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Zim sitting on debt time bomb ...spiralling out of control

PHILIMON MHLANGA

Zimbabwe is now sitting on a sovereign debt time bomb that could trigger at any time due to the ballooning external and domestic debts.

Analysts who spoke to *Business Times* say the debt has contributed significantly to the crisis facing Zimbabwe, which is in debt distress. The crisis is likely to worsen if the government fails to act.

Three key factors—penalties on overdue external debt, budget deficit, and the depreciation of the local currency—is driving Zimbabwe's debt crisis. Put it all together, it looks like a very toxic mix as the country can no longer safely carry the debt. The dramatic increase within the last seven months is a source of concern, according to analysts.

Zimbabwe's total debt, which was ZWL\$66.8bn at end of June 2019 is said to have quickened to ZWL\$287.3bn as of this week.

In June last year, external debt stood at US\$8.1bn (ZWL\$58.8bn using a direct conversion of the interbank rate of ZWL\$7.25: US\$1 in June last year) but, has skyrocketed by 134.18% to ZWL\$137.7bn (using the interbank rate ZWL\$17: US\$1 this week). Out of this, about US\$5.9bn is accumulated arrears, interest arrears and penalties, which constitute about 72.8% of external debt. This means the principal debt is merely about US\$2.2bn.

In the face of the local currency depreciation, external debt becomes expensive to service, given that more Zimbabwe dollars are required to purchase the greenback as the local currency continues to depreciate against the United States dollars.

Domestic debt was about ZWL\$8.8bn in June last year, which translated to about 13% of total debt. In United States dollar terms, after the government abandoned the 1:1 parity policy, it was about US\$1.33bn using the ZWL\$7.25:US\$1 interbank rate. Now, the debt has shot up 1 600% to ZWL\$149.6bn.

Another catch is that despite government benefitting from domestic debt being eroded by the massive depreciation of the Zimbabwe dollar against the US dollar, local creditors have been ripped off the real value of their loans which may further threaten Zimbabwe's country risk profile. They lost nearly a tenth of their money in real terms.

The thorny issue regards the legal framework on what happened to the domestic debt on change over from the multiple to the mono currency regime in June 2019.

Domestic debt to GDP was 37% last year which was very significant compared to that of regional countries which is lower than 20%. This implies that pressures on government are significant.

The domestic debt figure, however, could be significantly lowered following a landmark ruling by the Supreme Court on Tuesday this week.

Chief Justice Luke Malaba, in an appeal case involving Zambesi Gas against N.R Barber and the Sheriff of Zimbabwe, ruled that all debts incurred before February 22 last year must be settled in the local currency at 1:1 rate against the United

States dollar in line with Statutory Instrument (SI) 33 of 2019. The SI abolished the multicurrency regime and reintroduced the Zimbabwe dollar.

Analysts told *Business Times* this week that the domestic and external debt is now unsustainable.

They said debt crises have been devastating, creating the need to cautiously monitor this recent debt build-up.

In terms of composition by creditor, according to official data obtained from the Ministry of Finance and Economic Development, 44% of external debt is owed to Paris Club creditors, 31% to multilateral creditors, 20% to non-partisan creditors and 5% to bilateral creditors.

IMF resident representative to Zimbabwe Patrick Imam said the public debt is an issue that has contributed significantly to the economic crisis facing Zimbabwe.

"Seven countries are in debt distress, Eritrea, Zimbabwe, Gambia, Mozambique, Republic of Congo, Sao Tome and Principe and South Sudan. Zimbabwe's debt is more than 70% in interest accruals while only 20% is the principal debt. As interest payments have been rising, this will divert a larger portion of fiscal revenues going forward away from more urgent spending such as health, education, and infrastructure," Imam said.

Zimbabwe's resources are insufficient to finance its vast development agenda. But, its failure to deal with the debt will sow the seeds for more trouble.

The events that led to spike in borrowing started in the 80s from a public spending spree by the Zimbabwe government to stimulate the economy through rapid finance developmental expenditure.

But, for the past 20 years Zimbabwe neglected to service its debts.

This has constrained the government from accessing foreign loans except from a few creditors because there are no guarantees.

The accumulation of external payment arrears resulted in the International Monetary Fund (IMF) declaring Zimbabwe ineligible for the general resources account of the IMF financing window.

