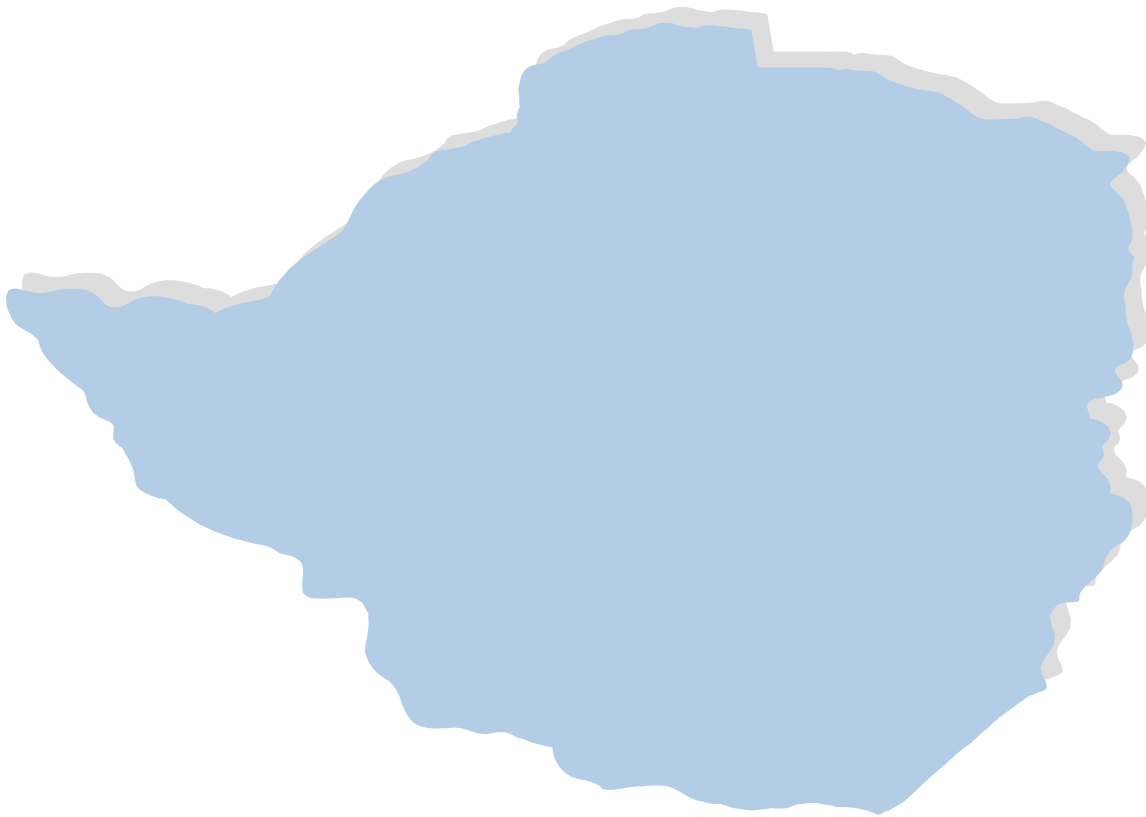




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Zimbabwe

Economic Performance Assessment: A Benchmark Study



September 2007

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Zimbabwe

Economic Performance Assessment: A Benchmark Study

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Sponsored by the Economic Growth office of USAID's Bureau of Economic Growth, Agriculture and Trade (EGAT), under Contract No. PCE-I-00-00-00013-00, Task Order 004, the Country Analytical Support (CAS) Project, 2004–2006, Nathan Associates Inc. developed a standard methodology for producing analytical reports to provide a clear and concise evaluation of economic growth performance in designated countries receiving USAID assistance. The reports are tailored to meet the needs of USAID missions and regional bureaus for country-specific analysis. Each report contains

- A synthesis of key data indicators drawn from numerous sources, including the World Bank, the International Monetary Fund, the Millennium Challenge Corporation, the United Nations, other international data sets, and host-country documents and data sources;
- International benchmarking to assess country performance in comparison to similar countries, groups of countries, and predicted values based on international data;
- An easy-to-read analytic narrative that highlights areas in which a country's performance is particularly strong or weak, to assist in the identification of future programming priorities;
- A summary of main findings, in the form of a Highlights Table and a Performance Scorecard (in lieu of an Executive Summary).

Under Contract No. GEG-I-00-04-00002-00, Task Order 004, 2006-2008, Nathan Associates continues to provide support to the EGAT Bureau by producing analytical reports evaluating economic growth performance in designated host countries. Through the same task order, Nathan is developing a template for countries emerging from crisis, assessing data issues in countries with large gaps in their data, conducting in-depth sector reviews based on the diagnostic analysis in the country reports, and providing other analytical support to the EGAT Bureau.

The authors of the present report are Bruce Bolnick, Alexander Greenbaum, and Pooja Pokhrel of Nathan Associates and Krista Hendry of the Fund for Peace. Peter Miller of Nathan Associates assisted with data management. The study team also benefited from perceptive comments from USAID/Harare and from John Robertson in Harare.

The CTO for this project at USAID/EGAT/EG is Rave Aulakh. USAID missions and bureaus may seek assistance and funding for country analytical studies or in-depth follow-on studies by contacting Ms. Aulakh at raulakh@usaid.gov.

Subject to EGAT consent, electronic copies of reports and materials relating to the CAS project are available at www.nathaninc.com. For further information or hard copies of CAS publications, please contact:

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Contents

Highlights of Zimbabwe’s Performance	v
Zimbabwe: Notable Strengths and Weaknesses—Selected Indicators	vii
1. Introduction	1
Methodology	1
Data Quality	3
2. Overview of the Economy	5
Growth Performance	5
Poverty and Inequality	8
Economic Structure	10
Demography and Environment	12
Gender	14
3. Conflict Risk	17
The CAST Scores	17
Indicators of State Capacities	20
4. Private Sector Enabling Environment	21
Fiscal and Monetary Policy	21
Business Environment	24
Financial Sector	26
External Sector	28
Economic Infrastructure	33
Science and Technology	36
5. Pro-Poor Growth Environment	39
Health	39
Education	41
Employment and Workforce	42
Agriculture	44
Appendix. CAS Methodology	

Illustrations

Figures

Figure 2-1. Real GDP Growth	6
Figure 2-2. Investment Productivity, Incremental Capital-Output Ratio	7
Figure 2-3. Human Poverty Index	9
Figure 2-4. Output Structure and Labor Force Structure	12
Figure 2-5. Urbanization Rate	13
Figure 2-6. Labor Force Participation Rate, Male and Female	15
Figure 4-1. Inflation Rate	23
Figure 4-2. Overall Budget Balance, including Grants, % of GDP	23
Figure 4-3. Control of Corruption Index	25
Figure 4-4. Interest Rate Spread	27
Figure 4-5. Ease of Trading Across Borders	30
Figure 4-6. Gross International Reserves, Months of Imports	32
Figure 4-7. Paved Roads as Percent of Total	34
Figure 4-8. Quality of Infrastructure—Electricity Supply	35
Figure 4-9. FDI Technology Transfer Index	36
Figure 5-1. Maternal Mortality Rate per 100,000 Live Births	40
Figure 5-2. Net Secondary School Enrollment Rate	42
Figure 5-3. Unemployment Rate	43
Figure 5-4. Agriculture Value Added per Worker	44

Tables

Table 1-1. Topic Coverage	3
Table 3-1. Component Ratings of Zimbabwe 2007 CAST Scores	18

HIGHLIGHTS OF ZIMBABWE'S PERFORMANCE

Economic Growth	Zimbabwe's GDP is contracting rapidly (at an average annual rate of 5.8 percent in the past five years), as is its per capita income. The collapse has been driven by an attack on property rights and civil rights that led to a stifling policy regime and very low and inefficient levels of investment.
Poverty	The incidence and severity of poverty have increased drastically in the past ten years. A severe shortage of food and other necessities has left nearly half the population undernourished.
Economic Structure	Agriculture produces just 15 percent of GDP while employing 34 percent of the workforce, indicating very low labor productivity in this sector.
Demography and Environment	Extremely high HIV prevalence and mass emigration have resulted in falling population growth, while destructive policies have led to a decrease in urbanization. On the brighter side, the population is highly literate, and Zimbabwe scores well on environmental sustainability.
Gender	Gender parity in education is not matched by a similar equality in labor force participation. A disparity in life expectancy in favor of males reflects a gender differential in the impact of HIV/AIDS, combined with deteriorating health services for women.
Conflict Status	Zimbabwe's score for the 2007 Failed State Index signals a high risk of state collapse. Contributing factors include population displacement, economic collapse, de-legitimization of the state, deteriorating public services, and sustained rights violations.
Fiscal and Monetary Policy	Zimbabwe's economy is in a state of collapse, characterized by hyperinflation, large (recorded) budget deficits, and uncontrolled growth of the money supply. Credible stabilization policies are urgently needed.
Business Environment	The institutional environment for doing business is poor and declining. Major problems include declines in the rule of law, in government effectiveness and regulatory quality, and an increase in corruption.
Financial Sector	Data showing a rise in monetization and credit to private sector disguise severe problems of inefficient credit subsidies, rapid printing of money, and strongly negative real interest rates.
External Sector	Exports are performing badly as the economy continues its tailspin. The official exchange rate is only a fraction of the parallel market rate. Foreign reserves were dangerously low at an estimated 0.8 months of exports in 2006 and foreign direct investment is drying up.
Economic Infrastructure	Infrastructure is deteriorating rapidly, constraining investment and eroding competitiveness. Roads, air transport, the rail network and electricity, in particular, need attention. Urban water supplies are also inadequate.
Science and Technology	Zimbabwe's scientific and technological capacity is comparable to regional benchmarks, but many skilled workers have fled the country, and the adverse policy regime is blocking the integration of new technologies through foreign investment.
Health	Poor health conditions are affecting economic growth. Zimbabwe has one of the highest HIV prevalence rates (18.1%) and maternal mortality rates (1063/100,000), as well as an extremely low life expectancy (42.5 years).
Education	Primary and secondary enrollment, as well as youth literacy rates, are high; however, the quality of education is reportedly declining, and Zimbabwe is experiencing a massive brain drain.
Employment and Workforce	The unemployment rate has soared to 44.6 percent, according to official numbers. Unofficial estimates are far higher. Recent price controls are exacerbating an already dire situation.
Agriculture	Following the implementation of the infamous Fast Track Land Reform Scheme, agricultural productivity has plunged in a country once known as the breadbasket of southern Africa.

Note: The methodology used for diagnostic benchmarking is explained in the Appendix.

ZIMBABWE: NOTABLE STRENGTHS AND WEAKNESSES— SELECTED INDICATORS

Selected Indicators	Strengths	Weaknesses
Growth Performance		
Real GDP growth		X
Investment productivity—incremental capital-output ratio (ICOR)		X
Gross fixed capital formation, percentage of GDP		X
Poverty and Inequality		
Percentage of population living on less than \$2 PPP per day		X
Poverty headcount, below national poverty line		X
Population below minimum dietary consumption		X
PRSP status		X
Demography and Environment		
Adult literacy rate	X	
Environmental Performance Index	X	
Gender		
Girls' primary education completion rate	X	
Female life expectancy at birth		X
Conflict Status		
Mounting demographic displacement		X
Chronic and sustained human flight		X
Severe economic decline		X
Criminalization and/or de-legitimization of the state		X
Deterioration of public services		X
Suspension or arbitrary application of human rights		X
Security apparatus operates as a “state within state”		X
Fiscal and Monetary Policy		
Government expenditure, percentage of GDP		X
Growth in the money supply		X
Inflation rate		X
Overall budget balance, including grants, percentage of GDP		X
Business Environment		
Ease of doing business ranking		X
Rule of Law Index		X
Control of Corruption Index		X
Regulatory Quality Index		X
Government Effectiveness Index		X

Selected Indicators	Strengths	Weaknesses
Financial Sector		
Interest rate spread		X
Stock market capitalization rate, percentage of GDP	X	
Real interest rate		X
External Sector		
Export growth goods and services		X
Gross international reserves		X
Present value of debt, percentage of GNI		X
Inward FDI Potential Index		X
Trade Policy Index		X
Ease of trading across borders		X
Economic Infrastructure		
Roads, paved as percentage of total		X
Quality of infrastructure—air transport		X
Internet users per 1,000 people	X	
Science and Technology		
Scientific and technology journal articles, per million people	X	
FDI technology transfer index		X
Health		
Life expectancy at birth		X
Maternal mortality rate		X
HIV prevalence		X
Education		
Net primary enrollment rate (%)	X	
Youth literacy rate (%)	X	
Net secondary school enrollment rate (%)	X	
Employment and Workforce		
Unemployment rate		X
Firing costs, weeks of wages		X
Agriculture		
Cereal yield		X
Growth in agriculture value added		X
Agricultural Policy Costs index		X

Note: The chart identifies selective indicators for which Zimbabwe's performance is particularly strong or weak relative to benchmark standards, as explained in the Appendix. Details are discussed in the text. The separate Data Supplement presents a full tabulation of the data and international benchmarks examined for this report, along with technical notes on the data sources and definitions. The supplement is available at <http://www.nathaninc.com/casreports>.

1. Introduction

This report is one of a series of economic performance assessments prepared for the EGAT Bureau to provide USAID missions and regional bureaus with a concise evaluation of key indicators covering a broad range of issues relating to economic growth performance in designated host countries. Because of Zimbabwe's unique political situation and broad economic collapse, USAID has requested that this report serve as a basis for planning future program priorities to help restore economic growth, contingent on a change in political conditions. The report draws on a variety of international data sources¹ and uses international benchmarking against reference group averages, comparator countries, and statistical norms to identify major constraints, trends, and opportunities for restoring growth and reducing poverty. This report reflects data available as of July 2007. At the request of the USAID mission in Harare, the study uses two neighboring countries, South Africa and Zambia, as comparators. Zambia provides a baseline for direct comparison, whereas South Africa represents the regional standard that Zimbabwe should aspire to achieve. In addition, Zimbabwe's performance is also compared to median values for other low-income countries in sub-Saharan Africa (LI-SSA).

METHODOLOGY

The methodology used here is analogous to examining an automobile dashboard to see which gauges are signaling problems. Sometimes a blinking light has obvious implications—such as the need to fill the fuel tank. In other cases, it may be necessary to have a mechanic probe more deeply to assess the source of the trouble and determine the best course of action.² Similarly, the Economic Performance Assessment is based on an examination of key economic and social indicators, to see which ones are signaling problems. Some “blinking” indicators have clear implications, while others may require further study to investigate the problems more fully and identify appropriate courses for programmatic action.

¹ Sources include the World Bank, the International Monetary Fund, the Millennium Challenge Corporation, the United Nations (including the Millennium Development Goals database), the World Economic Forum, and host-country documents and data sources.

² Sometimes, too, the problem is faulty wiring to the indicator—analogous here to faulty data.

The analysis is organized around two mutually supportive goals: transformational growth and poverty reduction.³ Broad-based growth is itself the most powerful instrument for poverty reduction. At the same time, programs to reduce poverty and lessen inequality can help to underpin rapid and sustainable growth. These interactions can create either a virtuous cycle of economic transformation and human development—or, as in Zimbabwe, a vicious circle of economic decline and humanitarian distress.

Transformational growth requires a high level of investment and rising productivity. This is achieved by establishing a strong *enabling environment for private sector development*, involving multiple elements: macroeconomic stability; a sound legal and regulatory system, including secure contract and property rights; effective control of corruption; a sound and efficient financial system; openness to trade and investment; sustainable debt management; investment in education, health, and workforce skills; infrastructure development; and sustainable use of natural resources.

In turn, the impact of growth on poverty depends on policies and programs that create opportunities and build capabilities for the poor. We call this the *pro-poor growth environment*. Here, too, many elements are involved, including effective education and health systems, policies facilitating job creation, agricultural development (in countries where the poor depend predominantly on farming), dismantling barriers to micro and small enterprise development, and progress toward gender equity.

In countries that are suffering from political turmoil, such as Zimbabwe, risks associated with social unrest and security conditions are highly damaging to economic growth, and the economic distress in turn exacerbates security problems. By the same token, an end to the turmoil can deliver strong economic dividends, and successful economic recovery can help restore political stability. Accordingly, this report views economic performance in Zimbabwe through a conflict lens, and includes a separate section on conflict risk.

The present evaluation must be interpreted with care because a concise analysis of selected indicators cannot provide a definitive diagnosis of economic performance problems, nor simple answers to questions about programmatic priorities. Instead, the aim of the analysis is to identify signs of serious problems that are affecting economic growth, subject to limits of data availability and quality. The results should provide insight about potential paths for USAID intervention, to complement on-the-ground knowledge and further in-depth studies.

The remainder of the report presents the most important results of the diagnostic analysis, in four sections: Overview of the Economy; Conflict Risk; Private Sector Enabling Environment; and Pro-Poor Growth Environment. Table 1-1 summarizes the topical coverage. The appendix provides a brief explanation of the criteria used for selecting indicators, the benchmarking methodology, and a table showing the full set of indicators examined for this report.

³ In USAID's white paper *U.S. Foreign Aid: Meeting the Challenges of the Twenty-first Century* (January 2004), transformational growth is a central strategic objective, both for its innate importance as a development goal and because growth is the most powerful engine for poverty reduction.

Table 1-1. Topic Coverage

Overview of the Economy	Conflict Status	Private Sector Enabling Environment	Pro-poor Growth Environment
<ul style="list-style-type: none"> • Growth performance • Poverty and inequality • Economic structure • Demographic and environmental conditions • Gender 	<ul style="list-style-type: none"> • Social indicators • Economic indicators • Political and military indicators • Indicators of capacities of the state 	<ul style="list-style-type: none"> • Fiscal and monetary policy • Business environment • Financial sector • External sector • Economic infrastructure • Science and technology 	<ul style="list-style-type: none"> • Health • Education • Employment and workforce • Agriculture

DATA QUALITY

The breadth and quality of economic data collected for Zimbabwe, once very good, has seriously deteriorated. This is evident in the World Bank's Statistical Capacity Indicator, which declined by 15 points between 2005 and 2006, to a score of 53 percent. The Bank cites particular problems with Zimbabwe's failure to update its national accounts data and collect timely data on agriculture and poverty. Moreover, the inflation rate has reached such a high level, and the official exchange rate is so far from equilibrium, that even a basic indicator such as the dollar value of per capita income exhibits extreme volatility resulting from measurement problems. For the same reason, indicators defined as ratios to GDP are highly problematic in Zimbabwe. In short, serious data problems arise repeatedly in the analysis below.

2. Overview of the Economy

This section reviews basic information on Zimbabwe's macroeconomic performance, poverty and inequality, economic structure, demographic and environmental conditions, and indicators of gender equity. Some of the indicators cited here are descriptive rather than analytical, and are included to provide context for the performance analysis.

GROWTH PERFORMANCE

Over the past ten years Zimbabwe has experienced a pervasive economic collapse. The crisis can largely be attributed to economic mismanagement, poor governance, and loss of support from the international community, all compounded by periods of drought. The collapse was triggered by the government's decision in 1997 to ignore fiscal constraints in making large payments to veterans of the Independence struggle. Then, in the wake of political setbacks in 1998, the government announced the seizure of white-owned farms, which exacerbated the instability. Another pivotal event was the controversial *Fast Track Land Reform* scheme for involuntary land redistribution in 2000, which led to a precipitous decline in productivity and output in agriculture, formerly the mainstay of the economy. The economic contraction has been accentuated by linkage effects operating in reverse, with each declining industry causing hardship up and down the value chain.

