and 6% for fixed and variable interest rates, respectively (Figure 5). The large exposure to fixed interest rate debt, however, mitigates against fluctuations in market spreads. Compared to 2018, the external debt composition by interest rate did not change much given the limited access to new external loans.

2.2.3 Creditor Composition of External Debt

As at the end of 2019, external PPG debt comprised bilateral debt of USD 5,482 million (52%) while multilateral debt was USD 5,074 million or 48% of the total. Compared to 2018, there was a substantial increase in multilateral debt due to an increase on RBZ external liabilities on behalf of government. These quasi-fiscal activities conducted by the RBZ rose from 6% in 2018 to 23% of total PPG in 2019, (Figure 6).

Figure 6: PPG External Debt by Creditor Type



Source: Ministry of Finance and Economic Developments

Paris Club creditors are Zimbabwe's main bilateral creditors and were owed 62% of total bilateral debt at end-2019, while non-Paris Club and commercial creditors were owed 29% and 9% of bilateral debt, respectively. The main Paris Club creditors are: Germany, France, Japan, United Kingdom, and United States while the non-Paris Club creditors are China, India, South Africa, and Kuwait. The bulk of the Paris Club debt is in the form of arrears, amounting to US$2,883 million as at end-2019. Commercial debt constitutes mainly the Reserve Bank of Zimbabwe liabilities that were assumed by the central Government. Germany is the major creditor among the Paris Club creditors, followed by France, Japan, United Kingdom, United States and Others[3] as shown in Table 3 below.

Debt relief from Paris Club members would help Zimbabwe improve its current debt situation. However, recent engagements between the Government of Zimbabwe and this group of creditors suggest that the country should pay the accumulated arrears on outstanding debt as a condition for the debt relief negotiations.

[2] Other currencies are CHF, BWP, SEK, NOK and KWD

Table 3: External Bilateral Debt (USD million)

	Total 2018	Total 2019	Percentage of Total (2019)
Bilateral Creditors	**5,377**	**5,482.01**	**100.00**
Paris Club	**3,469**	**3,900**	**61.8**
Germany	950	906	16.5
France	628	592	10.8
Japan	397	417	7.6
UnitedKingdom	375	373	6.8
United States	283	294	5.4
Others	836	804	14.7
RBZ Assumed External Debt	***417***	***513***	**9.4**
Non-Paris Club	**1,491**	**1,582**	**28.9**
China	1,395	1,448	26.4
India	70	69	1.3
South Africa	21	21	0.4
Kuwait	5	4	0.1
Other	-	39	0.7

Source: Ministry of Finance and Economic Development

Among the multilateral creditors, the World Bank was owed US$1,500 million or 30% of total multilateral debt as at end 2019. Of this amount, US$1,300 million was in arrears. The other major multilateral creditors are the African Development Bank and European Development Bank which were owed 14% and 7% of total multilateral debt, respectively. BADEA, NDF, OPEC and IFAD were owed 1.3% of total multilateral debt (Table 4). Zimbabwe does not owe the IMF because the Government repaid its debt amounting to US$107.9 million in 2016, which had been in arrears since 2001. This was paid using SDRs that Zimbabwe received from IMF.

RBZ external liabilities in 2019 account for 49% (US$2,463 million) of total multilateral debt. This is owed to several creditors including AFREXIMBANK, PTA Bank and other commercial creditors.

Table 4: External Multilateral Debt (USD million)

	Total 2018	Total 2019	Percentage of tota 2019
Multilateral Creditors	**2,562**	**5,074**	**100**
World Bank	1,489	1,511	29.8
African DevelopmentBank	692	705	13.9
European Investment Bai	309	329	6.5
Others	72	66	1.3
RBZ External Liabilities	-	2,463	48.5

Source: Ministry of Finance and Economic Development

Table 5: External Debt Service Per Quarter in 2019 (US$ millions)

	Jan-Mar	Apr-Jun	Jul-Sep	Oct-Dec	Total
Token Payments to Multilateral Development Banks (MDBs)	-	3.2	1.6	1.6	**6.4**
Other multilaterals	-	2.51	2.29	1.16	**5.96**
Bilateral Non-Paris Club	-	2.02	3.55	13.5	**19.07**
Total	**-**	**7.73**	**7.44**	**16.26**	**31.43**

Source: Ministry of Finance and Economic Development

2.2.4 External Debt Service

Zimbabwe has been making token payments to some creditors since 2013 as part of the re-engagement efforts with multilateral and bilateral creditors as well as to unlock new financing and as conditions for disbursements of grants (Table 5).

> "There are a few creditors that lend to the government and the amounts are also limited."

2.2.5 New Financing

Disbursements have been critically low during the past two decades due to lack of access to new loans as the Government continues to accumulate arrears. There are a few creditors that lend to the government and the amounts are also limited. During 2017 - 2019, the government contracted external loans amounting to US$572.5 million. Of this amount, US$113.5 million was contracted from India and China in 2019. The other creditors that have lent to Zimbabwe since 2017 are Kuwait Fund, BADEA, OFID and GEMCORP CAPITAL LLP (see Table 6).

Table 6: External Loans Contracted in 2017 to 2019.

Facility	Creditor	Date Signed	Interest Rate	Tenor	Amount (USD Millions)	Date Gazetted	Date Approved by Parliament
Zhove Irrigation Project	Kuwait Fund	24 March 2017	1%	25 years	20	29 June 2017	12 July 2017
BADEA Restructured Facility	BADEA	19 July 2017			21	N/A	Restructured Facility
Small -holder Irrigation Revitalisation Project	OFID	8 March 2018	1.5%	20 years	15	27 March 2018	10 May 2018
R.G. Mugabe International Airport	China Exim Bank	13 Apri l 2018	2%	20 years	153	20 April 2018	10 May 2018
Financing of purchase price for commodities by importers from the Sellers	GEMCORP Capital LLP	8 September 2018			250	6 September 2019	Guarantee
Amendatory Agreement to the Deka Pumping Station and river sy stem uptake project	India Exim Bank	3 June 2019	1.75%	20 years	19.50	9 August 2019	
Upgrading of Bulawayo thermal Power Station	India Exim bank	3 June 2019	1.75%	20 years	23	9 August 2019	
Netone Mobile Network Expansion Project (Phase III)	China Exim Bank	26 June 2019	2%	20 years	71	9 August 2019	

Source: Ministry of Finance and Economic Development

Table 7: Disbursements per quarter in 2019 (US$ millions)

	Jan-Mar	Apr-Jun	Jul-Sep	Oct-Dec	Total
Multilaterals	2.02	1.57	0.53	3.14	**7.26**
Bilateral Non-Paris Club	45.69	7.01	-	-	**52.70**
Total	**47.71**	**8.58**	**0.53**	**3.14**	**59.96**

Source: *Ministry of Finance and Economic Development*

Disbursements on external loans amounted to US$60 million in 2019, of which about 88% was from bilateral non-Paris Club creditors and about 12% from multilateral creditors (Table 7).

2.2.6 Terms of Borrowing

Some of the loans contracted during 2017 - 2019 were not concessional, with grant element of approximately 30%, which is below the threshold of 35%. Concessionality measures the softness of the terms of the loan such as interest rate, grace period and maturity at the time the loan is signed. The degree of concessionality of a loan is measured by the grant element. A loan is considered concessional if the grant element is equal or greater than 35%. Concessional loans have more favourable terms, i.e. longer grace periods and maturities and lower interest rates (normally fixed), while non-concessional loans are subject to commercial terms.

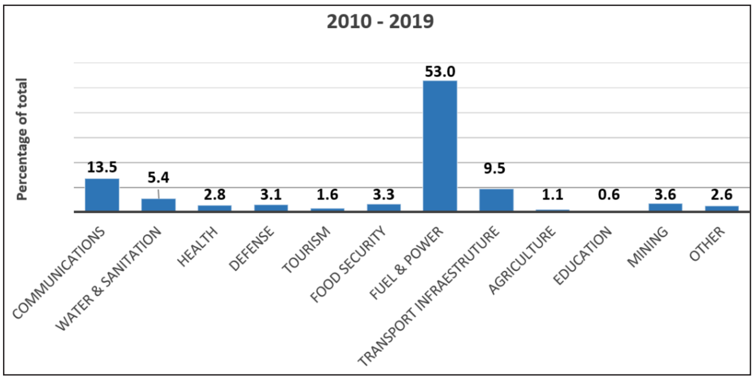
The loans contracted from China and India were non-concessional, while the loans contracted from Kuwait Fund and OFID were concessional. Other loans were secured on market terms, and securitized by future commodity exports, (IMF, Zimbabwe: 2019 Article IV Consultation-Press Release: staff Report: And Statement By the Executuve Director of Zimbabwe, 2020). Commercial borrowing is a risky option for the government which continues to accumulate arrears. In an environment where the global market conditions are tight and uncertain, the Government would pay heavily on commercial debt due to higher interest rates and short-term repayment schedules.

2.2.7 Use of Externally Borrowed Resources

Zimbabwe contracted loans amounting to US$3,202.63 during the period 2010 to 2019. Of the total borrowed funds in the period, the largest amount was allocated to the Fuel and Power sectors (53%), corresponding to a total amount of US$1,697.00 million, of which US$250 million was a guarantee issued by the Government in 2018 to finance the price differential between the purchase price of commodities by the importers from the sellers.

The resources contracted were also allocated to Communication (14%), Transport Infrastructure (10%), Water and Sanitation (5%). The other sectors which also received funding from borrowed resources are Health, Defense, Tourism, Food Security, Agriculture, Education and Mining. The component called "Other" (3%) refers to operations of debt rescheduling agreement with Sinosure and debt restructured with Kuwait and BADEA (Figure 7). **Annex 1** provides the detailed list of projects financed with borrowed funds (2010 to 2019).

Figure 7: Public External Borrowing by Sector 2010 - 2019



Source: *Ministry of Finance and Economic Development*

2.3 Public Domestic Debt

As mentioned in Section a) above, domestic debt was estimated at US$535 million (3% of GDP), a significant decline from US$8,398 million (37% of GDP) in 2018. Prior to 2019, domestic debt was effectively denominated in USD because of the 1:1 exchange rate peg between the USD and the Bond. However, domestic debt declined in the following year in USD terms because of the adoption of a market determined exchange rate and the subsequent depreciation of the Zimbabwe dollar. Table 8 shows the composition of public domestic debt.

