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Structural Adjustment and the Effect of Drought: The Case of Zimbabwe

by

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Structural Adjustment and the Effect of Drought:
The Case of Zimbabwe

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Abstract

This paper examines the Economic Structural Adjustment Programme (ESAP) of Zimbabwe and considers the effect of drought on the realisation of targets set in the ESAP.

The paper concludes that (i) the ESAP was introduced before the debt problem was serious, (ii) the structural repairs were necessary, (iii) the ESAP contained many elements designed to counter the oft-quoted adverse effects of SAPs and (iv) the drought seriously affected the realisation of many of the targets set in the ESAP.

Introduction

The Zimbabwe Economic Structural Adjustment Programme (ESAP) was launched in 1991. The objectives of the programme included the correction of macroeconomic imbalances in relation to balance of payments and the budget, and the removal of microeconomic distortions, particularly in relation to prices, but also deriving from the regulatory framework. The ultimate objective was to generate an environment where real living standards would increase in the long run at a rate faster than under a continuation of existing policies. This is the final year of the Programme, and while it is still too early to judge the long-term impact of the changes, the macro-performance of the economy remains well below that expected at the time the Programme was launched. The drought had a significant impact on performance and has been a major contributory factor to the non-realisation of some of the targets.
Section I. Economic Reform in Zimbabwe

Background

The ESAF was introduced following the decade of the 1980's, when, although much progress had been made in relation to the provision of health services and the extension of education, the macroeconomy performed poorly, with GDP growth at 2.7 per cent per annum, contrasting with population growth of 3.4 per cent per annum. Towards the end of the decade, the growth in the labour force - particularly with the flow of school leavers - outstripped the economy's previous employment growth, so that unemployment reached 25 per cent by 1989. Much of the growth in employment in the formal sector that had occurred in the 1980's was in the public sector in the provision of social services, but the public finances were seriously constrained.

The overall budget deficit (i.e. current plus capital borrowing) averaged 10 per cent of GDP over the 1980's, though the bulk of this related to capital expenditure. However relative indebtedness continued to rise - reaching 72 per cent of GDP by 1990. (External debt was 28 per cent of GDP) The ratio of indebtedness to GDP by the end of the decade was lower than in many other countries. Formally, so long as the real rate of interest is lower than the real growth in the economy, the level of debt is not dynamically unstable. The official view in Zimbabwe was that real interest rates were negative, as inflation (consumer prices) averaged 15 per cent throughout the 1980's while nominal interest rates were 12 per cent. Thus, even though the economy was slow-growing the debt issue was less a concern than in many other countries. However, the authorities recognised that interest rates would rise and become positive with the reform programme and the debt would then become explosive. This provided one logical case for correcting the public finance imbalances - i.e. the unsustainability of the end 1990's position. The general view of the authorities may have been too sanguine; the debt/GNP ratio rose throughout the 1980's, the GDP deflator increased by 11.5 per cent rather than the 15 per cent of consumer prices; and capital expenditure did not result in increased output in the long run.

The primary budget deficit throughout the late 1980's was approximately 2 per cent of GDP, and quite small changes in expenditure could transform this into the required surplus to prevent the debt/GDP ratio from becoming unstable.

The ESAF was introduced before the debt/GDP problem became serious and could readily be corrected. The background was thus favourable to a change in policy.

The Economic Structural Adjustment Programme

While the debt/GDP issue often lies behind a SAP these programmes are rarely ever solely about the macroeconomy. The economy performed poorly over an extended period for a variety of structural factors, so that the ESAF not only sought to correct the macro imbalance, it also proposed structural changes, designed to make the economy, which had been heavily regulated since UDI, into a market economy.

The fiscal adjustment of the ESAF involved cuts in current expenditure, charging for services, and reductions in subsidies to public enterprises. The structural changes proposed covered public enterprises, financial sector reform, trade liberalisation and deregulation.

