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Fiscal Reforms, Deficits and Economic Growth in Zimbabwe: A Critique

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Abstract
Despite undertaking varied fiscal reforms, most developing countries continued to grapple with budget deficits, low rates of economic growth per capita terms and increasing levels of poverty. This paper, therefore, critically discusses the fiscal policy performance and how it has influenced economic growth dynamics in Zimbabwe since independence in 1980. The revenue, expenditure, institutional and legal reforms that occurring in public finance management in Zimbabwe over the review period were highlighted in the paper. The review of country-based literature and analysis of trends provide evidence of interaction effects between fiscal reforms, deficits and macroeconomic performance in Zimbabwe. The study found that fiscal policy reforms in Zimbabwe evolved from market-intervention policies to market-based policies, and later to market-intervention policies. These reforms were predominantly driven by both internal and external circumstances. Internally, the government sought to achieve social, economic and political goals, while externally, reforms were influenced by natural conditions, global economic and financial developments. The study recommends that for successful and sustainable growth-oriented fiscal reforms, there is need to pay attention to the composition of public spending and to sequence appropriately government expenditure and revenue reforms.

Keywords: *Deficits, economic growth, fiscal consolidation, fiscal reforms, tax reforms.*

1. Introduction

Heretofore, governments of developing countries have endeavoured to address and respond to social imbalances and macroeconomic crises through market intervention stabilisation policies and market-based policies (International Monetary Fund “IMF”, 1997). However, in light of the complex interactions that exist in the theoretical and empirical literature between government policies and economic growth, it is difficult to pronounce a one size fits all fiscal reform approach across economies to enhance economic growth. The size, composition, and timing of the fiscal reforms have a bearing on the government’s fiscal space, and hence, on a country’s macroeconomic stability and effectiveness of its institutional framework (McDermott and Wescott, 1997).

In literature, three contrasting views exist on the link between fiscal reforms, deficits and economic growth. First, is the Keynesian view. This view primarily presupposes state activism to achieve full employment and macroeconomic stability (Lee, 2012). Keynes argued that in a capitalist economy, meagre aggregate demand could bring about protracted periods of high unemployment. Thus, during recession, which dampen demand, Keynesians argued that state interference is indispensable to restrain the booms and busts in economic activity. Aggregate demand is boosted by lowering current taxes and increasing public spending – financing the resultant with other sources of government revenues, including seignorage (Jahan, *et al*., 2014). Jahan, *et al*. (2014) further suggest that increased aggregate demand boost the returns of private investment irrespective of the level of interest rate. In the

main, therefore, the Keynesian view states that if government spending increases, then output will increase multiple time.

Second, is the Neoclassical view. According to the Neoclassical viewpoint, large fiscal deficits could crowd out private sector investment by raising both interest rates and perceived risk of monetarising budget imbalances. This proposition further assumes that fiscal deficits raise total lifetime consumption by shifting tax liability to subsequent generations (Barro, 1989). Third, is the Ricardian Equivalence hypothesis. The hypothesis assumes neutrality of budget deficits on real macroeconomic variables (Barro, 1989). That is, if people have perfect foresight, then there would be no crowding out of private investment when a deficit-financed cut in current taxes are offset by higher future taxes.

In light of the variations in literature on the relationship between fiscal policy and macroeconomic performance, this paper provides an exploratory critique of the three hypotheses by reviewing the interaction between fiscal reforms, budget balances and economic growth trends in Zimbabwe during the period 1980-2020. The paper explicitly aims to determine whether and to what degree the fiscal policies implemented in Zimbabwe from 1980 to 2020 were supportive of growth. The discussions are centred largely on revenue and expenditure policies and management, and some connections to economic performance.

This current study is relevant in that it illustrates how the following agents and sectors respond to fiscal adjustments in Zimbabwe; financial markets, private sector investment and consumption decisions, external sector, and development partners. Also, the study findings will guide policy direction in Zimbabwe particularly during this period when there is need for an optimal fiscal-monetary balance that promote sustainable growth while fighting the negative economic and human impact of the coronavirus pandemic. Furthermore, an understanding of fiscal policy developments in Zimbabwe help its authorities in several other fronts. First, it prevents potential spill-over of fiscal deficits into external deficits, thus inducing exchange rate misalignments. Second, it eliminates the crowding out of private sector investment and thus lead to a stable growth. Lastly, it helps in promoting good fiscal management.