Table 8: Composition of Public Domestic Debt (USD million)

	Total 2018	Total 2019
Domestic Debt	**8,398**	**535**
Treasury Bills and Bonds	**8,213**	**530**
Budget Financing	933	72
Government Debt	3,071	131
RBZ Assumed Debt	292	11
Capitalisation of SOEs	149	8
ZAMCO	-	64
RBZ Capitalisation	110	6
Restructured debt	-	238
RBZ (Not Issued with TBs)	28	-
Overdraft Facility	2,934	-
Loans (Central Bank)	696	-
Domestic Arrears	**185**	**6**

Source: Ministry of Finance and Economic Development

Treasury continued to issue domestic debt instruments to meet budget financing needs. Current Treasury policy is to limit the issuance of domestic debt securities by targeting a balanced budget. In order to promote domestic market development, improve transparency and increase competition, the Government introduced an auction system for issuance of treasure bills in July 2019. By November 2019, the Government had raised a total amount of ZWL$782 million at average rate of 15 percent (Table 9)

Table 9: Issuance of Treasury Bills in using the Auction System 2019 (ZWL million)

Auction	Maturity	Amount on offer	Average rate	Amount allotted	Total bids
09.07.2019	**91-days**	30	16.5	10	22
09.07.2019	**182-days**	30	19.5	6.5	17.5
09.07.2019	**365-days**	20	17	1.5	11.5
01.08.2019	**91-days**	30	15.6	30	132.75
22.08.2019	**365-days**	60	14.37	60	121
26.09.2019	**92-days**	100	13.68	102	419
03.10.2019	**365-days**	300	15.07	81	81
10.10.2019	**365-days**	150	15.49	51	72
12.11.2019	**182-days**	300	14.02	300	300
19.11.2019	**270-days**	200	14.51	105	105
29.11.2019	**182-days**	55	14.48	35	300

Source: Ministry of Finance and Economic Planning and Reserve Bank of Zimbabwe

2.4 Other Debts

Contingent liabilities also contribute to public debt accumulation in Zimbabwe. Contingent liabilities are defined as "obligations that do not arise unless a particular, discrete event(s) occurs in the future" (GFSM 2014) and they are a major source of fiscal risk. Contingent liabilities can emanate from guaranteed debt being called up, public private partnerships, legal disputes, financial crisis, among other unforeseen outcomes that may entail government intervention.

Guarantees have been one of the major sources of contingent liabilities in Zimbabwe. The arbitral award of 2009 by the International Center for Settlement of Investment Disputes (ICSID) requiring the Government to pay €8.22 million plus interest to claimants whose land was expropriated and for which no compensation was paid represents another source of contingent liability for the Government of Zimbabwe. The award remains unpaid. ICSID has periodically reminded Zimbabwe of this obligation.

In 2019, the Government of Zimbabwe issued an external guarantee to the Zimbabwe Electricity Distribution and Transmission Company (ZETDC) amounting to US$ 110.4 million for the payment of accumulated debt on imported electricity and procurement of prepaid smart meters. Domestic Guarantees were also issued for working capital and to finance inputs for the 2019/20 agriculture season. These included guarantees to Zimbabwe Consolidated Diamond Company (US$15 million), Lupane University (ZWL$15 million), Agribank

(ZWL$40 million) and CBZ (ZWL$103.7 million and US$3.3).

In addition, the Government also announced in 2019 a plan to start paying compensation to thousands of farmers who lost land during the land reform period nearly two decades ago. An amount of US$17.5 million was set aside in the 2019 budget and a further US$21 million for the same purpose in 2020. The initial payment was expected to target those in financial distress, while full compensation would be paid later. In July 2020, the government signed a US$3.5 billion agreement to compensate former white farmers displaced during land redistribution program two decades ago. Under the Global Compensation Deed agreement between the Government and the farmers whose land was expropriated under land reform, compensation will be made for improvements effected on the land before its acquisition in line with Section 72 subsection 2 of the Zimbabwe Constitution, (RepublicOfZimbabwe, 2013). The implementation of this Agreement is expected to attract foreign investment to further develop the economy. The Government plans to issue long term bonds as well as partner donors in raising the resources required for the compensation (CFU, 2020).

Furthermore, government has over the years taken over the obligations of guaranteed entities/individual beneficiaries in various agriculture support programmes. Since 2005 the government has launched various supportive programmes to boost agricultural production, which included (i) Agricultural Sector Enhancement Productivity Facility (ASPEF) worth more than US$114 million, (ii) Operation Maguta with over US$41 million and (iii) Local Authorities Reorientation Programme (PLARP) where local governments accessed at least ZW$1 trillion under the Parastatals. Other programmes followed in 2007 and 2008, such as the Mechanization Programme for mechanising agriculture production and improve crop yield per hectare and the Basic Commodities Supply Side Intervention (BACCOSSI) to alleviate the acute shortages of goods in supermarkets through giving households food hampers, respectively. However, most of these programmes invested millions of dollars but failed on implementation and to some extent has created moral hazard among beneficiaries of these programmes. In the absence of a framework for managing contingent liabilities, the envisaged guarantees under COVID-19 support scheme as set out in the *Government of Zimbabwe's ZWL$18 billion Economic Recovery and Stimulus Package where government outlined that government guarantees amounting to ZWL$ 2.5 billion and ZWL$500 million will be availed to support the manufacturing and tourism sectors, respectively,* may continue to worsen Zimbabwe's public debt in the event that the Government assumes such obligations in the case of default.

"In addition, the Government also announced in 2019 a plan to start paying compensation to thousands of farmers who lost land during the land reform period nearly two decades ago."

".......most of these programmes invested millions of dollars but failed on implementation and to some extent has created moral hazard among beneficiaries of these programmes."

3. Key Drivers of Public Debt Accumulation

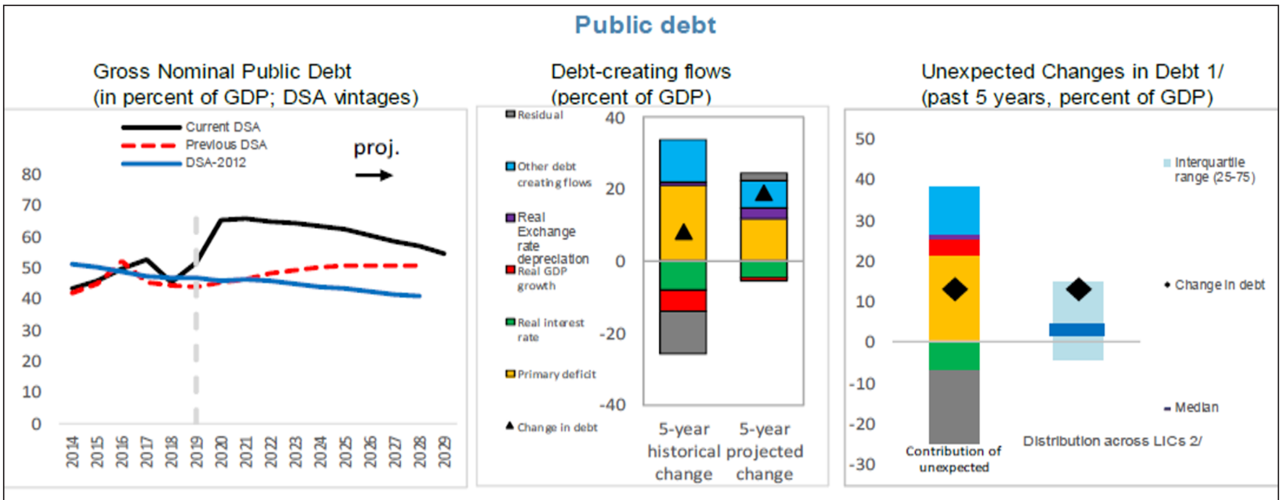
Zimbabwe's debt build-up during 2014 - 2019 was driven by arrears, primary deficit, real GDP growth and real exchange rate depreciation.

Zimbabwe's debt build-up during 2014 - 2019 was driven by arrears, primary deficit, real GDP growth and real exchange rate depreciation. External payment arrears increased from US$109 million in 1999 to about US$6.4 billion in 2019, which were partially reduced by the cancellation of arrears to the IMF of US$107.8 million and token payments to other multilaterals. The external debt arrears include the unsettled interest payments, penalty charges and principal payments.

The country's public debt has also been increasing due over to large fiscal deficits and quasi-fiscal activities conducted by the RBZ. Budget deficits increased from US$185 million (0.9 % of GDP) in 2014 to US$2.7 billion in 2018 (11.8% of GDP). The Reserve Bank of Zimbabwe has over the years been involved in public sector expenditure programmes such as the procurement of farming inputs, petroleum, medicines, grain and processed food, farm implements and electricity, among others. The widening fiscal gap has been financed through the central bank overdraft facility and domestic borrowing through issuance of Treasury Bills. Therefore, with limited access to external financing, the deficits were financed domestically through the banking system and the RBZ, as well as arrears. The contribution of the primary deficit to public debt accumulation was about 20% of GDP.

The real exchange rate has been depreciating since the introduction of the Zimbabwean dollar in February 2019. Zimbabwe's growth contracted sharply in 2019 to -8.3% from an average growth of 3% during 2016 to 2018, and as a result, the debt to GDP and debt to export ratios worsened leading to debt accumulation (Figure 8). The contraction in real GDP growth contributed to 4.1% of GDP increase in public debt accumulation.

Figure 8: Drivers of Public Debt Accumulation



1/ Difference between anticipated and actual contributions on debt ratios.