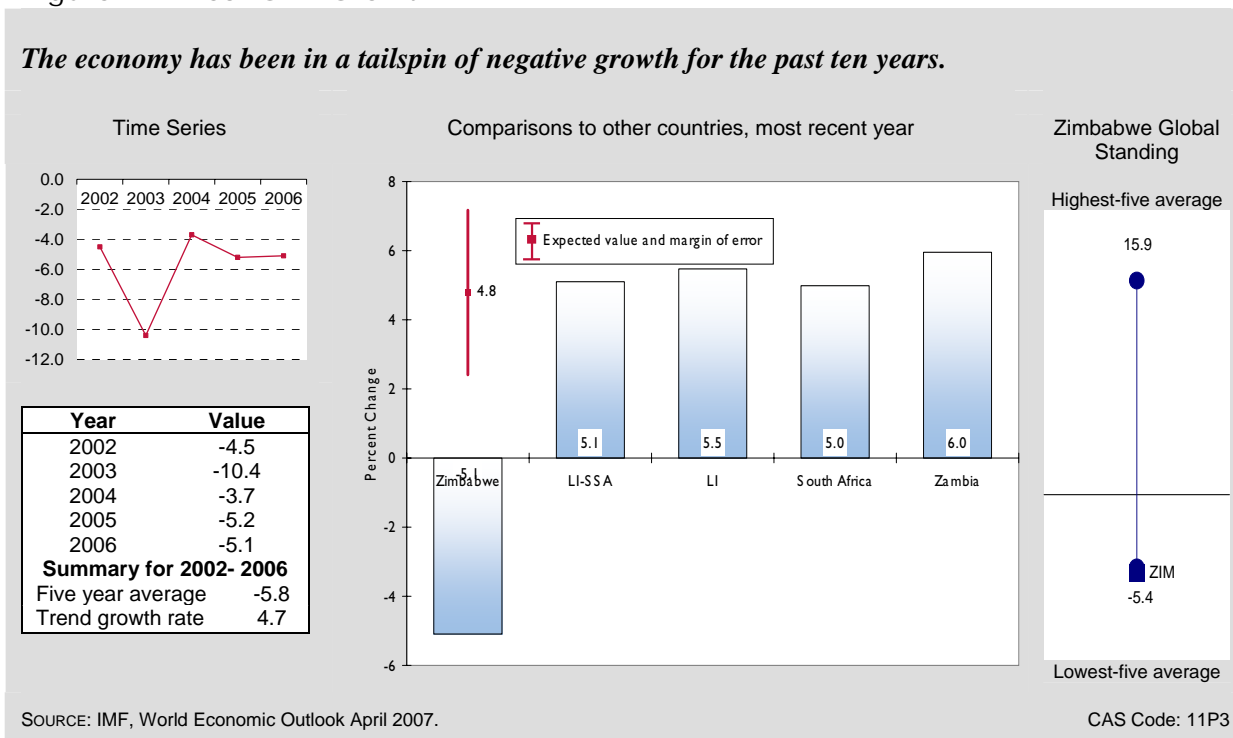
Using the purchasing power parity (PPP) method of calculating GDP, Zimbabwe's per capita income in 2006 was \$2,437—a drop of more than 23 percent since 1998.⁴ Although GDP per capita has been falling for ten years, it remains well above the median for low-income sub-Saharan African countries (LI-SSA) (\$1,172) and the income level in Zambia (\$1,083), but far below the level in South Africa (\$12,796).⁵ Over the past five years, to 2006, GDP in constant prices contracted at an average annual rate of 5.8 percent (see Figure 2-1) This performance is

⁴ Real GDP per capita in constant US dollars is often used for comparisons over time. Using 2000 prices and exchange rates, GDP declined from US\$651 in 2002 to US\$502 in 2006, a drop of 22.9 percent in just four years. Both GDP in constant US dollars and in PPP are important but slightly different indicators of economic growth. Our standard CAS template uses GDP per capita in PPP dollars as it is easier to make comparisons across countries using the PPP method. Due to exchange rate and estimation problems, GDP in current US dollars which is one of our standard indicators, does not accurately portray the economic situation in Zimbabwe and has therefore been dropped from the analysis.

⁵ Per capita income figures in PPP terms and current US\$ terms for Zimbabwe, Zambia, and South Africa are recent IMF estimates.

among the world's worst. By comparison, Zambia has grown at an average rate of 6.0 percent, and South Africa by 5.0 percent.

Figure 2-1. Real GDP Growth



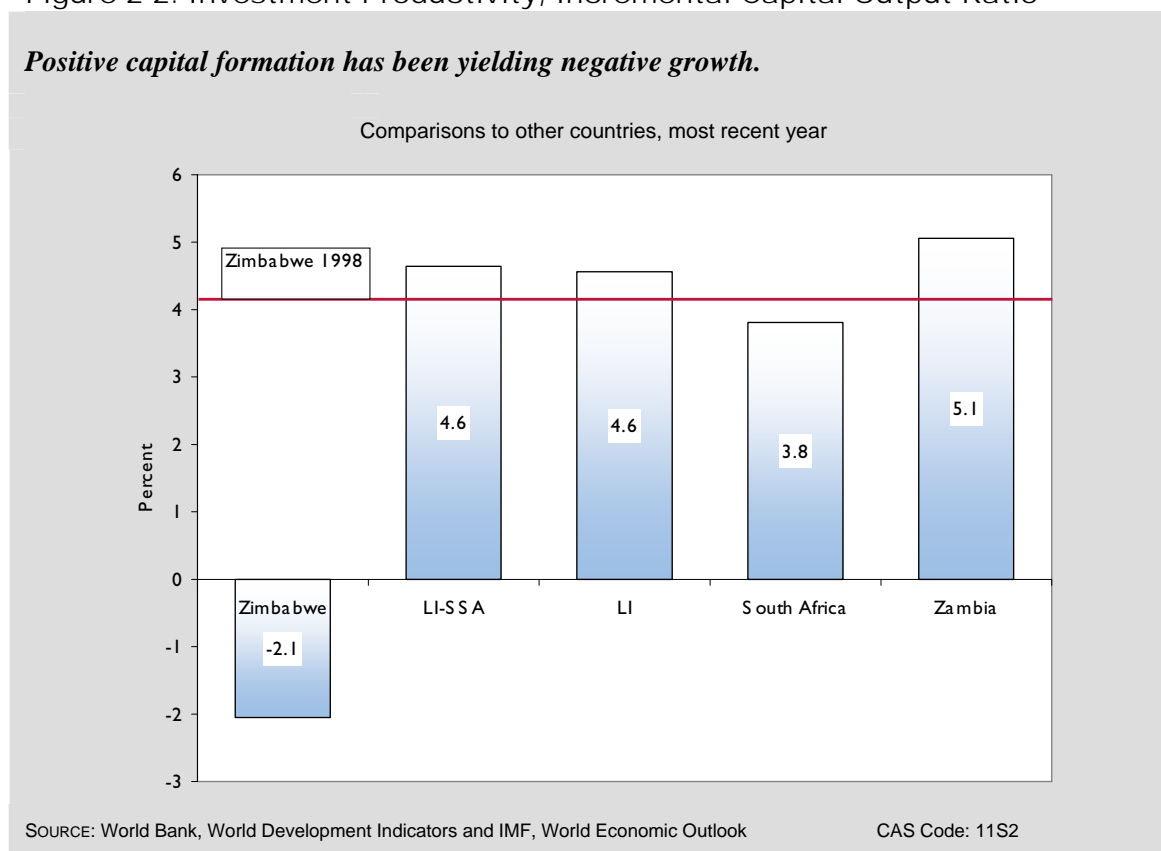
Underpinning Zimbabwe's poor growth performance is a low rate of investment. Official estimates show that gross domestic investment averaged 13.7 percent of GDP in the last five years, and was 16.1 percent in 2006. These figures have to be treated with great caution because of distortions caused by high inflation, a misaligned exchange rate, and concerns that the government has diverted budget allocations for capital expenditure into consumption spending. Even taken at face value, however, the investment rate is below the LI-SSA average of 18.8 percent of GDP, and falls far short of investment rates in Zambia (26.5 percent) and South Africa (17.1 percent).⁶ Furthermore, after accounting for government capital expenditure (see Fiscal and Monetary Policy), the estimated level of private investment has averaged just 3.2 percent of GDP over the past five years, which is not even enough to cover depreciation. Hence, the stock of capital in the private sector has been on a sustained decline.

The level of investment has not only been low, but also highly inefficient. This can be seen in the incremental capital-output ratio (ICOR), which is the amount of capital investment per unit of added output. For the period 2001–2005, the ICOR for Zimbabwe was negative, indicating that output has fallen steadily despite having 14 percent of GDP reportedly allocated to capital investment. In contrast, the ICOR averaged 4.1 over the five years to 1998; at that time,

⁶ Gross Fixed Investment as a percentage of GDP for South Africa and Zambia are IMF estimates.

Zimbabwe had a payoff of one dollar per year in extra output for every \$4.1 of capital investment, which is a reasonably good level of investment productivity. By comparison, the benchmark for LI-SSA over the five years to 2004 was an ICOR of 4.6, showing that \$4.6 of investment has been required in the region per unit of added output. The corresponding ICOR value for Zambia was 5.1 and for South Africa 3.8 (Figure 2-2).

Figure 2-2. Investment Productivity, Incremental Capital-Output Ratio



Unfortunately, there is no way to obtain a useful estimate of labor productivity growth because the labor force data available are totally at odds with widespread and credible reports of massive emigration to neighboring countries due to the economic crisis.

Notwithstanding the data problems, these indicators reveal a startling decline in output and income, driven by very weak and inefficient investment. Reversing these trends will require a transformation of the adverse climate for private sector development involving larger issues of political and economic reform, as discussed below. Meanwhile, donors have to be prepared to help Zimbabwe rehabilitate its economy and rebuild institutions when the political landscape changes. Careful sequencing of donor support will be essential to ensure that resources are used effectively. The immediate priorities will be to restore law and order and bring rampant inflation under control. But early attention is also needed to strengthen the business environment and rehabilitate infrastructure in order to stimulate investment, enhance efficiency, and create jobs. As

these changes take place, Zimbabwe should experience a reversal of capital and labor flight, and rebound quickly from the current economic quagmire.

POVERTY AND INEQUALITY

In an economy characterized by declining per capita income, hyperinflation, high unemployment, and shortages of food, fuel, and foreign currency, it is no surprise that poverty is becoming more widespread and more severe. However, the poor quality of data and the rapidity of the economic collapse make it difficult to gauge current poverty and inequality conditions accurately.

The most recent household survey data come from a 2003 Poverty Assessment, which estimated that 72 percent of the population fell below the poverty line defined in terms of total consumption. This is 17 percentage points higher than the 1995 figure of 55 percent.⁷ The incidence rate in Zimbabwe in 2003 was worse than the LI-SSA median of 42.1 percent, and even worse than the extremely high rate of 68.0 percent in Zambia (in 2004).⁸

The economic crisis has brought with it severe shortages in food and other necessities. Between 2002 and 2004, an average of 47.0 percent of the population could not fulfill their minimum dietary energy consumption needs. This deficiency rate is equal to that in Zambia, but 14 percentage points higher than the LI-SSA median (33.0 percent). The current rate is probably even higher, given that the cereal harvest in Zimbabwe this year has been poor. This is due to a combination of adverse weather conditions, deteriorating irrigation systems, the loss of service sector support in rural areas following the forced closure of the large-scale commercial farms, the lack of crucial agricultural inputs, and the imposition of the Grain Marketing Board as the sole-buyer monopoly for grains at unattractive prices. According to the World Food Program (WFP), more than 4 million Zimbabweans face food shortages over the next nine months.⁹ The crisis was worsened in June 2007 by price controls that prevented suppliers from recovering production costs and forced food processors to curtail production. This has reportedly caused many businesses to close, accentuating food shortages and affecting almost the entire population by the first weeks of August 2007. Currently, more than 70 percent of donor commitments to Zimbabwe involve providing food aid.¹⁰ Humanitarian relief programs, though critical for immediate relief, are not sustainable solutions to the unfolding crisis.

⁷ The study team did not have access to the 2003 Poverty Assessment itself. Figures cited in the text are from the UNDP draft country program for Zimbabwe (2007–2009). The UNDP report does not provide details on the definition of the total consumption poverty line. See:

<http://www.undp.org.zw/images/stories/Docs/Zimbabwe%20Country%20Programme%20doc.pdf>

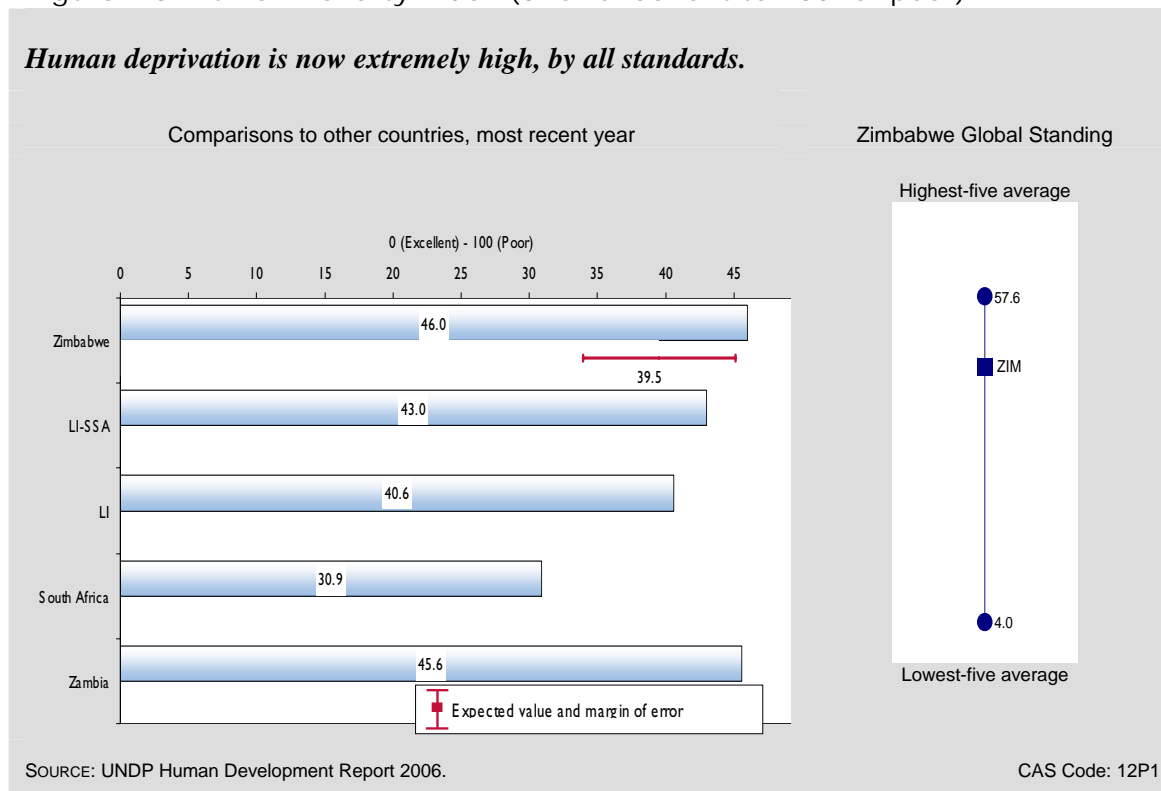
⁸ In 2000 an estimated 50 percent of the population in South Africa lived below the national poverty line. That poverty line, however, is much higher than in Zimbabwe and Zambia; hence, the percentage of South Africans living below the national poverty line is not a useful benchmark for Zimbabwe.

⁹ World Food Program, at http://www.wfp.org/country_brief/indexcountry.asp?country=716 (accessed July 30, 2007).

¹⁰ http://ocha.unog.ch/fts/reports/daily/ocha_R10_E15182_07073007.pdf (accessed July 30, 2007).

The UNDP’s Human Poverty Index (HPI) measures deprivation in terms of life expectancy, literacy, access to safe water, and child nutrition, For 2006, Zimbabwe received a score of 46.0 (see Figure 2-3), an improvement over its 2003 score of 52.0. In 1999, however, Zimbabwe’s score was 29.2 and it ranked 53rd in the HPI. The 2006 HPI score also lies outside the upper bound of the expected value¹¹ for a country with Zimbabwe’s characteristics, and falls well short of South Africa’s score of 30.9. It is on par with Zambia’s score of 45.6, even though per capita incomes in Zambia are much lower.

Figure 2-3. Human Poverty Index (0 for excellent to 100 for poor)



No recent data are available on the distribution of income as distinct from poverty rates. In 1995, just 4.6 percent of total incomes accrued to the poorest 20 percent of the population. This was below the expected value of 5.6 percent for Zimbabwe, though better than South Africa’s 3.5 percent and Zambia’s 3.6 percent. Given anecdotal reports of extreme increases in severe poverty among the countries’ poorest, it is likely that inequality has increased considerably since that time.

In summary, rising poverty is a critical challenge in Zimbabwe. Retrograde economic and social policies, hyperinflation, declining incomes, and political distress have aggravated the situation.

¹¹ The expected value of an indicator for Zimbabwe throughout this report is based on our regression benchmarking methodology. Please see the CAS Methodology section at the end of the report for a detailed explanation of our benchmarking methodology.

While humanitarian relief programs can alleviate some symptoms of destitution, a sustained period of rapid growth is needed to achieve a lasting reduction in poverty. This outcome hinges on an effective resolution of the political and economic crisis.

ECONOMIC STRUCTURE

In looking at the broad composition of value added in Zimbabwe, one must bear in mind that real GDP has declined by an estimated 52 percent since the Land Reform Program was launched. Thus, some sectors have increased as a percentage of the shrinking economy without actually growing. The most severely affected sectors, however, have fallen in both absolute and relative terms. In particular, the reported share of GDP originating in agriculture fell from 20 percent of GDP in 2001 to 17 percent by 2003 according to official figures, with recent estimates suggesting a further fall to 15 percent by 2006.¹² By comparison, agriculture accounts for 20.9 percent of Zambia's GDP and just 3.1 percent of South Africa's, reflecting a much greater degree of economic transformation.

Manufacturing has also declined more sharply than the economy as a whole, falling from about 19 percent of GDP in 2001 to 16 percent in 2003 and an estimated 15 percent by 2006. Mining accounts for a fairly small proportion of GDP because its value-added processes fall under manufacturing. But mining's direct share of GDP rose from 3.8 percent in 2001 to 4.9 percent in 2003. Investments in platinum mining have boosted the sector's contribution to GDP to an estimated 6.4 percent by 2006.

The contribution of services to GDP fell marginally from 58.9 percent in 2001 to an estimated 57.2 percent in 2006. The 2006 figure is significantly higher than the expected value for a country with characteristics similar to Zimbabwe's (46.3 percent), far above Zambia's 42.0 percent, yet well below South Africa's 66.1. However, the structure of the service sector itself has changed markedly over this period. Most notably, the value added in social services dropped from 10.8 percent of GDP in 2001 to an estimated 7.0 percent in 2006 while contributions from hotel and restaurants and financial services increased from 17.6 and 8.6 percent in 2001 to an estimated 23.0 and 12.5 percent in 2006, respectively.

In 2005/06, an estimated 32.4 percent of the labor force worked in agriculture, with 65.8 percent working in industry and services combined.¹³ These numbers reveal an economic structure that is more developed than average for LI-SSA, with a median labor force share in agriculture of 78.0 percent; for Zambia, the corresponding figure is fully 85.0 percent of the labor force. Here, too, South Africa is far more developed, with only 10.3 percent of the workforce in agriculture.

