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Supplement 1

CONTAINS CONFIDENTIAL
INFORMATION

September 14, 1988

To: Members of the Executive Board

From: The Acting Secretary

Subject: Zimbabwe - Staff Report for the 1988 Article IV Consultation

The attached supplement to the staff report for the 1988 Article IV consultation with Zimbabwe has been prepared on the basis of additional information.

Ms. Dillon (ext. 8313) or Mr. Callender (ext. 8750) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

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ZIMBABWE

Staff Report for the 1988 Article IV Consultation - Supplementary Information

Prepared by the Staff Representatives for the 1988 Consultation with Zimbabwe

Approved by A.D. Ouattara and H.B. Junz

September 13, 1988

The following information supplements the staff report for the 1988 Article IV consultation with Zimbabwe (SM/88/206, 8/30/88). Section I describes the fiscal outturn for 1987/88 (July-June), based on preliminary actual data, and the budget for 1988/89, which was presented to Parliament on July 28, 1988. Section II describes changes in the exchange and trade system introduced since the consultation discussions, and Section III supplements the earlier staff appraisal.

I. The 1987/88 Fiscal Outturn and the 1988/89 Budget

The preliminary actual data on the budget outturn for 1987/88, which are set out in the accompanying table, are broadly in line with the estimates presented in the staff report (Table 2 in SM/88/206). Total central government revenue and grants turned out to be Z$49 million (0.4 percentage point of GDP) higher than the earlier estimate, attributable primarily to better-than-expected customs duties collections. However, higher net lending and interest payments than originally estimated led to total expenditure and net lending Z$81 million (0.7 percentage point of GDP) greater than the estimate in the staff report. 1/ As a result, the overall deficit of the Central Government (including grants) in 1987/88 is now calculated to be 8.9 percent of GDP—an upward revision of 0.3 percentage point of GDP. With no change in the estimated parastatal losses and government subsidy payments to these enterprises, the limited public sector deficit is estimated to have widened by an equal magnitude to 8 percent of GDP.

The 1988/89 budget projects an increase in the deficit (excluding grants) of about 1 percentage point of GDP, to 11 percent. This deterioration in the fiscal position is accounted for entirely by a decline in revenue relative to GDP, as total expenditure and net lending

1/ A large part of the increase in net lending was in the form of new long-term loans to parastatals, which exceeded the original 1987/88 budget by Z$40 million (0.4 percent of GDP).

is expected to grow at a rate slightly below that of nominal GDP. With grants showing only a marginal increase in relation to GDP in the budget, the financing requirement of the Central Government is expected to increase by 0.8 percentage point of GDP, to 9.7 percent. Nearly 90 percent of the borrowing need is expected to be covered from domestic sources, of which about 35 percent will be met by the banking system.

The projected decline in the revenue/GDP ratio is wholly attributable to the expected fall in nontax revenue of more than 1 percentage point of GDP, because the budget will not benefit as it did in 1987/88 from the large transfer of profits from the Reserve Bank of Zimbabwe related to its sale of certain external securities. Although the impact of the acceleration in the payment schedule of company taxes, which contributed significantly to the buoyancy of tax revenue in 1987/88, will also be absent, taxes from income and profits are still expected to increase marginally in relation to GDP, largely on account of the relatively strong economic growth in 1988. The 1988/89 budget contains various minor revenue measures, including small increases in the customs duties on motor spirit and diesel (to be borne completely by the National Oil Company of Zimbabwe, which has been generating a surplus from its operations in the last two fiscal years, and with no change in the retail prices of these products) and excise duties on beverages and tobacco products. As a percentage of GDP, the additional revenue to be generated from these measures is not expected to be significant and, in any case, will be offset to some degree by the introduction of various tax exemptions and concessions.

While total expenditure and net lending is projected to fall marginally by 0.2 percentage point of GDP, the budget provides for a much lower current expenditure (by 0.7 percentage point of GDP) and higher capital expenditure (by 0.4 percentage point of GDP) than the preliminary 1987/88 outturn. The projected decrease in current expenditure stems largely from reductions in the budgeted subsidy payments to parastatals (by 0.6 percentage point of GDP) and other transfer payments (by 0.5 percentage point of GDP); the budgetary provision for the export subsidy scheme, at Z$58 million (0.5 percent of GDP), is, however, more than double the level of the previous fiscal year. The wage bill is budgeted to grow in line with nominal GDP, despite the fact that a large proportion of the impact of the across-the-board wage adjustment that was announced in February 1988 will be felt during this fiscal year (the 1988/89 budget does not provide for any additional wage adjustment). An anticipated improvement in project implementation is largely responsible for the higher budgetary provision for capital expenditure. On a functional classification basis, outlays on education (over 8 percent of GDP) and defense (over 6 percent of GDP) continue to exert a heavy burden on the budget.