Other international funders, who normally take a cue from IMF, notably the World Bank, the African Development Bank and traditional creditors from the Paris Club and others also suspended disbursements of existing loan facilities and also declared the country ineligible for new loans.

Analysts told *Business Times* this week that financial turmoil emerged as the country was navigating dangerous waters.

Failure to meet international debt payment obligations has left the country out of the international financial markets.

This implies that the country can only tap into domestic savings for borrowing which seriously limits investment opportunities at a time when the country requires financial resources in line with its aspirations of becoming a middle-income country by 2030.

While tapping into the domestic debt market provides a sound alternative and does not expose the country to foreign exchange risk, it has the potential to crowd out private sector

borrowing, thus hampering investment and output growth.

In the absence of any foreign loans, it is difficult for Zimbabwe to implement any development programme. It forces the government to resort to domestic borrowing crowding out private investment leading to slow growth since governments are usually inefficient compared to private sector investments unless if it is investment in key enablers in the country.

In the absence of loans, not much is happening on development.

According to a recent research by the African Forum and Development (AFRODAD) Zimbabwe's high debt service requirement inhibits future investment in social expenditure such as education and health, thereby perpetuating low productivity and poverty.

AFRODAD said social sectors would suffer more given the constrained fiscal space the country is grappling with, in the event that Zimbabwe decides to service its debts.

There are four major pieces of legislation that government public debt management in Zimbabwe—the Constitution of Zimbabwe, Public Debt Management Act, Public Finance Management Act and the Reserve Bank of Zimbabwe Act.

The Constitution sets limits on State borrowing, public debt, and State guarantees, full disclosure and transparency about public debt in a comprehensive manner among others. Section 300(3) of the Constitution prescribes the Minister responsible for Finance to gazette the terms of a loan agreement or guarantee concluded by the government within 60 days and accountability on public debt issues. Further, Section 300(5) requires the Minister of Finance to present a comprehensive statement of the public debt of Zimbabwe biannual lyrics before Parliament.

The Constitution also stipulates major guidelines on borrowing, maintenance, extinction of the debt, definition of contingent liabilities, exposure of government, borrowing powers of the Minister as well as the Minister's powers to give guarantees, borrowing by local authorities and public entities among other issues.

Zimbabwe's debt management legal framework is rated quite strongly by development partners such as the World Bank and the Macroeconomic and Financial Management Institute as one that meets minimum standards for debt management.

But, the government has been failing to comply with the law. "[Issues included with the failure by the government] to observe the borrowing limits and were not fixed by the National Assembly resolution. The other issue is the failure by the Ministry of Finance to present to Parliament a report on loans raised and guarantees issued by the State and a comprehensive report on public debt," AFRODAD report said.

The institutional arrangement for debt management in Zimbabwe includes but not limited to the Ministry of Finance and Economic Development, Debt Management Office (DMO), External and Domestic Debt Management Committee, Reserve Bank of Zimbabwe, Parliament of Zimbabwe.

The DMO is housed as a unit



Patrick Imam

within the Ministry of Finance and Economic Development.

"Concerns have been raised by some stakeholders regarding the independence of this office (DMO). They said its efficiency and effectiveness in debt management is more critical than where it is placed. Others strongly felt it requires operating autonomously to ensure checks and balances within the Ministry of Finance," AFRODAD said.

It is also argued that the front office for domestic debt is housed in the RBZ. Depending

on information flow from RBZ to the Ministry of Finance, this set up could also pose coordination issues thereby compromising sound debt management.

On several occasions, the Parliament of Zimbabwe last year highlighted non-compliance of Ministry of Finance to the Constitution with regards to the gazetting of loans contracted and guarantee issued as well as failure to present a report on loans raised and guarantees issued by the State and a comprehensive report on public debt.

Parliament highlighted breaches of many provisions in the Public Debt Management Act by the Minister of Finance.

In an attempt to address the debt problem in Zimbabwe, the government undertook a number of initiatives. Between 2001 and 2008, it undertook the Domestic Debt Restructuring policy. It, however, did not produce intended results due to the poor performance of the economy.

The other was Sustainable and Holistic Debt Strategy of 2010. No debt was, however, paid following the intervention.

Government also formulated the Zimbabwe Accelerated Ar-

rears Clearance Debt and Development Strategy in considering a debt relief mechanism under the Heavily Indebted Poor Countries (HIPC) initiative and make use of fresh financing from international institutions and mineral wealth to achieve sustainable development.