Source: IMF Article IV Report 2019

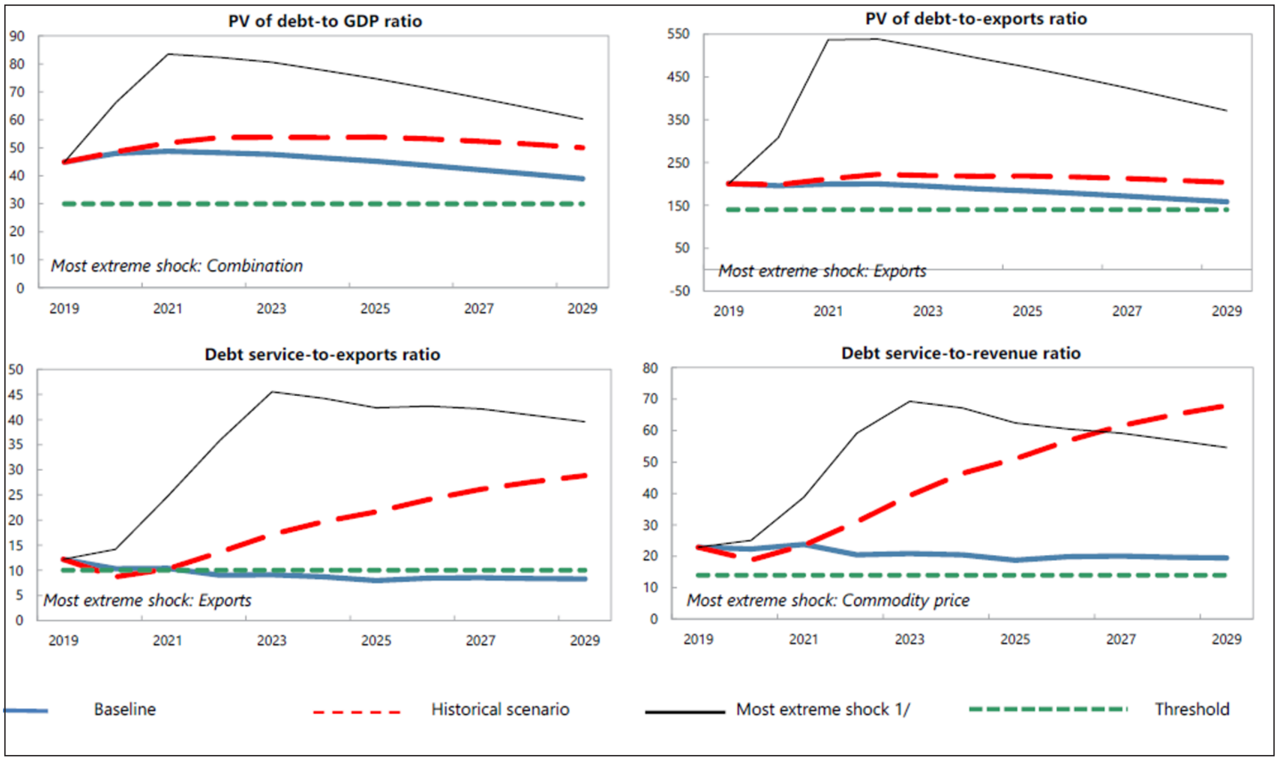
3.1 Debt Sustainability Analysis and Debt Restructuring Initiatives

3.1.1 Debt Sustainability Analysis

A Debt Sustainability Analysis (DSA) conducted by the IMF in 2019 concluded that Zimbabwe was "in external debt distress". A country is considered to be "in debt distress" when the present value of debt to GDP and exports ratio, and debt service ratios significantly breach the respective thresholds, and there is actual or impending debt restructuring negotiations and significant existence of arrears. In the case of Zimbabwe, external and total public debt ratios breached the respective thresholds and benchmark in both the baseline and shock scenarios. Moreover, the country is accumulating external arrears, and large contingent liabilities.

The present values of external debt-to-GDP and to export ratios are above the thresholds of 30% and 140%, respectively, for the entire projection horizon (2019 - 2029) under the baseline and the stress tests. Similarly, the debt service-to-revenue ratio is above the threshold of 10% (Figure 9). Weak export competitiveness, the withdrawal of foreign investment, and weak accumulation of international reserves have further compromised the country's capacity to service external debt obligations. Zimbabwe is vulnerable to a combination shock, exports shock and commodity price shocks, leading to substantial increases in all debt ratios relative to the baseline and thresholds.

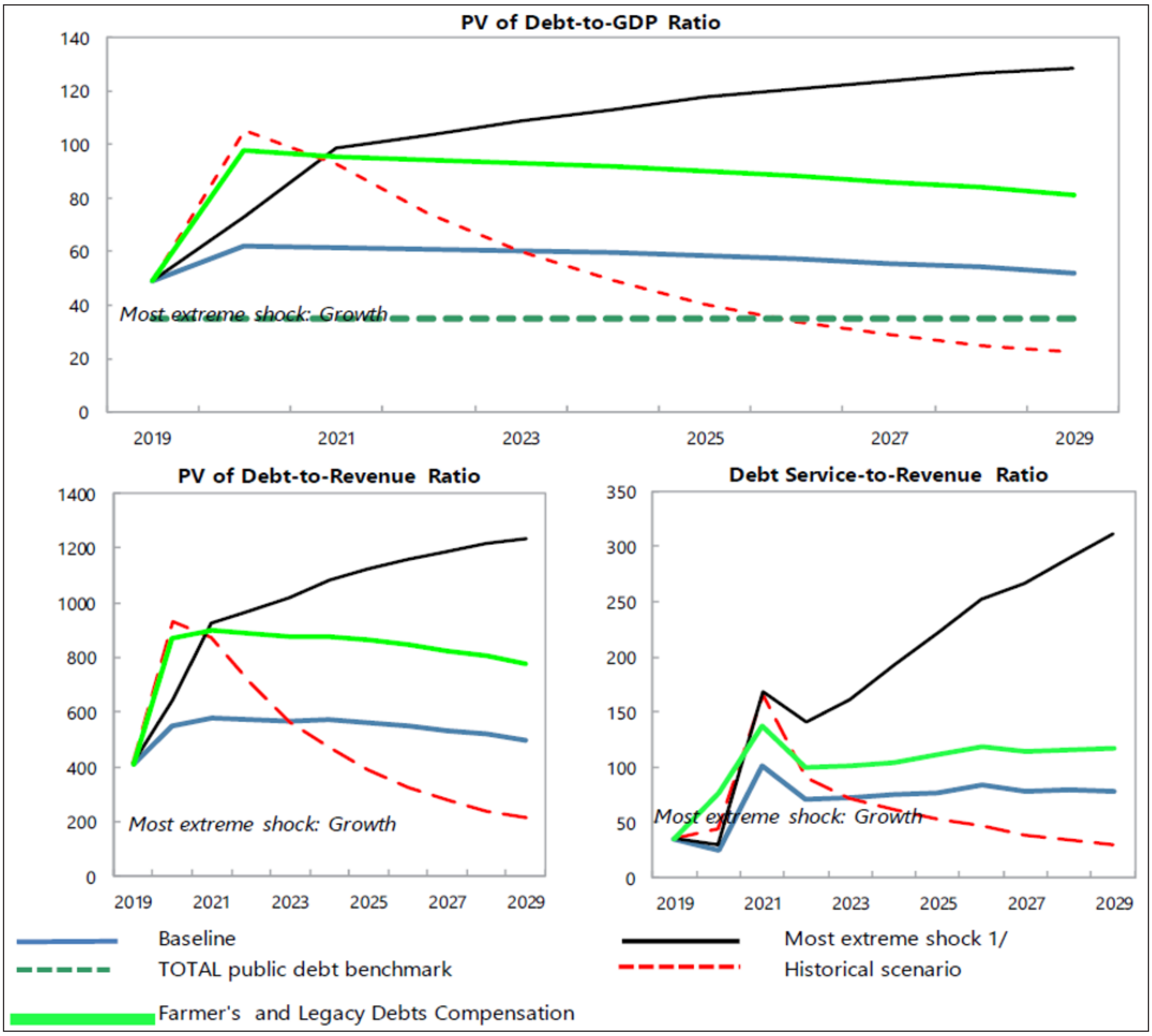
Figure 9: Indicators of Public and Publicly Guaranteed External Debt under Alternative Scenarios, 2019–29



Source: IMF Article IV Report 2019

Adding domestic debt to the analysis indicates that Zimbabwe's public debt is also unsustainable. The ratio of the present value of public debt to GDP ratio is substantially beyond the indicative threshold of 35% under both the baseline and the stress tests. The size of public debt was mainly influenced by the recapitalization and debt assumptions of the SOEs, subsidies to agriculture, and expansion in RBZ obligations. A real GDP shock would increase the public debt ratios permanently during the projection period while the farmers and legacy debt compensation also elevates the debt risks. A return to historical economic performance also increases the public debt risks.

Figure 10: Indicators of Public External Debt under Alternative Scenarios, 2019–29



Source: IMF Article IV Report 2019

3.2 Debt Reduction Initiatives by the Government

The continued accumulation of arrears remains a major setback on Zimbabwe's development agenda. For example, the country's perceived risk has decreased private sector's appetite to invest in the country as well as decreased donor level engagements due to arrears. The public sector's exclusion from most international capital markets also makes it vulnerable to fiscal shocks due to the country's small domestic capital market.

Resolution to the country's external debt and arrears clearance is central to unlocking new financing and investment flows in support of the country's recovery and development Agenda. Clearing arrears to International Financial Institutions (IFIs) will create conditions for the country to receive new Official Development Assistance (ODA) and private financial flows. This will help the country pull back from a cycle of isolation and fragility to a trajectory of sustainable growth and development and unleash its economic potential for prosperity.

Given Zimbabwe's financial constraints, improvements in the physical and human capital needed to achieve sustained high economic growth requires substantial external support for an extended period. To this end, a full normalisation of the country's relationship with the international community is needed. As part of the process to spearhead re-engagement with the international community, government developed a number of initiatives over the years.

In 2011, government adopted the Zimbabwe Accelerated Arrears Clearance Debt and Development Strategy (ZAADDS) to deal with the country's arrears and debt overhang, as well as laying a solid foundation for economic growth supported by investment from both domestic and external resources. ZAADDS was a hybrid debt resolution strategy, which entailed adoption of traditional debt resolution initiatives combined with leveraging the country's natural resources to achieve sustainable economic development. ZAADDS had the following key elements:

- establishing and operationalising a Debt Management Office;
- undertaking a validation and reconciliation exercise of the external debt database;
- re-engaging with creditors and the international community towards the removal of international sanctions;
- negotiating for arrears clearance, new financing and comprehensive debt relief; and
- leveraging Zimbabwe's natural resources in pursuit of debt relief and development.

In 2012, government adopted the Accelerated Reengagement Economic Programme (ZAREP) to prepare for eventual arrears clearance and debt relief by establishing a track record of sound macroeconomic management in the context of the IMF's Staff Monitored Programme (SMP), which was approved in 2013.

Clearing arrears to IFIs was seen as a first step towards re-engagement with development partners and eventually seeking a debt treatment under the Paris Club. A formal review of Zimbabwe's eligibility and qualification for HIPC conducted by the IMF and World Bank in August 2014, concluded that the country did not qualify (using end-2013 data). Consequently, the arrears clearance road map was to be premised on a non-HIPC debt resolution strategy and supported by credible economic reform agenda.

"In 2011, government adopted the Zimbabwe Accelerated Arrears Clearance Debt and Development Strategy (ZAADDS) to deal with the country's arrears and debt overhang..."

In view of this, government in 2015 developed a plan, the Strategy for Clearing External Arrears and Supportive Economic Reform Measures, to clear external arrears to the IFIs. The strategy entailed repayment of the IMF arrears (US$120 million) using Zimbabwe's SDR resources at the Fund, repayment of US$896 million IBRD arrears using a term facility syndicated by the African Export and Import Bank (Afreximbank) and Lazard Freres, and repayment of US$260 million and US$601 million IDA and AfDB arrears respectively, with a bridging facility from Afreximbank, which was to be refinanced from a future IDA development policy operation and AfDB's Transitional Support Facility. The plan, which also included the authorities' intention to approach the Paris Club after IFI arrears clearance, was broadly endorsed by major creditors and development partners during the Lima meetings in October 2015 and again in May 2016. It was envisaged that the clearance of arrears to the IFIs would be completed in 2016.