The rest of the paper is divided into two sections: Section two presents the country-based literature review. This section discusses the fiscal policy reforms, deficits and economic growth trends in Zimbabwe. This is then followed by section three that provides some concluding remarks.

2. Fiscal Policy and Macroeconomic Performance in Zimbabwe

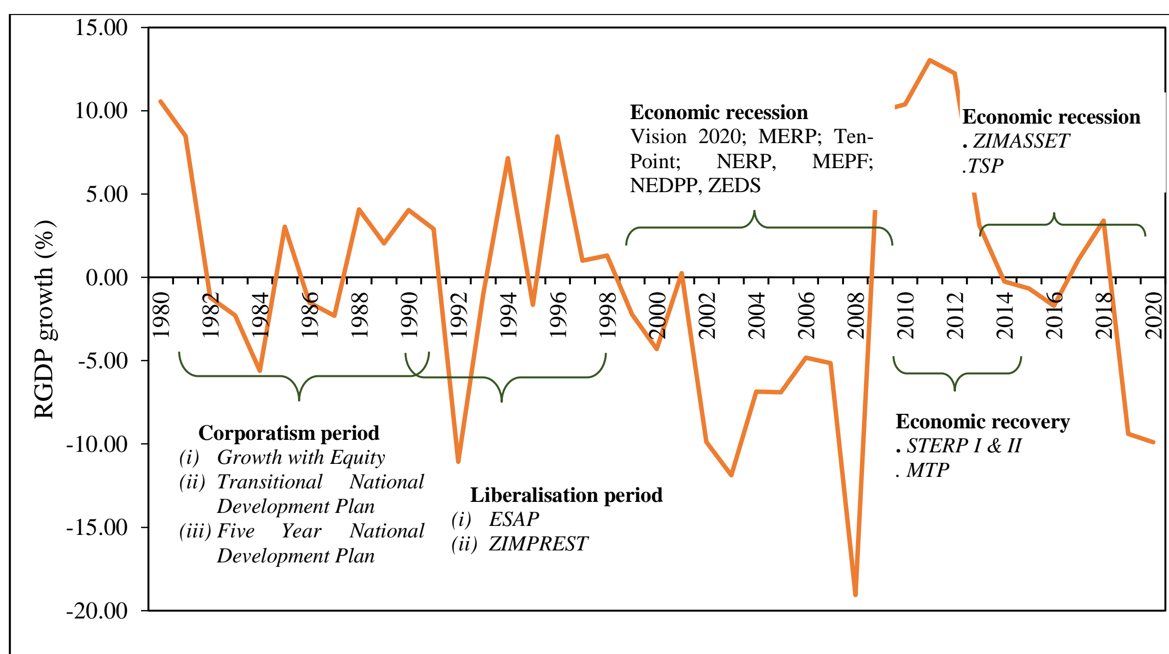
2.1 Economic Reforms and Growth Trends in Zimbabwe

There is a general perception that a stable political, economic and financial environment is a precondition for sustainable economic growth (United Nations Conference on Trade and Development, 2018; IMF, 2009). To attain such macroeconomic stability and growth, or correct previous disequilibria, it may call for vigorous fiscal adjustments. On the whole, the primary focus of fiscal policy is not limited to achieving a balanced budget. The structure and composition of fiscal reforms also matters most as it has an indispensable impact on a country's long-run growth and welfare prospects. There is a possibility that the achievement

of fiscal balance may come at the expense of realising sustainable higher rates of growth (IMF, 1997).

Zimbabwe's economic policies in the pre-1980 period promoted socio-economic self-sufficiency – mostly due to economic and political isolation from the international community (Leo and Moss, 2009). The formal sector was a culmination of strictly inter-sectoral linkages backed by diversified commodity and manufactured exports to selected international markets (Kanyenze, 2003). Thus, in 1980, Zimbabwe inherited a diversified economy that resembled characteristics of developed economies (Kanyenze, 2003). The implementation of successive and distinct development models, as well as changes in international relations particularly with donor countries, influenced the country's revenue base and resource mobilisation strategies.

