

Debt Sustainability In Fragile Economies: The Case Of Zimbabwe

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Abstract

Zimbabwe's efforts to reduce domestic and external debt to lower levels remain futile. It continues to grow. In December 2018 domestic debt stood at 98% of GDP, external debt at 70%. It has accelerated the re-engagement with the World Bank, IMF, AfDB and EIB and bi-lateral creditors. The study sought to analyse the sustainability of the growth in Zimbabwe's debt. The objectives were namely to identify the key fiscal and macroeconomic variables that influence public debt dynamics in Zimbabwe; assess the effects of unsustainable debt on economic growth and development in Zimbabwe; and to explore strategies of managing debt sustainability. Data was collected through in-depth interviews and questionnaires. The study concluded that Zimbabwe's debt is not sustainable due to non concessionary debts, limited productivity and weak institutional frameworks. Government should conduct a comprehensive debt audit to determine legitimate and illegitimate public debt, strengthen institutions and regulatory framework.

Keywords: Debt sustainability, debt sustainability theory, external debt, domestic debt, debt trap.

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1. INTRODUCTION

The attainment of sustainable growth and development remains an important objective of macroeconomic policies in many countries especially in fragile economies such as Zimbabwe. Most of these fragile economies are characterized by low capital formation due to low levels of domestic savings and investment.^[1] In order to perform efficiently and effectively, most countries require aid and debt to augment their low savings and revenues.^[2] Whenever fragile economies are faced with scarcity of capital they resort to borrowing from either internal or external sources to supplement domestic savings. In the best of times debt relaxes the domestic constraint on savings, consumption and finances investment. However, in the worst of times it is associated with debt overhangs, banking system collapses, exchange-rate crises and inflationary implosion.^[3] Therefore, borrowing can be considered as a second best option or alternative to capital formation during periods of depression in an economy. However, this borrowing should be sustainable as countries risk being trapped in debt. Zimbabwe has not been spared in this debt overhang dilemma. Its external debt has continued to escalate in the last four decades, cutting off the country from access to most external financing sources. In particular, Zimbabwe remains unable to access the International Monetary Fund (IMF) resources because of its continued arrears to the Fund. Debt sustainability plays an important role in the analysis of macroeconomic policies in low and middle-income countries (IMF, 2011). As a result, the debt sustainability assessments are a standard element of IMF Article IV and program reviews. In addition, they play an integral

role in Paris Club negotiations on debt rescheduling and figure prominently in determining the grant versus loan components of IDA14 allocations to low income countries.

The fiscal deficit of a government is defined as the excess of government expenditure over government revenue.^[4] At any point in time, the accumulated value of this deficit is the public debt. Thus, the deficit is a flow whereas the debt is a stock. High fiscal deficit impinge on the economy in several ways. A high fiscal deficit alters the allocation of resources between the private and the public sectors.^[5] The fiscal policy stance can be regarded as unsustainable if, in the absence of adjustment, sooner or later the government would not be able to service its debt (ibid). Unsustainable debt levels can lead, and have led, to major disruptions in economic activity and to reorientations of priorities in an economy.

Maintaining debt to sustainable levels has remained a major challenge for many developing countries especially in Sub-Sahara Africa, where there is huge development needs as indicated by large infrastructure gaps, high poverty levels, and below standards for health and education, with an estimated 43.7% of the population living below US\$1.90 per day.^[6] In the LDCs, domestic resources are far less than the financing requirements; hence they tend to borrow from external sources. However, the traditional and concessional sources of credit have been shrinking since the financial crisis of 2008. Zimbabwe has an economy that is heavily dependent upon its primary commodities in the agriculture and the mining sector. There are two major sources of debts in Zimbabwe, internal and the external sources. The internal sources include development

stocks, treasury bills, treasury certificate, treasury bonds and central bank overdrafts, while external debt sources include bilateral and multilateral sources such as World Bank, IMF and the African Development Bank. The gross increase in the total debt stock has exposed Zimbabwe to high debt burden. As at 31 December 2017, Zimbabwe's public debt stood at US\$15.3 billion (80% of GDP).^[7] Zimbabwe's high debt burden has had grave consequences for the economy and social welfare safety nets.

