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Changing growth patterns

Improving health outcomes

THE WORLD BANK
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Glossary

ANC	Antenatal Care
ASM	Artisanal and Small-Scale Mining
BOP	Balance of Payments
COMESA	Common Market for Eastern and Southern Africa
CPI	Consumer Price Index
CZI	Confederation of Zimbabwe Industries
DFID	Department for International Development (United Kingdom)
DHS	Demographic and Health Survey
FTLRP	Fast Track Land Reform Program
GDP	Gross Domestic Product
GNI	Gross National Income
HIV/AIDS	Human Immuno-deficiency Virus infection and Acquired Immune Deficiency Syndrome
IEE	Indigenization and Economic Empowerment
IMF	International Monetary Fund
LDC	Least Developed Countries
LIC	Lower Income Countries
MCH	Maternal and Child Health
MICS	Multiple Indicator Cluster Survey
MIMS	Multiple Indicators Monitoring Survey
MOHCC	Ministry of Health and Child Care
NHA	National Health Accounts
NPL	Non-Performing Loan
PC	Per capita
PICES	Poverty Income and Expenditure Survey
RBF	Results-Based Financing
RBZ	Reserve Bank of Zimbabwe
SSA	Sub-Saharan Africa
UN	United Nations
US	United States
WDI	World Development Indicators
WHO	World Health Organization
ZEU	Zimbabwe Economic Update

Preface

The World Bank presents the first edition of the Zimbabwe Economic Update (ZEU) - December 2015. The objective of the ZEU is, first, to provide a World Bank perspective on Zimbabwe's recent economic developments (Chapter 1) and second, to profile recent progress in a key sector or a key issue in detail. In this edition, we discuss the ongoing progress in improving health outcomes and review some of the policies and practices the sector has adopted in response to its challenges (Chapter 2).

Over the last five years, Zimbabwe has made significant progress in stabilizing and revitalizing its economy. The economy grew at an average of six percent annually, while inflation has been kept low. A steady, albeit gradual, sequence of economic and institutional reforms is gaining momentum, and is reflected in the World Bank's annual Country Policy and Institutional Assessment (CPIA). With strong Government commitment, steadfast household investments and substantial donor support, considerable progress has also been made towards regaining Zimbabwe's past performance in social outcomes, particularly in health and education. The authorities are now implementing a number of reforms to strengthen the financial sector, in particular, and to improve the business environment, in general.

Yet significant challenges remain. The economic boom that followed the introduction of the multi-currency system in 2009 appears to have run its course and the economy is facing significant headwinds. The Country was adversely affected by a drought in 2015, and is starting to experience the effects of El Nino this year, in particular on agriculture, energy and water supply. Industry remains subdued due to a challenging policy environment, shifting terms of trade and infrastructure weaknesses. The services sector, however, continues to grow, building on Zimbabwe's skilled labor force.

A high public debt overhang still constrains and raises the cost of capital for investment. Successfully addressing the arrears to mulitlateral and bilateral partners would enable relations with external creditors to be normalized. This would strengthen investor confidence and increase private financial flows, as well as allow partners to fully support Zimbabwe's development and to help protect the poor.

To raise growth, Zimbabwe will have to correct key macroeconomic imbalances in particular, the high current account deficit, which will require real improvements in investment, productivity and adjustments in public spending. Indeed, without substantial improvements in the allocation and efficiency of public spending, the poor will bear the brunt of the headwinds ahead.

I look forward to discussing these and other issues in a continuing constructive dialogue between the Government, its development partners, private-sector representatives and other stakeholders.

Guang Zhe Chen,
Country Director for Botswana, Lesotho, Namibia, South Africa, Zambia and Zimbabwe

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Executive Summary

Recent Developments

Trend economic growth is now around 2-3 percent per annum following the end of the dollarization boom in 2012. Prices have stabilized, and the turbulence of the 2000s is giving way to a restructured Zimbabwean economy. Agricultural production now represents a broadly constant share of total output, while the service sector is experiencing dynamic growth. However, the manufacturing and mining sectors are struggling to cope with rising capital costs, a difficult business climate and a decline in external competitiveness. As a result, there has been a shift in economic activity from industry to services.