Comparing the output and workforce structures in Zimbabwe, one can see that labor productivity is extremely poor in the agricultural sector because approximately a third of the labor force is producing just 15 percent of GDP (see Figure 2-4).

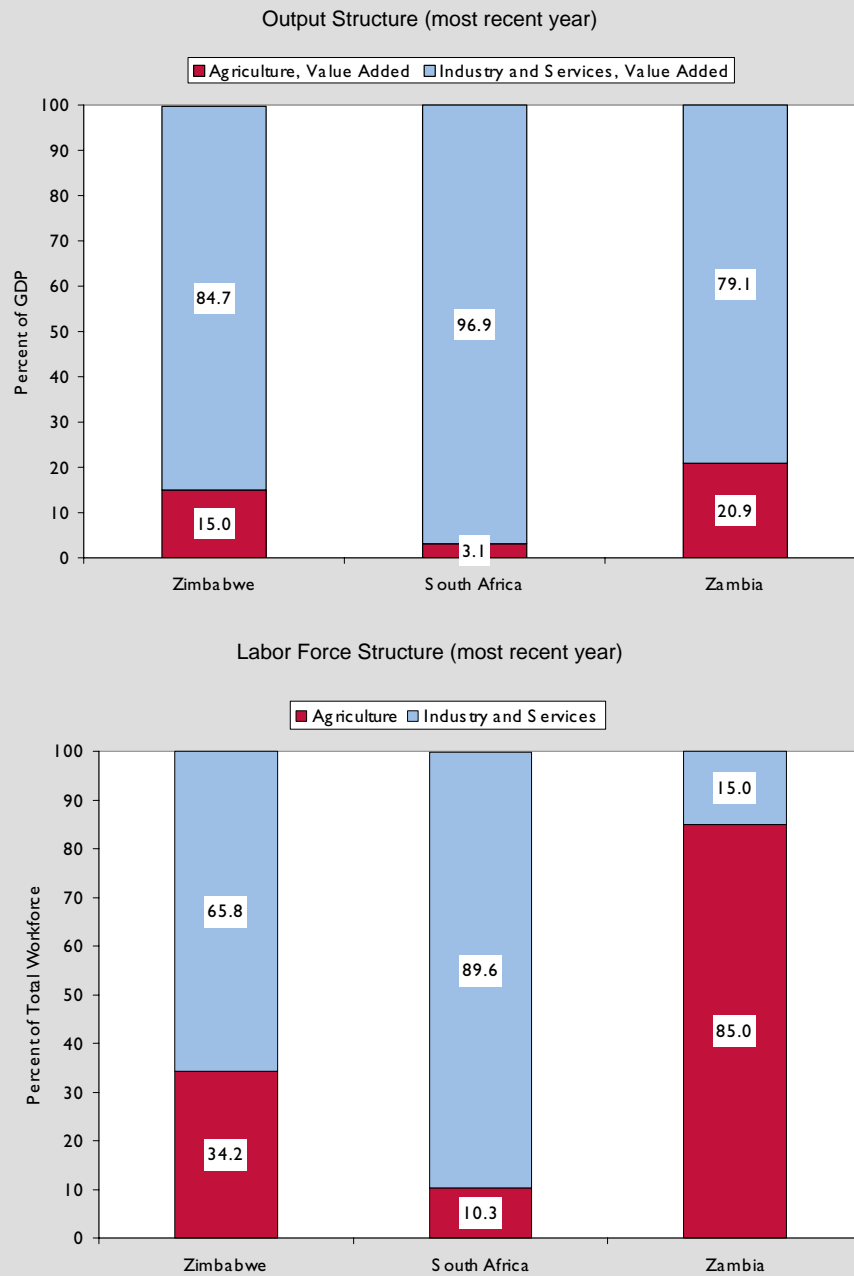
¹² We thank John Robertson, a leading independent Zimbabwean economist, for supplying up-to-date estimates of the economic structure.

¹³ 2005-06 Zimbabwe Demographic and Health Survey, pp. 37-38.

If donor programs resume in Zimbabwe, they will need to reverse regressive structural trends by promoting policies that stimulate agricultural productivity, economic diversification, and a general move away from agriculture as major source of low-wage employment. The poor quality of official data on output and employment over the past few years highlights the need for donor assistance to update and improve the collection and dissemination of basic economic statistics.

Figure 2-4. Output Structure and Labor Force Structure

Labor productivity is much lower in agriculture than in services and industry.



SOURCE: John Robertson and Zimbabwe Demographic and Health Survey 2005/06.

CAS Codes: 13P2 a-c, 13P1 a-c

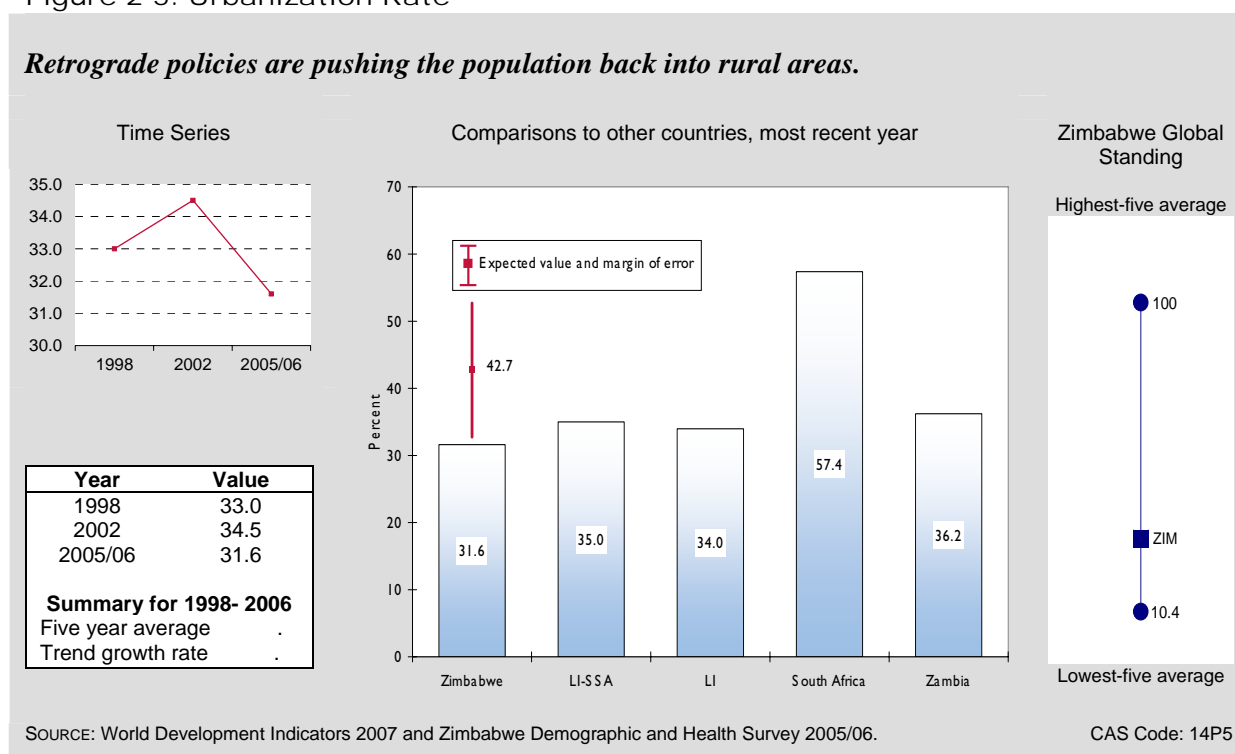
DEMOGRAPHY AND ENVIRONMENT

According to statistical reports, Zimbabwe's population of 13 million has been growing very slowly, at an average rate of 0.6 percent over the five years to 2005. Among other things, the low growth trend reflects high mortality rates from HIV/AIDS (see Health), as well as an exodus to neighboring South Africa and Botswana and other countries to flee the oppressive political regime and economic collapse. The HIV/AIDS factor is also responsible for a dramatic increase

in the number of orphans since 1998. UNICEF estimates that approximately 1.3 million Zimbabwean children have lost a parent, placing an additional financial burden on surviving relatives.¹⁴

Another clear result of the retrograde policies in place in Zimbabwe is the reversal of the trend toward urbanization. The urban population as a percentage of the total population increased from 33.0 percent in 1998 to 34.5 percent in 2002, then fell to 31.6 percent in 2006/06, according to the Zimbabwe Demographic and Health Survey 2005-06. This is well below the expected value of 42.7 percent for a country with Zimbabwe’s characteristics and South Africa’s 57.4 percent, and significantly lower than Zambia’s 36.2 percent (Figure 2-5).

Figure 2-5. Urbanization Rate



As a legacy of past success in education, the population is highly literate, at least by regional standards. The estimated adult literacy rate of 89.4 percent in 2004 exceeds the upper bound of the expected value for Zimbabwe (61.4 percent) by more than 18 percentage points. It is also 36 percentage points higher than the median for LI-SSA (53.2 percent), far above the corresponding figure for Zambia (68.0 percent) and, surprisingly, even better than in South Africa (82.4 percent). This strong base of human capital can facilitate a rapid transition back to a healthy growth path once the climate for private sector development improves. The human resource base

¹⁴ See http://www.unicef.org/infobycountry/zimbabwe_1403.html. Counting both orphans and vulnerable children, USAID/Harare estimates the figure at around 3 million, or nearly one-fourth of the entire population. See http://www.usaid.gov/stories/zimbabwe/fp_zimbabwe_aids.html

ought to be improving further, especially given the relatively low youth dependency rate of 0.71 children per adult of working age (2005 estimate). In reality, prospects for the future are much more grim because of a marked decline in the quality of the education system due in part to the emigration of qualified teachers.

Despite the economic crisis, Zimbabwe has been rated reasonably well on many aspects of environmental sustainability. The country scored of 63.0 out of a possible 100 in 2006 on the Environmental Performance Index, which incorporates a variety of indicators of environmental stress and ecosystem vitality. That score surpasses the expected value of 52.5 for Zimbabwe, as well as Zambia's score of 54.4, and narrowly beats South Africa's score of 62.0. Nonetheless, EPI subcomponent scores show serious deficiencies in dependence on nonrenewable energy and poor performance in wildlife protection. Zimbabwe was once a model of wildlife protection, the country's wildlife heritage has been decimated in recent years by poaching and mismanagement of conservation areas.

GENDER

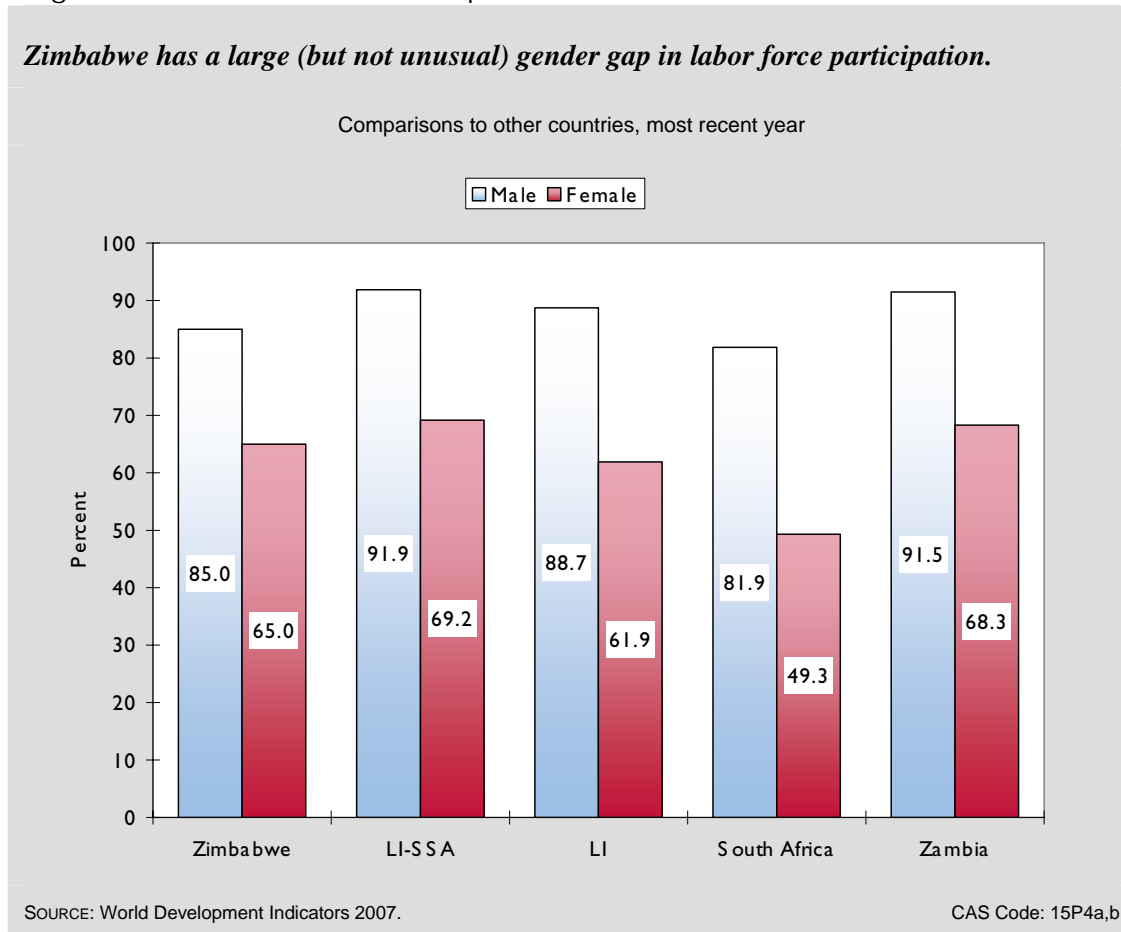
Gender equity enables faster economic growth by ensuring that all citizens can develop and apply their full productive capacities. Comparisons of life expectancy at birth are often used as a proxy for discerning gender differentials in access to health care and healthy living standards. In Zimbabwe, the average male and female life expectancies were 43.0 and 42.0 years, respectively, in 2005.¹⁵ These low expectancies reflect a tragic combination of widespread HIV/AIDS, poor nutrition, and severe poverty. That men are living longer than women is attributable to Zimbabwean women's very high maternal mortality rate and the more severe effect of HIV/AIDS on women in sub-Saharan Africa. In nearly every other country, women outlive men—by around 3 years in low-income countries, and by more than 5 years in countries with an advanced human development.

Zimbabwe's performance on gender equity in education is better than most benchmarks. For instance, the 78.6 percent primary education completion rate for girls in 2003 (latest year of data) is well above the upper bound of the 70.7 percent expected value for a country with Zimbabwe's characteristics. It is also far better than the LI-SSA median of 41.5 percent, as well as Zambia's 65.7 percent. Compared to South Africa's 98.7 percent, however, girls' education in Zimbabwe leaves a great deal to be desired. It must be noted, though, that Zimbabwe's 2003 figure reflects a steep decline in performance—down nearly 8 percentage points in just five years. A similar decline is also evident in the gross enrollment rates at all levels of schooling for both male and female students. In 2004, this figure was 54.0 percent for males and 51.0 percent of females, representing a decline of 7 percentage points for females and 8 percentage points for males in just four years (to 2004). These extraordinary reversals are symptomatic of the economic crisis.

¹⁵ According to the World Health Organization statistics, life expectancy for males and females in 2004 were 37.0 and 34.0, respectively. The abrupt jump in life expectancies in 2005 is presumably due to a change in estimation methodology.

The relatively small gender differential in schooling is accompanied by a larger gap in labor force participation. Thus, an estimated 85.0 percent of males were either working or seeking jobs in 2005, but only 65.0 percent of the women (Figure 2-6). This gender inequality in the labor market weakens the country’s productive potential. Even so, Zimbabwe’s gender gap in labor force participation is a below the LI-SSA average of 23 percentage points, South Africa’s huge gap of 32 percentage points, and Zambia’s 23 percentage points.

Figure 2-6. Labor Force Participation Rate, Male and Female



3. Conflict Risk

Conflicts can dampen growth by diverting resources into nonproductive military activities, impeding investment in physical capital and human resources, impairing fiscal capacity for other essential government expenditures, and imposing a debt burden that will encumber future budgets.¹⁶ According to one influential study civil wars reduce GDP per capita at an annual rate of 2.2 percent relative to estimates of the trend likely in the absence of conflict.¹⁷ The impact on per capita income is especially pronounced in regions affected directly by instability.¹⁸

In light of the potential adverse effects of conflict on economic growth, it is important to examine the risks in Zimbabwe, given the current political and economic climate and the degree of social unrest. The Conflict Assessment System Tool (CAST) developed by the Fund for Peace (FfP) assesses states' vulnerability to violent internal conflict and societal dysfunction by rating 12 factors in three categories: social, economic, and political/military. Each indicator is scored on a scale of 1 to 10, with 10 as the worst score.

To rate each state, FfP uses a computerized content analysis technique to process thousands of news articles and documents from approximately 12,000 sources. FfP researchers combine the results of this analysis with statistical data. A score of 90 or more indicates "critical danger." A maximum possible score of 120 indicates "state collapse."

THE CAST SCORES

In 2007, the CAST score for Zimbabwe was 111.8, up from 108.9 in 2006. This signals a very high risk of state collapse. For comparison, the score for South Africa was 57.4, and for Zambia 80.6. Table 3-1 shows the 2007 score for Zimbabwe for each indicator. All but three are in the critical range of 9.0 or above, and even the exceptions are close to this threshold. The acute risk of conflict in Zimbabwe is highly damaging to prospects for economic recovery.

¹⁶ Daniel Mejia, Conflict and Economic Growth: A Survey of the Theoretical Links, Webpondo, September 2004. http://www.webpondo.org/files/octdic2004/conflict_growth.pdf, accessed April 13, 2007.

¹⁷ Paul Collier, On the Economic Consequences of Civil War, *Oxford Economic Papers* 51 (1999), 168–83. <http://www.worldbank.org/research/conflict/papers/cw-consq.pdf>, accessed April 13, 2007.

¹⁸ Alberto Abadie and Javier Gardeazabal, The Economic Costs of Conflict: A Case Study of the Basque Country, July 2002. <http://ksghome.harvard.edu/~aabadie/ecc.pdf>, accessed April 13, 2007.

Table 3-1. Component Ratings of Zimbabwe 2007 CAST Scores

Category	CAST Score
SOCIAL	
Mounting demographic pressures	9.7
Massive movement of refugees or internally displaced persons	8.7
Legacy of vengeance- seeking group grievance or group paranoia	8.8
Chronic and sustained human flight	9.1
ECONOMIC	
Uneven economic development along group lines	9.5
Sharp and/or severe economic decline	10.0
POLITICAL AND MILITARY	
Criminalization and/or de-legitimization of the state	9.5
Progressive deterioration of public services	9.6
Suspension or arbitrary application of human rights	9.7
Security apparatus operates as a “state within a state”	9.5
Rise of factionalized elites	9.0
Intervention of other states or external political actors	8.7

The score of 9.7 for demographic pressure reflects a variety of factors. First, various reports estimate that the government’s April 2005 Operation *Murambatsvina* (Restore Order), which destroyed thousands of homes and businesses in poor urban slums, left 500,000 to 700,000 people homeless.¹⁹ Second, as highlighted in the Health section of this report, Zimbabwe faces a continuing public health crisis with approximately 350,000 HIV/AIDS victims in immediate need of antiretroviral drugs and 600,000 more lacking adequate care and support.²⁰ Potable water and food are in short supply, and outbreaks of waterborne illnesses are common.