Public Enterprise Reform

Public enterprises were in receipt of direct current subsidies of ZS29 million and a debt reduction of ZS300 million (in 1990/91 fiscal year). Public enterprises in addition were in receipt of indirect subsidies via subsidised loans, freedom from customs duties, and free Government services. The ESAF set out to restructure the sector by making it operate more commercially by reducing the extent of direct Government intervention and by deregulation in relation to pricing, labour and public procurement. The objective was to reduce the extent of direct subsidisation to ZS40 million and the elimination of indirect subsidisation.

Financial Sector Reform

The financial sector had been regulated by a series of direct measures in relation to credit controls, borrowing and lending rates, restrictions of the emergence of new financial instruments and control of entry to the sector. The objective of policy set out in the ESAF is to reverse these entirely - that in
relation to interest rates was already partly in place pre 1991. The ultimate objective is to move to a market determined interest rate, to allow the financial sector to evolve depending on the needs of the economy, and to encourage greater competition by freeing up entry to the sector and reducing market segmentation.

Trade Liberalisation

Pre 1991 Zimbabwe operated an import rationing scheme based on the allocation of foreign exchange. This rationing was carried out by bureaucratic means with an inter-ministerial committee deciding on the allocation of foreign exchange and hence imports. Imports were subject to customs duties, which in turn were subject to a surtax and an import tax. The objective of the ESAP is to move from the administered system to a market based system by this year (1995), with freedom to purchase imports at will i.e. direct access to foreign exchange rather than through the bureaucratic system. (The rationing system in place resulted in shortages of materials and equipment. This is widely believed to have been a major constraint in the export sector) The ESAP set out an elaborate framework for gradually liberalising imports, transforming the tariff and surtax system, and bringing public enterprises into the tax system on their imports. Exchange rate policy, as defined in the ESAP is to shift resources into exports and in the ESAP is to shift resources into exports and maintain export competitiveness.

Deregulation

The economy of Zimbabwe was one of the most tightly regulated in Africa following UDI. These controls were continued and extended after Independence. The ESAF envisaged a gradual relaxation of the regulatory environment in the following areas: Investment Approvals, Pricing and Distribution; Agricultural Prices and Marketing; the Labour Market; Local Government and Transport. The issue of Public Enterprise control has already been referred to. The guiding principle throughout is to increase domestic competition by reducing the regulatory constraints faced by business.

The Social Dimension of the ESAP

The ESAP was designed to improve the overall performance of the economy compared with a do nothing situation. The medium term projections accompanying the ESAP point to an improvement in the rate of growth of GDP, an increase in private investment as a proportion of GDP; a reduction in the relative importance of public expenditure from 48.3 per cent of GDP in 1989 to 41.5 per cent by 1995 and an associated reduction in the public sector deficit from 10.5 per cent of GDP to 5.1 per cent over the same period; a reduction in the rate of inflation from the 16 per cent experienced in 1991 to 10 per cent by end 1995; and finally, a worsening of the balance of payments on current account, as a result of the trade liberalisation, financed by increased grants and concessional lending as well as other lending. Clearly the ESAP depended on external financing. Without this, the likelihood of realising the targets would be remote. Taking the structure of the ESAP there was a recognition that even if the biggest targets were met some groups would suffer. These were identified as

(i) those becoming unemployed as a result of public sector cutbacks, and the elimination of uncompetitive firms in the more competitive environment. However, the impact here was seen as primarily functional.

(ii) those affected by inflation and relative price changes associated with the ESAP. The main channel whereby people were expected to be adversely affected was through a proposed reduction in the subsidy to the Grain Marketing Board. In order to counter this the intention was to liberalise grain marketing and to reserve some of the subsidy savings to deal with specific problems.