A poor growth and worsening external environment contributed to a deceleration in 2015 and growth is projected to remain at 1.5 percent in 2016. The GDP growth rate slowed from 3.8 percent in 2014 to 1.5 percent in 2015 and 2016, due largely to the impact of an ongoing drought, which is taking a heavy toll on agriculture production. The depreciation of the South African rand against the US dollar has weakened Zimbabwe's competitiveness vis-à-vis its main trading partner. Exchange-rate dynamics are having an especially negative impact on the mining and manufacturing sectors, which already face considerable challenges in attracting investment. The mining sector is experiencing a structural transition as the commodity super-cycle ends. Growth in the service sector particularly finance, insurance and construction has accelerated.

Weather-related shocks to the agricultural sector have had an especially negative impact on the poor. Over 90 percent of Zimbabwe's extremely poor live in rural areas. Of these households, the overwhelming majority depend directly or indirectly on agriculture. The drop in agricultural output in 2015 is estimated to have temporarily increased the poverty rate by about 1.5 percentage points, marginally reversing the substantial gains in poverty alleviation that were achieved during the stabilization period. Projections for a poor harvest in early 2016 suggest that poverty may increase further this year.

Low export prices and high production costs are contributing to a persistent deficit in the external accounts. Despite narrowing somewhat in recent years, Zimbabwe's current account deficit remains much larger than those of comparable countries in the region, and exports currently amount to just over half of imports. A decline in global prices for gold, platinum and other mineral commodities, coupled with unresolved supply-side constraints, has reduced the value of mining exports. Zimbabwe has also benefited from lower oil prices, but rising import volumes largely offset the impact on import values. Remittances gradually increased during 2010-2015 and are estimated to have reached almost 7 percent of Gross National Income (GNI) in 2015. The deficit is primarily financed by capital inflows, especially foreign borrowing, but unfavorable terms contribute to making this model unsustainable over time.

Growth has been largely driven by consumption, while both public and private investment has fallen substantially since 2011. Aggregate consumption exceeds GDP and has made a disproportionally large contribution to economic growth during 2010-15. Public sector investment is constrained by severely limited fiscal space for non-wage expenditures and scarce external borrowing opportunities. Investment fell to an estimated 13 percent of GDP in 2015, as a high cost structure and a difficult business climate continued to erode firm competitiveness. Capital inflows, including external borrowing and asset sales are sustaining consumption growth, but this is untenable over the long-term.

The domestic financial sector is slowly recovering from a post-dollarization credit boom and interest rates remain elevated. The Central Bank has stabilized the financial sector, a recent growth of broad money looks robust and bank lending has become market-driven. But still only blue-chip borrowers are able to access financing at competitive rates. The authorities are taking measures to update Zimbabwe's credit infrastructure, strengthen oversight and restore the regulatory framework.

Zimbabwe is experiencing a deflationary trend in response to these macroeconomic imbalances. The multicurrency regime, adopted in 2009, limits monetary policy instruments available to the authorities but also provides a level of fiscal and economic restraint. As competitive pressures increased, the consumer price index fell -2.5 percent, year-on-year, at end-2015. Declining prices should help to restore competitiveness over time, but should be accompanied by efforts to raise productivity at all levels of the economy.

The Government has maintained a tight fiscal stance in recent years and the primary deficit remains small and manageable. Fiscal revenue represented over 25 percent of GDP from 2011 to 2015, but the public sector wage bill accounts for more than three-quarters of total spending during recent years. A tight fiscal envelope has encouraged the authorities to adopt innovative financial management strategies in the health sector, improving health outcomes and generating important lessons for other sectors. Chapter 2 explores these issues in detail.

Outlook and Challenges

Zimbabwe's economic outlook is subdued, and growth is projected to remain at 1.5 percent in 2016 as El Nino related weather conditions depress agricultural output, but growth is expected to revert to trend growth of 2-3 percent in 2017-18. However, these projections are subject to upside and downside risks, both of which are intensified by the economy's dependence on a limited range of key sectors. Unfavorable weather conditions compounded by the 'El Nino' weather, power shortages, insufficient liquidity in agricultural markets and limited access to agricultural credit will continue to threaten agricultural production over the projection period. Meanwhile, a further decline in global commodity prices, an economic shock in South Africa, or the

further depreciation in the South African Rand against the US dollar could put Zimbabwe's recovery at serious risk. Finally, Zimbabwe's current account deficit is equal to over 17 percent of GDP, while the investment rate is 13 percent and the GDP growth is 1.5 percent; this situation is unsustainable.