There was also the Lima Strategy of October 2015, yet another attempt Zimbabwe made to clearing debt arrears. It was premised on a non-HIPC debt resolution strategy designed to clear debt arrears amounting to US\$1.8bn owed to IMF, World Bank Group and the African Development Bank as the first step towards seeking a debt treatment by the Paris Club after which the government would commence negotiations towards a resolution with the Paris Club.

Zimbabwe cleared its overdue obligation to the IMF in October 2016.

However, the country cannot acquire new debt from the international financial institutions and other creditors until they clear all the arrears they owe to creditors

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Opinion

Supreme Court judgement completes the grand heist

ALEX MAGAISA

The Supreme Court judgement in the case of Zambezi Gas Zimbabwe (Private) Limited v N.R. Barber (Private) Limited and another SC3/20 represents a judicial confirmation of the grand heist that took place in February 2019 when the government issued a decree regarding the conversion of the US Dollar to the RTGS dollar at the command rate of one-to-one.

Statutory Instrument 33 of 2019 (SI 33/2019) was issued in terms of the Presidential Powers (Temporary Measures) Act, the controversial statute which permits the president to issue decrees. Its major purpose was to provide for the recognition of the RTGS dollar as legal tender (although it was already in use). It also provided for the command conversion of the US dollar-denominated assets and liabilities at the fixed rate of one-to-one. This is a fiction that the government had maintained since 2016.

A windfall and a calamity

The decree was a windfall for debtors whose debts were denominated in US dollars. At the stroke of the presidential pen, their debts had been significantly reduced in US dollar terms because contrary to the government's command rate, the RTGS was weaker than the US dollar. For the creditors, however, it was a total nightmare. This is because of one of the provisions of SI 33/2019 which provided that "for accounting and other purposes" all assets and liabilities which were "valued and expressed" in US dollars immediately before its effective date would be "deemed to be values in RTGS dollars at a rate of one-to-one to the United States dollar".

So if the debtor owed US\$1 million on 21 February 2019, on 23 February 2019, just two days later, they owed just RTGS\$1 million. But in the real world, RTGS\$1 million was obviously significantly weaker than US\$1 million. All because the government said so, via a draconian decree. This is the essence of a command and control approach governance which is the hallmark of the Zimbabwean regime. While it was a boon for debtors, it represented a devastating blow to creditors.

Fighting over debts

The ramifications of the government's decree were felt across the economic landscape and predictably, the drama was soon being played out before judges in the courts of law. This is because debtors suddenly found the energy to pay up their debts – by simply converting their US dollar-denominated debts to RTGS dollar debts at the rate of one-to-one, effectively profiting at the expense of their creditors.

Both creditors and debtors approached the courts for relief, debtors insisting on their right to convert US dollar-denominated debts at the rate of one to one and creditors protesting that this was improper and arguing that debtors should honour

their contractual obligations in US dollars. One of these cases reached the Supreme Court, which delivered its judgement on 20 January 2020. It is a heavy blow to anyone who was owed US dollar debts and obligations on 22 February 2019 and confirms the windfall for debtors.

For the economy, confirmation of the legality of the decree is a traumatic assault on business confidence as it erodes the right to private property and shatters the sanctity of contracts. It makes a mockery of Zimbabwe's claim of advances in Ease of Doing Business. Let's take a quick look at the facts of the case.

The Zambezi Gas case

The facts of the matter in the Zambezi case are very simple. In June 2018, N.R. Barber Pvt Ltd (Barber) won a lawsuit against Zambezi Gas Zimbabwe Pvt Ltd for US\$3,885,000.00, a debt which has arisen for services rendered. There was an additional charge of interest and legal costs. Zambezi's appeal against the judgement was thrown out in May 2019. A week later, Zambezi deposited RTGS\$4,136,806.54 as a settlement of the debt. Barber protested that the amount was far less than what Zambezi Gas had been ordered by the court. It stated that the amount paid was only equivalent (at the prevailing Interbank market rate) to US\$144,788.23 (out of the US\$3,992,018.31, which it was expecting).

Zambezi Gas insisted that it had complied with the law. After all, it argued, SI 33/2019 allowed the conversion of all US dollar-denominated local assets and liabilities at the government-decreed rate of one-to-one. Barber instructed the Sheriff of the High Court to attach Zambezi Gas' property to settle the difference. That is when Zambezi Gas went to the High Court pleading for a stay of execution and a declaration that the payment it had tendered in RTGS dollars was a full and final settlement of the judgement debt.