The score of 9.1 for human flight reflects that thousands of Zimbabweans, including many highly educated workers, attempt to illegally enter South Africa and other neighboring countries each week. In the first five months of 2007, South Africa deported 57,600 illegal immigrants back to Zimbabwe.²¹ Economic development received a score of 9.5. An estimated 72 percent of the

¹⁹ The lower figure was reported by the BBC news (<http://news.bbc.co.uk/2/hi/Africa/4416820.stm>, accessed July 16, 2007); the higher figure number was provided by USAID/Harare.

²⁰ Human Rights Watch, Essential Background; 2006 Overview of human rights issues in Zimbabwe (<http://hrw.org/englishwr2k7/docs/2007/01/11/zimbab14720.htm>).

²¹ Orla Guerin, Zimbabwe’s starving border jumpers, BBC News, May 10 2007 (<http://news.bbc.co.uk/2/hi/africa/6642619.stm>).

population lives in poverty, unemployment is extremely high, and income inequality is very high (see the sections on Poverty and the Labor Force).²²

On the economic decline indicator, Zimbabwe received the worst possible score of 10. As mentioned, the economy has been in a severe downward spiral for the past ten years since the government started to violate standard maxims of economic management and to undermine property rights. A series of political decisions crippled commercial agriculture, eliminating tens of thousands of jobs, scaring away investment, and stimulating capital flight. In 2006, the official inflation rate topped 1,000 percent as the government resorted to printing money as a primary source of funding to sustain operations, and to purchase the foreign currency needed to pay international debts. In July 2007, official year-on-year inflation topped 7,500 percent, and unofficial estimates are much higher (see Fiscal and Monetary Policy). The imposition of price controls in June 2007 led to more acute shortages and the arrest of more than 1,000 business owners for violating the price controls.²³

The score of 9.5 on legitimacy of the state reflects the judgment of independent observers that the parliamentary election of 2000, the presidential election in 2002, and the parliamentary election of 2005 were neither free nor fair. Security forces have abused and intimidated the MDC, the main opposition party, and the President has sanctioned excessive force against opposition demonstrators, including a violent crackdown on a peaceful prayer meeting in Harare in March 2007. The government has also curtailed freedom of the press, shutting down several newspapers and jamming foreign radio broadcasts, while forcibly evicting citizens and demolishing homes.²⁴

Zimbabwe scored 9.6 on public services. A large portion of the populace now faces hunger on a daily basis and lacks access to health care. In the category of human rights, Zimbabwe received an extremely poor score of 9.7. Arbitrary arrests, detentions, and brutal beating by police and security forces have been common. Peaceful protests are often violently disrupted by police, and members of the opposition and the press are regularly intimidated and abused.²⁵

The security apparatus received a score of 9.5 because of the high level of military involvement with the ruling party and military influence in policy formulation. In addition, government-backed youth militias and bands of “veterans” of the liberation war operate with impunity. Economic collapse has eroded salaries in the armed forces, allegedly leading them into criminality, including cross-border armed robbery.²⁶

²² CIA Factbook (<https://www.cia.gov/library/publications/the-world-factbook/geos/zi.html>).

²³ BBC News, Mass Zimbabwe arrests over prices, July 9, 2007 (<http://news.bbc.co.uk/2/hi/africa/6688755.stm>).

²⁴ U.S. Department of State, Country Reports on Human Rights Practices–2006; Zimbabwe, March 6, 2007 (<http://www.state.gov/g/drl/rls/hrrpt/2006/78765.htm>).

²⁵ Human Rights Watch, Essential Background; 2006 Overview of human rights issues in Zimbabwe (<http://hrw.org/englishw2k7/docs/2007/01/11/zimbab14720.htm>).

²⁶ International Crisis Group, Zimbabwe’s Continuing Self-Destruction, Africa Briefing N°38, June 6, 2006 (<http://www.crisisgroup.org/home/index.cfm?id=4162&l=1>).

INDICATORS OF STATE CAPACITIES

A country's ability to cope with the pressures described above depends on the strength of its institutions. The FfP also rates the legitimacy, representativeness, and professional competence of a state's executive and legislative leadership, police, military, civil service, and judicial service by quality quintile. All of Zimbabwe's ratings are in the bottom quintile.

These ratings reflect the basic observation that power is concentrated squarely in the hands of President Mugabe, who has ruled since Independence in 1980 and was reelected in highly flawed elections in 2005. He is increasingly using state force and a variety of policy instruments to serve his own interests and those of his collaborators at the expense of the rest of the country.

Corruption in government—military, police, and civil service—is widespread and increasing largely due to the collapse of government salaries in the face of economic woes, poor governance by state-institution leaders, and an absence of checks and balances. Many state organizations lack the resources to deliver effective services and the judiciary has lost its independence. The executive branch not only influences judicial decisions, but also reportedly intimidates judges who do not follow the party line.

In summary, if the political climate were to change in Zimbabwe and donors were to resume normal programming, it would be essential that initial measures help to re-establish law and order and calm social unrest. Rebuilding state capacity and rehabilitating the economy will require stabilizing security.

4. Private Sector Enabling Environment

This section reviews key indicators of the enabling environment for rapid and efficient growth of the private sector. Sound fiscal and monetary policies are essential for macroeconomic stability, a necessary though not sufficient condition for sustained growth. A dynamic market economy also depends on basic institutional foundations, including secure property rights, an effective system for enforcing contracts, and an efficient regulatory environment that does not impose undue barriers on business activity. Financial institutions play a major role in mobilizing and allocating savings, facilitating transactions, and creating instruments for risk management. Access to the global economy is another pillar of a good enabling environment because the external sector is a central source of potential markets, modern inputs, technology, and finance, as well as competitive pressure for improving efficiency and productivity. Equally important is the development of physical infrastructure to support production and trade. Finally, developing countries need to adapt and apply science and technology to attract efficient investment, improve competitiveness, and stimulate productivity. In nearly every respect the present environment in Zimbabwe is highly detrimental to growth and poverty reduction.

FISCAL AND MONETARY POLICY

Destructive fiscal and monetary policies are a leading cause of Zimbabwe's economic tailspin. The most obvious sign of macroeconomic instability is hyperinflation. According to official Reserve Bank statistics, prices rose by more than 1,000 percent in 2006, by far the highest inflation rate in the world (see Figure 4-1). Independent Zimbabwean economists estimate that the true inflation rate may have reached 10,000 percent during the first half of 2007.²⁷ By comparison, the expected value for a country with Zimbabwe's characteristics is 5.6 percent, and the inflation rates in South Africa and Zambia are 4.6 percent and 9.2 percent, respectively. Even in the 1990s, inflation was high and rising, averaging 28.6 percent; this was an early sign of irresponsible macroeconomic management.

Unless the government attacks hyperinflation with strong and credible macroeconomic policies, capital and labor will continue to flee, poverty will deepen, pressures leading to social unrest will likely intensify, and economic recovery will be an impossible dream. The government's efforts to

²⁷ This estimate was provided by Dr. John Robertson, a leading independent economist in Zimbabwe.

cure inflation through arbitrary price controls only diminishes the legal supply of basic goods, accentuates shortages, and enhances the incentive for black market activity.

The hyperinflation is a result of both fiscal and monetary mismanagement over the past ten years. On the fiscal side, the IMF reports that the budget deficit, including grants, stood at 10.0 percent of estimated GDP in 2006.²⁸ This is nearly triple the deficit of 3.0 percent of GDP achieved in 1998,²⁹ and more than six times the expected value of 1.5 percent for Zimbabwe. In comparison, South Africa virtually balanced its budget³⁰ (see Figure 4-2).

The fiscal deficit has been driven by uncontrolled spending, but both expenditures and revenues have been extraordinarily high relative to GDP. According to IMF estimates, government expenditure reached 53.5 percent of GDP in 2006, more than double the expected value of 24.7 percent, South Africa's 26.4 percent, and Zambia's 22.8 percent. The main components of expenditure have been capital projects (24.3 percent) and emoluments for government employees (29.9 percent). The available data probably overstate the actual size of government expenditure relative to GDP due to the problems of measuring GDP in the context of rampant inflation and expanding black market activity; even so, the indicators show that the government is absorbing an extremely large share of resources in the formal economy. In addition, a recent IMF report shows that the government has used the central bank to finance enormous "quasi-fiscal" expenditures by providing foreign exchange to favored enterprises at highly favorable rates, price supports to exporters, and subsidized credit to farmers and public enterprises.³¹

Government revenue, too, is extremely high as a percentage of estimated GDP, and this ratio has risen rapidly over the past five years to reach 43.3 percent in 2006. This is far higher than the expected value of 25.8 percent, South Africa's 26.5 percent, and Zambia's 16.9 percent. Even in 1998, the revenue ratio in Zimbabwe was already very high by benchmark standards at 30.9 percent of GDP. Fundamentally, the government in a low-income country should be leaving a much larger share of the economic pie in the hands of the private sector in order to foster sustainable growth.

IMF Program Status for Zimbabwe

Between 2001 and 2006, Zimbabwe was in continuous arrears to the General Resources Account of the IMF. As a result, the IMF suspended Zimbabwe's voting rights. Zimbabwe then paid back these arrears in full in February 2006; however, it was still in arrears to the Poverty Reduction and Growth Facility-Exogenous Shocks Facility (PRGF-ESF). Because of this debt and policy mismanagement, the IMF suspended technical assistance and removed Zimbabwe from the list of PRGF-ESF-eligible countries. The voting ban and other sanctions remain in place.

²⁸ IMF, *Regional Economic Outlook for Sub-Saharan Africa* April 2007, Washington DC.

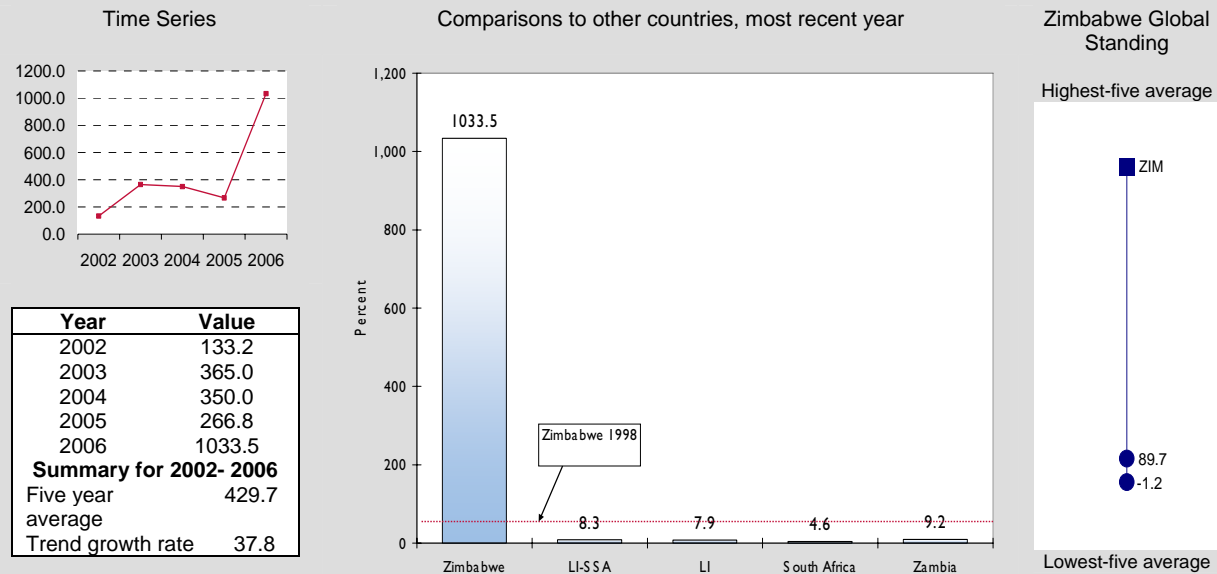
²⁹ IMF, *Article IV Consultation—Staff Report*, 2000.

³⁰ The same report recorded Zambia as having a 20 percent surplus; this, however, is an anomaly as grants in 2006 included debt relief equivalent to 21.4 percent of GDP.

³¹ IMF Working Paper, *Central Bank Quasi-Fiscal Losses and High Inflation in Zimbabwe*, April 2007.

Figure 4-1. Inflation Rate

Even the official statistics show hyperinflation that is crippling the economy.

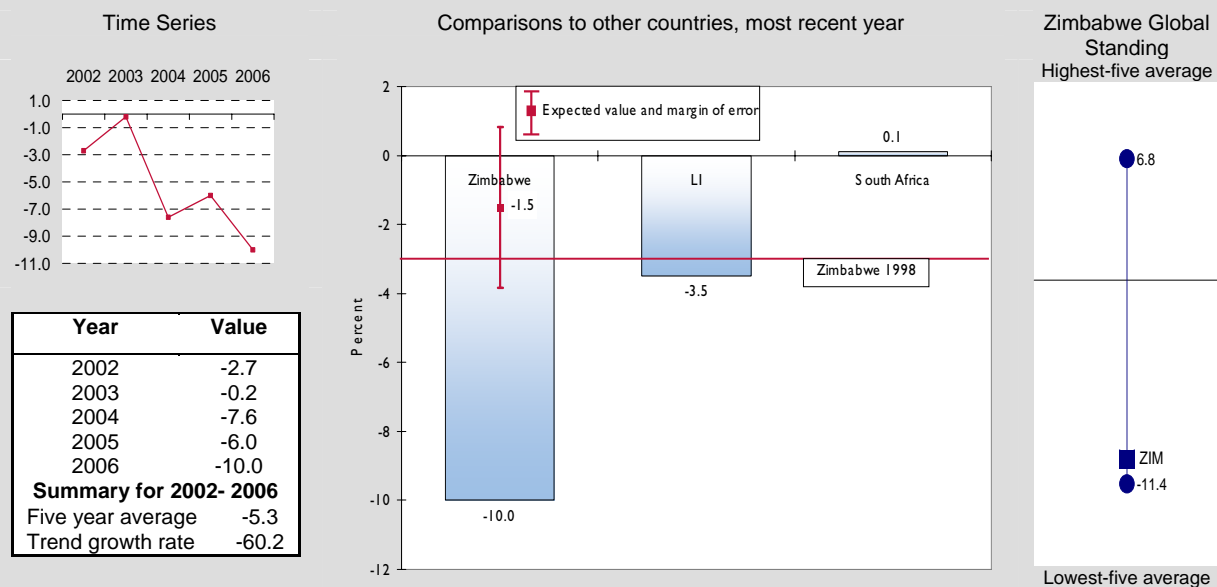


SOURCE: World Economic Outlook and Reserve Bank of Zimbabwe.

CAS Code: 21P4

Figure 4-2. Overall Budget Balance, including Grants, % of GDP

Huge budget deficits are fueling inflation and domestic debt.



SOURCE: Regional Economic Outlook Sub-Saharan Africa, April 2007.

CAS Code: 21P5

While the budget has been a major source of macroeconomic instability, poor monetary policy has been the immediate impetus for high inflation. According to Reserve Bank of Zimbabwe, the nominal money supply increased by 1,044 percent in 2006, approximately 70 times the expected value of 15.0 percent, and Zambia's 14.6 percent. The corresponding figure for South Africa was 23.1 percent. In 2006, 79.1 percent of the increase in broad money was for credit to government; in effect, the government is printing money at a reckless rate to finance public programs. For the past two years, money supply growth has outpaced measured inflation, creating a reservoir of hidden inflation via the black market, and pressures for even faster inflation in the future.

Once a change in the political landscape allows donors to resume support for economic programs in Zimbabwe, the restoration of macroeconomic stability should be one of the top priorities for immediate attention. Other countries that have suffered extremely high inflation have been able to reduce rates to manageable levels within one to two years through a steadfast commitment to fiscal and monetary adjustments. A substantial commitment of donor support will be needed, however, to minimize the contraction effect on income and production from such adjustments.

BUSINESS ENVIRONMENT

Institutional barriers to doing business, including corruption in government, are another critical determinant of private sector development and prospects for sustainable growth. To compound the severe economic mismanagement in Zimbabwe, the business environment is poor and deteriorating.

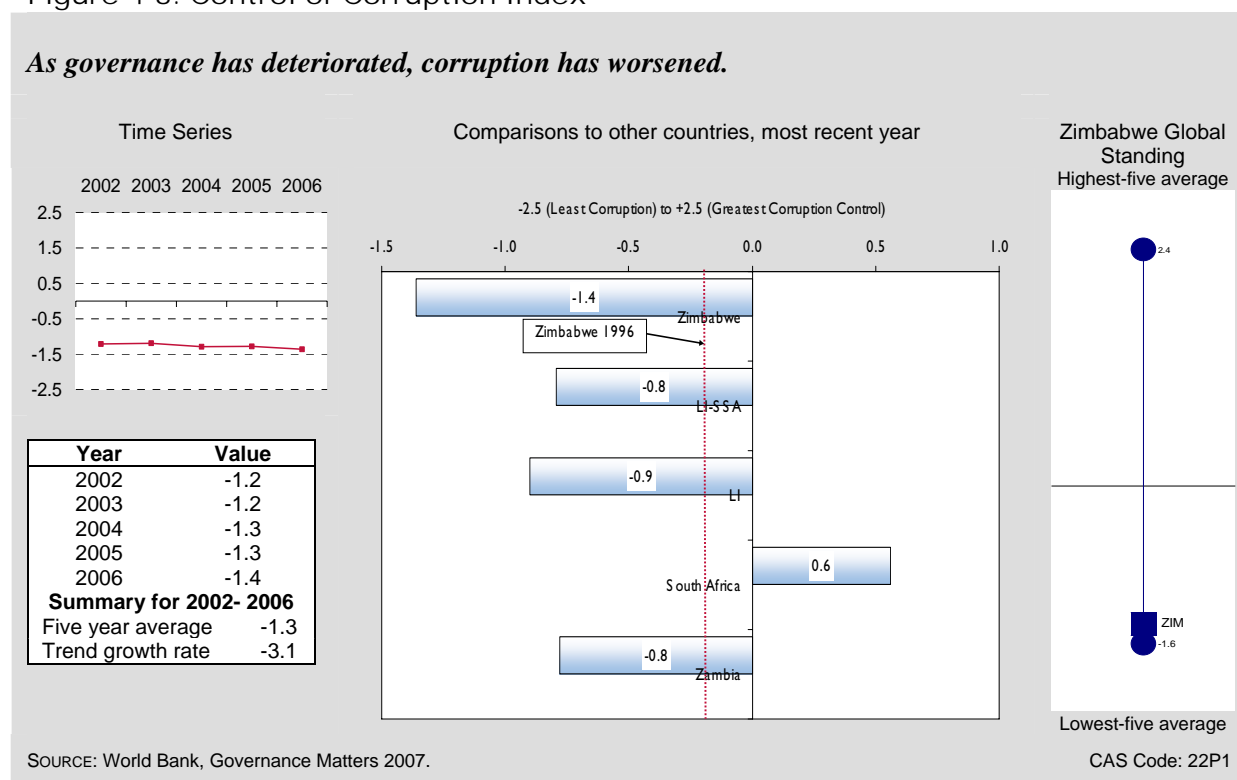
Zimbabwe ranks near the bottom of the World Bank's global index of the Ease of Doing Business—153 out of 175 countries rated in 2006 and a drop of eight places from 2005. Zimbabwe's ranking for 2006 is far worse than the expected value of 129, and puts the country 124 places behind South Africa and 51 places behind Zambia. Still, some requirements in Zimbabwe remain less onerous than the average for the region. This includes the number of procedures required to enforce a contract (33 versus an average of 36 for LI-SSA), register property (4 versus 6) and start a business (10 versus 11), as well as the time required to register property (30 days versus 98 days). The corresponding figures for South Africa are 26, 6 and 9 procedures, and 23 days; and for Zambia, 21, 6, and 6 procedures, and 70 days. For the time required to start a business (96 days), however, Zimbabwe performs particularly badly compared to the LI-SSA average of 43 days and 35 days for both South Africa and Zambia.