Zimbabwe has enormous potential for inclusive growth, but it will be a complex challenge to ensure that recovery is truly broad-based and not regressive. As a country, Zimbabwe's education expenditures relative to GDP are among the highest in Sub-Saharan Africa and the Country has an impressive human capital base. Following the economic disruptions of the 2000s, income distribution is more equitable than at any time in the country's recent history. But the price of this redistribution, and the new downside risks facing the economy have a disproportionately negative impact on middle and low-income households. The authorities have demonstrated a credible commitment to broad-based growth, but without correcting key imbalances in both private sector and public sector service delivery, the recovery could take place in a way that is regressive and could compromise Zimbabwe's path toward a fair distribution of the gains from further economic growth.

Clearing external debt arrears is important to Zimbabwe's medium-term growth trajectory. The total public and publicly guaranteed external debt was estimated to be US$7.1 billion (51 percent of GDP) as at September 2015, with external arrears occupying a large share at US$5.6 billion (79 percent of total external debt). The public debt burden has had a deleterious impact on the cost of capital and the economy. It has limited Zimbabwe's access to financing for development and raised the cost to the private sector of accessing international capital markets. The authorities have recognized that clearing the arrears would allow for a resumption of longer term and concessional development financing both for investment and for buffering the impact of current shocks on the poor and vulnerable. To this end, the Government has presented a strategy to clear Zimbabwe's arrears to multilateral institutions in 2016 using own resources and loans, at a meeting with its international creditors during the 2015 annual World Bank – IMF meetings. If successful, this strategy will go a long way to lifting Zimbabwe's medium-term growth outlook.

Chapter 1:

Recent Economic Developments[1]

Exogenous shocks have had a major negative impact on Zimbabwe's recovery. Adverse weather conditions reduced agricultural output in 2015 and continue to disrupt production in early 2016. The recent appreciation of the US dollar against the South African rand, combined with domestic factors, has negatively affected external competitiveness, and falling commodity prices have reduced the value of mining exports. This difficult external environment is not unique to Zimbabwe, and similar developments have been observed in other countries in the region and beyond. Indeed, the impact of these shocks on Zimbabwe's macroeconomic indicators has been mitigated by the country's ongoing recovery following a decade of economic crisis and profound structural change (Box 1). In the wake of this turbulent period, a profoundly altered Zimbabwean economy is emerging, one defined by a new configuration of economic sectors and value chains driven by a new growth model.

Box 1: Zimbabwe's Recent Growth in Historical Perspective

Incompatible macroeconomic policies caused Zimbabwe to suffer a dramatic economic decline during 1998-2008, which spurred large-scale emigration among skilled workers and severely eroded the country's institutional capacity. Unsustainable fiscal deficits coupled with the emergence of hyperinflation in the early 2000s severely damaged Zimbabwe's economy. Meanwhile, the implementation of the Fast-Track Land Reform Program (FTLRP) disrupted agricultural output and undermined related industries, including input supply and food processing. While some agricultural subsectors have since recovered, sectoral value chains are much weaker and irrigation networks are less extensive. As a result, agricultural production is now more susceptible to external shocks, particularly adverse weather conditions. An exodus of skilled workers undermined institutional capacity, and the perception of insecure property rights discouraged foreign direct investment and contributed to domestic capital flight.

The adoption of a multicurrency regime in early 2009 effectively dollarized the economy, reestablishing price stability and laying the foundation for a substantive economic recovery. Zimbabwe's economy grew by more than 10 percent per year during 2010-12 as prices stabilized and bank credit rapidly expanded. A robust increase in bank deposits pushed the annual flow of net credit to the economy to almost 10 percent of GDP during 2010-11, and renewed private sector confidence temporarily boosting investment. However, demand expanded faster than supply, as rising employment and public sector wage increases bolstered consumption. Fiscal management remained prudent but did not serve as a countercyclical brake on the expansion. Indeed, the current account deficit widened from around 15 percent of GDP in 2009 to almost 30 percent in 2011. In 2012, a sharp contraction in manufactured exports was only partially offset by increased mining and agricultural exports. As investor confidence waned and the availability of financing diminished, imports began to contract, and investment decreased by around 10 percentage points of GDP.

