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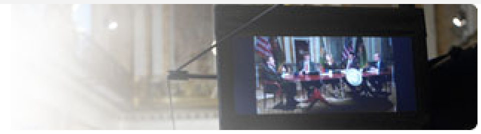

Remarks of Acting Assistant Secretary Andy Baukol, As Prepared for Delivery, Senate Foreign Relations Subcommittee on African Affairs: “Exploring U.S. Policy Options during Zimbabwe's Transition”

9/30/2009

TG-301

Chairman Feingold, Senator Isakson, and distinguished members of the Committee, thank you for inviting me to testify at this important hearing on the current situation in Zimbabwe. Thank you also for asking my colleagues from the Department of State and USAID to join me at the witness table. I think we all agree that Zimbabwe's economy has taken a turn for the better over the last seven months and that progress could be fleeting if it is not supported by a political solution that restores democracy, rule of law, and strong institutions.

People who follow Zimbabwe closely are probably familiar with the recent economic trends, but it is worth recapping the economic mismanagement that devastated the country and contributed to the profound fragility of the current situation. When Robert Mugabe took office as leader of Zimbabwe after a long civil war, Zimbabwe had all the ingredients necessary for prosperity. With a per capita GDP of around $1,400 [1], Zimbabwe was blessed with ample mineral resources, decent infrastructure, and productive farms that made it a breadbasket to Southern Africa. In 1980, Tanzania's then-President Nyerere told Mugabe he had inherited the "jewel of Africa." For almost two decades, Mugabe's government managed to maintain economic growth and roughly stable per capita GDP, but beginning in the late 1990s, the wheels began to come off. Thanks to a set of disastrous economic policies, headlined by a chaotic land redistribution scheme, five decades of economic progress were erased in five years, with per capita GDP in 2005 roughly equaling that in 1953, according to an analysis by the Center for Global Development. The combination of undermining the rule of law, instituting oppressive economic decrees, and suppressing press freedoms and political opposition led one observer in 2003 to describe Zimbabwe as a case study in "How to Kill a Country." [2]

The economic crisis further deepened as bad policies and the government's paranoid reaction to international isolation due to gross violations of human rights fed the spiral of decline.

- The government revalued the currency in 2006 but quickly began resorting to the printing press to paper over yawning budget deficits. Inflation hit 90 sextillion percent in November 2008.
- Despite its former status as a breadbasket for the region – one that sourced UN-sponsored food aid to other countries in Africa [3] – Zimbabwe's agricultural output declined to the point that about half of the population was in need of food aid in 2008.
- Neglect of the medical sector and water infrastructure helped lead to a cholera outbreak that killed 4,276, according to the WHO. [4]
- An estimated one-fourth of the population left conditions in Zimbabwe over the last decade; most went to South Africa in search of jobs to support their families.
- The country's reserves plummeted to $5.8 million by the end of 2008, according to the IMF, [5] despite the country's possession of mineral resources such as chromite, coal, platinum, asbestos, copper, nickel, gold, and iron ore.
- Economic activity and GDP plummeted, with the IMF estimating that per capita GDP fell to $188 on a PPP basis in 2008.

In this context, the last seven months have been characterized by relative economic stability as reformist elements of the transitional government began to undo some of the more disastrous economic policies of the previous nine years. In the weeks before the transitional government became effective and only weeks after introducing a 100 trillion Z-dollar note, the acting finance minister acknowledged the ongoing dollarization of the economy by allowing Zimbabweans to conduct business in other currencies. The rapid abandonment of the Zimbabwe dollar by the populace – and later steps by the government to do away with the discredited currency – have led to stabilization of prices and some revival of economic activity. Finance Minister Biti has also introduced other measures to reduce the government's interference in the economy, including eliminating the 7.5 percent foreign exchange surrender requirement, eliminating the 5 percent tax on bank profits, eliminating import duties on capital equipment and raw materials, cutting import duties in half on intermediate products, and stopping quasi-fiscal activities at the Reserve Bank of Zimbabwe (which took the form of directed lending for favored businesses and sectors). Consumer demand has rebounded modestly, and businesses are also reacting to the new incentives of a stable currency and the removal of many restrictions on economic activity.

Government revenues are beginning to recover, and the Zimbabwean government expects to take in about $1 billion in revenue this year, or about 25 percent of GDP. This would represent a sharp uptick from an estimated 4.2 percent of GDP in 2008. The Finance Ministry has slashed government expenditures to more closely match expected revenues, thereby avoiding the accumulation of massive arrears or the printing of money to pay government debts. Yet the government is facing significant pressures for increased civil service pay and expenditures in basic social services that were neglected in recent years, especially in health and education. It is also banking on large amounts of budget support by the donor community, roughly 10 percent of GDP, which has not materialized yet.

While there may be an interest from businesses in resuming production and some room for the agricultural sector to take advantage of the current situation, recovery will not be easy. The banking sector – traditionally a critical source of funding for business growth – suffers in Zimbabwe from a lack of liquidity. There are only $700 million in deposits in the country's banking system – not nearly enough to fund the lending needed to restart the economy. Zimbabwe's banking sector is interested in gaining access to lines of credit from abroad to enable local lending, but the general uncertainty about the investment climate and the lack of a credible central bank make it unlikely that Zimbabwe will be able to access additional credit lines. Even local branches of international banks are strapped for liquidity, with their parent banks unwilling to take on the risk of funneling more capital into Zimbabwe. The central bank in Zimbabwe (RBZ) has been an active part of the economic destabilization of the last decade, but it has been neutralized for the time being by dollarization. Substantial reform of the RBZ is needed to enable it to play a positive role in the economy. In summary, Zimbabwe remains one of the riskiest locations for investment, and Dunn & Bradstreet recently called it the worst investment location in the world, equal to Afghanistan.