Doing Business scores are based on an assessment of formal procedures. For Zimbabwe, however, the formal regulations are far less important for business development than the poor quality of governance. This is clearly seen in the World Bank Institute's (WBI) indices for government effectiveness, rule of law, and regulatory quality. These indices are expressed on a scale of -2.5 to +2.5, with a global mean of 0.0. In 2006, the Government Effectiveness index for Zimbabwe was -1.5, versus an expected value of -0.7, and scores of 0.8 and the -0.7 for South Africa and Zambia, respectively. The latest score is a far cry from Zimbabwe's standing ten years earlier (-0.4). The indices for rule of law and regulatory quality have also declined drastically, falling from -0.7 for both scores in 1996 to -1.7 for rule of law and -2.2 for regulatory quality in 2006. These indices will surely decline further in light of developments in 2007, including

accelerating inflation, the imposition of price controls, and reports that the government seeks to confiscate capital in foreign-owned companies.³²

Hand in hand with poor governance has been a sharp increase in perceived corruption. According to WBI's Control of Corruption index, (also on a scale of -2.5 to +2.5), the score for Zimbabwe plunged from -0.2 (52nd percentile) in 1996 to -1.4 (4th percentile) in 2006. Corruption is now considerably worse than in neighboring Zambia and many other low-income countries in sub-Saharan Africa, not to mention South Africa, where it is far less pervasive (Figure 4-3).

Figure 4-3. Control of Corruption Index



These governance problems severely affect the business environment. By all indications, these adverse conditions are the result of the current government's political strategy that rewards supporters and undermines the economic base of other constituencies. This strategy is being pursued at the expense of the general economy and the welfare of the general population. Despite the sharp decline in economic activity and per capita income, government supporters still benefit from access to credit, foreign exchange, and scarce commodities (such as gasoline) on highly preferential terms. Other policies serving the same end include the redistribution of farm land, the

³² Mail and Guardian, July 23, 2007. Zimbabwe to Debate Nationalization. http://www.mg.co.za/articlePage.aspx?area=/breaking_news/breaking_news_africa/&articleid=314751. Accessed July 31, 2007.

prospective redistribution of other foreign-owned capital, and deeply negative real interest rates on savings vehicles (see Financial Sector).

With Zimbabwe performing poorly on vital indicators of the basic business environment, donors will need to see clear signs of a fundamental transformation in the political situation before resuming support for economic growth programs. Particularly important are convincing measures to restore the rule of law, re-establish property rights, and dismantle the most serious barriers to market-driven private sector development. Red tape, as such, is not the critical factor at this stage. Thus, most programs dealing with regulatory quality and capacity should probably be sequenced later in the recovery process. However, easy-to-implement measures such as helping the government to streamline business registration could be undertaken early to facilitate the recovery of private investment.

FINANCIAL SECTOR

A sound and efficient financial sector is a key to mobilizing savings, fostering productive investment, and improving risk management. In Zimbabwe, financial sector indicators paint a very unusual but generally grim picture.

One basic indicator of financial development is the degree of monetary deepening, measured by the ratio of broad money (currency plus bank deposits) to GDP. In Zimbabwe, this ratio increased from 23.3 percent in 2002 to 42.5 percent by 2006.³³ A rise in the ratio is typically a positive sign. In this case, however, the enormous increase over a short period largely reflects the printing of money at an alarming rate, along with underestimation of prices in the measurement of GDP, rather than healthy financial development (see Fiscal and Monetary Policy).

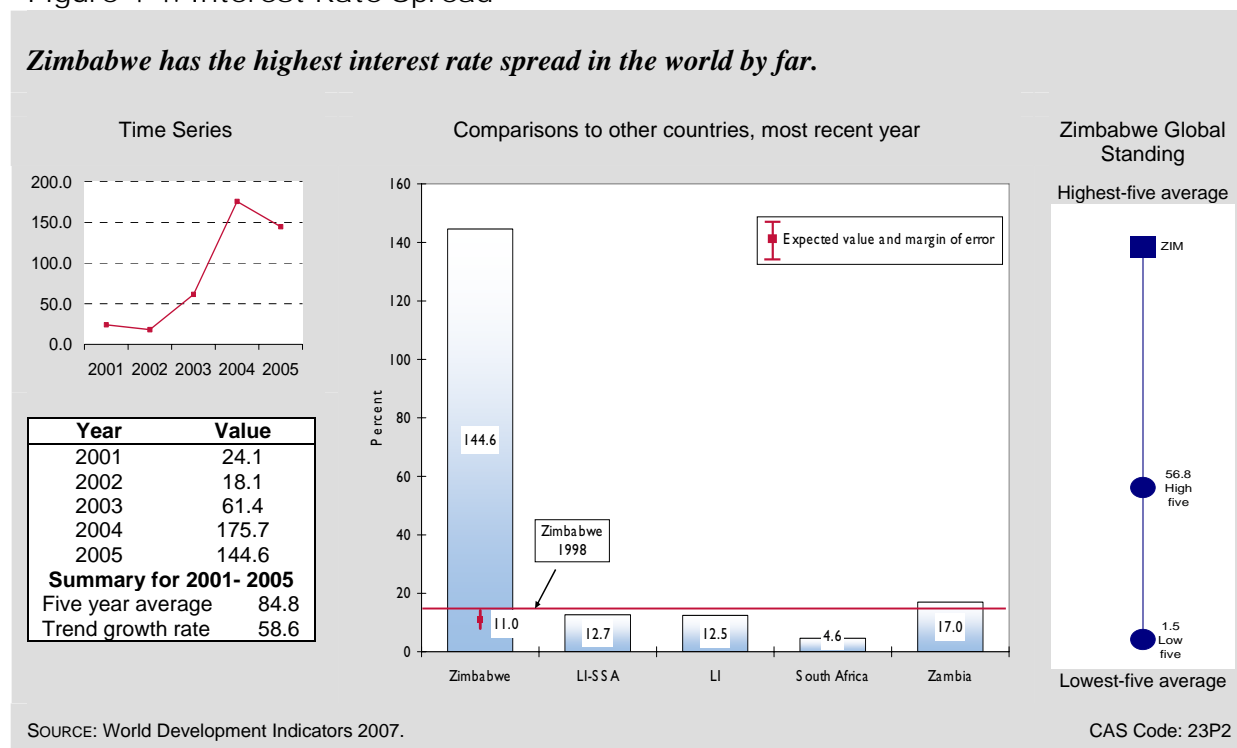
Another primary indicator is domestic credit to the private sector. In Zimbabwe, credit to the economy (excluding government) rose from 18.2 percent of the GDP in 2001 to 27.0 percent in 2005. Both figures are much better than the credit ratio for Zambia (7.6 percent) and the LI-SSA median (10.8 percent); South Africa is on a different plateau of financial sophistication, with a credit ratio of 143.5 percent of the GDP. As with the monetization ratio, the increase in credit to the economy largely reflects monetary mismanagement rather than financial deepening. In particular, the Reserve Bank has been channeling large volumes of credit to agriculture, public enterprises, and local authorities at interest rates far below the rate of inflation. The loans are financed by issuing domestic debt that commercial banks and pension funds are required to purchase, and by printing money.³⁴ In addition, informed reports indicate that the government imposed a statutory reserve requirement of as much as 60 percent of bank deposits at a zero interest rate between January 2004 and June 2006, effectively. These mechanisms have severely drained the economy's financial resources by appropriating savings to politically driven uses.

³³ Under usual circumstances, we normally calculate the ratio of broad money to GDP as end of period broad money as a percentage of GDP for the period. Owing to the hyperinflation, it was calculated as an average of broad money over the whole period as a percentage of GDP for the period.

³⁴ IMF Working Paper, Central Bank Quasi-Fiscal Losses and High Inflation in Zimbabwe, April 2007, p. 10-11.

Favorable interest rates in government-directed credits effectively provide a bountiful subsidy that does not appear on the government budget. Indeed, the IMF estimates that the real interest rate on bank loans averaged *minus* 27.7 percent in the five years to 2005, becoming increasingly negative over the period.³⁵ This compares to an average of *plus* 10.7 percent for LI-SSA, 5.6 percent in South Africa, and 7.7 percent in Zambia. The negative rates mean that borrowers repay the banks less than the amount received after adjusting for inflation. Furthermore, negative real interest rates completely negate the critical role of interest rates as a price mechanism for screening out inefficient or unproductive investments. To the extent that official statistics understate inflation, the true “cost” of borrowing is even more negative.³⁶

Figure 4-4. Interest Rate Spread



Another sign of inefficiency in the banking sector is the extremely high spread between the interest rate on loans and deposits. In 1998, the interest rate spread for Zimbabwe was 13.0 percent. It now has one of the highest spreads in the world—in 2005, 144.6 percent, compared to the expected value of 11.0 percent, South Africa’s 4.6 percent, and Zambia’s 17.0 percent (Figure 4-4). Given that lending rates are negative in real terms, the large spread indicates that depositors receive a yield so negative as to constitute a confiscation of wealth. These are ideal conditions for provoking capital flight and the hoarding of foreign currency and commodities, in lieu of

³⁵ Ibid.

³⁶ Taking into account the tax-deductibility of interest expenses, the effective real interest rate is even more strongly negative, because the tax deduction reduces the financial cost of borrowing.

financial savings. In all respects, the economy is suffering from intense financial repression, which works at cross purposes to the development of a sound and efficient financial sector.

Aside from macroeconomic stability, another requirement for financial development is an effective regulatory environment. In this regard, the World Bank's Doing Business report gives Zimbabwe a moderate score of 6.0 on its index of Legal Rights of Borrowers and Lenders for 2006 (on a scale of 0 to 10, from poor to excellent); this is below Zambia's score of 7.0, but considerably better than the median of 4.0 for LI-SSA. Yet the Bank gives Zimbabwe the lowest possible score (0.0) on its index of Credit Information depth, which gauges "the rules affecting the scope, accessibility and quality of credit information available through either public or private credit registries."³⁷ Effective distribution of high quality credit information will be very important for facilitating the expansion of bank credit beyond prime clients once the current regime of financial repression ends.

For a low-income country, Zimbabwe has a relatively well-developed equities market. Stock market capitalization amounted to 71.2 percent of the GDP in 2005, far better than the LI-SSA median of 14.3 percent or Zambia's low ratio of 13.6 percent; South Africa again is on a far higher plateau, at 236.0 percent. Because of the underestimation of GDP caused by the spread of black market transactions and unrecorded inflation, this measure is likely to overestimate the strength of the stock market. Nevertheless, there have been real increases in recent years, reflecting the fact that an equity claim on real assets serves as a hedge against inflation.

On balance, the financial sector is being used as an instrument for economic mismanagement rather than being developed as a cornerstone for sustainable growth. The combination of directed credits and highly negative interest rates feeds inflation and inefficiency, while stimulating capital flight. Without a major improvement in governance and monetary management, these outcomes will continue. When conditions change, the financial sector is likely to recover on its own merits, though donor support, including sustainable approaches to microfinance, may be useful in accelerating the expansion of access to credit by non-prime clients.

EXTERNAL SECTOR

Fundamental changes in international commerce and finance, including lower transport costs, advances in telecommunications technology, and fewer policy barriers, have fueled a rapid increase in global integration in the past 25 years. The international flow of goods and services, capital, technology, ideas, and people offers great opportunities for countries such as Zimbabwe to boost growth and reduce poverty by stimulating productivity and efficiency, providing access to new markets and ideas, and expanding the range of consumer choice. At the same time, globalization creates challenges, including the need for reforms to take full advantage of international markets, and cost-effective approaches to cope with the resulting adjustment costs and regional imbalances.

³⁷ World Bank, Doing Business; Getting Credit Category: Methodology & Surveys
<http://www.doingbusiness.org/MethodologySurveys/GettingCredit.aspx>

Following independence in 1980, Zimbabwe took steps to liberalize trade and attract foreign investment, but also announced its intention to establish a socialist state. As a result very little new investment arrived, and the business climate remained unattractive until improvements took place with the launch of a Structural Adjustment Program in 1991, with IMF support. However, IMF conditionality also dismantled some of the mechanisms used for political patronage and prompted demands for other benefits such as war pensions and land transfers. In response, the government started a process that led to a deterioration of both macroeconomic stability and property rights. Trade and investment policies also shifted into reverse, driven by intense nationalism and a disregard for economic consequences of the populist program, including the advent of hyperinflation. With the official exchange rate tightly controlled, one result was an extreme overvaluation of the currency since 2001 (which also creates strong incentives for corruption). For the 12 months ending in July 2007, the official rate was 250 Zimbabwean dollars to one U.S. dollar, but over that period the black market rate increased from Z\$650 per U.S. dollar to a range of Z\$150,000 to Z\$300,00 one.³⁸

The huge gap between official and open market exchange rates makes it very difficult to gauge external sector trends using indicators based on local currency values. Some indicators, though, are measured directly in foreign exchange. It is thus very clear that exports are rapidly declining, the external debt burden is rising, foreign investment is low, foreign exchange reserves are dangerously depleted, and Zimbabweans are increasingly relying on remittances and food aid.

International Trade and Current Account Balance

The most common indicator of trade openness is the ratio of exports plus imports (goods and services) to GDP. For Zimbabwe the ratio was 71.5 percent in 2006 using the official exchange rate and the IMF estimate of GDP. Given the aforementioned measurement problems, this number is almost meaningless. Looking back to 1998, when Zimbabwe's political problems were just beginning to take shape, one can obtain a solid figure of 88.0 percent. When the current macroeconomic problems are brought under control and the exchange rate is allowed to reach equilibrium, this ratio will be a reasonable target at which to aim in the reconstruction process.

The poor economic policy environment has caused export earnings to plummet in dollar terms despite high world prices for most commodities. Over the five years to 2006, exports declined at an average annual rate of 3.6 percent.³⁹ In contrast, the expected value for a country with Zimbabwe's characteristics is a growth rate of plus 3.9 percent. In comparison, South African exports grew by 4.9 percent in 2005, and exports from Zambia by 12.6 percent. In 1998, Zimbabwe's exports grew by 19.9 percent, so rapid trade growth is feasible under the right conditions.

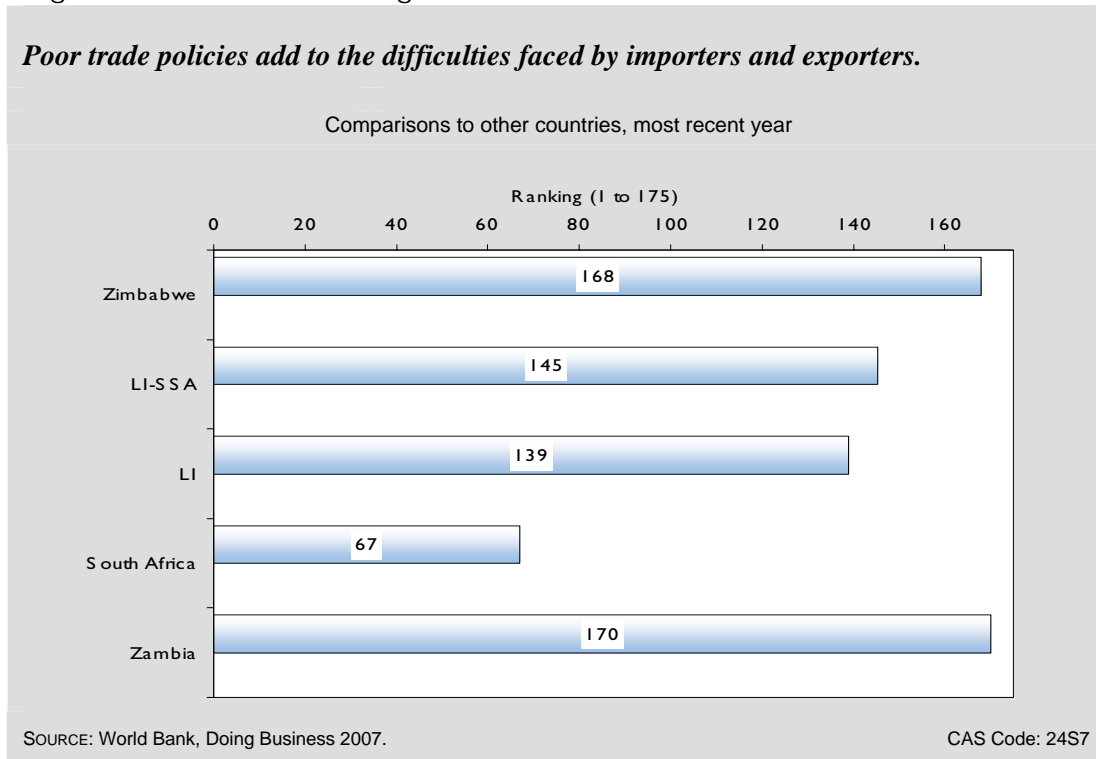
³⁸ The lower rate was provided by John Robertson in a communication on July 11, 2007. The higher rate was reported in a Guardian Unlimited story, *U.S. Predicts Regime Change in Zimbabwe as Hyperinflation Destroys the Economy*, on June 22, 2007. See <http://www.guardian.co.uk/zimbabwe/article/0,,2108910,00.html>, accessed July 31, 2007

³⁹ Reserve Bank of Zimbabwe.

The decline in exports is unquestionably related to poor economic policies and a very difficult business environment. But trade policies are also a major factor. This can be seen in Zimbabwe's poor score of 42.6 percent in 2007 on the Heritage Foundation's Trade Freedom Index (on a scale of 0 to 100, from least to most free). This is 26.6 percentage points lower than South Africa's score of 68.8 percent and 18.2 percentage points below Zambia's score of 60.8.

Furthermore, the World Bank's Doing Business report for 2007 ranks Zimbabwe 168 out of 175 countries on the ease of trading across borders. Zimbabwe's rank is much worse than the LI-SSA median of 145 and South Africa's 67, but comparable to Zambia's poor rank of 170⁴⁰ (Figure 4-5). In addition to the economic policy environment, rising world oil prices have meant that Zimbabwe's terms of trade fell from 100 to 78.4 between 2000 (the index base year) and 2006. This shows that the unit value of Zimbabwe's exports declined by 21.6 percent relative to the unit cost of imports. In this regard, most other low-income countries have been better prepared to weather hikes in oil prices. Over the same period, the average terms of trade for LI-SSA only fell by 6.1 percent to 93.9, while South Africa's terms of trade rose to 109.6 and Zambia's to 204.3 (because of high copper prices).⁴¹

Figure 4-5. Ease of Trading Across Borders



⁴⁰ One reason for the low scores in Zambia and Zimbabwe is that the Doing Business methodology is based on a standardized case involving a shipment by sea through the nearest port, and both countries are landlocked.

⁴¹ IMF, Regional Economic Outlook for Sub-Saharan Africa April 2007, Washington DC. Other references in this section to IMF estimates are from the same source.