Economic growth gradually decelerated after 2013, as the initial stabilization effects of dollarization-led growth ran its course. Meanwhile, global commodity prices weakened, and the depreciation of the rand against the dollar eroded the competitiveness of Zimbabwe's traded goods sector. Burdensome regulations, outdated infrastructure and weak institutional capacity contributed to declining competitiveness. The manufacturing sector was hit especially hard, and exports of manufactured goods fell to less than half their 2010-11 levels. As employment opportunities in the formal sector evaporated, informality became increasingly pervasive. The 2011/12 PICES survey estimated that the informal sector accounted for 19.5 percent of economic activity in 2011.

The Government maintained a prudent fiscal policy stance. The current account deficit slowly began to narrow, though it remained above 17 percent of GDP as consumption persistently exceeded income. However, the deficit was largely financed by unsustainable private capital flows, with negative implications for future economic growth.

Meanwhile, the financial sector experienced a painful restructuring. The Reserve Bank of Zimbabwe (RBZ) required banks to tighten lending practices in response to a rise in Non-Performing Loans (NPLs), and it closed six banks that failed to meet regulatory requirements. These measures increased the resilience of the banking system, but the flow of bank lending slowed from almost 10 percent of GDP in 2010-11 to just 0.7 percent in 2013-14.

[1] Developments reported are based on actual data up to 2014, estimates for 2015 and projections from 2016 onwards

Regulatory barriers continued to pose a major obstacle to Zimbabwe's recovery. The 2015 Doing Business report highlighted insolvency issues as an important constraint on Zimbabwe's private sector. Moreover, capital costs remained elevated due to external pressures, including a large debt burden. Consequently, most investment in the agricultural sector was financed by retained earnings. Limited access to affordable capital compelled farmers to adopt more labor-intensive production methods, which not only diminished the sector's productivity but also weakened its resilience to adverse weather conditions and other external shocks.

High capital costs were especially damaging to the inherently capital-intensive mining and manufacturing sectors, which had already suffered from an erratic electricity supply, administrative trade barriers and other obstacles to doing business. These challenges slowed the introduction of more sophisticated and specialized mining techniques. And while some Zimbabwean manufacturers have successfully moved to exploit niche markets, the sector's overall contribution to GDP growth declined. By contrast, the service sector performed well over the period despite the difficult environment, and certain service subsectors grew rapidly.

GDP GROWTH

Economic growth in 2016 is expected to remain at 1.5 percent. While there is expected to be continued growth in the services sectors, growth of industry is expected to remain stagnant. Moreover, growth of the agriculture sector is expected to be subdued.

This downturn in growth prospects has followed a general trend of significant deceleration after several years of robust expansion following the adoption of the multicurrency regime. Indeed, real GDP growth slowed from 3.8 percent in 2014 to 1.5 percent in 2015. The robust growth of the construction sector (7 percent) and the finance and insurance sectors (6 percent), drove the larger trend. Conversely, contractions in the electricity and water sectors (-11 percent), agriculture (-3.6 percent) and mining (-2.5 percent) slowed the pace of expansion.