The international financial institutions (IFIs) have taken a cautious approach to engagement in Zimbabwe due to the large arrears by the government – over $1.3 billion – and the lack of a track record on reform. The IMF has begun to lead short-term, targeted technical assistance missions, [6] and the World Bank is administering a multi-donor trust fund to support basic analytical work on the Zimbabwean economy and to assess its needs. Further actions will depend on a track record of reform as well as a plan to address Zimbabwe's arrears.

Zimbabwe has around $6 billion in foreign debt, of which $1.3 billion is arrears to multilateral bodies. It owes the IMF 89.5 million SDRs, or around $140 million. At the development banks, Zimbabwe has $702.5 million in arrears to the World Bank and $468.8 million in arrears to the African Development Bank as of July 2009. Clearing Zimbabwe's arrears at the IFIs will depend greatly on whether the IMF and World Bank Boards find Zimbabwe eligible for the Heavily Indebted Poor Countries (HIPC) Initiative. Zimbabwe has limited domestic resources, and competing expenditure priorities make it unlikely that it could repay arrears – even in part – in the foreseeable future.

I would note that the donor community has been functioning well in the case of Zimbabwe. The donor community coordinates closely and has adopted a common set of principles for engagement in Zimbabwe. Donors are united in seeking to support reformers when appropriate and enhance social service delivery in key sectors such as health and education. They are also working to enhance food production and reduce Zimbabwe's dependence on food aid. Finally, some donors are working on key economic governance issues, such as improving the Ministry of Finance's financial management capability. We are actively looking at what role the U.S. can play in assisting reform-minded Zimbabwean officials in areas of economic governance in order to stabilize the region. The depressed state of the Zimbabwean economy introduces fragility and risk to the region, as witnessed by recent refugee flows and the spread of the cholera epidemic beyond Zimbabwe's borders. Sustained improvements in the economy will not come without a full restoration of democracy and law and order. We are disturbed by new violent farm invasions and other violations of the Global Political Agreement (GPA) that cast doubt on the commitment of the ZANU-PF to true cooperation with the MDC. The continued presence of Gideon Gono as head of the central bank is one example fueling these doubts. Mugabe reappointed Gono as head of the RBZ at the beginning of the new government despite Gono's leadership over the monetary policies that led to one of the world's worst cases of hyperinflation. Gono has also been linked to several corruption scandals and is currently subject to U.S. and EU sanctions. Finance Minister Biti, the leading force behind recent economic reforms and a member of the MDC, has effectively limited Gono's power by terminating the RBZ's quasi-fiscal activities and has introduced legislation to increase oversight over the RBZ.

We continue to look for signs of sustained commitment to economic reform and believe that it will be important for U.S. agencies to have the ability to respond positively if conditions for assistance are demonstrated. Broad assistance programs or cash assistance by the U.S. are not appropriate given the tenuous nature of the reform process, but targeted technical assistance that complies with current legal restrictions could help address the capacity constraints that have arisen from years of political repression and brain drain. Such technical assistance would have to be provided to officials and ministries who have demonstrated the willingness to reform and stabilize the economy and who can show a continued commitment to these efforts. Such assistance could also be deployed – or withdrawn – quickly, according to circumstances on the ground. Assistance to Zimbabwe is also affected by other legislation, such as the Zimbabwe Democracy and Economic Recovery Act (ZDERA) and the recent designation of Zimbabwe as non-compliant with minimum standards under the Trafficking Victims Protection Act.

As you know, the United States does not have broad economic sanctions on the country of Zimbabwe. In accordance with Executive Order (E.O.) 13469 of July 25, 2008, E.O. 13391 of November 22, 2005, and E.O. 13288 of March 6, 2003; the Treasury Department has maintained targeted economic sanctions against the Mugabe regime and has designated dozens of senior regime officials, supporters, and state-owned or -controlled companies. In cases where the behavior of listed individuals or institutions changes, the U.S. government could consider easing sanctions via licensing, delisting or other appropriate measures, if warranted.

In summary, Zimbabwe has arrived at a second crucial crossroads in its modern history. In light of Robert Mugabe's continued resistance to heed the results of democratic elections, the United States and the rest of the international community have a right to be skeptical of his actions and withhold full reengagement and development assistance. However, we should also support people and institutions in Zimbabwe that are pursuing appropriate economic policies and working to bring about a government that reflects the will of Zimbabwe's people.

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[1] Michael Clemens and Todd Moss, "Costs and Causes of Zimbabwe's Crisis," *CGD Notes*, Center for Global Development, July 2005.

[2] Samantha Power, "How to Kill a Country," *The Atlantic Monthly*, December 2003.

[3] Ibid.

[4] World Health Organization, June 9, 2009 update (http://www.who.int/csr/don/2009_06_09/en/index.html).

[5] International Monetary Fund, 2009 Article IV Consultation With Zimbabwe, 6 May 2009, PIN No. 09/53 (http://ww.imf.org)

[6] In May, the IMF's Executive Board approved a request to lift the suspension of technical assistance and allow targeted technical assistance in the areas of tax policy, payments systems, lender-of-last-resort operations and banking supervision, and central banking governance and accounting.