The post-independence Zimbabwean economy evolved from a quasi-socialist system from 1980 to 1990 to a quasi-liberal economy from 1991 to 2013. During this later period, the country instituted several macroeconomic reforms that scaled down government's direct control of the economy. In association with the International Financial Institutions, mostly the IMF and World Bank, Zimbabwe removed excessive market controls, such as goods and labour prices, exchange and interest rates, and also rationalised its social welfare packages (IMF, 2003). Finally, is the period 2014 to 2020, associated with a perceptible transition towards a command economy (Ministry of Finance and Economic Development "MOFED", 2020; 2014). Figure 1 summarises Zimbabwean government policies and the associated annual growth rates from 1980 to 2020.



Source: Author computation using data from the World Bank (2020); MOFED, 2020; GoZ (2013; 1991; 1981).

Figure 1: Economic reforms and growth trends in Zimbabwe (1980-2020)

Key:
ESAP - Economic Structural Adjustment Programme (1991-1995)
ZIMPREST - Zimbabwe Programme for Economic and Social Transformation (1996-2000)

MERP - Zimbabwe Millennium Economic Recovery Programme (2000-2002)
NERP - National Economic Revival Programme (2003-2004)
MEPF - Macro- Economic Policy Framework (2005-2006)
NEDPP - National Economic Development Priority Programme (NEDPP) (2006-2008)
ZEDS - Zimbabwe Economic Development Strategy (ZEDS) (2007-2011)
STERP I & II - Short Term Emergency Recovery Programme (STERP) (2009-2012)
MTP - Medium Term Plan (2010-2015)
ZIMASSET - Zimbabwe Agenda for Sustainable Socio-Economic Transformation (2013-2018)
TSP - Transitional Stabilisation Programme (2018-2020)
GoZ – Government of Zimbabwe

The expansionary public sector policies instituted during the corporatism period resulted in growing fiscal deficits and oscillating growth rates, averaging 5.3% (World Bank, 2020; Brett, 2005; GoZ, 1981, 1991.) The period between 1990 and 2008 was characterised by extensive structural reforms on account of adverse shocks, policy failures and poor economic performance, averaging -3.14% (World Bank, 2020; IMF, 2003). The period 2009-2013 was made up of short-term and medium-term stabilisation and adjustment programs, including (i) privatisation of some public enterprises; (ii) restoration of the financial system; (iii) re-engagement of the international community; and (iv) strict adherence to public sector expenditure and revenue management principles (IMF, 2014). The cumulative impact of these government initiatives drastically reduced fiscal deficits and prompted positive economic growth rates, averaging 8.1% (World Bank, 2020). Between 2014 and 2020, a series of adverse internal and external shocks, as well as public sector expenditure and financial mismanagement, weakened the financial position of the government, leading to budget difficulties and a negative average growth rate of 1.6% (World Bank, 2020).

2.1.1 Government Revenue Overview and Reforms in Zimbabwe

During the review period, 1980-2020, government revenue was derived from individuals and corporates income and property taxes, monetarisation of public debt, administrative fees, trade taxes, dividends from state owned enterprises, foreign aid and grants (GoZ, 1981; 1991; MOFED, 2020). The transition from a highly formal economy, 1980-2000, to a highly informal economy, 2001-2020, is reflected in the country's revenue reforms and returns. A contracting formal economy and flourishing informal sector made it difficult to depend particularly on certain revenue sources, such as corporate taxes and Pay As You Earn (PAYE) taxes. The situation was further compounded by: (i) the disappearance of external financial support from the international community; (ii) absence of revenue transparency in some sectors, for instance in the mining sector (particularly in diamond, gold and platinum revenues); (iii) misuse of public funds; (iv) ineffective revenue collection mechanisms; and (v) corrupt activities at ports of entry and in public sector procurement procedures (African Forum and Network on Debt and Development, 2015; GoZ, 2013; 2011; 2009; IMF, 2017; 2014). Conceptually, government revenue is a function of tax bases available, rates applied to these revenue bases, and the chances and costs of collecting the taxes. Thus, the listed factors above have not only narrowed the government of Zimbabwe's tax base but increased revenue leakages. The cumulative impact was persistent and widening fiscal deficits and ballooning public debts. Accordingly, there were a series of institutional and legislature reforms and successive tax adjustments, in terms of both the number and rates, in order to continue funding government activities.