According to the IMF reports, Zimbabwe's current account deficit, excluding grants, was 5.0 percent of GDP in 2006. Taking grants into account the deficit was 3.9 percent of GDP, down from 11.2 percent in 2005. The 2006 number is in line with the expected value of 3.1 percent, and better than South Africa's 6.4 percent, but considerably worse than Zambia's deficit of 0.4 percent. Even so, it would be a mistake to see this as a sign of improvement. Rather it is testament to the lack of access to foreign capital inflows and a negligible pool of foreign reserves; in short, the country lacked the means to finance a larger inflow of imports. The IMF also estimates that Zimbabwe's external debt at the end of 2006 at US\$4,700 million, of which arrears totaled US\$2,700 million. This has earned Zimbabwe, which once had an impeccable debt service record, the lowest credit rating possible.

No recent data are available on remittances to Zimbabwe—a major component of the current account in many developing countries. Nonetheless, numerous reports suggest that remittances from family members are now essential to the survival of many poor households.⁴² Because of the prevailing governance problems, most of the money is not sent through official channels, and is therefore not detected in the balance of payments data.

Foreign Investment, External Assistance, and International Reserves

Foreign direct investment (FDI) can catalyze productivity gains and growth by transferring technology, developing human capital, enhancing competition, and expanding access to foreign markets. In 2005 (latest year of available data), the flow of FDI into Zimbabwe reached 2.3 percent of estimated GDP.⁴³ Considering the political situation, this is surprisingly high. Still, it is far less than the 1998 figure of 7.3 percent, as well as the expected value of 4.1 percent and Zambia's 6.2 percent; in South Africa, FDI inflows amounted to just 0.3 percent of GDP in 2004. An article in the *Financial Gazette* of Harare suggests that recent FDI flows were stimulated in large part by a package of incentives to foreign mining firms.⁴⁴ However, the article also reports rising doubt among investors about the government's promises, and worries about the extreme shortage of foreign currency reserves. It appears that some mining companies are considering pulling out of Zimbabwe, not least because of the government's announced consideration of nationalizing or indigenizing foreign-owned assets. International corporations are normally keen on natural resource investments even in countries with a poor business climate. Zimbabwe, however, receives one of the lowest scores in the world on UNCTAD's index of Inward FDI

⁴² A recent survey by the International Organization for Migration in London (Mapping Exercise Zimbabwe, December 2006) found that the majority of expatriate Zimbabweans in the UK send remittances home. Large remittances flows are undoubtedly coming from South Africa and other neighboring countries, as well, though no data are available.

⁴³ Calculated using absolute FDI statistics from UNCTAD's World Investment Report 2006 and GDP estimates from the IMF's World Economic Outlook April 2007. As this would amount to about US\$100 million, it could represent the capital inflow to Zimbabwe Platinum Mine, which is the only significant investment project.

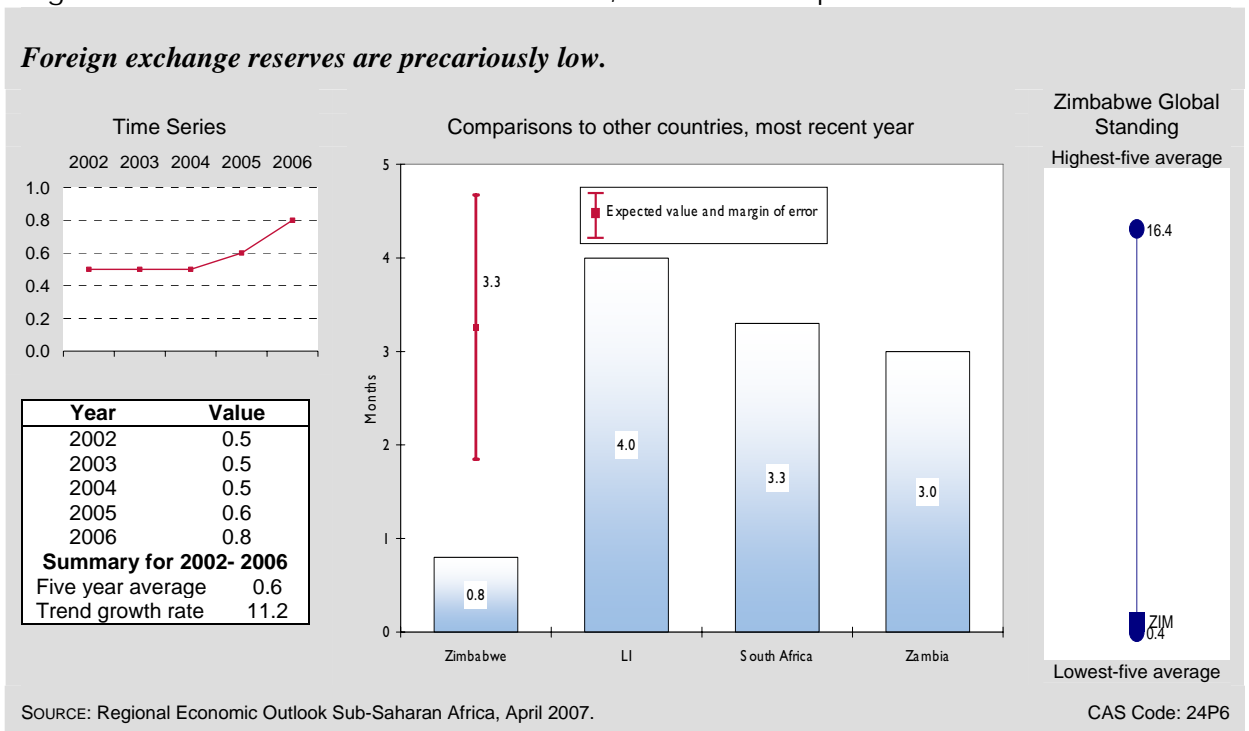
⁴⁴ See <http://allafrica.com/stories/200706140920.html> accessed on July 24, 2007.

Potential, at 0.04 on a scale of 0 to 1 (poorest to best). This compares to an average for LI-SSA of 0.10, South Africa's 0.18, and Zambia's 0.09.

Foreign assistance is another vital source of foreign currency for most low-income countries. Because of the data problems mentioned above, our usual benchmark of measuring foreign aid relative to GDP does not provide useful information in this instance; in absolute terms, aid to Zimbabwe plummeted from US\$369 million to US\$187 million between 1996 and 2004, before rising to close to US\$368 million in 2005.⁴⁵ Most of that rise, however, is in the form of health and emergency relief.⁴⁶

The extreme shortage of foreign currency reserves is also extremely troubling. According to IMF estimates, gross reserves accounted for just 0.8 months of imports in 2006, well below the expected value of 3.3 months for a country with Zimbabwe's characteristics, South Africa's 3.3 months, and Zambia's 3 months. Moreover, the IMF generally recommends that countries retain foreign exchange reserves between 3 and 4 months worth of imports, as a minimal cushion against external shocks (Figure 4-6).

Figure 4-6. Gross International Reserves, Months of Imports



⁴⁵ World Development Indicators 2007.

⁴⁶ <http://www.oecd.org/dataoecd/12/60/1883524.gif>, accessed July 31, 2007.

Debt

Our fiscal analysis showed that the government and the monetary authorities have been issuing mountains of debt, largely domestic debt. Zimbabwe was able to stave off the burden from foreign debt for several years, but as real GDP declined the debt burden as a percentage of GDP rose considerably. According to the 2007 World Development Indicators, public and publicly guaranteed debt fluctuated around US\$3 billion between 1995 and 2005. But the most recent IMF Article IV consultation report for Zimbabwe (October 2005) shows that the debt actually rose to \$4.9 billion in 2004. This higher figure includes accumulated arrears rather than new borrowing, as Zimbabwe has qualified for very little external credit. Over the same period, real GDP fell by an estimated 25 percent, which accentuated the increase the debt burden.

If the political situation changes in Zimbabwe, there will most likely be a pressing need for donors to help the government restructure the escalating international and domestic debt, negotiating debt relief as part of a reconstruction program and to avoid penalizing citizens for economic mismanagement by the current leadership.

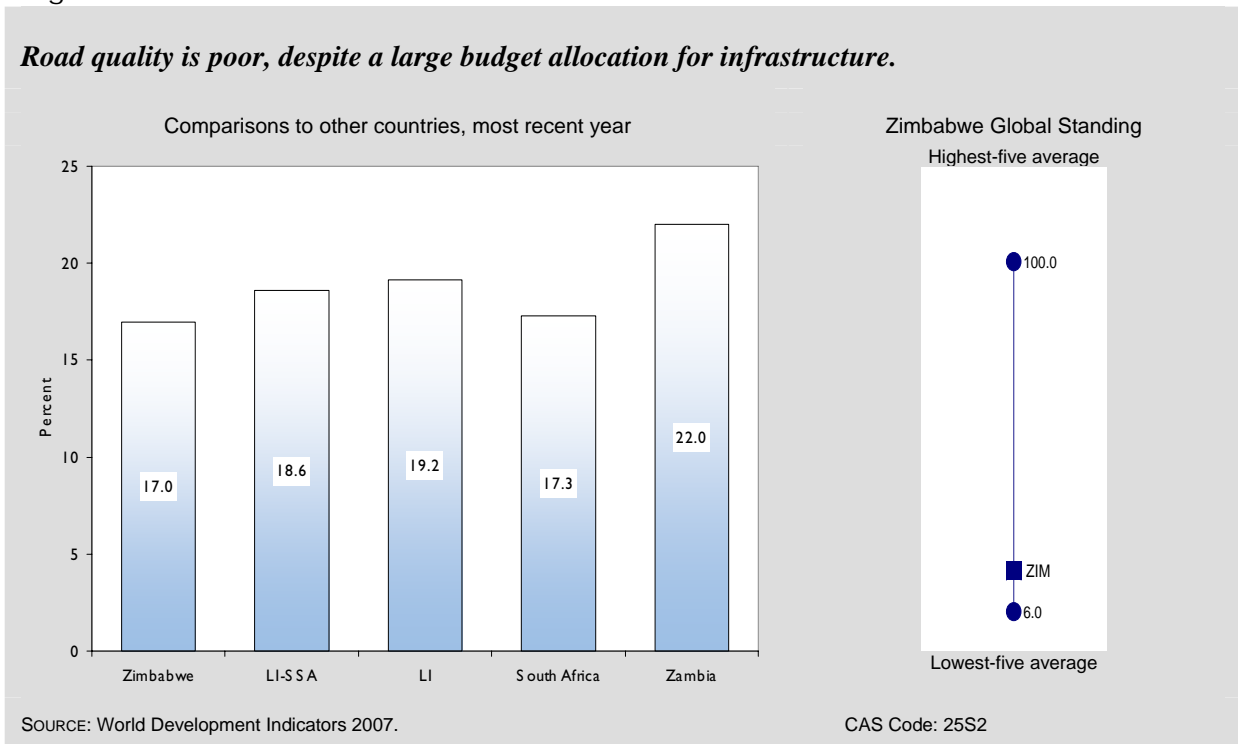
ECONOMIC INFRASTRUCTURE

A sound system of physical infrastructure—for transportation, communications, power, and information technology—is necessary for competitiveness and productive capacity and relies heavily on an enabling macroeconomic and political environment. Zimbabwe once had some of the best infrastructure in sub-Saharan Africa, but quality has been deteriorating, compounding other disincentives to investment. The World Economic Forum (WEF), which compiles an annual index of infrastructure quality based on a survey of executive opinion in each country, scored Zimbabwe 2.9 on a scale of 1 to 7 (poor to excellent) in 2006, a drop of more than one full point from its 2002 score of 4.0. Yet Zimbabwe still fares well relative to cohort comparisons, including the expected value of 2.6, the median for LI-SSA of 2.2, and Zambia's latest score of 1.9. South Africa outshines other countries in the region with a score of 4.6, showing what can be achieved with a well-managed economy.

Finding a good indicator for benchmarking road quality is difficult. One widely used proxy is the percentage of roads that are paved. According to a World Bank report, about 17.0 percent of roads in Zimbabwe were paved in 2006.⁴⁷ This falls short of all benchmarks—LI-SSA at 18.6 percent, South Africa at 17.3 percent in 2001, and Zambia at 22.0 percent in 2001 (see Figure 4-7). The 2006 figure is also a drop of 2 percentage points since 2002, possibly reflecting the withdrawal of donor support for the road sector. The World Bank report estimates that it will cost about US\$1.7 billion to restore the road network to “good” condition. It also notes that institutional weaknesses, lack of modern information management systems, and poor local capacity are major deterrents to improving Zimbabwe's roads.

⁴⁷ World Bank, Zimbabwe Infrastructure Assessment Note for Roads, Railways and Water Sectors, 2006, Executive Summary (p. X).

Figure 4-7. Paved Roads as Percent of Total

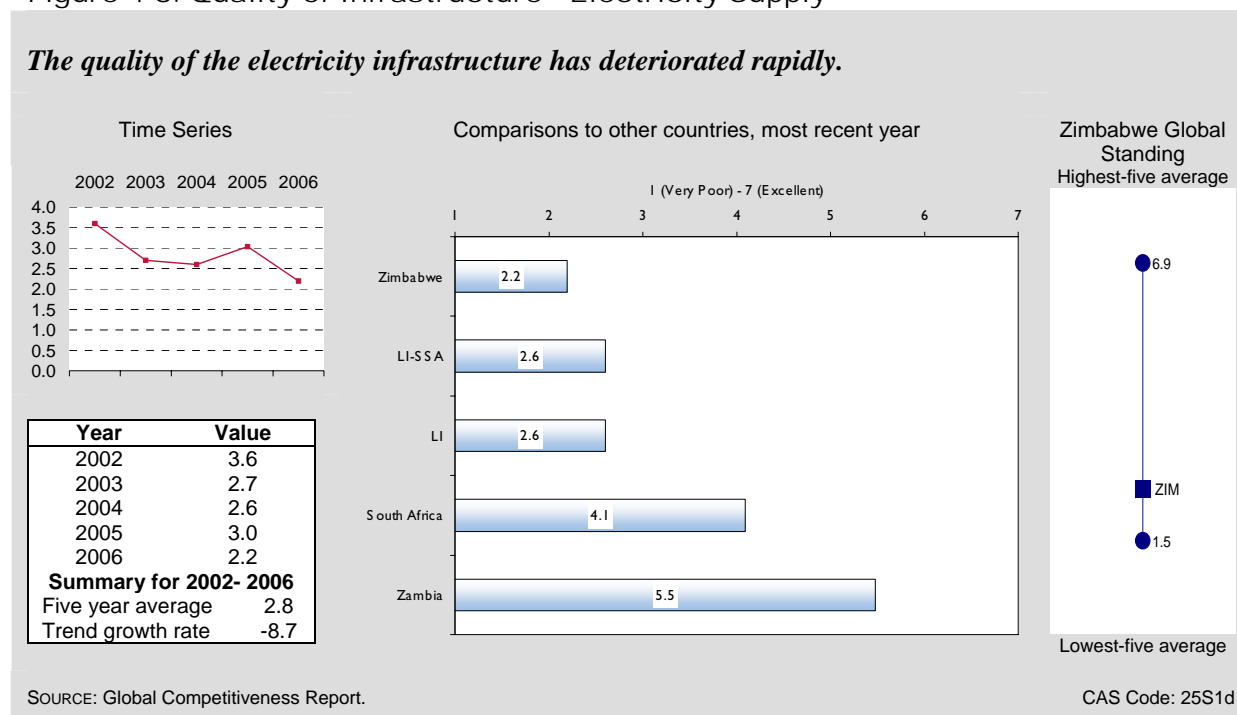


For a landlocked country like Zimbabwe, railroad and air transport systems are critical elements of the physical infrastructure. The WEF has downgraded Zimbabwe's railroads rating from 3.4 in 2002 to 2.7 in 2006. This is still above the LI-SSA median and Zambia's score, both of which are 1.6, though below South Africa's score of 3.5. Foreign exchange and fuel shortages, as well as poor availability of locomotives are serious constraints in the railroad sector.⁴⁸ The WEF rating for the quality of air transport has also deteriorated to 2.6 in 2006, from 3.3 five years earlier, putting Zimbabwe well below the LI-SSA median (3.1), and the scores for Zambia (4.6) and South Africa (5.8).

The story is similar for electricity infrastructure, where the WEF rating for Zimbabwe has fallen from 3.6 in 2002 to just 2.2 in 2006, below the LI-SSA median (2.6) and well below scores for Zambia (5.5) and South Africa (4.1). A return to the 2002 score is a minimum indicator for where the country ought to be, were the political and economic situation less damaging to the economy (see Figure 4-8).

⁴⁸ World Bank, *Zimbabwe Infrastructure Assessment Note for Roads, Railways and Water Sectors*, 2006, p. xii. .

Figure 4-8. Quality of Infrastructure—Electricity Supply



For modern economic growth, information and communications infrastructure is just as important as transportation and electricity. The number of Internet users in Zimbabwe has grown almost tenfold in the five years to 2005, to reach to 76.9 users per 1,000 people. Compared to the LI-SSA median of 5.5 or Zambia's 20.1, Zimbabwe's performance is remarkably good. Nonetheless, Zimbabwe is at risk of being left behind, as illustrated by South Africa's figure of 108.8 Internet users per 1,000 people. Telephone density, the number of fixed line and mobile phones per 1,000 people, stood at 55.2 in 2004, showing that Zimbabwe is still faring better than Zambia (33.7). Nonetheless, it lags far behind the expected value of 123.9, and even further below South Africa's exemplary standard of 473.1.

Moreover, Zimbabwe's economic decline has compelled many technically skilled people to emigrate in search of better prospects for career development and job security. Economic assistance to Zimbabwe will have to factor in the urgent need to attract engineers, technicians, managers, administrators and other professionals back to the country, and to rehabilitate training institutions that are needed to attract new talent into each profession and trade.

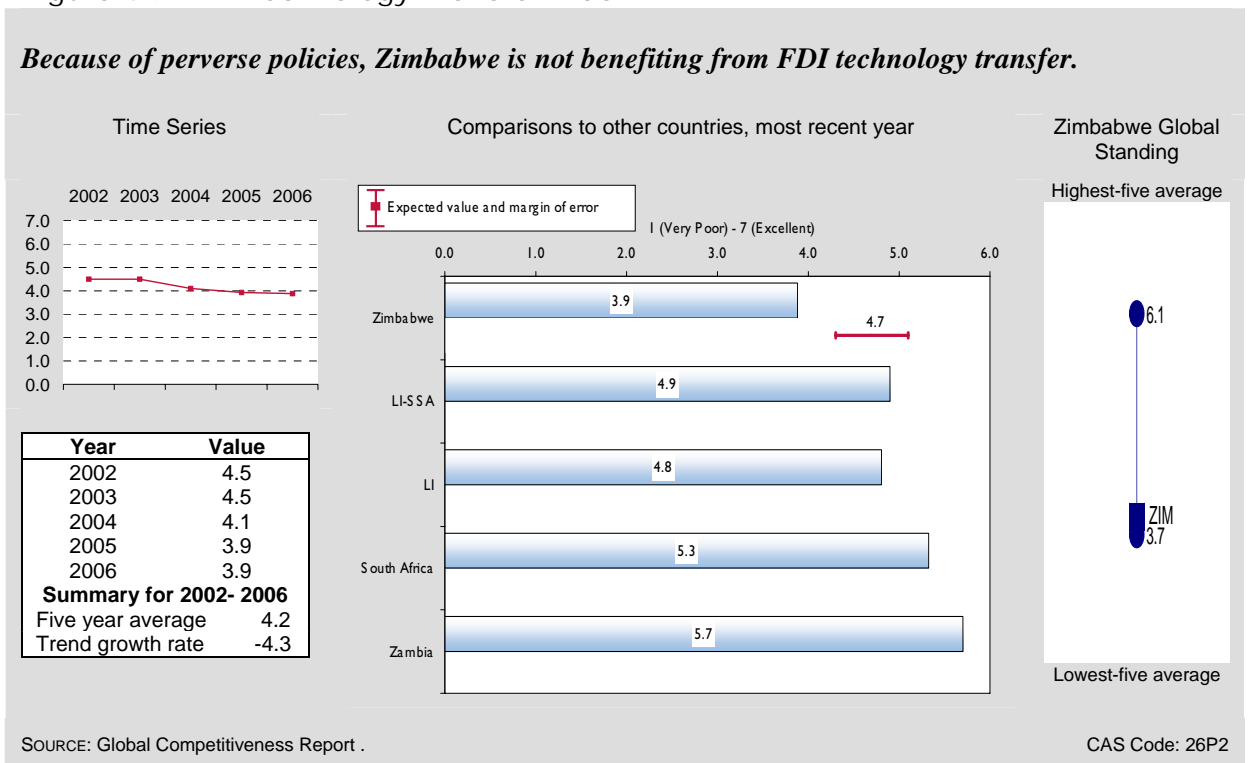
Overall, the quality of infrastructure is now an impediment to investment and a drag on competitiveness. The government rightly identified infrastructure development as a priority in the 2006 National Economic Development Priority Plan (NEDPP), and allocated a large fraction of the budget to capital projects (see Fiscal Policy). Until the larger problems of macroeconomic instability and political unrest have been addressed, however, infrastructure investment will not put the economy onto the path of rapid growth. Conversely, once underlying conditions improve, infrastructure investment can provide a strong direct and indirect stimulus to growth.