In late 2016, government cleared its arrears to the IMF, and allowing the country's PRGT eligibility to be restored and the declaration of non-cooperation to be lifted. However, the envisaged bilateral loan to clear arrears to the World Bank Group did not materialize. As reengagement with international institutions is delayed, and concerns about governance, corruption, human and property rights have not dissipated. This has undermined the prospects for new external financing, while insufficient assurances of new financing weakened the government's incentives for reform.

The coming in of a new government in 2018 resulted in a renewed commitment by the authorities to normalize relations with the international community. In his inaugural speech, the President expressed commitment to clear external arrears and normalize relations with Zimbabwe's creditors. The July 2018 elections were seen as a litmus test to put the country on a path toward ending its isolation, bringing about an end to sanctions, securing debt relief, and reopening borrowing lines from international creditors. However, the new government's response to social unrests in the wake of the elections raised questions internationally about the administration's commitment to peacefully resolving disputes and about human rights and civil liberties. While government adopted an agenda focused on macroeconomic stabilization and reforms supported by an IMF Staff Monitored Program adopted in May 2019, IMF has since declared the reforms off-track, due to delays and missteps in implementation.

“The coming in of a new government in 2018 resulted in a renewed commitment by the authorities to normalize relations with the international community.”

Given this, there is growing recognition that the arrears clearance and debt resolution process might take longer to complete. Experiences from other transition processes in recent history highlight that the process of reengagement can be challenging.

First, decades of isolation have created a dual narrative. For the government, the continued sanctions and restrictive measures have fuelled a tendency toward ideology-driven policies that trumped economic realism. For the international community, reengagement has become tied to improvements needed in governance, human rights, land tenure security, and electoral reforms. The process of reaching political agreement on normalization will require the country, and the international community, to confront and reconcile the existing disconnect and many of the predetermined narratives that have been forged over the years.

Second, the quest to lift sanctions is a legal one and, in some instances, will necessitate changing the law in the imposing countries. Third, clearing arrears also requires reaching agreement with IFIs on a range of reforms which require government to demonstrate its commitment to implement, as the country seeks to normalize relations and benefit from access to international markets in a rapidly changing global context.

Zimbabwe debt indicators are not projected to improve much on current policies. The magnitude of the required resources for economic transformation will require augmenting domestic efforts with catalytic bilateral and multilateral financial injections. Without the clearance of external payment arrears, Zimbabwe cannot access regular development assistance from these institutions. Moreover, critical offshore credit facilities contracted by the private sector will remain expensive on account of perceived country risk, and foreign direct investment inflows subdued due to depressed investor confidence and unfavourable business environment. Reforms, if managed with support from the IMF and the World Bank, will boost market confidence, private sector investment and unlock new, fresh lines of credit.

Debt relief can be a reality with the commitment of government and stakeholders in implementing sound reforms. In March 2020, Somalia reached the HIPC Decision Point with the International Monetary Fund (IMF) and the World Bank's International Development Association having determined that the country had taken the necessary steps to begin receiving debt relief under the enhanced Heavily Indebted Poor Countries (HIPC) Initiative. According to the **Prime Minister of the Federal Government of Somalia,** "*The journey leading to this decision required hard work, dedication and partnership, (WorldBank, 2020).*

Support from bilateral partners is key in debt resolution. A case in point is where the Japan Bank for International Cooperation provided the Myanmar with a bridge loan that enabled the government to pay off about $900 million in overdue debts to the Manila-based Asian Development Bank (ADB) and the World Bank resulting in the multilateral institutions resuming funding to the country. Another example is where Somalia received a short term bridge loan of almost US$366 million from the Norwegian Government in March 2020 which the country used to clear its arrears to the World Bank, (Norway, 2020). Furthermore, in 2008, the Government of Liberia also received a bridge loan from the United States government to clear its arrears with the IMF amounting to an equivalent to SDR543 million (about US$888 million)(IMF, 2008).

It is important to note that, without external financial support, Zimbabwe risks further economic decline and deterioration of poverty and social conditions, leading to high levels of deprivation.

4 Legal and Institutional Framework for Public Debt Management in Zimbabwe

a well-articulated legal framework for public debt management increases transparency and predictability in debt management operations.

4.1 Legal Framework for Public Debt in Zimbabwe

A comprehensive legal and regulatory framework is desirable to facilitate effective public debt management through strong governance arrangements as well as clear roles and responsibilities. In addition, a well-articulated legal framework for public debt management increases transparency and predictability in debt management operations. Furthermore, it provides creditors with the assurance that Government's debt management objectives are being pursued as well as providing clear and consistent principles for borrowing.

According to the World Bank DeMPA methodology, a sound legal framework for public debt management should clearly set out the following provisions:

- clear authorization by the parliament or congress to the executive branch of government (to the president, cabinet or council of ministers, or directly to the minister of finance) to approve borrowings and loan guarantees on behalf of the central government;
- specified borrowing purposes
- clear debt management objectives
- Requirement to develop a debt management strategy
- Mandatory annual reporting to parliament or congress of debt management (DeM) activities covering evaluation of outcomes against stated objectives and the determined strategy

The Constitution of Zimbabwe provides for the enactment of the main law regulating central government borrowing and other debt management activities in Zimbabwe i.e. the Public Debt Management Act (PDMA) of 2015 and Public Debt Management Regulations of 2019. In addition, legal provisions for central government borrowing are also provided in the Reserve Bank of Zimbabwe Act.

The Table 10 below outlines the legal provisions of Zimbabwe's public debt management laws against the key tenets specified in sound practice as provided in the World Bank's Debt Management Performance Assessment (DeMPA) methodology.

> "The Constitution of Zimbabwe provides for the enactment of the main law regulating central government borrowing and other debt management activities in Zimbabwe...."

Table 10: Sound Practice Vs. Provisions in Zimbabwe's Debt Legislation

Key Tenant	Provision in Zimbabwe's Public Debt Legislation
Clear authorization to borrow	PDMA section 11 Subsection (4) - "*Subject to section 300 of the Constitution, the Minister shall have sole authority to borrow money on behalf of Government by concluding loan agreements, issuing Government securities, or entering into supplier's credit agreements and to issue Government guarantees, in Zimbabwe and in both local and foreign currencies*".
Specified borrowing purposes	PDMA section 12: - The Minister may borrow for the borrowing purposes : *(a) to finance national priority infrastructure and productive sector projects with high economic and social impact, provided that debt shall only be incurred on projects that can generate sufficient revenues to repay the loan;* *(b) to finance Government budget deficits;* *(c) to maintain a credit balance on the Treasury main account at a level determined by the Minister;* *(d) to provide Government loans or credits to local authorities and public entities;* *(e) to honour obligations arising under Government guarantees;* *(f) to refinance outstanding debt or repay a loan prior to its date of repayment;* *(g) to immediately protect, mitigate or eliminate effects caused by a natural disaster or any other national emergency;* *(h) to replenish international reserves;* *(i) to meet requests by the Reserve Bank to issue Government securities for the sole purpose of supporting monetary policy objectives; and* *(j) to fulfil any other purpose as the National Assembly may approve by resolution.*
Clear debt management objectives	PDMA section 3: - The public debt management objectives for Zimbabwe are: "*to ensure that Government's financing needs and its payment obligations are met at the lowest possible cost over the medium to long term, with a prudent level of risk, and to promote development or the domestic debt market*".
Mandatory annual reporting to the parliament of debt management activities covering evaluation of outcomes against stated objectives and the determined strategy	PDMA section 36: "*At least twice a year, the Minister shall furnish Parliament with a report on government debt management activities, guarantees and lending*".

Source: Author's Compilation

4.2 Observations/ Gaps in Adherence to Legal Provision

In general, Zimbabwe is among the countries with a robust legal framework for public debt management, based on the sound practice requirements outlined in the DeMPA methodology. DeMPA conducted by the World Bank, MEFMI and UNCTAD in 2019 indicated that the legal framework governing public debt management in Zimbabwe is comprehensive as it contains the recommended components.

Despite the availability of a robust legal framework for public debt management, it is observed that there has been weak adherence to some aspects of the law. Below are some examples where the provisions of the law have not been adhered to:

Legal Provision

i. Limits to borrowing

In line with section 300 of the Constitution of the Republic of Zimbabwe, Section 11, Subsection (2) of the PDMA states that "*the aggregate of the amounts that may be borrowed in any financial year by way of loans shall not exceed the limit fixed by National Assembly, which limit the Minister may propose to the National Assembly for approval by resolution or by means of a provision in a Finance Bill*". In addition, Section 11, Subsection 1(a) of the Reserve Bank of Zimbabwe Act states that: The Bank shall not— *(a) lend or advance moneys to, or directly buy, discount or re-discount bills, notes or other obligations from, the State or any fund established by the State so that the amount outstanding at any time exceeds the equivalent of twenty per centum of the previous year's ordinary revenues of the State;*

Although the country's total publicly guaranteed debt has not exceeded 70% of GDP limit set in the PDMA, it is observed that the annual debt limit has not been set by the National Assembly over the years despite the legal provisions. According to the Section 11 of PDMA, the EDDC is expected to recommend to the Minister of Finance the maximum amount of new borrowing and guarantees which may be undertaken throughout a given year. The Minister in turn submits the proposal to the National Assembly for approval. In addition, the limit on RBZ[5] lending to the government has not been consistently adhered to as evidenced by the historical high stock of government overdraft to the central bank as highlighted in column 8 of the Table 11 below. These overdraft amounts have since been restructured into long term debt securities as highlighted in the 2020 National budget. In the absence of borrowing limits and annual borrowing plan, there will be risk of over borrowing which may infringe on debt sustainability as shall be highlighted in sections below.

> "Despite the availability of a robust legal framework for public debt management, it is observed that there has been weak adherence to some aspects of the law."