Large debt service payment obligations and debt burden have depressed investment and hence economic growth through its illiquidity and disincentive effects. Zimbabwe is the midst of resource underutilization, high levels of poverty and infrastructural decay. Zimbabwe's public debt grew gradually in the 1980s during its reconstruction period. The debt, mainly external then ballooned in the 1990s and early 2000s. This was attributed to Economic Structural Programme (ESAP), a series of reforms prescribed by the IMF and the World Bank. Under ESAP the Zimbabwean economy deteriorated to an extent that by 1999 it could hardly service its debts.

A basic principle of loan contraction and management is that contracted loans should grow the economy, improve social wellbeing and enhance capacity to repay, however, for Zimbabwe it has been different as the debt appear to have led to a crisis. All the ESAP loans failed to improve the economy. In 2010, US\$4.8 billion or about 70% of this external debt was in accumulated arrears. As long as Zimbabwe is unable to service its debts, growth in arrears will continue unrestrained. By 2012 Zimbabwe's external debt stood at more than US\$9 billion owing largely to accumulated arrears.

In 2017 alone, the Government of Zimbabwe increased its borrowing requirements to US\$2.9 billion comprising of financing of fiscal deficits of \$1.7 billion (9.4% of GDP) and debt repayment for maturing debt obligation amounting to \$1.2 billion. This budget deficit was financed through the issuance of Treasury Bills and the recourse to the overdraft facility with the Reserve Bank of Zimbabwe (RBZ). The trend was expected to increase owing to a projected budget deficit of US\$672.3 million (3.5% of GDP) in 2018. Zimbabwe just like any other Less Developed Economies has relied on both external and domestic finance to fund its developmental projects.

Zimbabwe has not been able to pay its external and domestic obligations for sometime against the background of progressive decline in export performance and the depletion of the foreign currency reserves. The meagre foreign currency resources available have been allocated towards critical social needs such as education and health delivery systems. This coincides with a period when the economy had entered into a sustained phase of economic decline and hyperinflation.

Zimbabwe is in the process of drafting a cocktail of measures to expunge the debt obligations. The debate on the debt resolution issues in Zimbabwe has been taking place in the absence of a proper analytical background or framework that captures the real dynamics behind the impact of public debt on economic growth. Reinhart et al (2003) posed a "debt intolerance" question pointing out that debt defaults have often occurred in emerging market economies with moderate debt levels and in addition, they asked why emerging market economies have defaulted so often compared to advanced economies with comparable or even higher debt burdens. It

is against this background that this study sought to analyse the sustainability of the growth in Zimbabwe's debt. The objectives were as follows:

- i. Identify the key fiscal and macroeconomic variables that influence public debt dynamics in Zimbabwe;
- ii. To assess the effects of unsustainable debt on economic growth and development in Zimbabwe and
- iii. Explore strategies of managing debt sustainability in Zimbabwe.

The hypothesis of the study was:

- a. H₀: Public debt does not affect economic growth in Zimbabwe

The study assumed that the Keynesian theory of public borrowing holds and its theoretical framework holds. The Keynesians view fiscal policy as the best policy that brings about growth and development in any economy since it acts in the interest of the general public. According to Keynes, when the governments embark on borrowing to finance its expenditure, unemployed funds are withdrawn from the private pockets and as such the consumption level of the private individuals is unaffected. These funds when injected back into the economy by the government lead to a multiple increase in aggregate demand causing an increase in output and employment. This according to Keynes is the multiplier effect of government expenditure.^[8] The study also assumed that the Ricardian Equivalence does not hold and that public debt can affect real variables. If the Ricardian Equivalence does not hold, the decrease in public savings brought about by a higher budget deficit will not be fully compensated by an increase in private savings. This study was guided by the debt sustainability theory from Ferrarin et al (2012),^[9] whose study was to establish public debt sustainability in India. The Ferrarin et al (2012) study however, assumes that the central bank does not finance any part of the public debt which is different from the Zimbabwean case where the Reserve Bank of Zimbabwe (RBZ) overdraft facility is used. Therefore, any excess of government expenditure over government taxation must be financed through government borrowing by issuing bonds.