SCIENCE AND TECHNOLOGY

Science and technology are vital to a dynamic business environment and a driving force behind increased productivity and competitiveness. Even for a low-income country like Zimbabwe, transformational development depends on acquiring and adapting technology from the global economy. Inability to access and use technology prevents an economy from leveraging the benefits of globalization.

Unfortunately, very few international indicators can be used to judge performance in this area for low- and lower-middle-income countries. From the limited information that is available, it appears that Zimbabwe's science and technology capability is comparable to regional benchmarks, despite the economic and political crisis. For example, the WEF compiles an annual index of the availability of scientists and engineers based on executive perceptions. For 2006, Zimbabwe received a score of 3.9 (on a scale of 1 to 7, from worst to best) placing the country 89th out of 125 countries rated. Though this is not a particularly good score, in absolute terms, it is on par with the LI-SSA median and the score for Zambia, and virtually the same as South Africa's score of 3.8.

Figure 4-9. FDI Technology Transfer Index



On WEF's FDI Technology Transfer Index, which gauges the degree to which FDI integrates new technology into an economy (again on a scale of 1 to 7) Zimbabwe scored 3.9 in 2006, more than half a point lower than in 2002, far short of the LI-SSA median of 4.9, Zambia's 5.7, and South Africa's 5.3. This is not surprising, given that there has been almost no high-technology foreign investment in Zimbabwe in recent years (Figure 4-9). On WEF's Intellectual Property

Rights Index, Zimbabwe scored 2.9 in 2006. This is slightly higher than the LI-SSA median (2.8) and Zambia (2.4), but well below the impressive score for South Africa (5.1).

Yet Zimbabwe has had the advantage of a relatively strong base of intellectual resources. In 2003 (latest data), the country produced 96 scientific and technology journal articles per million people. This compares very favorably with the average for LI-SSA (14) and with Zambia (26 in 1999), though, here too, vastly below South Africa (2,364 in 2003). Despite Zimbabwe's remarkable educational achievements for a low-income country (see Education section), the economic crisis is preventing the country from even approaching its full potential in science and technology performance.

5. Pro-Poor Growth Environment

Rapid growth is the most powerful and dependable instrument for poverty reduction; and conversely, economic contraction is a breeding ground for poverty intensification. In either direction, the link from growth to poverty reduction is not mechanical. The trend in income growth for poor households often deviates from the overall trend in per capita income. The deviation is most favorable to the poor when policies and institutions improve opportunities and capabilities for disadvantaged citizens while reducing their vulnerabilities. Pro-poor development is associated with investment in primary health and education, the creation of jobs and income opportunities, the development of skills, the extension of microfinance, agricultural development, and gender equality. This section focuses on four of these issues: health, education, employment and the workforce, and agricultural development.

HEALTH

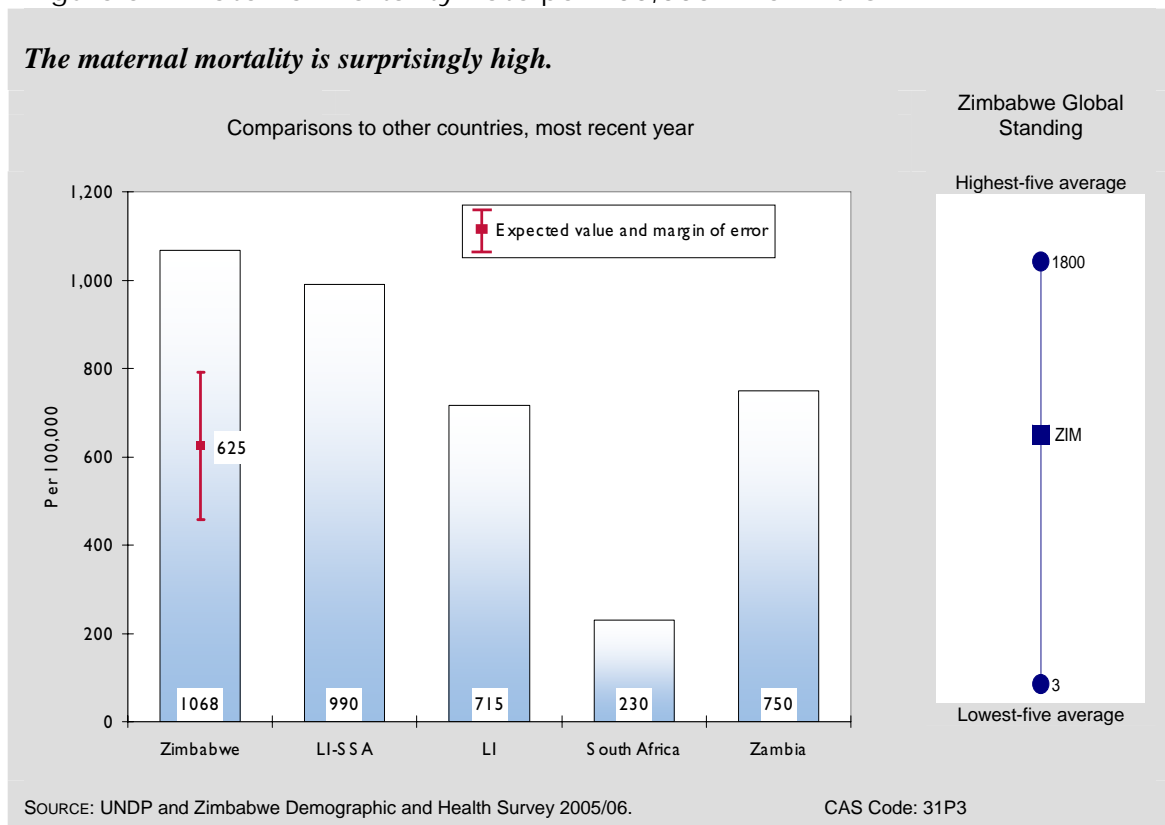
The provision of basic health service is a major form of human capital investment and a significant determinant of growth and poverty reduction. Although health programs do not fall under the EGAT bureau, an understanding of health conditions can influence the design of economic growth interventions.

Life expectancy at birth is commonly regarded as the best overall indicator of health status of a population. Mainly as a result of HIV/AIDS, life expectancy in Zimbabwe has fallen precipitously from 58.6 years in 1990 to an estimated 43.0 and 42.0 years for males and females, respectively, in 2005—among the lowest in the world.⁴⁹ By comparison, the median life expectancy for LI-SSA is 46.4 years, for Zambia 38.4 years, and for South Africa 47.7 years. All of these figures are heavily affected by premature deaths from HIV/AIDS. Indeed, the Zimbabwe Demographic and Health Survey (2005-06) estimates that 18.1 percent of the population aged 15 to 49 are infected, while UNAIDS estimates 20.1 percent. In either case, HIV prevalence has declined since 2003, when an estimated 22.1 percent of the population in that age cohort was HIV positive.

⁴⁹ The website for Zimbabwe's Central Statistics Office reports a life expectancy of 45 years based on the 2002 population census. Figures cited in the text are from the latest World Health Organization Statistical Information System at <http://www.who.int/whosis/en/index.html>.

Another indicator of health in Zimbabwe is its tragically high maternal mortality rate (MMR) of 1,068 per 100,000 live births, as measured by the 2002 census.⁵⁰ This rate is one-third higher than the upper bound of the expected value of 625, far worse than Zambia's rate of 750, and well above the median of 990 for LI-SSA (Figure 5-1). The high MMR is surprising given that a relatively high fraction of births in Zimbabwe are attended by skilled health personnel. The 2005-06 Demographic and Health Survey estimates that 79.7 percent of deliveries are attended by either a doctor, nurse, midwife, or trained traditional birth attendant. The corresponding benchmarks are 47.0 percent for the LI-SSA median, 43.4 percent for Zambia in 2002, and a remarkable 92.0 percent for South Africa in 2003.

Figure 5-1. Maternal Mortality Rate per 100,000 Live Births



Access to improved water and sanitation are among the most important determinants of health outcomes. In 2005-06, only 42.0 percent of Zimbabwe's population had access to improved sanitation, according to Demographic and Health Survey results.⁵¹ While this level of access to sanitation surpasses the LI-SSA median of 34.0 percent, it is far below the achievements in Zambia (55.0 percent) and South Africa (65.0 percent). For the same period, 75.8 percent of

⁵⁰ The 2005-06 Demographic and Health Survey estimates the MMR to be far lower, at 555 deaths per live birth. However, the survey notes that this estimate is based on a small number of maternal mortality events. The 2002 census result is a more reliable figure.

⁵¹ 2005-06 Demographic and Health Survey. p. 20.

Zimbabweans had access to an improved water source. In this case, Zimbabwe's performance is far above the LI-SSA median of 59.5 percent and Zambia's 58.0 percent (in 2002), though still below South Africa (88.0 percent in 2004).⁵² Equally important, the 2005 estimates for Zimbabwe represent a decline from 2002, when 57.0 percent of the people had access to improved sanitation, and 83.0 percent had access to clean water—another sign that the development process has been working in reverse.

The data indicate that Zimbabwe performs relatively well in providing child health care services. Child immunization rates are very good by regional standards. An average of 87.5 percent of children were immunized against DPT and measles in 2005—a jump of 5 percentage points over the previous year. This exceeds the LI-SSA median (71.2 percent) and Zambia's rate (82.0), and nearly matches the rate in South Africa (88.0 percent). Child malnutrition, at 16.6 percent in 2005-06, though high in absolute terms, is far less than the LI-SSA median (25.6 percent) and the incidence in Zambia (23.0 percent in 2003). Nonetheless, this figure represents a troubling increase in child malnutrition from 13.0 percent the previous year.

Access to health care is a fundamental human need, and good health is essential for a productive workforce. It is thus incumbent on the government and the international community to invest in health care, curtail the spread of HIV, reduce maternal mortality, improve child nutrition, and limit the ravages of other preventable health problems. Government expenditure statistics suggest that Zimbabwe is heading in the right direction, as public health expenditures have risen from 2.1 percent of GDP in 2002 to 4.3 percent in 2006. But this improvement is more apparent than real, as the decline in real GDP and the severe under-reporting of inflation combine to inflate the ratio. Indeed, in real terms, public health expenditures may actually be falling, as other health indicators suggest an overall deterioration in public health services.

EDUCATION

Investment in human capital is a cornerstone of economic growth and development. Thus far, the economic and political turmoil in Zimbabwe has not eroded key indicators of education access, in which Zimbabwe generally outperforms most African countries. According to the Zimbabwe Demographic and Health Survey 2005-06, which was released in early 2007, the net primary enrollment rate in 2005/06 was 91.4 percent, which is 17 percentage points higher than the expected value of 74.3 percent, and marginally better than the enrollment rates in South Africa (87.1 percent) and Zambia (88.9 percent). The survey also shows virtually no difference in enrollment rates for males (91.3 percent) and females (91.6 percent). Moreover, net secondary school enrollment rates for both males and females were about 44 percent, much above the LI-SSA median of 20.2 percent and Zambia's 23.7 percent, though significantly lower than South Africa's 61.7 percent (see Figure 5-2).

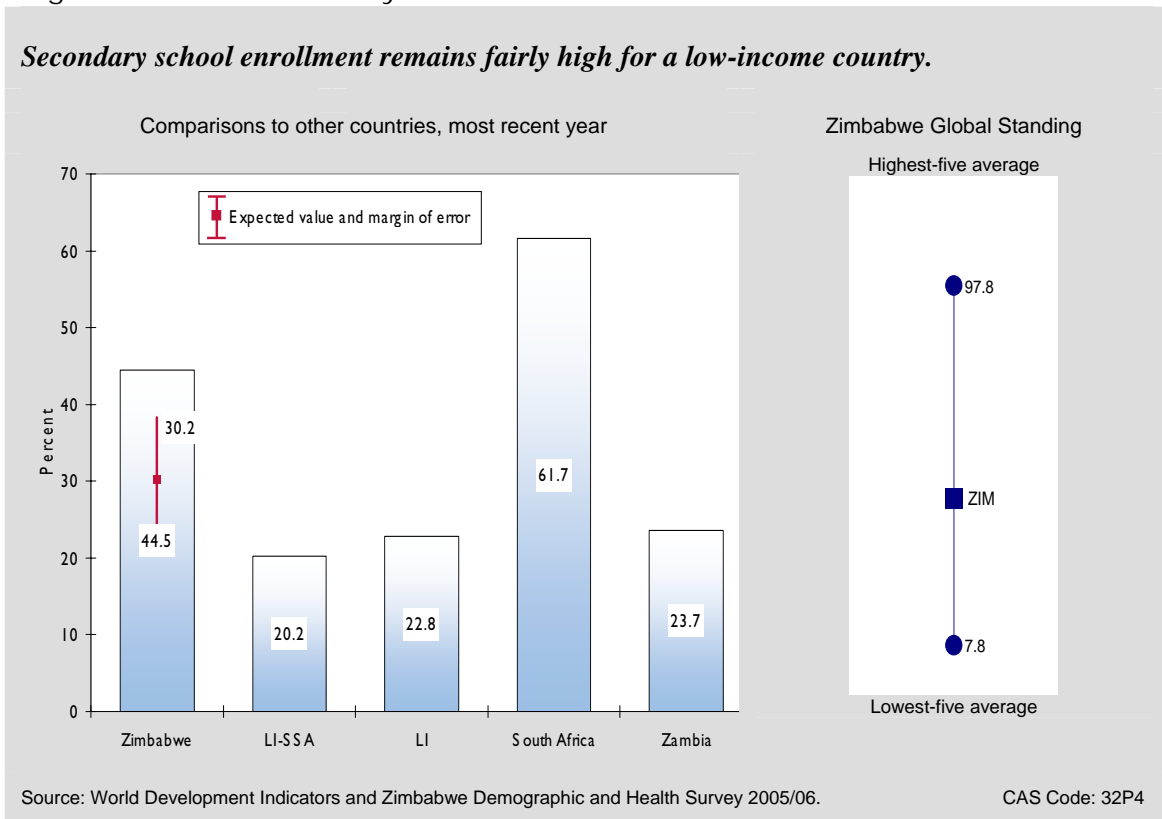
Youth literacy is very high. According to the Demographic and Health Survey 2005-06, 95.8 percent of youths are literate. This achievement is more than 24 percentage points better than the expected value of 70.7 percent, as well as youth literacy rates in South Africa (93.9 percent) and

⁵² Ibid, p. 19.

Zambia (69.5). As with enrollment rates, there is no disparity between males and females, according to findings from the survey.

These impressive statistics must be interpreted in light of widespread reports that the *quality* of education has declined greatly in the current political and economic climate. Moreover, Zimbabwe is suffering a severe brain drain as many educated people flee the country to escape repression and seek better opportunities. Once the political climate changes, some of these emigrants will return spontaneously to help rebuild the country, but the government and its international partners will also have to encourage and facilitate this process.

Figure 5-2. Net Secondary School Enrollment Rate



EMPLOYMENT AND WORKFORCE

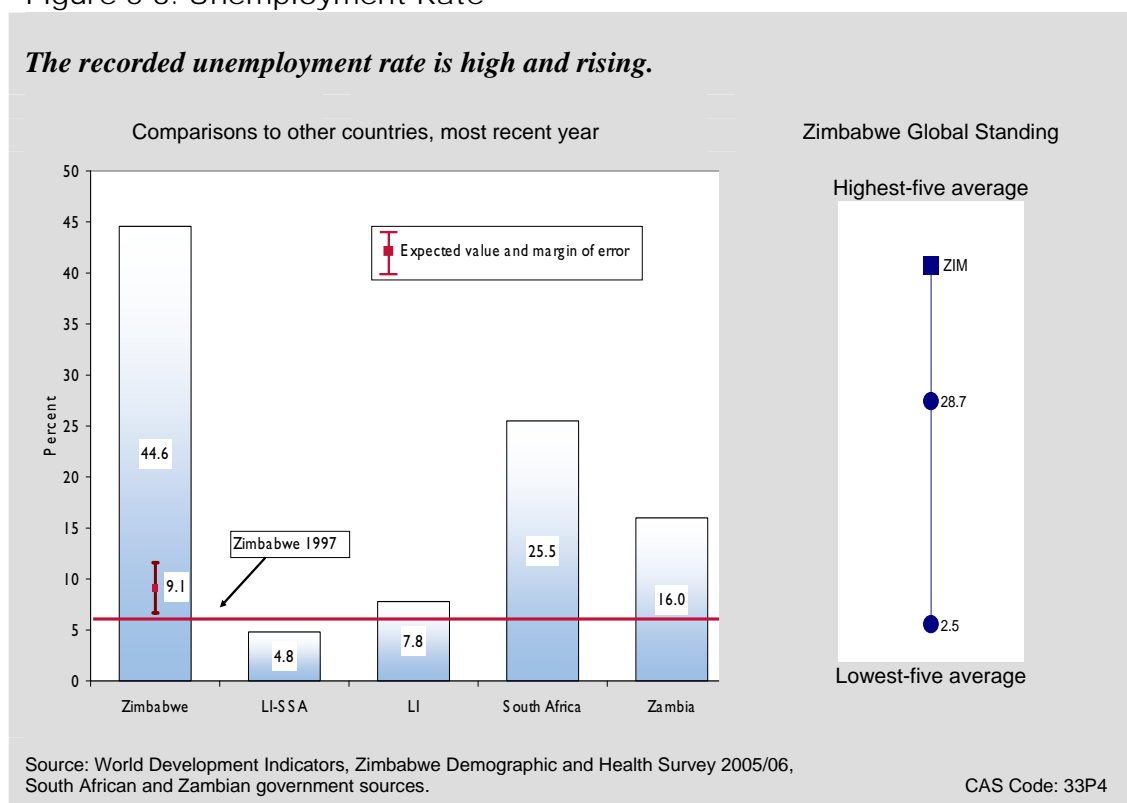
The Zimbabwean workforce was estimated at 5.8 million people in 2005, including informal sector workers. Investment and job-creation in the past ten years has been so low that very few young people have found gainful employment. Indeed, estimated employment in the formal sector has fallen from 1,323,000 to 972,000 over the past decade.⁵³ Consequently, more and more workers face a harsh choice between reverting to subsistence activity, pursuing black market activities, living on humanitarian assistance, or fleeing the country. Considering that millions

⁵³ These estimates are from John Robertson in direct correspondence, August 2006.

seem to have emigrated, government statistics showing continued growth of the labor force and a steady labor force participation rate must be viewed with great skepticism.