[5]The statutory limit is set at 20% of the previous year's revenue

Table 11: Domestic Debt Stock: 2012-Sept 2018 (US$ million)

	Statutory Reserves	Budget Financing	Gvt Debt	RBZ Debt	Capital-isation	RBZ (Not Issued with TBs)	Arrears	Over-draft Facility	Loans	*TOTAL*
2012	83.4	9.9	0.0	0.0	0.0	0.0	182.6	0.0	0.0	275.83
2013	58.4	74.5	93.6	0.0	0.0	0.0	148.9	0.0	0.0	***375.41***
2014	33.4	206.4	123.6	250.2	350.3	440.3	145.5	126.4	0.0	***1,676.10***
2015	0.0	206.8	541.6	291.8	396.4	398.8	124.8	278.8	0.0	***2,238.90***
2016	0.0	267.0	1252.0	410.8	742.8	199.4	164.6	941.8	47.7	***4,026.14***
2017 Dec	0.0	471.4	3023.9	389.9	901.8	38.3	108.4	1369.4	693.2	***6,996.20***
2018 Jan	0.0	487.1	2957.1	389.9	915.6	38.3	108.6	1291.3	712.2	***6,900.08***
2018 Feb	0.0	452.1	2938.3	389.9	919.2	38.3	108.6	1401.3	719.1	***6,966.77***
2018 Mar	0.0	440.1	3063.0	308.7	945.8	38.3	108.6	1486.2	959.5	***7,350.19***
2018 Apr	0.0	441.0	3169.5	297.7	945.8	38.3	95.4	1593.9	967.7	***7,549.28***
2018 May	0.0	456.5	3300.3	297.7	949.6	38.3	109.3	1741.0	881.3	***7,774.11***
2018 Jun	0.0	514.1	3660.3	292.3	945.2	38.3	115.8	1847.6	914.1	***8,327.76***
2018 Jul	0.0	514.7	3702.5	265.7	1334.0	38.3	123.8	2050.3	1006.8	***9,036.22***
2018 Aug	0.0	431.0	4059.4	265.7	1524.0	38.3	115.9	2298.4	811.4	***9,544.22***
2018 Sep	0.0	351.3	4005.4	260.1	1524.4	38.3	117.6	2476.5	851.2	***9,624.89***

Source: 2019 National Budget Statement

i. Formulation and implementation of a Medium-Term Debt Management Strategy:

Section 12 of the PDMA requires the Minister of Finance, with the assistance of the PDMO, formulates and adopts a Medium-Term Debt Management Strategy for public debt to guide debt management operations.

There is a debt management strategy in place covering the period 2017-2021, and it contains the key elements as expected in any sound debt management strategy. These include debt management objectives spelt out, the strategy covering all government debt, debt portfolio review, description of future environment including key assumptions for the macroeconomic environment and financing, the alternative debt management strategies under different scenarios as well as the recommended strategy and its rationale. The main drawback, however, is that the strategy has not been implemented as it was premised on the success of the country's arrears clearance strategy. The strategy assumed clearance of multilateral arrears by 2018, re-introduction of the auction system, lengthening of maturities for domestic securities among others. The arrears resolution remains outstanding with debt securities still concentrated on the shorter end of the market. In this regard, this can be interpreted as not having a strategy in place. In addition, the reporting to parliament through the national budget statement does not mention the progress and challenges in the implementation of this strategy as recommended in sound practice for public debt management. Furthermore, there is no annual borrowing plan in place as provided by section 5, subsection 2(b) of the PDMA. Currently government domestic borrowing is determined on a monthly basis through the Cash Flow Committee. The absence of a borrowing plan restricts government from undertaking structured borrowing operations in any given year.

ii. Publication of the terms of borrowing within 60 days of finalising the agreement

In line with section 300, subsection (3) of the Constitution of the Republic of Zimbabwe, Section 18, Subsection (2) of the PDMA states that, "Within sixty days after Government has concluded a loan or guarantee agreement, the Minister must cause its terms to be published by notice in the Gazette".

This provision has not been consistently adhered to and has in the past raised concerned amongst parliamentarians as highlighted in the July 2019, Public Accounts Committee Report, (ParliamentofZimbabwe, 2019). The requirement to publish information on the terms and conditions of new borrowing is key in enhancing transparency and accountability of government borrowing operations.

iii. Publication of a Debt Bulletin

Sound practice requires that central government periodically prepare and publish debt statistical bulletins to enhance accountability and transparency, meet statutory obligations or international reporting requirements and to provide timely and accessible information on public debt to stakeholders. The information should be timely, complete, consistent, accurate and widely disseminated/readily available. Section 5 (o) of the Zimbabwe Public Debt Management Act (2015) mandates the Public Debt Management Office "*to prepare an annual report on government debt management activities including debt stock position, related debt service projection, new borrowing, guarantees and lending.*"

Up until March 2020, the public debt management office had never published a debt bulletin which is a key document in providing information on debt management operations to stakeholders. The key milestone in publishing the maiden debt bulletin in March 2020 is highly commended. The bulletin, which is comprehensive as set out recommended sound practice, however, excludes information on the cost and risk indicators of the current country's debt portfolio and lacks an analysis of loan guarantees. In addition, another key deficiency is that the data provided was outdated as it reported developments as at December 2018. Sound practice requires that information published should not be more than 6 months old as at the date of publication.

4.3 Institutional framework for Public Debt Management in Zimbabwe

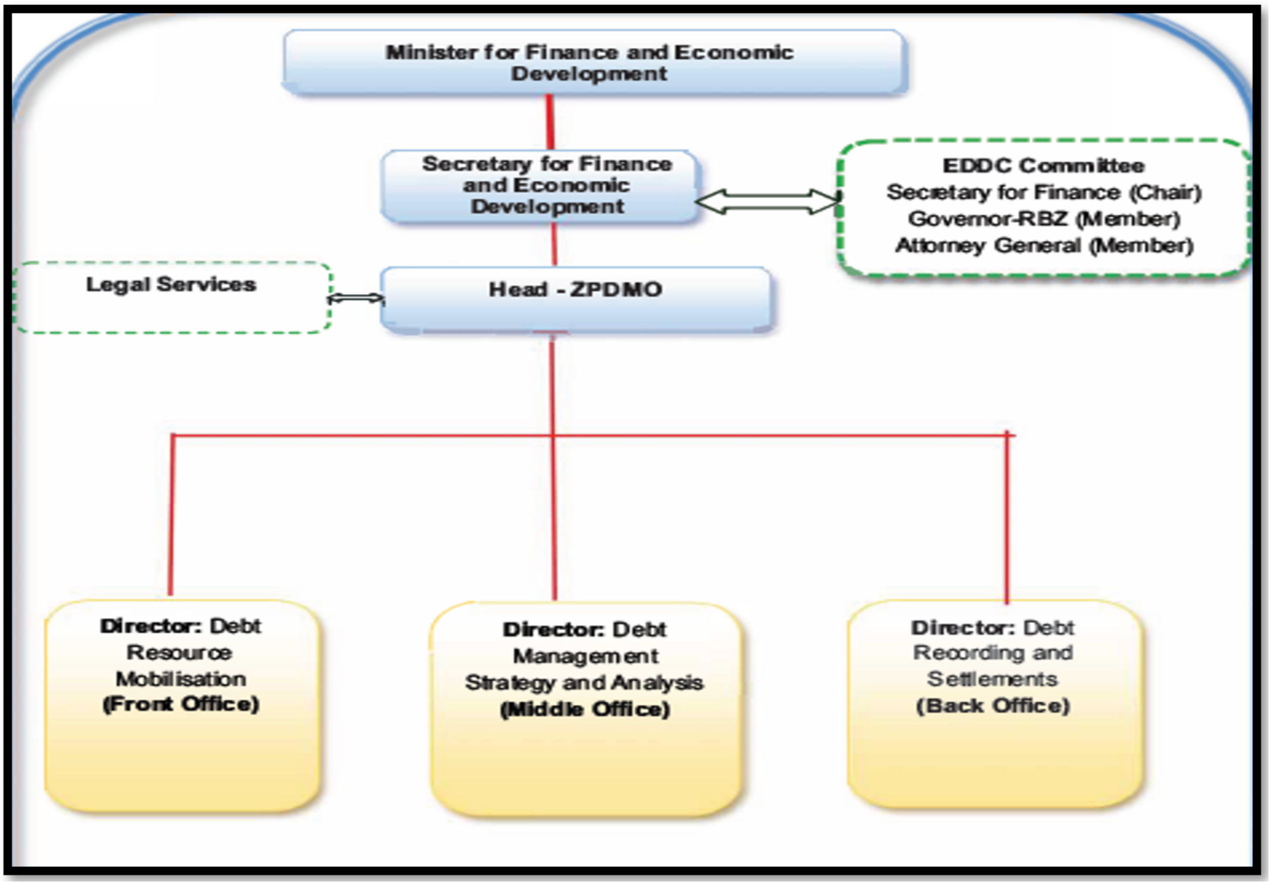
To enhance coordination within departments responsible for debt management, sound practice requires that there be a dedicated unit to carry debt management functions. This principal debt management entity is supposed to comprise Front, Middle and Back office sections that are responsible for debt contraction, analysis and recording, respectively. The unit can be located in the Ministry of Finance, central bank or an independent organisation as long as the debt management functions are carried out effectively. There is also need for strong coordination mechanisms across departments/entities tasked to perform public debt management functions.

In practice, Debt Management Offices (DMOs) are generally organised differently across countries, some functions remaining shared among various departments. In Zimbabwe, debt management is conducted by the PDMO in the Ministry of Finance and Economic Development, which was legally established in 2015. During 2015 - 2019, the PDMO was responsible for middle and back office operations of debt management while the front office functions were being performed in a separate directorate located in the same Ministry.

Following the approval of a new structure of MOF in 2019, all debt management functions were consolidated under the PDMO. According to a debt management performance assessment conducted by the World Bank, MEFMI and UNCTAD in 2019, the PDMO has adequate and well-trained staff to conduct debt management operations. Below is the organogram of the PDMO.

> "There is also need for strong coordination mechanisms across departments/entities tasked to perform public debt management functions."

Figure 11: PDMO Organogram



Source: Zimbabwe Annual Public Debt Bulletin, 2018

The PDMO coordinates with other public sector institutions such as the Reserve Bank of Zimbabwe, Parliament, the External and Domestic Debt Committee (EDDC)[6], and offices of the Accountant General, Auditor General and the Attorney General in undertaking public debt management operations in Zimbabwe. The Table 12 below summarises the key functions of these institutions in debt management and related functions. The table aims to provide stakeholders with a benchmark for assessing the performance of institutions undertaking public debt management functions against their set mandates.