2. MATERIALS AND METHODS

The study chose the pragmatism research philosophy as it mixes the two major designs, the qualitative and quantitative. Note that mixed methods, both qualitative and quantitative, are possible, and possibly highly appropriate, within one study.^[10] The study used the non-probability purposive sampling. Purposive sampling was used in order to access the views/opinions. Specific participants for interviews were selected due to their strategic positions. Face to face open ended in depth interviews were held with economic and debt experts from the Ministry of Finance and Economic Department's (MoFED) Debt Management Office; the RBZ's Debt Office and the African Forum and Network on Debt and Development (AFRODAD). In addition, 60 self-administered questionnaires were distributed via e-mail, and by hand to the following organizations namely the MoFED, the RBZ, AFRODAD and ZIMCODD.^[11] Some of the questions were Likert scaled. Of the ten scheduled in-depth interviews, seven were held, and of 60 questionnaires distributed, 45 were completed.

3. RESULTS AND DISCUSSION

All the respondents for both interviews and questionnaires held the view that the debt level in Zimbabwe was not sustainable. It is not able to repay the accumulated debts which are mainly

financing consumption as opposed to financing capital.

4. THE QUESTIONNAIRES

Several reasons were given to causes of high debt levels. These were poor governance, failure to service previous debts, inherited debts, mismanagement of debt resources, recurring fiscal and current account deficits, declining economic activity and exogenous shocks such as the decline in international commodity prices. The causes of high levels of debts in Zimbabwe were attributed to growth in imports, recurring fiscal deficits, non-concessionary debts, weak government institutions, corruption, limited productivity and inadequate investment in infrastructure. This has resulted in low investment inflows, high risk profile, poverty, unemployment, low economic growth, corruption and illicit financial flows. Respondents argued that ensuring fiscal sustainability will assist in reducing the use of debt creation instruments. They indicated that the reason behind borrowing in most countries was to finance the gap created between revenue generation and expenditures, hence fiscal discipline will eliminate the need for borrowing. Persistent government deficit has kept Zimbabwe in a debt trap and the deficits have caused an exponential increase in external debt. Following disagreements with the international financial institutions, both the IMF and the World Bank withdrew financial assistance to Zimbabwe in 2000; the government resorted to domestic borrowing which led to a rise in domestic debt in early the 2000s. Since 2012 the government has been attempting to meet the current spending whilst paying interests and penalties on external debts. The following were put forward as the strategies needed to enhance fiscal sustainability in Zimbabwe:

- i. Fiscal discipline. There is need to reduce fiscal expenditure as which would reduce over borrowing from both the external and domestic market by the government;
- ii. Improving productivity;
- iii. Good governance (zero tolerance to corruption and curbing illicit financial flows) and enhance domestic resource mobilisation;
- iv. Import substitution policies so as to reduce the import bill;
- v. Contraction of debt should concentrate on concessionary loans;
- vi. Servicing of previous debts so as to reduce accumulation of arrears and penalties;
- vii. The need for Zimbabwe to embark on a comprehensive debt audit to determine legitimate and illegitimate debt.

5. THE INTERVIEWS

The interviewees indicated that Zimbabwe's economic growth was under threat from debt overhang. Interviewees from RBZ, and MoFED indicated that debt levels for Zimbabwe were estimated to be US\$17.29 billion in 2018, disaggregated as external debt of US\$7.66 billion and domestic debt amounting to US\$9.63 billion. The interviewee from the MoFED's Debt office revealed that the Zimbabwean issue remains unique and challenging in that the country's indebtedness has been exacerbated by the huge debt arrears currently at over 76% of the total external debt. The interviewees indicated that the debt levels which were 97% of GDP before rebasing of the country's GDP from US\$18 billion to US\$25.8 billion is now at around 70.3% of GDP. AFRODAD indicated that apart from the external

debts the Zimbabwean government has continued to borrow excessively from domestic sources, as a result the country was facing difficulties in repaying the debts. Domestic debts that were accumulated through the issuance of Treasury Bills were affecting economic growth. Zimbabwe has little chance of emerging from the debt trap even in the long run hence the need for debt restructuring as well as ramping up international support for debt forgiveness.