Aggregate Demand

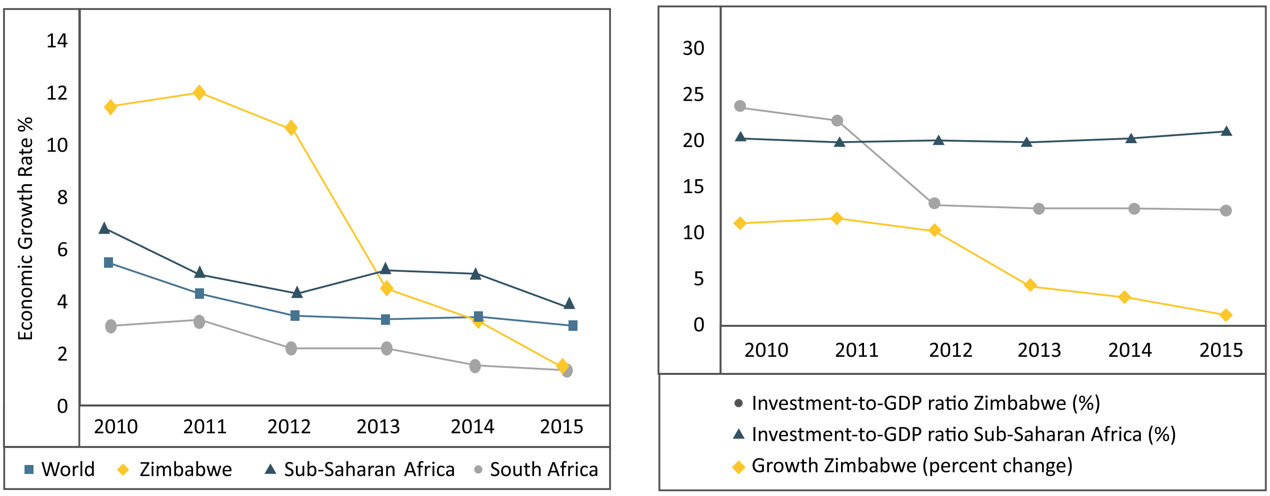
Rising consumption financed in part by capital inflows has underpinned Zimbabwe's recent growth. In 2015, public and private consumption increased by respectively 0.9 and 2.1 percent. Capital inflows, primarily external borrowing coupled with rising remittances, have fueled the growth of private consumption.

Overall investment is expected to remain at around 13 percent of GDP in 2016 with subdued public and private investment. Zimbabwe's investment ratio in 2015 was about two-thirds of the average for SSA (Figure 1). Low rates of investment are the result of high capital costs, electricity shortages, labor-market rigidities, policy uncertainty and external pressures, including the depreciation of the rand and the possibility of rising US interest rates. Major changes in Zimbabwean labor laws bode well for labor market flexibility, while measures to reduce or remove other important impediments to foreign investment are currently under consideration (Box 2).

Figure 1: Growth Rates and Investment-to-GDP Ratios, Zimbabwe and Selected Comparators, 2010-15

a. Growth

b. Growth and Investment to GDP



Source: World Bank (2015) Global Economic Prospects

Source: IMF (2015) World Economic Outlook

Box 2: Regulatory Developments

Zimbabwe's labor and capital market regulations have improved significantly in recent years, but are accompanied by a modest increase in external tariffs. Improvements in the functioning of Zimbabwe's labor and capital markets has been much more profound than the slight shift towards trade protection observed in 2015. The increase in tariff rates remains manageable within the framework of Zimbabwe's regional trading commitments. The high administrative costs of cross-border trade, especially those caused by customs delays, far outweigh recent increases in import duties. The authorities have adopted a broad strategy to reduce the cost of paying taxes and trading across borders.

There have been efforts to improve labor market flexibility in 2015. A Supreme Court ruling in July 2015, allowed firms to retrench workers with three months notice. During the weeks following the ruling, a substantial number of workers were laid off, and in August 2015, the labor code was amended to stipulate that severance payments should equal one month's salary for every two years of service. This flexibility remains critical to Zimbabwe's external competitiveness now that the multicurrency regime has eliminated the option of exchange-rate depreciation.

The Indigenization and Economic Empowerment Act (IEE) continues to be a challenging hurdle for private investors, while authorities have recently made an attempt to clarify flexibilities in its application. Designed to address historic economic marginalization, the IEE mandates that indigenous Zimbabweans hold a minimum 51 percent ownership stake in any business that is transferred, merged, subdivided or otherwise restructured, or which is undertaking new investments valued at US$500,000 or more. The Act contains several provisions that allow for both gradual and alternative application of the thresholds but these have largely been applied on a discretionary and non-transparent basis. In 2014, the process was partly decentralized from the Ministry of Youth, Indigenization and Economic Empowerment to sector ministries to enable implementation to more closely reflect conditions in specific sectors, but without commensurate improvements in transparency. In January 2016, the Government published Guidelines for Implementing the IEE Act that explains in part, how the 51 percent indigenized equity can be substituted with a range of measures and introduce longer periods for business to comply with IEE regulations. In addition, the Guidelines introduce a price-based compliance levy and sets a new requirement that 50 percent of all procurement of goods and services by all companies (private and state-owned) be procured from local businesses. The level of the aforementioned levy has not yet been promulgated and further details are needed to fully understand the alternate measures of compliance.