[6] The EDDC is established under section 7 of the Public Debt Management Act (2015)

Table 12: Institutional Framework for Debt Management

Public Debt Management Office	Reserve Bank of Zimbabwe	External and Domestic Debt Committee (EDDC)	Parliament of Zimbabwe

The PDMO is the principal debt management agent in Zimbabwe. The key functions of the Office are summarised as follows:
• The Front Office is responsible for mobilisation of resources (both external and domestic), which include contracting loans, on-lending, issuing guarantees, treasury bills, bonds, other government securities and other operations related to debt contraction
• The Middle Office is responsible for all the analytical, reporting and risk management functions of debt management that enable government to meet its financing needs and its debt service obligations, at the lowest possible cost, with a prudent degree of risk exposure, as well as development of the domestic debt market. It also monitors compliance of Public Debt Management Office and public entities' performance on the chosen strategy and risk and cost limits.
• The Back Office is responsible for maintaining a comprehensive debt database that is complete, accurate and consistent
	As a fiscal agent of government, the RBZ is mandated with the following debt management functions:
	• Facilitate the issuance of domestic security as well as maintaining of information on the holders of government securities in a secure registry system
	• Facilitating the externalisation of funds for foreign debt service
	• Advising government on all borrowings
		The EDDC, which was established by the PDMA is a committee comprising of the Permanent Secretary of Finance (Chair), RBZ governor and Attorney General with the PDMO as the Secretariat. The committee is mandated to provide recommendations to the Minister on all public debt management issues. This includes performing the following functions:
		• Review all borrowing, securities, guarantee and on-lending proposals and recommend to the EDDC;
		• Review negotiation strategy on all loans, securities, guarantees and on-lending requests;
		• Review the reports submitted by the PDMO which include:
		  ○ Medium Term Debt Strategy and Debt Sustainability Analysis Report;
		  ○ Annual Borrowing Plan;
		  ○ Issuance Calendar;
		  ○ Public Debt Statistical Bulletin;
		  ○ Bi-annual Public Debt Report to Parliament;
		  ○ Any other reports or documents related to debt management.
			The Parliament is mandated by the Constitution to monitor and oversee government resources. In reference to public debt, the Parliament's role is to:
			• Authorise the Minister of Finance to borrow and issue guarantees on behalf of the government of Zimbabwe
			• Enact laws to govern public debt management
			• Ratify all external loan agreements
			• Assess, evaluate, monitor and oversee public finances including public debt management operations in Zimbabwe
			• Approve the annual public debt limit
			• Set limit limits for guarantee issuance

Other institutions involved in debt management related activities included the following:

- *Attorney General's Office* - which participates in all loan negotiations and also provides legal opinion on new borrowing
- *Office of the Auditor General* - Undertakes the following audits of the public debt office (Financial/value for money, performance, Information technology system)

5. Zimbabwe's Borrowing Processes

From 2012 until 2019, government borrowing in the domestic market was through private placement of treasury bills and bonds. Under this arrangement, government would contact potential investors for lending at the predetermined price and yield.

Zimbabwe's borrowing processes are guided by the approved procedures manuals for domestic and external borrowing and issuance of guarantees as well as the Public Debt Management Regulations. The programmes and projects to be financed through borrowing proceeds are outlined in the country's national development plan for a given Phase, in this case the Transitional Stabilisation Programme (2018-2020). The Programme outlines the country's development priorities in the short to medium term.

5.1 Domestic Borrowing

From 2012 until 2019, government borrowing in the domestic market was through private placement of treasury bills and bonds. Under this arrangement, government would contact potential investors for lending at the predetermined price and yield. Through bilateral discussions, government and the potential investor agree on the volume and tenures of the required financing. When a consensus is reached, an agreement letter signed by the Minister of Finance and Economic Development is sent to the investor.

This method of issuing government securities inhibits transparency in government's domestic debt market operations and does not support the growth of domestic securities market. Sound practice in public debt management requires that domestic debt instruments are issued through market based instruments, i.e. through the auction system. Despite having an efficient domestic debt market prior to 2009, the government of Zimbabwe resumed the issuance of domestic securities in 2012 using the private placement mechanisms following years of suspended domestic borrowing as government was operating on a balanced budget during the Inclusive Government Era.

However, strides have been made by the PDMO with the introduction of the auction system in 2019 which being used concurrently with private placement to mobilise funds on the domestic debt market. The government intends to discontinue the private placement in the near future as the domestic debt market gets developed and investor confidence in the government gets restored.

The current process for mobilising finances through the auction system comprises of the following steps:

- In the absence of an annual borrowing plan and issuance calendar, the decision to go to the market is determined by the cash flow/government financing need. In addition, it also takes in into account the number of institutions willing to participate in the auction which is an indication of market capacity. This information is also obtained through market canvasing.
- The PDMO drafts a memorandum with the likely amount to be raised in the auction for the Permanent Secretary and Minister's signature
- The Accountant General sends an instruction to the RBZ to conduct an auction
- The PDMO participates in the auctions
- The cut-off amount in determined by the Permanent Secretary based on recommendations from the PDMO
- Auction results are communicated on the same day

5.2 External Borrowing

Although external financing has dwindled since 2000 owing to accumulation of arrears, the Government of Zimbabwe has historically utilised external borrowing to finance its high infrastructure development needs including large scale social projects. These projects are outlined in the National Development Plan. On an annual basis, a line ministry or public entity submits to the MOFED their annual borrowing plan for inclusion in the National Budget. Key considerations by MOFED when incorporating a project for funding through the use of external borrowing include assessing whether the project is part of the country's priorities outlined in the economic development plan, impact on debt sustainability that the borrowing would not breach the annual debt ceilings, the debt to GDP ratio not exceeding 70% as the main consideration.

The PDMO has detailed procedures manuals in place to guide both external borrowing which are summarized below:

- MoFED evaluates the feasibility of the project that is to be financed by foreign funding and produces a project evaluation report. The report is presented to the External and Domestic Debt Committee, (EDDC) for approval.
- The negotiation team with representatives from MoFED (lead), Attorney General's office and the line ministry under which the project falls is charged with negotiating the loan terms.
- The draft loan agreement with the terms agreed by the lender and the negotiation team presented to EDDC for approval.
- Upon recommendation of the EDDC, the Minister of Finance signs the loan agreement
- The Minister is required to gazette the terms and conditions of the loan within 60 days of signing the financing agreement. However, there has been concern raised by the Parliament in the past on the disclosure of these terms

5.3 Issuance of Guarantees and On-lending

The Minister of Finance and Economic Development is mandated to issue guarantees in line with the PDMA. According to the PDMA, guarantees are issued to a Person (entity) to support an initiative, which in the Minister's opinion "promotes employment, or the development of natural resources or tourist industry or otherwise in the public interest or in the interest of the economy of Zimbabwe".

The guarantee issuance process includes the following steps:

- An entity seeking a guarantee sends an application to the respective line ministry for approval and onward submission to the MoFED
- The Public Sector Investment Programme Department within the MoFED grants clearance of the request and it is submitted to the PDMO, with the financial statements of the guarantee applicant submitted to the Accountant General's Department for appraisal
- In line with the regulation, the PDMO is expected to undertake a credit risk assessment, based on which, a risk-based guarantee fee is calculated.
- The PDMO provides recommendation to the EDDC on the application.
- The EDDC approves the guarantee application before it is submitted to the Minister for the guarantee issuance.

Despite having provision for the issuance of guarantees in the PDMA, currently there is no framework in place for issuance of guarantees to provide a clear process on how the above operations should be undertaken. This exposes the country to risk of accumulating unsustainable levels of contingent liabilities emanating from government guarantees.

Some of the provisions of the PDMA on management of guarantees which the government has not adhered to include the following:

- The Minister levying a fee on guarantees
- The Parliament of Zimbabwe setting the limit of the guarantees to be issues in any financial year.

The guarantees' issuance process can be further enhanced if a credit risk assessment is undertaken to mitigate government exposure to credit risk from the beneficiaries.

6 Challenges Arising from Debt Crisis

If a country's debt level exceeds repayment capacity, debt service obligations become an increasing function of output level.

Achieving the national as well as Sustainable Development Goals requires significant investments, but governments in developing countries are often limited in their ability to mobilize domestic revenues or private investment. Debt can be an important economic policy tool, especially when used to finance projects with high social or economic return. In addition, during periods of crisis, countercyclical fiscal policy to stimulate the economy is often recommended when there is fiscal space, even though such spending can increase indebtedness.

Theoretical literature suggests that borrowing has a positive impact on investment and growth up to a certain threshold, beyond which it harms growth and the poor. High public debt can inhibit private investment, increase fiscal pressure, reduce social spending, and limit governments' ability to implement reforms.

If a country's debt level exceeds repayment capacity, debt service obligations become an increasing function of output level. This implies that some of the returns from investing in the domestic economy are effectively taxed away by existing foreign creditors, and investment by domestic and foreign investors, and thus economic growth, is discouraged. As debt service obligations continue to rise, going forward, this will divert a larger portion of fiscal revenues away from more urgent spending such as health, education, and infrastructure.

Zimbabwe is in debt distress, and arrears to most of its creditors continue to accumulate. Due to its non-accrual status, the country is ineligible to receive funding from international lenders, notably IMF, the World Bank and the African Development Bank. The government has not been able to borrow from these lenders since 1999, when it started defaulting on its debt. Other traditional bilateral creditors, who normally take a cue from these institutions, particularly the Paris Club members, suspended disbursements of existing loan facilities and also declared the country ineligible for new loans.

As the Government is in arrears to the World Bank, the World Bank's International Development Association (IDA) funding is not available to Zimbabwe, and there have been no investment operations directly channelled through the Government for over 15 years. This has deprived Zimbabwe of a critical source of long-term and predictable development financing and has put a severe strain on stable economic growth and socio-economic development for its population. The Table 13 below shows the opportunity cost Zimbabwe has had to endure over the period 2000 and 2018 compared to peers in the region.

> Zimbabwe is in debt distress, and arrears to most of its creditors continue to accumulate.