Interviewees from MoFED indicated that the huge domestic debts were mainly caused by the limited or lack of external lines of credit. Therefore, under such a scenario domestic borrowing became the only option. However, the fact that Zimbabwe has been using the multi-currency system where the USD is the dominant currency meant that the implications of both the external and domestic debt on the economy are the same. They indicated that it is not by accident that the country is faced with infrastructure deficiencies, weak social service delivery, foreign currency and cash shortages, unsustainable budget and current account deficits and emerging inflationary pressures and these are as a result of heavy debt. Following the rebasing of the GDP in 2018, the debt levels in Zimbabwe are now in line with its Public Finance Management Act which states that the debt levels should not exceed 70% of GDP. MoFED officials indicated that Zimbabwe was pursuing different strategies to manage the debt to sustainable levels. They argued that there was nothing out of the ordinary with borrowing to finance government programs.

ZIMCODD officials indicated that Zimbabwe was in violation of the SADC Protocol on Finance and Investment, which makes Zimbabwe bound by the SADC debt sustainability threshold compelling member states to maintain public debt to GDP ratio to below 60%. Despite this provision, Zimbabwe set its debt to GDP ratio at 70% in violation of the regional benchmark. Despite having such comprehensive national and regional frameworks, ZIMCODD noted that compliance with the legislative provisions, in particular, relating to loan acquisition and debt management, has generally been low.^[12] The levels of debt in Zimbabwe are difficult to quantify although official data indicates that external debt continued on an upward trend reaching US\$7 billion in 2015 up to US\$7.5 billion in 2017. By the end of 2017, with the increasing domestic debt, the total publicly guaranteed debt stood at US\$14.642 billion, rising to above US\$17.3 billion as of August 2018 but the figures were not clear given that the RBZ continues to accumulate other debts from the Afreximbank. Only a comprehensive debt audit will give actual figures.

AFRODAD officials indicated that despite such huge debt, the government of Zimbabwe has continued to borrow excessively from domestic sources. Huge debt levels had negative implications on intergenerational equity as a greater proportion of development resources for subsequent years is pre-empted to debt service at the expense of growth, employment creation, maintenance of critical services and infrastructure development and has undermined the government's ability to fulfill its social and economic rights obligations. Zimbabwe's debt overhang can be viewed in a historical context as it inherited colonial debts which were increased by persistent droughts in 1983, 1985 and 1992 when the country experienced severe droughts which forced government to commit resources for drought mitigation thus worsening the country's debt position hence some of the debt was justified. Certain levels of debt in Zimbabwe are

associated with economic performance, while those for the period 1999 and beyond could be associated with the declining economic performance.

AFRODAD highlighted that the Zimbabwe's indebtedness is a systemic and structural issue that requires both national and global level approaches. There is the need to break the syndrome of relying on external support as it has perpetuated a virtuous cycle of debt since the 1980s. They proposed the following strategies. Fiscal sustainability should be ensured, comprehensive debt audit should be carried out to determine the true and correct levels of debt. A comprehensive debt settlement should be set in and securitization of the mineral resources and institutional frameworks should be strengthened, emancipated. Productivity should be enhanced to ensure generation of revenues to enable repayment of debts.

The high debt levels have resulted in deficiencies, weak social service delivery, poor credit ratings, low public confidence and distrust, foreign currency and cash shortages, unsustainable budget and current account deficits and emerging inflationary pressures. The RBZ noted that the Zimbabwe's foreign currency inflows have been weakening hence it has limited access to foreign currency to facilitate foreign payments of debts. Weak exports competitiveness as well as the withdrawal of foreign investments has affected its ability to service its loans. Exchange rate devaluation increased Zimbabwe's domestic as well as foreign debt levels, making it difficult for the country to expunge its debts.

CONCLUSION

The study revealed that public debt in Zimbabwe remains high and unsustainable. High levels of debts in Zimbabwe have several effects on economic growth. These include limited fiscal space, poor social service delivery, infrastructural decay and high risk profile which causes lenders put a high premium on loans advance. Several strategies can be employed in managing the debt levels in Zimbabwe. These include inter alia ensuring fiscal discipline through reducing fiscal expenditure; reduce over borrowing from both the external and domestic market by the government, improving productivity, ensuring good governance (zero tolerance to corruption and curbing illicit financial flows).

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