The authorities are beginning to address the large unfinished agenda in land administration, following the Fast Track Land Reform Program (FTLRP). The appropriation and redistribution of targeted agricultural holdings under the FTLRP appears to be approaching completion. However, the economic potential of the reform is yet to be realized. The unfinished clarification of land use and tenure security arrangements for redistributed holdings has stymied investment by the new landholders, engendered a new phase of land disputes, and delayed the reactivation of a land market. The land administration system is yet to be adapted to provide adequate services to the increased number of landholders. The Government has started an audit of reformed landholdings, accelerated the distribution of permits to smallholders and is working to clarify the leasing arrangements for larger land holders to facilitate commercial bank lending.

Insufficient rainfall and the depreciation of the South African rand against the US dollar are contributing to Zimbabwe's slowing growth rate. While the growth of services remained strong through 2015, agriculture and industry are highly susceptible to shocks. The disruption of irrigation networks and input value chains caused by the FTLRP greatly increased the vulnerability of agricultural production. Rainfall is also critical to Zimbabwe's water utilities and hydroelectric power subsector. Power, water and agriculture all have direct implications on poverty trends.

KEY SECTORS

Agriculture

The continued impact of the drought is projected to cause agricultural output to contract in 2016. Erratic rainfall in 2015 compounded a number of underlying structural issues in the agricultural sector, causing output to contract by 3.6 percent. Zimbabwe's most important food crop, maize, was among the most affected, though the production of tobacco and other export crops also fell sharply. This is in stark contrast to the sector's average annual growth rate of 13 percent between 2009 and 2014, which largely reflected the expansion of tobacco cultivation.

Table 1: Agricultural Growth by Volume, 2004-2015 (percent)

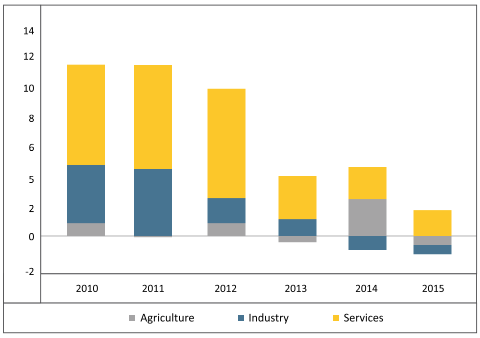
	Weight in sector	2004-14	2009-14	2014	2015
Sector average:	100.0	1.5	13.0	23.0	-3.6
Of which selected cash crops include:					
Tobacco	25.5	12.1	29.8	29.7	-7.4
Cotton	12.5	-8.0	-7.4	0.6	-16.6
And selected subsistence crops include:					
Wheat	3.6	-7.0	4.1	49.7	-2.6
Maize	14.0	4.4	3.3	82.3	-49.0
Groundnut	3.2	4.7	-9.0	55.6	-34.2

Source: Ministry of Finance and Economic Development and Zimstat

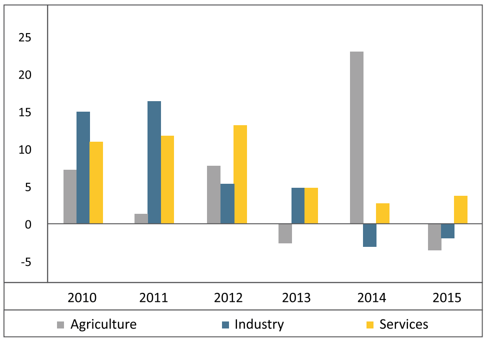
The weak harvest in 2015 caused a temporary increase in the poverty rate. Agriculture is the foundation of rural livelihoods, and rural areas are home to two-thirds of Zimbabwe's population, as well as 79 percent of the poor and 92 percent of the extreme poor.[2] Both cash and subsistence crops have important poverty implications. The production of cash crops such as tobacco, sugar and cotton is a major source of employment for low-skilled workers, while food crops such as maize, groundnuts and sorghum are critical to food security and the welfare of poor rural households. The contraction in agricultural output appears to have increased the national headcount poverty rate by at least 1.5 percentage points in 2015 (Figure 2). Recent developments in late 2015 and early 2016, suggest that poverty rates may increase further before declining as trend growth resumes. A significant increase in non-income poverty, particularly in terms of health indicators, has also been observed, since cost is the most significant barrier to treatment among low-income households (Chapter 2).