If the combined operating losses of parastatals were to remain at the 1987/88 level of Z$373 million (implying a fall of 0.5 percentage point of GDP), the 1988/89 budget would lead to a widening of the limited public sector deficit (including grants) by about 1 percentage point of GDP to 8.9 percent, reflecting largely the deterioration in the central government fiscal position.

In his budget statement to Parliament, the Honorable Dr. B.T.G. Chidzero, Senior Minister of Finance, Economic Planning and Development, acknowledged that the 1988/89 budget is a standstill budget--it contains neither fundamental policy reforms nor measures to allow Zimbabwe to overcome the deficit impasse. In particular, he noted that he had not yet found ways to reduce spending on defense, education and subsidies to levels that would help to narrow the fiscal imbalance, and he expressed strong concern regarding the operational performance of parastatals and the rate of debt accumulation.

II. Exchange and Trade System

Some changes in Zimbabwe's exchange and trade system intended to promote new investment were announced by the Government in the 1988/89 budget. These included (1) permission for those foreign companies that bring into Zimbabwe equity in the form of plant and equipment to qualify (as was already the case for new equity in the form of foreign currency funds) for new venture capital status and the right to remit 50 percent of their after-tax profits; (2) an increase in the period for exchange risk cover from the present six months to five years; and (3) the extension of that exchange cover scheme, previously limited to import and export transactions, to the principal amount of approved external borrowings. The use of the exchange risk cover scheme is voluntary and premia will be paid of 3 percent per year for contracts for forward purchases of exchange by the Reserve Bank of Zimbabwe and of 5 percent per year for contracts for forward sale of exchange by the Reserve Bank. (The average annual nominal effective depreciation of the Zimbabwe dollar over the five years to January 1988 was 7.8 percent.) During a follow-up discussion in Washington on August 29, 1988 the staff noted that, while the implementation of this scheme is consistent with the authorities' objective of stimulating investment, it could impose a serious constraint to the achievement of the overall objectives of macroeconomic policy. In particular, if the authorities undertake the type of active exchange rate policy that the staff considers would be necessary to support a trade liberalization program, the scheme would likely lead to substantial subsidy payments by the Government, thereby exacerbating the budgetary problem. The Zimbabwean representatives said that it was not the intention of the Government to provide a subsidy through this scheme and that they would continue to monitor carefully exchange rate developments and to review accordingly the premium rates for new contracts.

III. Staff Appraisal

Although the 1988/89 budget provides for a lower level of current expenditure in relation to GDP than that of the previous fiscal year, the overall deficit is still high and unsustainable. The lower level of expenditure is achieved through a drop in the projected subsidy payments to parastatals, which would help to narrow the limited public sector deficit only if the financial performance of these enterprises were to improve concomitantly. As noted in the staff report, the large budget deficits in recent years have resulted in the rapid accumulation of outstanding government debt and sharp rises in the associated interest payments. Unless effective measures are taken quickly to narrow the fiscal imbalance, the current rate of debt accumulation is untenable. The 1988/89 budget, if implemented without major changes, would not provide an adequate framework to avert the deteriorating fiscal position. The staff therefore urges the authorities to take prompt actions to reduce the budgetary deficit, particularly through increasing government savings, and to strengthen the financial position of parastatals.

The staff welcomes, as a step in the right direction, the authorities' decision to allow foreign companies making equity investments in the form of plant and equipment to remit 50 percent of their after-tax profits on those investments. However, the forward exchange cover arrangement is a cause for concern as it could either inhibit necessary exchange rate action or result in exchange losses and worsen the budgetary problem. While the authorities intend to monitor the scheme closely to avoid incurring losses, the staff considers that it will be difficult--particularly in the context of a major trade liberalization--for the authorities to project accurately the needed exchange rate adjustments and, in effect, to announce them through changes in the required premia. The staff notes that substantial losses would in fact have been incurred if the system, with the announced premium rates, had been in place over recent years. The staff urges the authorities to reconsider the recent extension of the exchange risk cover scheme.