Probably the most reliable figures on the labor force are in the 2005-06 Demographic and Health Survey, which found the unemployment rate to be 44.6 percent. This is almost four times the expected value of 9.1 percent, 75 percent higher than South Africa’s very high unemployment rate of 25.5 percent (2006), and well above the rate of 16.0 percent in Zambia (2005).⁵⁴ The latest data for Zimbabwe also mark an enormous worsening compared to the unemployment rate of 6.1 percent recorded in 1997 (Figure 5-3). The recent imposition of price controls has reportedly resulted in more businesses shutting down, which can only force more workers out of their jobs. Indeed, many news articles cite an unemployment rate of 80 percent (but without attribution to solid data).⁵⁵

Figure 5-3. Unemployment Rate



Job creation, first and foremost, requires a transformation in the business environment to attract investment. But institutional impediments in the labor market itself will also need to be lessened.

⁵⁴ Unemployment rates for South Africa and Zambia are from national labor force surveys. See: www.statssa.gov.za/keyindicators/lfs.asp and www.zamstats.gov.zm/soc/lforce.asp

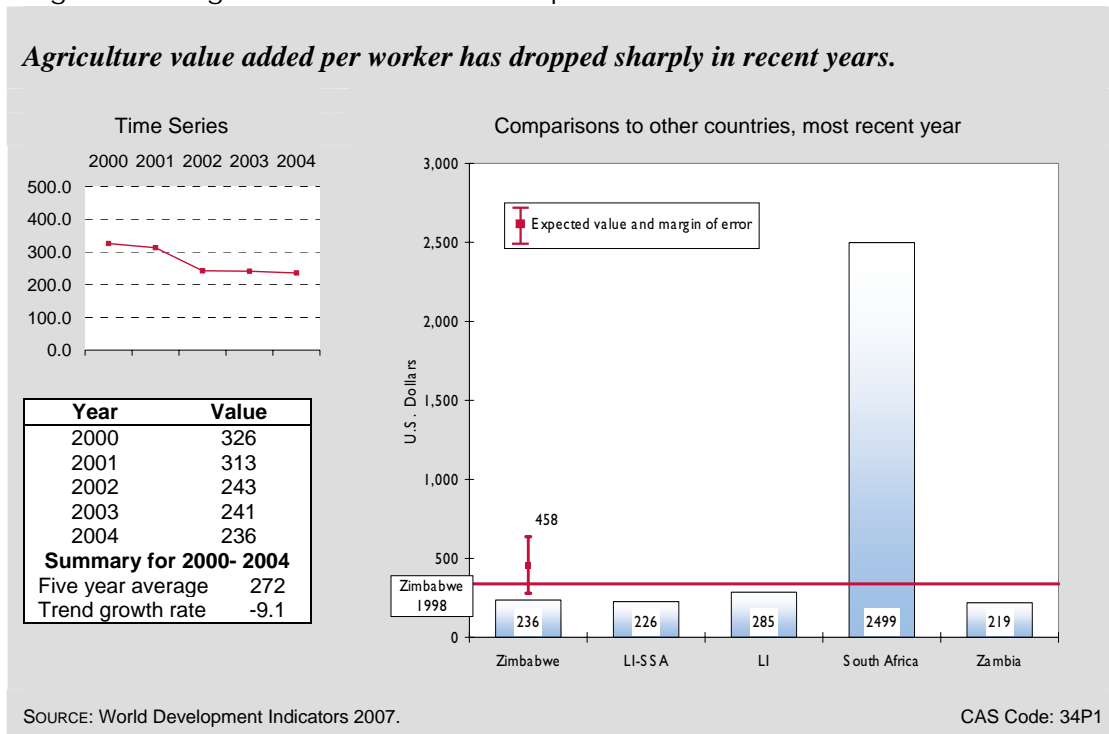
⁵⁵ According to John Robertson, this figure is based on the assumption that about 3,600,000 additional adults would seek to join the existing formal sector employees if opportunities arose, and that their departure from informal activities would make little or no difference to GDP or family incomes.

The World Bank's Rigidity of Employment index measures the difficulty of hiring and firing workers. For 2006, Zimbabwe received a score of 34.0 on employment rigidity. This is better than the LI-SSA median of 49.8, and even South Africa's score of 41.0, though not nearly as good as Zambia's score of 23.0. One component stands out: the Bank estimates that firing a worker in Zimbabwe in 2006 would cost an employer an astronomical 446 weeks of wages—more than eight years' worth of wages. This compares to 37 weeks as the LI-SSA average, 24 weeks for South Africa, and a very high 178 weeks for Zambia. Policies and regulations that lower the cost of firing are vital to job creation because high costs make it much more risky to hire workers in the first place.

AGRICULTURE

In the discussion of Economic Structure, we saw that labor productivity is very low in agriculture, with an estimated 34 percent of the workforce producing just 15 percent of GDP. Agricultural value added per worker in 2004 (latest year) was just \$236 (in constant 2000 prices). This compares very unfavorably with the expected value of \$458, and a productivity figure of \$2,499 per worker for South Africa. In Zambia, however, labor productivity in agriculture is even lower, at \$219 per worker (Figure 5-4).

Figure 5-4. Agriculture Value Added per Worker



More worrying is the sharp decline in agricultural value added in recent years. Between 2000 and 2004, estimated agricultural value added per worker fell by nearly one-fourth, while overall value added in the sector fell by more than one-third. The latter indicator has declined every year since 2000, at an average rate of 8.1 percent per annum. These figures attest to the collapse of a once

thriving sector in the wake of a destructive policy environment and implementation of the *Fast Track Land Reform* scheme in 2000.⁵⁶ The scheme severely disrupted commercial farming throughout the country and drove up unemployment by causing widespread loss of commercial farm jobs.

The policy mismanagement is highlighted by WEF's Agriculture Policy Costs Index. On a scale of 1 (excessively burdensome) to 7 (well balanced), Zimbabwe scored a 1.9 in 2006. By this assessment, agricultural policies are among the most burdensome in the world. Zimbabwe's score is barely half the LI-SSA average of 3.7, itself very weak, and falls far below the scores in South Africa (4.3) and Zambia (5.3).

The picture of poor performance is reinforced by FAO data showing that cereal yields have declined drastically. In 2005, the average yield was 717 kilograms per hectare, representing a drop of 40 percent in just five years. That yield is also much lower than the expected value of 1,085 kilograms per hectare, as well as yields in South Africa (3,330) and Zambia (1,595). A recent FAO and World Food Program assessment of crop and food security in Zimbabwe estimates a harvest of 799,000 MT of maize and 126,000 MT of small grains in 2006/07. The report estimates that more than 1 million tons of cereal imports will be required to meet food security needs. The FAO's Crop Production Index shows a similar decline, registering a mere 66.1 percent of average production for the 1999–2001 baseline period. The LI-SSA average is 104.9, with figures of 102.6 and 108.2 for South Africa and Zambia, respectively. Livestock production has fared somewhat better, remaining relatively stable over the same period, with an FAO index number of 99.0 in 2004. This is well below the LI-SSA value of 106.6 and South Africa's 108.6, but comparable to the index value of 98.9 for Zambia in the same year.

The decline in agriculture is extremely serious because of its broad impact on growth, employment, poverty, and social unrest. On the positive side, Zimbabwe was once known as the breadbasket of southern Africa, and the agricultural sector has outstanding potential for rebounding to higher levels of productivity and output once the policy regime becomes more conducive to private investment and market-determined pricing. At a minimum this will require a restoration of macroeconomic stability, credible and sustainable improvements in governance, and restoration of property rights. Revitalization of agriculture will also require the rehabilitation of rural infrastructure, a revival of efficient banking services, and market-oriented programs to support the growth of both commercial and family agriculture.

⁵⁶ It must be noted that the government had a genuine grievance against the appropriation of nearly all the best farmland by minority white farmers during the colonial period. At issue is the manner in which the government sought to redress this historic inequity.

Appendix. CAS Methodology

CRITERIA FOR SELECTING INDICATORS

The economic performance evaluation in this report is designed to balance the need for broad coverage and diagnostic value with the need for brevity and clarity. The analysis covers 15 topics related to economic growth and just over 100 variables. For the sake of brevity, the write-up in the text highlights issues for which the “dashboard lights” appear to be signaling problems, which suggest possible priorities for USAID intervention. The table below provides a full list of indicators examined for this report. The separate Data Supplement contains the complete data set for Zimbabwe, including data for the benchmark comparisons, and technical notes for every indicator.¹

For each topic, the analysis begins with a screening of *primary performance indicators*. These Level I indicators are selected to answer the question: Is the country performing well or not in this area? The set of primary indicators also includes descriptive variables such as per capita income, the poverty head count, and the age dependency rate.

When Level I indicators suggest weak performance, we review a limited set of *diagnostic supporting indicators*. These Level II indicators provide additional details, or shed light on *why* the primary indicators may be weak. For example, if economic growth is poor, one can examine data on investment and productivity as diagnostic indicators. If a country performs poorly on educational achievement, as measured by the youth literacy rate, one can examine determinants such as expenditure on primary education, and the pupil–teacher ratio.²

The indicators have been selected on the basis of the following criteria. Each must be accessible through USAID’s Economic and Social Database or convenient public sources, particularly on the Internet. They should be available for a large number of countries, including most USAID client states, to support the benchmarking analysis. The data should be sufficiently timely to support an assessment of country performance that is suitable for strategic planning purposes. Data quality is another consideration. For example, subjective survey responses are used only when actual measurements are not available. Aside from a few descriptive variables, the indicators must also be useful for diagnostic purposes. Preference is given to measures that are widely used, such as Millennium Development Goal indicators, or evaluation data used by the

¹ The Data Supplement is merged with the main report on our website, and available at <http://www.nathaninc.com/casreports>.

² Deeper analysis of the topic using more detailed data (Level III) is beyond the scope of this series.

Millennium Challenge Corporation. Finally, redundancy is minimized. If two indicators provide similar information, preference is given to one that is simplest to understand, or most widely used. For example, both the Gini coefficient and the share of income accruing to the poorest 20 percent of households can be used to gauge income inequality. We use the income share because it is simpler and more sensitive to changes.

BENCHMARKING METHODOLOGY

Comparative benchmarking is the main tool used to evaluate each indicator. The analysis draws on several criteria, rather than a single mechanical rule. The starting point is a comparison of performance in Zimbabwe relative to the average for countries in the same income group and region—in this case, lower-middle-income countries in Africa.³ For added perspective, three other comparisons are examined: (1) the global average for this income group; (2) respective values for two comparator countries approved by the Zimbabwe mission (in this case Zambia and South Africa); and (3) the average for the five best- and five worst-performing countries globally. Most comparisons are framed in terms of values for the latest year of data from available sources. Five-year trends are also taken into account when this information sheds light on the performance assessment.⁴

For selected variables, a second source of benchmark values uses statistical regression analysis to establish an expected value for the indicator, controlling for income and regional effects.⁵ This approach has three advantages. First, the benchmark is customized to Zimbabwe's level of income. Second, the comparison does not depend on the exact choice of reference group. Third, the methodology allows the quantification of the margin of error and establishment of a "normal band" for a country with Zimbabwe's characteristics. An observed value falling outside this band on the side of poor performance signals a serious problem.⁶

Finally, where relevant, Zimbabwe's performance is weighed against absolute standards. For example, a corruption perception index below 3.0 is a sign of serious economic governance problems, regardless of the regional comparisons or regression result.

³ Income groups as defined by the World Bank for 2004. For this study, the average is defined in terms of the mean; future studies will use the median instead, because the values are not distorted by outliers.

⁴ The five-year trends are computed by fitting a log-linear regression line through the data points. The alternative of computing average growth from the end points produces aberrant results when one or both of those points diverges from the underlying trend.

⁵ This is a cross-sectional OLS regression using data for all developing countries. For any indicator, Y , the regression equation takes the form: Y (or $\ln Y$, as relevant) = $a + b * \ln \text{PCI} + c * \text{Region} + \text{error}$ – where PCI is per capita income in PPP\$, and Region is a set of 0-1 dummy variables indicating the region in which each country is located. When estimates are obtained for the parameters a , b , and c , the predicted value for Zimbabwe is computed by plugging in Zimbabwe-specific values for PCI and Region. Where applicable, the regression also controls for population size and petroleum exports (as a percentage of GDP).

⁶ This report uses a margin of error of 0.66 times the standard error of estimate (adjusted for heteroskedasticity, where appropriate). With this value, 25 percent of the observations should fall outside the normal range on the side of poor performance (and 25 percent on the side of good performance). Some regressions produce a very large standard error, giving a "normal band" that is too wide to provide a discerning test of good or bad performance.

STANDARD CAS INDICATORS

Indicator	Level ^a	MDG, MCA, or EcGov ^b
Statistical Capacity Indicator	I	EcGov
Growth Performance		
Per capita GDP, in purchasing power parity dollars	I	
Per capita GDP, in current US dollars	I	
Real GDP growth	I	
Growth of labor productivity	II	
Investment Productivity, incremental capital-output ratio (ICOR)	II	
Gross fixed investment, % GDP	II	
Gross fixed private investment, % GDP	II	
Poverty and Inequality		
Human poverty index (0 for excellent to 100 for poor)	I	
Income-share, poorest 20%	I	
Population living on less than \$1 PPP per day/ \$2 PPP per day ^c	I	MDG
Poverty Headcount, by national poverty line	I	MDG
PRSP Status	I	EcGov
Population below minimum dietary energy consumption	II	MDG
Economic Structure		
Employment or labor force structure	I	
Output structure	I	
Demography and Environment		
Adult literacy rate	I	
Youth dependency rate/ elderly dependency rate ^d	I	
Environmental performance index (0 for poor to 100 for excellent)	I	
Population size and growth	I	
Urbanization rate	I	
Gender		
Girls primary completion rate	I	MCA
Gross enrollment rate, all levels, male, female	I	MDG
Life expectancy at birth, male, female	I	
Labor force participation rate, male, female	I	
Fiscal and Monetary Policy		
Govt. expenditure, % GDP	I	EcGov
Govt. revenue, excluding grants, % GDP	I	EcGov
Growth in the broad money supply	I	EcGov
Inflation rate	I	MCA
Overall govt. budget balance, including grants, % GDP	I	MCA, EcGov
Composition of govt. expenditure	II	

Indicator	Level ^a	MDG, MCA, or EcGov ^b
Composition of govt. revenue	II	
Composition of money supply growth	II	
Business Environment		
Control of Corruption Index (-2.5 for poor to +2.5 for excellent)	I	EcGov
Ease of doing business ranking	I	EcGov
Rule of law index (-2.5 for poor to 2.5 for excellent)	I	MCA, EcGov
Regulatory quality index (-2.5 for poor to 2.5 for excellent)	I	MCA, EcGov
Government effectiveness index (-2.5 for poor to 2.5 for excellent)	I	MCA, EcGov
Cost of starting a business	II	MCA, EcGov
Procedures to enforce a contract	II	EcGov
Procedures to register property	II	EcGov
Procedures to start a business	II	EcGov
Time to enforce a contract	II	EcGov
Time to register property	II	EcGov
Time to start a business	II	MCA, EcGov
Total tax payable by business	II	EcGov
Business costs of crime, violence, terrorism index (1 for poor to 7 for excellent)	II	
Senior manager time spent dealing with government regulations	II	EcGov
Financial Sector		
Domestic credit to private sector, % GDP	I	
Interest rate spread	I	
Money supply, % GDP	I	
Stock market capitalization rate, % of GDP	I	
Credit information index (0 for poor to 6 for excellent)	I	
Legal rights of borrowers and lenders index (0 for poor to 10 for excellent)	II	
Real interest rate	II	
Number of active borrowers	II	
External Sector		
Aid, % GNI	I	
Current account balance, % GDP	I	
Debt service ratio, % exports	I	MDG
Export growth of goods and services	I	
Foreign direct investment, % GDP	I	
Gross international reserves, months of imports	I	EcGov
Gross Private capital inflows, % GDP	I	
Present value of debt, % GNI	I	
Remittance receipts, % exports	I	

Indicator	Level ^a	MDG, MCA, or EcGov ^b
Trade, % GDP	I	
Trade in services, % GDP	I	
Concentration of exports	II	
Inward FDI potential index	II	
Net barter terms of trade	II	
Real effective exchange rate (REER)	II	EcGov
Structure of merchandise exports	II	
Trade policy index	II	MCA, EcGov
Ease of trading across borders ranking	II	EcGov
Economic Infrastructure		
Internet users per 1,000 people	I	MDG
Overall infrastructure quality index (1 for poor to 7 for excellent)	I	EcGov
Telephone density, fixed line and mobile	I	MDG
Quality of infrastructure—railroads, ports, air transport, and electricity	II	
Roads paved, % total roads	II	
Science and Technology		
Expenditure for R&D, % GDP	I	
FDI and technology transfer index (1 for poor to 7 for excellent)	I	
Availability of scientists and engineers index (1 for poor to 7 for excellent)	I	
Science and technology journal articles per million people	I	
IPR protection index (1 for poor to 7 for excellent)	I	
Health		
HIV prevalence	I	
Life expectancy at birth	I	
Maternal mortality rate	I	MDG
Access to improved sanitation	II	MDG
Access to improved water source	II	MDG
Births attended by skilled health personnel	II	MDG
Child immunization rate	II	MCA
Prevalence of child malnutrition (weight for age)	II	
Public health expenditure, % GDP	II	MCA, EcGov
Education		
Net primary enrollment rate – female, male, total	I	MDG
Persistence in school to grade 5	I	MDG
Youth literacy rate, all, male, female	I	
Net secondary enrollment rate	I	
Gross tertiary enrollment rate	I	

Indicator	Level ^a	MDG, MCA, or EcGov ^b
Education expenditure, primary, % GDP	II	MCA, EcGov
Expenditure per student, % GDP per capita—primary, secondary, and tertiary	II	EcGov
Pupil-teacher ratio, primary school	II	
Employment and Workforce		
Labor force participation rate, total	I	
Rigidity of employment index (0 for minimum rigidity to 100 for maximum)	I	EcGov
Size and growth of the labor force	I	
Unemployment rate	I	
Economically active children, % children ages 7-14	I	
Firing costs, weeks of wages	II	EcGov
Agriculture		
Agriculture value added per worker	I	
Cereal yield	I	
Growth in agricultural value-added	I	
Agricultural policy costs index (1 for poor to 7 for excellent)	II	EcGov
Crop production index	II	
Livestock production index	II	
Agricultural export growth	II	

^a Level I = primary performance indicators, Level II = supporting diagnostic indicators

^b MDG—Millennium Development Goal indicator

MCA—Millennium Challenge Account indicator

EcGov—Major indicators of economic governance, which is defined in USAID's Strategic Management Interim Guidance to include "microeconomic and macroeconomic policy and institutional frameworks and operations for economic stability, efficiency, and growth." The term therefore encompasses indicators of fiscal and monetary management, trade and exchange rate policy, legal and regulatory systems affecting the business environment, infrastructure quality, and budget allocations.

^c \$1 PPP for lower income countries and \$2 PPP for lower middle income countries.

^d Under Demography and Environment, the elderly dependency rate is applied to Eastern Europe and Former Soviet Union countries only.