Figure 2: Growth and Poverty Rates, 2010-2015 (percent)

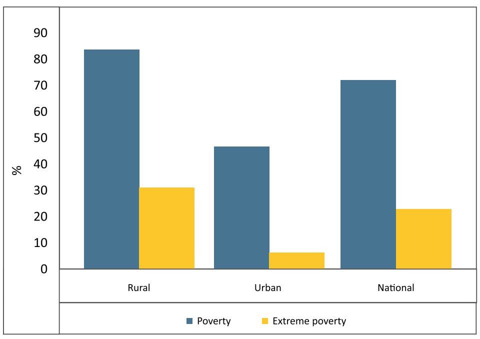
a. Contribution to GDP Growth at Market Prices, Percent



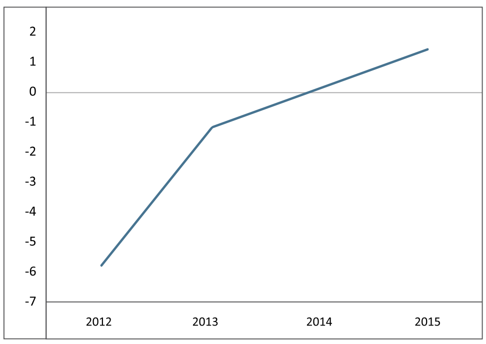
b. Growth by Sector Percent



c. Poverty Rates



d. Poverty Rate Changes Over Time (Percentage Points)[3]



Source: Ministry of Finance and Economic Development and Zimstat

[2] Zimstat, PICES Survey, 2012

[3] This chart presents projected changes in the poverty rate based on an estimated growth elasticity of poverty reduction

Mining

The mining sector contracted by an estimated 2.5 percent in 2015. Growth is expected to remain stagnant in 2016. Low international commodity prices combined with an unstable policy environment, weak investor confidence and rising production costs have caused mining output to decline. Platinum producers have reportedly delayed expansion projects as a result of a new export tax on semi-processed platinum-group metals that took effect in January 2015, and platinum output is estimated to have fallen in 2015. Diamond production is also estimated to have fallen in 2015 as diamond firms consolidate their operations and transition from alluvial to costlier hard-rock mining. However, gold production continued to grow by an estimated 17 percent in 2015 driven by the artisanal and small-scale mining (ASM) subsector.

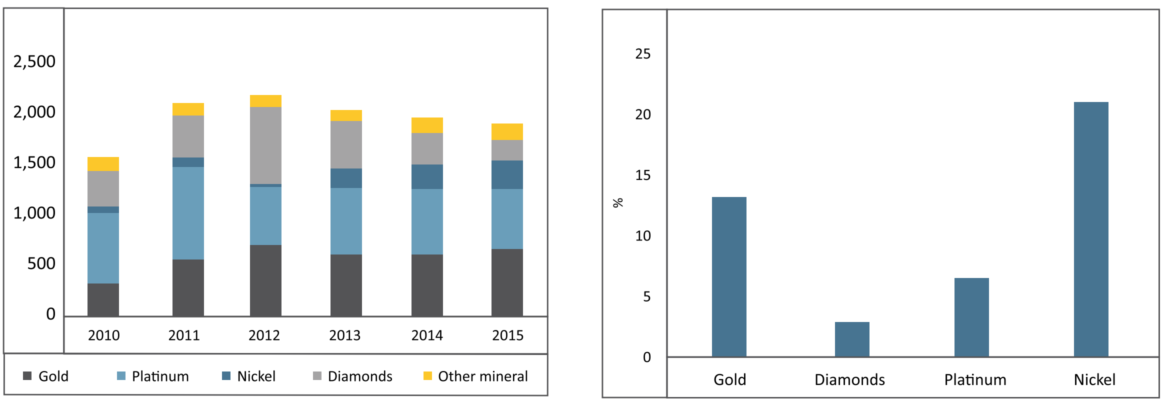
Growth remains strong in the less capital-intensive ASM subsector. Artisanal and small-scale gold output increased by about 153 percent in 2015.[4] The ASM subsector is an important source of income among the rural poor. It employs an estimated 350,000 Zimbabweans, and over a million depend on income from the subsector. However, the largely informal nature of ASM raises serious concerns. Transactions are not recorded in official statistics, the subsector contributes little to fiscal revenues and environmental, health and safety regulations are not observed, posing a risk to Zimbabwe's gains in the health sector (Chapter 2). In an effort to address these issues, Government is taking steps to formalize ASM operations.