Table 13: IDA Disbursements: 2000 – 2018 (US 'Million)

	2000 - 2004	2005 -2009	2010 - 2014	2015 - 2018	Total
Zimbabwe	8	-	-	-	**8**
Zambia	692	253	327	396	**1,669**
Mozambique	643	1,115	1,135	797	**3,690**
Malawi	374	141	331	462	**1,308**
Kenya	553	577	1,862	2,260	**5,252**

Source: World Bank

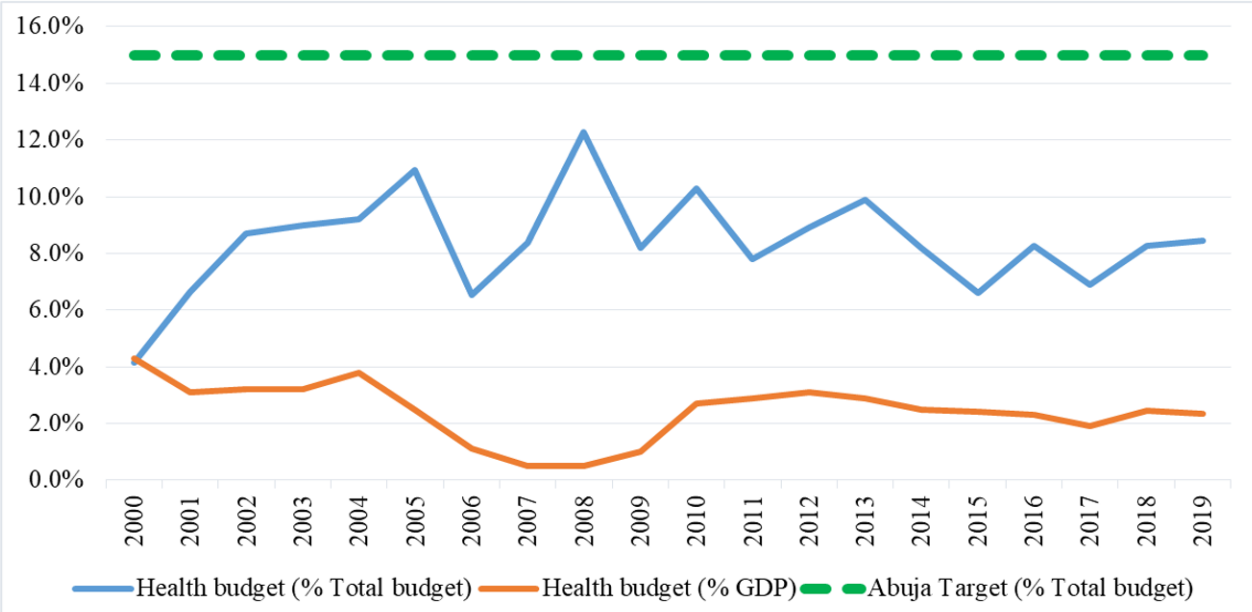
As the table highlights, Zimbabwe received a mere US$8 million in disbursements from the World Bank's concessional window, the IDA, while its peers in the region received in excess of US$1 billion. The opportunity cost increases when potential disbursements from other multilateral lenders are considered.

In order to support economic activity, developed infrastructure is critical. Zimbabwe's anticipated infrastructure investment patterns from 2019 until 2030 will be substantially higher than comparable economies. Infrastructural investment needs in Zimbabwe across the four major infrastructure subsectors, will total US$33.8 billion according to the AfDB estimates (AfDB, 2019). The World Bank puts this estimate at US$40 billion (World Bank, 2014). A long-term strategy cannot be pursued without re-gaining, in the medium-term, access to external financing. The magnitude of the required resources requires augmenting domestic efforts with catalytic bilateral and multilateral financial injections. Access to external finance and investment, is, however, dependant on resolution of Zimbabwe's external debt and arrears. Hence, normalisation of relations with all development partners is central is to unlocking new financing and investment flows in support of the country's recovery and development Agenda.

Limited access to external funding is putting the health sector in a financially vulnerable position. Despite the stated objective of the health financing strategy (2016-2025) to mobilize adequate resources for predictable sustainable funding for the health care sector and increase public spending on health to 15% of government spending, limited access to external funding makes it unlikely for the government to achieve this objective. Together with continued deterioration in economic conditions, this is posing significant challenges to the health sector, ranging from shortage of foreign currency to import essential drugs and equipment, power outages and intermittent fuel supply, which significantly impact on the operations of health care centres, and depreciating local currency and increasing inflation, which erodes the health budget, among others.

At an average of 8.3% of the total government budget over the period 2010 to 2018, Zimbabwe's health care budget was lower than the 15% budget share recommended under the Abuja Target, and the SADC average budget share of around 11.3%.

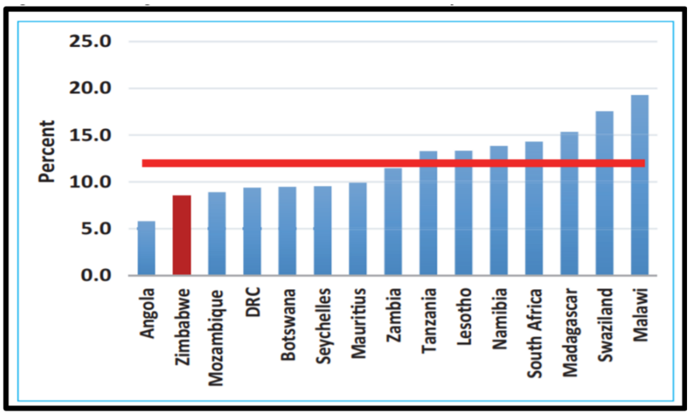
Figure 12: Trends in Health Care Budget Allocations in Zimbabwe (2010-2018)



Source: World Bank and UNICEF (various publications)

Mozambique, Madagascar, Zambia, Tanzania, Lesotho and Malawi, which have comparable income levels, each spend more on health than Zimbabwe and get closer to the Abuja Declaration Target of 15% budget allocation to health. However, except for Mozambique, these countries do not have as deep a debt problem as Zimbabwe.

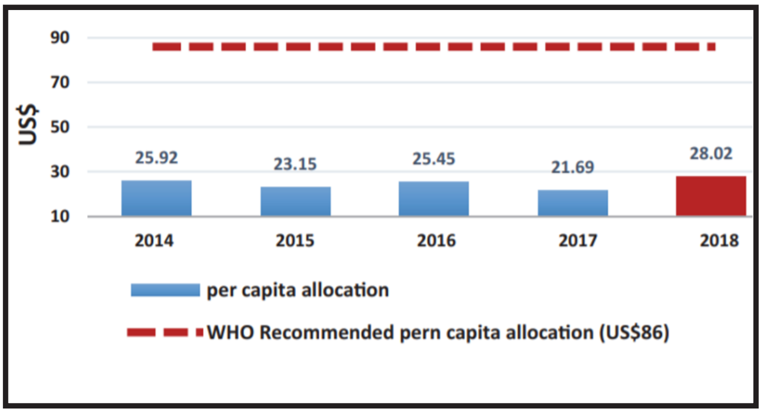
Figure 13: Average Share of Health in Government Expenditure in SADC (2010 to 2018)



Source: UNICEF (2019)

As a share of GDP, the allocation is low relative to the regional average. For example, Zimbabwe's 2018 health care allocation translates to 2.4% of GDP, 4.2 percentage points below the SADC average of 6.6% of GDP. In addition, the 2018 allocation is relatively lower than regional averages and internationally recommended allocation for health in per capita terms. Zimbabwe's per capita allocation of US$24.18 in 2018, is US$57.98 less than the US$86 per capita health spending recommended by WHO.

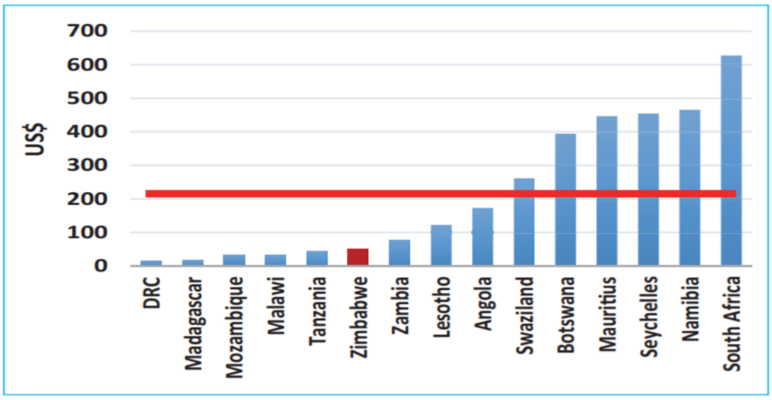
Figure 14: Trends in per capita Health spending in Zimbabwe: 2014-2018



Source: UNICEF (2019)

Furthermore, it is US$106.88 below the SADC average per capita spending which stood at around US$134.90.

Figure 15: Average per capita health spending in the SADC Region (2010 to 2014)



Source: UNICEF (2019)

The low levels of per capita spending cannot guarantee adequate access and quality services for the population, including children. Inadequacy in public health spending by government implies that the health sector will continue to significantly rely on out-of-pocket expenditures and donor assistance, which are both unsustainable. With limited access to external financing and hence limited fiscal space, government's capacity to respond to shocks is also reduced. For example, in response to the materialization of three external shocks, namely the El Niño related drought in 2019, the extensive damage inflicted by Cyclone Idai in 2019 and COVID-19 pandemic in 2020, government resorted to commercial borrowing, collateralized against future commodity exports. While the debt is necessary to assist in the country's response to the economic and humanitarian crisis, it has the potential to further complicate negotiations with external creditors to restore debt sustainability.

The debt crisis has also locked the country out of the international financial markets. This implies that the country can only tap into domestic savings for borrowing which seriously limits investment opportunities at a time when the country requires financial resources in line with its aspirations of becoming a middle-income country by 2030. While tapping into the domestic debt market provides a sound alternative and reduces the country's exposure to exchange risk, it has the potential to crowd out private sector borrowing, thus hampering investment and output growth.
Domestic debt, which was negligible in 2013, increased sharply over the years to more than 25% of GDP in 2018, and was on an unsustainable trajectory. Due the underdeveloped nature of the domestic debt market, the expansionary fiscal stance implied government absorbed much of the available capital from the domestic market, exacerbating the US dollar liquidity scarcity in the economy, and crowding out the private sector. In addition, short-term debt instruments, particularly arrears, central bank advances and T-bill issuance were used to finance the government. This created a huge refinancing risk in the near term, exacerbating uncertainty in government's capacity to service its debt.

The financing of fiscal deficits by the RBZ overdraft facility and Treasury Bills in the context of a nominally dollarized economy became the primary cause of liquidity challenges in recent years. It created electronic deposits or Real-Time Gross Settlement (RTGS) in the banking system. While this enabled the Government to make payments without concomitant increases in US dollar cash balances, it destabilized the banking system and constrained liquidity. The mismatch between US dollar cash balances and RTGS balances has resulted in limits on cash withdrawals from bank deposits, a weakening of exchange rate and inflation. These activities culminated in a significant downturn in the economic performance, which further impoverished the poor and most vulnerable groups in society. Growing difficulties in delivering public services (transport costs, and a severe contraction in public servants' real wages), and demand from some providers (health) to be paid in US dollars is excluding a growing share of population from receiving essential services.

The public sector's exclusion from most international capital markets also makes it vulnerable to fiscal shocks due to a small domestic capital market. Furthermore, the new global banking regulations (such as "Know Your Client") may keep Zimbabwe isolated even after arrears clearance and financial sector restructuring, as international financial institutions might take time to trade with Zimbabwe, given the current high cost of borrowing and high-risk premium ascribed to Zimbabwe

The county's debt and arrears have also inhibited efforts towards attracting the much needed foreign direct investment required to revive and resuscitate the economy through growing local industries and the local economy through meaningful contributions to critical sectors such as agriculture, mining, manufacturing, education and health. The continued accumulation of external debt payment arrears is undermining the country's sovereign creditworthiness, increasing perceived country risk premium and consequently, the cost of accessing regular international financing by the public and private sector.