Structural revenue reforms started with major revisions on the country's legal system. Taxes in Zimbabwe are levied in terms of the applicable Acts. The main tax laws are the Income

Tax Act [Chapter 23:06], the Capital Gains Tax Act [Chapter 23:01], the Value Added Tax Act [Chapter 23:12], the Finance Act [Chapter 23:04], the Customs and Excise Act [Chapter 23:02] and the Stamp Duties Act [Chapter 23:09].

To begin with, Zimbabwe introduced the Sales tax in 1985, at a rate of 10%, which was later revised to 20% and 25% in the same fiscal year (GoZ, 1997). With increased private sector participation in the economy, the government in 1994 amended the Sales Tax Act to include provisions that permit tax payments by instalments (GoZ, 1997). To boost revenue flows and widen fiscal space amid a contracting industrial base, the Sales tax Act was amended to include services in 1998 and bricks sales in 2002 (GoZ, 2004). In 2004, the government repealed the Sales Act and enacted the Value Added Tax Act (Statutory Instrument 273 of 2003) (GoZ, 2004). VAT had the advantage of enlarging the revenue net of the government since it is levied on transactions, and hence it is based on the country's consumption base. The introduction of this tax in Zimbabwe was particularly noble since it happened at the height of international isolation, contracting production base and increased aggregate consumption (Leo and Moss, 2009). The tax is levied pursuant to the Value Added Tax Act [Chapter 23:12] and in 2020, the rate was 14.5% (MOFED, 2020).

In 2005, the government introduced the presumptive tax targeting the participation of informal businesses in tax payments, thus broadening the country' taxable base. Presumptive taxes are levied under the Income Tax Act [Chapter 23:06] in respect of income earned by small to medium enterprises, such as transport operators (omnibuses and goods vehicles), driving schools, hair salons, restaurants, bottle stores, small miners and informal traders, among others.

Further, the Department of Taxes had introduced PAYE on wages above the zero rate tax bracket, as provided in Finance Act [Chapter 23:04]. PAYE, which was introduced in the Zimbabwean tax system before 2000, is a high-yielding revenue collector and is deducted over the course of the year rather than once at the end of the year. Over time, the income tax rates structure are changed to reflect the inflationary developments in the economy. According to the Finance Act [Chapter 23:04], the employers are mandated to withhold both PAYE and AIDS Levy of 3% of total PAYE due from employees.

Following the introduction of a multicurrency system in 2009 by the Government of National Unity, there was a notable improvement in revenue collections and grant inflows (GoZ, 2009). The government also introduced toll road fees, which were in addition to the already existing transit fees, fuel levy, and vehicle licencing fees, as provided in the Roads Act of 2001. As of December 2020, the government had erected 36 toll fee collection points along highways linking cities (Zimbabwe National Roads Administration "ZINARA", 2020). The government, through the road administration authority, ZINARA, has been reviewing toll rates since 2009 in line with both inflation levels, monetary systems in place, and government priority goals.

With stagnation of the economy in 2014, the government widened its tax net by introducing two new taxes, that is, the 5% turnover tax on tobacco and the 5-cents levy on every mobile network transaction (MOFED, 2020). In 2018, the government changed the Intermediated Money Transaction Tax from a specific tax of 5-cents per transaction to a 2% on mobile money and electronic financial transactions (MOFED, 2020). Between 2018 and 2020, the government further amended the Income Tax Act, adding provisions for the payment of

withholding taxes and other taxes on foreign priced goods and services in foreign currency (MOFED, 2020). Withholding taxes are levied on resident shareholders' dividends, non-resident shareholders' dividends, non-residents' fees, non-residents' remittances, non-residents' royalties, non-residents' interest, automated financial transactions, intermediated money transfers, and non-executive directors' fees (MOFED, 2020).