(iii) those affected by reductions in social services or increased charges for services. In order to reduce the impact, the ESAP planned to maintain the relative importance of health expenditure in GDP, to reduce the degree of subsidisation of better off schools, and to charge for some services for those whose incomes are above a certain level.
Conclusion

The ESAP was a very ambitious programme. The medium term projections were based on a belief that the economy was supply constrained due to an absence of materials and equipment, and due to the extent and severity of the regulatory environment. The reduction in the public deficit, with its counterpart on the balance of payments, released external resources and these when supplemented by increased foreign transfers were expected to be sufficient to allow the private sector to overcome the direct supply shortages. Together with the micro reforms this was expected to result in the projected growth. Overhanging all this was a concern about the level and the growth of debt, which had the capacity to become explosive.

Section II The Impact of the 1992 Drought

The ESAP was formulated at a time when the world economy had experienced a decade of sustained growth, and after the establishment of stable institutions following independence. This relative stability was destroyed within a short period. In 1992 the country experienced its worst drought in recorded/living memory, the world economy was in deep recessions and simultaneously the authorities were attempting systemic change. As a consequence, the growth performance of the economy deteriorated, the public finances worsened, both in response to the drought induced recession and as Government sought to cushion the effect of drought on the population, the balance of payments worsened, and inflation rose.

In output terms, the initial impact of the drought was a reduction of 6.25 per cent in GDP. At a sectoral level, agricultural output fell by 25 per cent, with the decline in maize production catastrophic, but with wheat and soya bean production also adversely affected. Manufacturing output also fell, but the drought effect is not clear - there were shortages of materials in the second half of the year, domestic demand weakened as drought affected incomes, but some sectors e.g. clothing and textiles, were experiencing competition from outside following the trade liberalisation.

The agricultural sector recovered in 1993 with output rising by almost 50 per cent and reaching a new peak level. However the manufacturing sector experienced a further decline of 8 per cent, due partly to a shortage of materials in the first half of the year, and lower demand following the decline in agricultural incomes, but began to recover thereafter. The mining sector was also experiencing difficulties as a result of the world recession. A shortage of water during the drought also affected production in the mining sector. Overall output rose by 2 per cent in 1993 i.e. still less than pre-drought.

The impact of the drought on the population was ameliorated through public action. The Government provided higher subsidies to the Grain Marketing Board, increased expenditure directly to finance food for drought relief, farm inputs and water supply. Subsidies were also required in relation to power...
imports. The consequence of the drought on the public finances was a deterioration both on the expenditure and revenue side, with the budget deficit for fiscal 1992/93 at 11 per cent of GDP. The deficits in 1992/93 were 7.9 per cent and 5.8 per cent of GDP respectively. In addition, the deficit of public enterprises, excluding the exceptional circumstance of the Grain Marketing Board, continued to deteriorate. The public finance deterioration meant that a major part of the reform strategy was not met.

Furthermore, external financing was less than anticipated, and this, combined with the larger budget deficit following the drought, led to increased monetary financing of the deficit with the money supply rising by 25 per cent during 1992/93. In the context of exchange control in operation, this resulted in an acceleration in inflation. Indeed the inflation of 1992 and 1993 was due to a combination of factors - the drought itself, deregulation of prices under the ESAP (both for private sector firms and public enterprises) and monetary growth. The Central Bank sought to limit the inflationary effect through higher reserve ratios and increasing interest rates - with money market rates exceeding 40 per cent during 1992/93.

It is clear that the drought has impacted very seriously on the macro-aggregates in the ESAP. The growth performance has been seriously affected. As a consequence the public finances have deteriorated dramatically. External financing has been less than anticipated at the time the ESAP was framed, and consequently much less than necessary, given the impact of the drought. Other aspects of the ESAP have proceeded, particularly trade liberalisation and deregulation, but it is difficult to estimate the impact of these measures in the context of the drought. In the most recent budget, the Minister for Finance referred to the lack of a supply side response but assigned the fiscal imbalances as the prime cause.

While one can doubt the fiscal causal factor, it is clear that the structural reforms in themselves will have great difficulty in generating output growth in the face of the supply shock associated with the drought. This issue remains, as, in this, the final year of the ESAP, the society is experiencing a further drought which is expected to lead to little or no growth in the economy - with agricultural output falling by 10 to 15 per cent.