An additional challenge has arisen that adds to the vulnerability of the Zimbabwean economy: greater de-risking by banks and renewed challenges to offshore financial centres. De-risking in which banks tighten lending to countries at greater risk leads to the loss of corresponding relations with international banks. De-risking strategies by many large global banks could cripple investment, remittance flows and economic growth in the country.

Thus, Zimbabwe's debt overhang is impeding the country's access to external financing and hampering the economic and social transformation agenda. Successful resolution of the external payment arrears is expected to send strong signals to the international community, reduce the perceived country risk premium, and unlock affordable financing for government and the private sector. This would strengthen investor confidence and increase private financial flows, as well as allow partners to fully support Zimbabwe's development and to help protect the poor.

The continued isolation has also fuelled a tendency toward ideology-driven policies by the government and created a dual narrative about the country. For the government, continued restrictive measures have provided grist for domestic and pan-African politics. For international community, reengagement has become tied to improvements needed in governance, human rights, land tenure security, and electoral reforms. This disconnect in the narrative has not in any way benefited the poor and vulnerable groups in society. Clearing arrears requires the country, and the international community, to confront and reconcile many of the predetermined narratives that have been forged over the years.

"An additional challenge has arisen that adds to the vulnerability of the Zimbabwean economy: greater de-risking by banks and renewed challenges to offshore financial centres."

7 Conclusion and Recommendations

To this end, the country has over the years formulated and implemented policies aimed at revamping the economy such as the ZIMASSET, the current Transitional Stabilisation Plan (TSP) among other initiatives.

Since 2000, the country has been characterised by protracted fragility induced by recurrent cycles of political crises, which drained the country's institutional capacity, especially in core governance functions, service delivery to citizens, and systems to resolve economic and external stresses. Capacity utilisation for the key productive sectors has dwindled over the period. Export performance has also declined inhibiting the country's ability to service its external debt service obligations resulting in the accumulation of arrears. The external debt arrears situation has hindered the country's access to the much-needed financing to meet its development needs and may negatively affect the attainment of the Sustainable Development Goals.

To this end, the country has over the years formulated and implemented policies aimed at revamping the economy such as the ZIMASSET, the current Transitional Stabilisation Plan (TSP) among other initiatives. In addition, the Government has accelerated its re-engagement efforts with external creditors and related institutions and agencies with a bid to unlock new financing.

Furthermore, the Government of Zimbabwe has made commendable strides in strengthening public debt management operations in Zimbabwe with the enactment of the Public Debt Management Act in 2015 as well as the establishment of the Public Debt Management Office although issues of adherence to some legal provisions remains key. The introduction of the auction system is an essential step in the development of the local currency bond market, a pivotal source of financing in the wake of dwindling financing from traditional external concessional sources. The country is currently faced with a low fiscal space which has resulted in its inability to meet the debt service obligations, hence accumulation of arrears. The accumulation of arrears since year 2000 as well as shallow local currency bond markets continue to constrain economic development as the country is unable to access the required financing. This situation has negatively impacted the attainment of the Sustainable Development Goals.

7.1 Recommendations

In the absence of an arrears clearance resolution, the current debt situation will continue to stifle the country's growth and development as it negatively impacts the resource mobilisation initiatives by the government. Comprehensive reforms remain pivotal to the implementation of the government's arrears clearance and re-engagement initiatives. Re-engagement and arrears clearance is crucial in ensuring the Zimbabwe's public debt returns to a sustainable path. Although the government of Zimbabwe has crafted various debt relief and arrears clearance strategies, these have not yielded any results to date. A comprehensive and realistic approach is required in resolving the crisis. In addition, commitment to resolve this challenge should be shared across all levels of stakeholders. To this end, the government should consider some of the following issues in resolving the debt challenge:

- Ensuring policy consistency: this is an important aspect to communicating Government's commitment to reforms and its effort to enhance economic stability and growth. This also includes government's commitment to operate within the agreed benchmarks under the Staff Monitoring Programme with the IMF. Policy inconsistencies and reversal have been one weakness within the current environment. Economic reforms were important in the debt relief process.

- The success of the re-engagement process is not the sole responsibility of the government as it should be all inclusive. Experience elsewhere has shown that stakeholders such as non-governmental organisations and development agencies have played a pivotal role in advancing the call for debt relief in other countries. To this end, there is need for government to engage some of these organisations and come up with one **Zimbabwean Statement on Re-Engagement and Arrears Clearance**.

- The need to engage creditors cannot be overemphasised in the process of obtaining debt relief. An important element will be to get a champion from amongst the creditors who can advocate on behalf of the country. Through this engagement with creditors, the country can obtain firm commitments of the amount and nature of relief that creditors will be willing to avail. Such information will then be used in formulating an implementable re-engagement and arrears clearance strategy. A vital component however, will be for government to keep its part of the commitment.

- Transparency is a key component in the debt relief process. Publishing data on economic variables and government borrowing activities is one key component. Stakeholders including creditors need information in making their decision, thus government should always ensure that it is readily available in order to avoid speculations. The publication of the 2018 debt bulletin by the Government of Zimbabwe is a commendable initiative. This should be done continuously and at regular frequencies with more updated statistics. In addition, government operations including public debt should be subjected to audit and the findings audited. This helps in advancing government's commitment of transparency and accountability.

To further enhance strengthen debt management operations in Zimbabwe, below are some key issues for considerations:

- The parliament's role as the custodians of the laws and regulations on the use of public funds is to provide an oversight and ensuring that the provisions are adhered to. Going forward, there is need for Parliament to ensure the debt management operations are aligned to the provisions of the laws such as the requirement to set borrowing limits, report to parliament bi-annually on debt management operations, among other provisions..

- A key tenet of the previous Staff Monitoring Programmes has been the restriction on non-concessional borrowing. Borrowing on non-concessional terms as noted in sections above further worsens the debt position of the country in addition to increasing the cost of government debt which impacts negatively on other government's resource requirements such as social and capital expenditures. To this, Government, where possible should ensure that borrowing is at terms that do not infringe on sustainability though this is a difficult option within the current environment.

- Materialisation of contingent liabilities has contributed to the increase in public debt over the year as noted in earlier sections owing to inconsistent government policy which has created moral hazard as well as the absence of framework for managing contingent liabilities. To this end, Government should put in place a framework for managing contingent liabilities arising from guarantees, on-lending and Public Private Partnership agreements. Furthermore, Government should also ensure that beneficiaries of government guarantee programmes perform in line with the terms and conditions set in the agreements to ensure that these will not be called up as this further worsens the country's debt burden. Government should desist, by all means possible, from issuing guarantees as this has and will continue to create moral hazard among guaranteed entities.

- The domestic debt market is key in providing resources requirements for economic growth. In this regard, government needs to put in place measures to ensure the growth of the local currency bond market. This include putting in place measures that preserve value of domestic debt securities such as curtailing inflation as well as currency depreciation. There is also need for government to adopt a market based mechanism in mobilising domestic market resources so ensure transparency and market development.

- Government should continue to engage in responsible borrowing behaviours which do not negatively impact on future generation. To this end, it is recommended that where possible, Government should reduce the recourse to collateralised external borrowing as has been the trend in the past few years, in order to preserve these resources for future generation.

- Sound practice recommends the formulation of a debt management strategy to guide governments borrowing decisions. Ad-hoc borrowing decisions not based on any strategy can be detrimental to the sustainability of the country's debt portfolio or further worsen the debt position as in the case of Zimbabwe. As noted in the earlier sections, in as much as the country has an approved debt management strategy in place, the strategy has not been implemented to a greater extent as it was premised on the success of the arrears clearance strategy. In light of this, a key recommendation is on the need for the country to formulate a strategy which takes into account the environment in which it will be implemented. The options for the strategy should take into account the financing sources that the country can tap from in arrears environment and in this case the most feasible option could be the domestic debt markets or other emerging creditors. Government then weighs the cost and risk of the available options and come up with a recommended strategy which is implementable.

Annex 1: Loans Contracted From 2010 To 2019

	Facility	Creditor	Date Signed	Amount (USD Millions)
1	Net-One Mobile Network Expansion (Phase 1)	China Exim Bank	Aug-10	45.00
2	Harare Water and Sanitation Rehabilitation	China Exim Bank	21-Mar-11	144.00
3	Medical Equipment Supplies	China Exim Bank	21-Mar-11	89.90
4	National Defence College Project	China Exim Bank	21-Mar-11	98.00
5	Debt Rescheduling Agreement	Sinosure	15-Aug-12	54.50
6	Upgrading of the Victoria Falls International Airport	China Exim Bank	5-Apr-12	150.00
7	Upgradation of Deka Pumping Station	India Exim Bank	21-Jun-12	28.60
8	Kariba South Hydro Power Station Extension	China Exim Bank	11-Nov-13	319.50
9	Kuwait Restructured Facility	Kuwait Fund	31-Dec-13	6.80
10	Brazil More Food International	Government of Brazil	29-Aug-13	98.70
11	Net-One Mobile Network Expansion (Phase 11)	China Exim Bank	25-Aug-14	218.00
12	SMEDCO Facility	BADEA	22-Oct-14	3.00
13	Ministry of Tourism and Hospitality Industry	India Exim Bank	4-Dec-14	49.92
14	Mining Equipment for Hwange Colliery	India Exim Bank	4-Dec-14	13.01
15	Purchase of small scale mining equipment	Xuzhou Construction Machinery Group (CMG) of China	8-Dec-14	100.00
16	First Education Project	OFID	9-Oct-15	20.00
17	Upgradation of Bulawayo Thermal Power Station	India Exim Bank	27-Oct-15	87.00
18	Tel-One Broadband and Network Expansion	China Exim Bank	1-Dec-15	98.60
19	Construction of Hwange 7&8 Thermal Power Stations	China Exim Bank	30-Jun-16	998.00
20	Poverty Alleviation Project	OFID	23-Aug-16	7.60
21	Zhove Irrigation Project	Kuwait Fund	24-Mar-17	20.00
22	BADEA Restructured Facility	BADEA	19-Jul-17	21.00
23	Smallholder Irrigation Revitalisation Project	OFID	8-Mar-18	15.00
24	Robert Gabriel Mugabe International Airport	China Exim Bank	13-Apr-18	153.00
25	Financing of the purchase price of Commodities by the Importers from the Sellers	GEMCORP CAPITAL LLP	8-Sep-18	250.00
26	Amendatory Agreement to the Deka Pumping Station and River Water Uptake System Project	India Exim Bank	3-Jun-19	19.50
27	Upgradation of Bulawayo Thermal Power Station Project	India Exim Bank	3-Jun-19	23.00
28	Net-One Mobile Network Expansion Project (Phase III)	China Exim Bank	26-Jun-19	71.00

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