The High Court dismissed Zambezi Gas's application. Zambezi Gas then appealed to the Supreme Court. It is this Supreme Court judgement that has sent shock-waves in the markets. In effect, however, the Supreme Court has merely confirmed the ill-conceived and highly destructive step taken by the Minister of Finance, Mthuli Ncube last February. The consequences, however, are noxious.

The Supreme Court agreed with Zambezi Gas that SI 33/2019 permitted it to convert the US dollar-denominated judgement debt at the government decreed rate of one-to-one. The Chief Justice Luke Malaba rejected the High Court judge's reasoning that SI 33/2019 did not include judgement debts in its ambit. As long as the liabilities were expressed in US dollars, the Chief Justice stated, the provision applied.

Interestingly, because of SI 33/2019's express mention of US dollars, the Chief Justice was prepared to concede that it would not have applied if the liability was expressed in another foreign

currency other than the US dollar. This suggests that liabilities expressed in South African Rands or another currency would have been safer than liabilities expressed in US dollars. This is an example of the absurdities that can result from a rigid and pedantic insistence on a literal interpretation of statutes, which takes no account of context. If the Supreme Court is right, the discrimination between US dollar creditors and creditors owed in other foreign currencies is irrational and unfairly discriminatory, itself a potential ground for unconstitutionality of the provision.

Also, if the Supreme Court is right, it shows poor legislative drafting or, at worst, the inconsistency of government in policy-making. Was it the intention of the government to affect only those who were owed US dollar balances? If so, what would be the basis for not affecting those who were owed debts in other foreign currencies?

Toxic consequences

The implications of this judgement could not be more devastating for the many who find themselves in the same situation as Barber. It is worse for creditors who were owed US dollar balances and have not yet been paid because the exchange rate has tumbled greatly since February 2019. The Zimbabwe dollar has on average been trading at one-to-sixteen on the Interbank Market and over 20 on the parallel market. Those poor creditors will be getting RTGS dollars that are far weaker than they were in February 2019.

The problem, of course, lies with the government which issued this decree. Law, and in particular the interpretation of statutes, is not an exact science. Courts can only work with the laws that are on the statute books and bad laws tend to produce bad outcomes. It is hard to see the justice of permitting debtors in Zambezi Gas' position who, having failed to pay their debts, and having been sued for it, suddenly find themselves on much higher ground than their creditors. Having enjoyed services worth US\$3.9 million, Zambezi Gas only had to pay \$144,000, a mere pittance in the circumstances. It's a huge loss to the creditor and a massive gain for the debtor. The creditor says this violates the sanctity of contracts. The debtor replies that it's vis major (an Act of God). In reality, it's a hare-brained government decree that does significant harm to the economic environment.

Erosion of private property

Clearly, these figures represent a significant loss of property for the creditor and all others in its position. However, it is Chief Justice Malaba's comments on the effect of conversion which are quite astounding. Barber's lawyers advanced a plea for consideration of parity, arguing that "the conversion of foreign currency denomination amounts to a lesser value in the local currency". It's worth quoting the judge's full statement:

"There can be no parity to talk about once it is accepted that the RTGS dollar is a currency denomination with a set legal value. It is the legal tender in Zimbabwe and as such carries a specific value. Once a conversion of the value of an asset or liability denominated in United States dollars is made to the value of RTGS dollars, the converted value remains the same, as the two different currency denominations both carry value. No exchange rate can be applied as the judgment debt remains a judgment debt with a value after it is converted to the local currency. The RTGS dollar has the value given under the one-to-one rate and it remains on that value even after the effective date."

It is hard to make sense of this reasoning when one considers what has happened to the RTGS dollar since SI 33/2019 was issued in February 2019. How can it be said that "the RTGS dollar has the value given under the one-to-one rate and it remains on that value even after the effective date" when it is trading at around one-to-sixteen to the US dollar on the day that the judge was delivering his judgement? Is the ivory tower of justice so divorced from the economic realities so as to produce such esoteric comments from the country's leading justice?

Perhaps the judge wanted to say something that his words did not express with sufficient coherence and clarity. Missing completely from this is



Chief Justice Luke Malaba

the fact that the chief problem with SI 33/2019 was the command rate of one-to-one which it imposed. It was unrealistic then and it is even more absurd now. This, of course, is the government doing but the Chief Justice had no business trying to justify the unjustifiable. It's shocking that there was no dissenting opinion.