Zimbabwe: Summary of Operations of the Limited Public Sector, 1/
1982/83-1987/88

	1982/83	1983/84	1984/85	1985/86	1986/87 2/	1987/88 Estimated outturn 3/	1987/88 Prel. actuals	1988/89 Budget
	(In millions of Zimbabwe dollars)							
Central government revenue and grants	1,817.7	2,037.4	2,317.7	2,626.4	3,061.0	3,735.8	3,784.9	4,211.0
Total revenue	1,765.0	1,943.6	2,131.4	2,519.3	2,954.7	3,615.8	3,661.3	4,051.0
Tax revenue	1,579.5	1,743.5	1,902.1	2,247.7	2,638.1	3,082.1	3,108.4	3,576.0
Nontax revenue	185.5	200.1	229.3	271.6	316.6	533.7	552.8	475.0
Grants	52.7	93.8	186.3	107.1	106.3	120.0	123.6	160.0
Central government expenditure and net lending	2,246.4	2,618.5	2,841.6	3,303.8	4,072.5	4,635.2	4,716.0	5,373.7
Current expenditure	1,820.0	2,223.2	2,438.1	2,905.3	3,530.2	3,964.2	3,987.1	4,494.5
Capital expenditure	191.9	208.7	203.2	221.2	293.1	432.0	408.7	521.3
Net lending	234.5	186.5	200.3	177.3	249.2	239.0	320.3	357.9
Central government deficit (-) 4/	-428.7	-581.1	-523.9	-677.4	-1,011.5	-899.4	-931.2	-1,162.7
Plus parastatal losses (-)	-297.3	-264.5	-331.8	-386.8	-350.8	-372.9	-372.9	-372.9 5/
Less government transfers to parastatals	103.8	207.1	324.6	306.0	403.5	466.4	466.4	463.6 6/
Limited nonfinancial public sector deficit (-) 4/	-622.2	-638.5	-531.1	-758.2	-958.8	-805.9	-837.7	-1,072.0 5/
	(In percent of GDP) 7/							
Memorandum items:								
Total revenue and grants	31.9	32.2	33.0	31.9	32.9	35.7	36.1	35.1
Total revenue	31.0	30.7	30.4	30.6	31.8	34.5	34.9	33.8
Tax revenue	27.7	27.6	27.1	27.3	28.4	29.4	29.7	29.8
Nontax revenue	3.3	3.2	3.3	3.3	3.4	5.1	5.3	4.0
Grants	0.9	1.5	2.7	1.3	1.1	1.1	1.2	1.3
Total expenditure and net lending	39.4	41.4	40.5	40.1	43.8	44.3	45.0	44.8
Current expenditure	31.9	35.2	34.8	35.2	37.9	37.8	38.1	37.4
Capital expenditure and net lending	7.5	6.3	5.8	4.8	5.8	6.4	7.0	7.3
Central government deficit (-) 4/	-7.5	-9.2	-7.5	-8.2	-10.9	-8.6	-8.9	-9.7
Parastatal losses (-)	-5.2	-4.2	-4.7	-4.7	-3.8	-3.6	-3.6	-3.1 5/
Central government transfers to parastatals	1.8	3.3	4.6	3.7	4.3	4.5	4.5	3.9 6/
Limited nonfinancial public sector deficit (-) 4/	-10.9	-10.1	-7.6	-9.2	-10.3	-7.7	-8.0	-8.9 5/
Central government financing (net)	7.5	9.2	7.5	8.2	11.0	8.6	8.9	9.7
External financing	0.9	0.8	7.0	2.6	2.3	1.1	1.4	1.1
Domestic financing	6.6	8.4	0.5	5.7	8.7	7.5	7.5	8.6
Banking system	1.9	3.3	-3.9	-2.7	0.8	2.4	1.2	...
Nonbank borrowing	4.8	5.1	4.4	8.4	7.9	5.1	5.3	...

Sources: Financial statements; data provided by the Ministry of Finance, Economic Planning and Development; and staff estimates.

1/ Comprises the Central Government and selected public enterprises.
2/ Revised.
3/ As shown in Table 2 of the staff report (SM/88/206).
4/ Including grants.
5/ Based on the assumption that the combined parastatal losses in 1988/89 will remain unchanged at the 1987/88 level in Zimbabwe dollar terms.
6/ Includes an amount of Z$140 million officially classified as grants to the Zimbabwe Steel Corporation.
7/ For 1987/88 and 1988/89, calculations are based on nominal GDP growth of 12.6 percent and 14.6 percent, respectively; the corresponding real GDP growth rates are 2.2 percent and 2.8 percent, respectively.