The tax reforms were augmented by institutional rearrangements to help improve revenue collection and administration. In 2001, the government formed a unified tax authority, the Zimbabwe Revenue Authority (ZIMRA), which was an amalgamation of the Department of Taxes and Department of Customs and Excise (GoZ, 2004). ZIMRA is mandated with assessing, collecting, accounting and enforcing payment of all tax revenue through the Ministry of Finance as specified by the Revenue Authority Act [Chapter 23:11] (GoZ, 2004).

2.1.2 Government Expenditure Overview and Reforms in Zimbabwe

Optimising the contribution of the public sector to economic performance requires attention to the total and composition of fiscal expenditure, as much as to total revenue. In addition, successful growth-oriented fiscal reforms also require appropriate sequencing in public sector expenditures. In view of the intrinsic difficulties associated with obtaining accurate and up-to-date government expenditure records, the analysis in this study focuses on government spending information within the public domain.

In the early1980s, the government implemented a series of reforms, including agrarian reforms, security reforms, labour market regulations, education and health care interventions, as outlined in Growth with Equity policy (GoZ, 1981). Other programs that forced up government expenditures were: (i) formations of parastatals, which offered subsidised products and services to the public; (ii) aggressive expansion of the civil service, augmented by the minimum wage policy; (iii) expansion of social protection net; (iv) massification in both basic and tertiary education; and (v) provision of primary health care across the country (Brett, 2005; GoZ, 1981). The compounding effect of recurrent and capital expenditures, recurring droughts in 1980/81 and 1984/85, as well as the global economic crisis of 1982/3, stretched the national budget resulting in growth of fiscal deficits and public debt (UNRISD, 2019; GoZ, 1982).

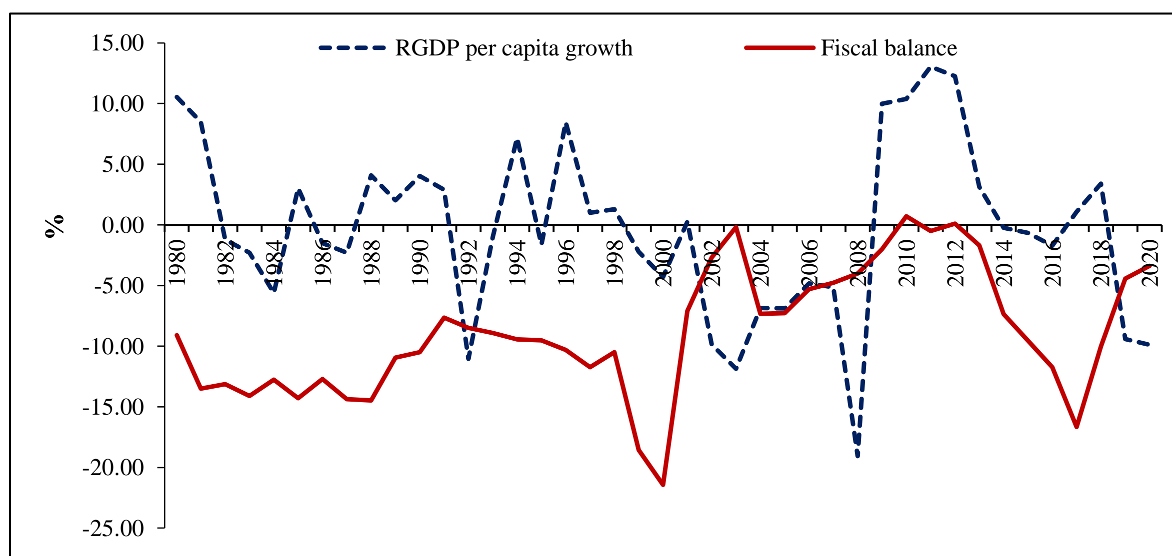
Budget crisis deepened in the late 1980s until 2000 due to (i) growing budget deficits; (ii) worsening of public debt crisis, particularly accrual of arrears; (iii) drop in international financial support; (iv) mounting inflation pressures in the economy, (v) active involvement in diplomatic missions; (vi) de-industrialisation, among other factors (UNRISD, 2019). High government debt levels increased interest expenditure, which crowded out other growth enhancing expenditures such as health care and investment. As the budget crisis became unsustainable, the need for expenditure reforms became indispensable. The reforms between 1991 and 2000, included the abandoning of the previously adopted socialism ideology in favour of market-based policies. The government also imposed a moratorium on most domestic and foreign payments resulting in massive accrual of arrears (Brett, 2005). Some of the structural expenditure reforms were supported by the Bretton Woods Institutions (Brett, 2005). However, the double effect of rising unemployment and removal of social support programs increased the severity of poverty in the country (Saungweme and Odhiambo, 2018).