One thing for sure though is that this judgement brings to the fore the hazardous nature of the Zimbabwean economic terrain for those engaged in trade and commerce. Just a simple decree can have devastating consequences. For perspective, there are many more in Barber's situation who are now counting their losses in the wake of the Supreme Court judgement confirming the patently unjust effects of last year's decree. They include commercial entities and individuals who were owed US dollar debts and obligations before 22 February 2019. Now they must settle for payment in RTGS dollars converted at a rate of one-to-one when in fact the Interbank and parallel market rates are nowhere near that.

To visualise the scale of the injustice, consider a person who was owed US\$100 in January 2019. She will now get RTGS\$100. If she changed US\$100 at the Interbank market rate she would be getting RTGS\$1,600. That's a loss of RTGS\$1500. The Supreme Court says it's what the law allows.

A reduction in an asset from US\$3.9 million to US\$144,000 is, by all accounts, a serious erosion of violation of one's private property rights. There is, one might imagine, a good case for challenging the constitutionality of SI 33/2019 (and the subsequent Finance Act No. 2, which replaced and confirmed it in August 2019). Yet, in view of the reasoning given by the Chief Justice, such an application is unlikely to succeed. The comments suggesting that there is no loss of value suggest a foreclosure of any arguments that there is erosion of private property right.

Conclusion

As the biggest domestic debtor, the biggest beneficiary in all this is the government itself. All its domestic debts which were denominated in US dollars cannot now be challenged, now that the Supreme Court has spoken. All those who are owed by the government must count their losses.

In effect, SI 33/2019 allowed the government to reduce its domestic debt by theft and the Supreme Court has just confirmed it. Yet in doing so, the government has made itself a hard sell. Creditors will be very cautious and wary the next time it comes asking for credit.

Lawyers operating in an authoritarian environment must find more ingenious ways of protecting the value of their clients' property in any contractual arrangements. Those who have gained may find comfort in their windfall, but any comfort that comes from authoritarian decrees is false and misleading comfort.

For the rest of the people whose losses have been confirmed, it's yet another sobering lesson that salvation from authoritarian rule is not to be found in the courts of law; instead, it is in their hands.

Alex Magaisa holds a PhD in Law from University of Warwick in the U.K. He trained as a lawyer in Zimbabwe and the U.K and he currently teaches law at Kent Law School, the University of Kent.

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Zim sitting on debt time bomb

From 9

Despite all these strategies there has been limited success achieved in addressing Zimbabwe's debt problem.

Tafadzwa Chikumbu, Zimbabwe Coalition on Debt and Development socio-economic analyst said Zimbabwe has reached a critical moment and needs to wean itself from the debt trap and associated macroeconomic stagnation.

"The government's ambitious Vision 2030, where it aspires to be a middle-income economy by 2030, will remain a fallacy unless critical steps are taken to resolve the debt crisis. The national debt should therefore be viewed and treated as a symptom of the wider structural and political challenges inherent in the economy. Dealing with these challenges will form an integral part of a sustainable

debt strategy," Chikumbu said.

"The Zimbabwean case remains unique and challenging in that the country's indebtedness has been exacerbated by the huge debt arrears currently at 76% of the total external debt, continuously violation of legal and constitutional provisions, secrecy and exclusionary decision making by policy makers. Resolving the country's debt crisis therefore remains central in reforming the broader macroeconomic framework for Zimbabwe."

He said the government should simultaneously implement structural, political and sound macroeconomic policies as part of a sustainable and inclusive debt management strategy.

The performance of a sustainable debt management framework is hinged on sound public finance management.

However, even without a sound debt

management framework in place, Zimbabwe has continued to contract new loans from China. This threatens the repeat of past mistakes of over-reliance on foreign borrowing rather than using domestic resources and using foreign borrowing for activities which will not create sufficient returns to repay the loans.

In its 2020 economic outlook, Invictus Securities noted the deficit is likely to widen this year, forcing government to borrow more.

"Fiscal policy will be expansionary, while monetary policy will have to be accommodative to finance government expenditure which is expected to substantially exceed the budgeted Z\$64 billion," Invictus said in its latest research note, adding the budget deficit is expected to exceed ZWL\$5bn this year.