The economic and political crises in the country between 2000 and 2008 forced the government to finance its deficits through money printing (Hanke and Kwok, 2009). Due to hyperinflation, the government undertook several currency reforms, including the slashing of zeros on its currency (Hanke and Kwok, 2009). In 2009, the GNU implemented the cash budgeting system to curb budget imbalances and also to reduce additional accrual of domestic debt (GoZ, 2009). Use of financial planning and cash management systems restricted government expenditures to revenue collected rather than to the cash flow profile associated with the approved estimates. The government also (i) restructured the public service bill through labour audit – to get rid of 'ghost workers'; (ii) called off bonuses for civil servants; (iii) froze public service recruitment and salaries, among other measures (MOFED, 2020; GoZ, 2013). Coordination of aid and loans with budget during the fiscal years 2009 to 2013, as well as improved public debt management frameworks had a cumulative impact of containing government spending (IMF, 2014).

More so, between 2009 and 2013, some state-owned businesses were privatised, such as the Dairibord Zimbabwe Limited, Cotton Company of Zimbabwe and the Commercial Bank of Zimbabwe; while others were commercialised, such as the National Railways of Zimbabwe and the Zimbabwe United Passenger Company (Saungweme and Odhiambo, 2018). In addition, to increase public finance management and accountability, the government, in conjunction with the World Bank, undertook Public Expenditure and Financial Accountability Assessments in 2017 and Public Expenditure Reviews in 2016 (MOFED, 2020). Between 2018 and 2020, the government reduced its imports on nonessentials, maintained a freeze on civil servants (except for critical posts), limited foreign travels by government officials, among other measures (MOFED, 2020).

2.1.3 Trends in Fiscal Balance and Economic Growth in Zimbabwe

Fiscal balance and economic growth levels have undergone significant transitions since 1980, consistent with policy reforms, political and external environments as discussed in Section 2.21 to 2.2.3 of this paper. Figure 2 provides fiscal balance and economic growth trends in Zimbabwe for the period 1980-2020.



Source: Author's computation using data from the World Bank (2020).

Figure 2. Fiscal Balance and Economic Growth Trends in Zimbabwe (1980-2020)

In the 1980s, expansionary fiscal policies, including stepped-up public investment, brought about some fiscal imbalances, although overall economic growth rate remained positive, averaging 1.5% (World Bank, 2020). Fiscal deficits from 1980 onwards, steadily increased until 1988, where deficit was almost -14.4% of GDP (World Bank, 2020). This was because of successive years of recurrent expenditure growth, well more than nominal GDP growth. A large drop in national output between 1998 and 2008, accompanied by severe hyperinflationary environment, led to the adoption of numerous economic programs and monetary measures, involving also quasi-fiscal activities (Saungweme and Odhiambo, 2018). Both fiscal balance and growth remained negative averaging -6.3% and -8.1%, respectively (World Bank, 2020). Between 2000 and 2008, for instance, Zimbabwe's GDP contracted by at least 50%, inflation reached one billion and fiscal revenues fell from an average of 30% of GDP prior to 2000 to less than 5% of GDP in 2008 (Central Statistical Office, 2008).

The elimination of widespread domestic price controls, vigorous efforts to restructure and privatise a large public enterprise sector, elimination of mandatory wage indexation and other regulatory restrictions between 1991 and 1998, failed in eliminating the most severe macroeconomic and fiscal imbalances – with real GDP per capita growth and fiscal balance/GDP ratio averaging 0.1% and -11.6%, respectively (see Figure 2) (World Bank, 2020). Considerable changes during 1997 and 2000, such as government expenditure related to compensation of war veterans, involvement in diplomatic regional peace building missions in the DRC and Mozambique wars, and the fast track land reform program, also reflect the deepening fiscal imbalances (Jones, 2011). From 2000 to 2008, there were huge unbudgeted government expenditures to insulate the economy from the impact of sanctions imposed on the country in 2000 and measures taken to stimulate the economy.

After a period of unsuccessful macroeconomic stabilisation attempts, sustained fiscal adjustment was achieved during the GNU period, 2009-2013, founded on significant fiscal consolidation and structural reforms (see Figures 1 & 2). Together with more favourable terms of trade, improvement in international relations, positive rational expectations by the general populace and good weather conditions, this led to an upward trajectory in economic growth. However, the gains were short-lived. The expansionary public sector policies of 2014-17 (increasingly financed by monetary accommodation), rising corruption activities and a wide range of structural weaknesses resulted in growing fiscal imbalance and a downward economic growth path. Economic growth decelerated sharply after 2014, government revenue fell with the economic decline, and fiscal deficit widen as public spending soars (Imam, 2019). Major economic adjustment and fiscal consolidation efforts undertaken in 2018 produced significant but brief improvements in budget balances and growth. The combination of fiscal and monetary tightening and structural reforms, in particular sound foreign exchange market control measures, succeeded in reducing inflation and improving the primary budget balance. A decrease in deficits shows that the government is taking actions in reducing mainly mandatory expenditure, but not necessarily a rise in revenue. Economic growth, however, remained low, reflecting continuing serious structural distortions in the economy (see Figure 2).

In 2020, the covid19 induced lockdown measures further paralysed economic activities and dampened recovery efforts (MOFED, 2020). Overall, in recent years, government spending has been managed in a sustainable and prudent manner with public recurrent expenditure

growing at a lower rate than growth in the economy. In the main, it is important not to repeat fiscal mistakes that were made in the past. These led to unsustainable and pro-cyclical economic and public sector recurrent expenditure policy reforms prior to the economic turmoil.

3 Conclusion

This paper discussed the relationship between fiscal policy and macroeconomic performance in Zimbabwe since independence in 1980. The revenue, expenditure, institutional and legal reforms that occurring in public finance management in Zimbabwe over the review period were outlined in the paper. The study found that from 1980 to 1990, institutional and fiscal policy reforms in Zimbabwe supported a quasi-socialist system, that is, the government followed market intervention policies. From 1991 to 2013, the government implemented market-based policies. Between 1998 and 2008, the economy experienced persistent economic challenges that prompted unsustainable expansionary fiscal policies. However, growth-promoting fiscal strategies implemented between 2009 and 2013 resulted in (i) sizable cuts in total public recurrent expenditure; (ii) partial restoration of macroeconomic stability; and (iii) miniscule improvement in revenue collection and administration efficiency. The fractional increase in government revenue and the little elimination of unproductive expenditure, contributed to the upward economic growth trajectory realised during the period. Contrary, expansionary fiscal policies (largely consumptive) between 2014 and 2018, coupled with poor revenue performances and management, worsened the budget position of the government and made the country susceptible to external shocks. Nevertheless, a combination of fiscal and monetary consolidation and structural reforms, in particular sound foreign exchange market control measures between 2018 and 2020, succeeded in reducing inflation and improving the primary budget balance. The study further found that covid19 induced lockdown measures instituted in 2020 are paralysing economic activities and dampening the government's economic recovery efforts.

In view of the literature survey, the study recommends that for successful and sustainable growth-oriented fiscal reforms, there is need to (i) pay attention to the composition of public spending, as much as to total government expenditure, and to the structure of the tax system; (ii) improve tax collection and administration systems – this includes effective cash accounting and management; and (iii) sequence appropriately government expenditure and revenue reforms. Furthermore, it would be ideal for future studies to empirically test the linkages between fiscal balance, public debt and economic growth in Zimbabwe using contemporary econometric techniques.

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