The mining sector continues to represent an essential component of export earnings and mining output accounts for around half of total exports (Figure 3). Zimbabwe's royalty rates are similar to those of many comparable countries, but the rate structure has been subject to frequent revisions. Faced with low global mineral prices, a depreciating rand, a restrictive investment climate and an uncertain fiscal and regulatory framework, the Zimbabwean mining sector is struggling to attract capital and encourage innovation.

Figure 3: Mining Sector Indicators (in percent unless otherwise specified)

a. Mining export earning, US$ million

b. Average annual production growth, 2010-15



Source: Reserve Bank of Zimbabwe and Ministry of Finance and Economic Development

Manufacturing

Manufacturing is projected to grow slowly in 2016 following modest growth of 1.6 percent in 2015. Food processing, textiles and clothing production grew during 2015, while processed wood, furniture, paper and chemical industries contracted. Certain sectors, including textiles and clothing, have been partially shielded by tighter import restrictions announced in the mid-term Fiscal Policy Review. Imports from COMESA countries enter duty free providing competition and greater diversity. However, an inadequate electricity supply coupled with adverse exchange-rate dynamics is eroding the competitiveness of Zimbabwe's traditional manufacturing industries. Meanwhile, the high cost of doing business in Zimbabwe, including an outdated insolvency regime, weaknesses in corporate governance and limited and costly term financing, are inhibiting the restructuring process and slowing growth across the manufacturing sector.

[4] The subsector's output increased from 1,232 kg during the first six months of 2014 to 3,117 kg in the first six months of 2015. These figures only represent gold that was sold through Fidelity Printers and Refiners and do not represent national gold output.

[5] The 2015 Confederation of Zimbabwe Industries (CZI) manufacturing survey shows a decline in capacity utilization from 36.5 percent in 2014 to 34.3 percent in 2015, while both the 2015 CZI Quarterly Business Confidence Index and Purchasing Manager's Index remain low.

Services

The service sector, currently 60 percent of GDP, grew at an average rate of 8.5 percent per year during 2010-14, 4.3 percent in 2015 and is projected to grow by over 3 percent in 2016. Construction, finance and insurance and hotels and distribution recorded strong growth in 2015. Telecommunications is also expected to continue to make important contributions to overall growth as its customer base continues to expand. In 2015, the mobile phone penetration rate (active) rose to 93 percent, and internet access reached 47 percent of the population.[6] While the telecommunications industry remains pivotal to the service sector's development, signs of weakening domestic demand are likely to dampen its growth prospects in the short-term.

Knowledge-intensive subsectors that employ skilled workers and serve upper-income consumers led the sector's growth (Table 2). Non-tradable services such as, education and public administration also experienced rapid growth, partly in response to increasing fiscal expenditures and rising public sector wages, including teachers' salaries. The rise of knowledge-intensive subsectors such as finance, transport and communications underscores the growth potential of Zimbabwe's service sector. By contrast, sectors that tend to employ less-skilled workers expanded slowly.

Table 2: The Growth of Services by Subsector, 2010-15 (percent)

		Growth	
	Share in GDP (factor cost)	Average 2010-14	2015
Construction	2.4	22.7	7.0
Finance and insurance	7.2	13.5	6.0
Real estate	2.8	25.7	3.9
Distribution, hotels and restaurants	16.1	3.8	4.7
Transport and communication	8.0	3.7	4.2
Public administration	3.4	11.8	1.5
Education	6.5	24.7	2.1
Health	1.3	4.3	2.1
Domestic services	1.4	1.3	2.0
Other services	4.5	1.3	3.0

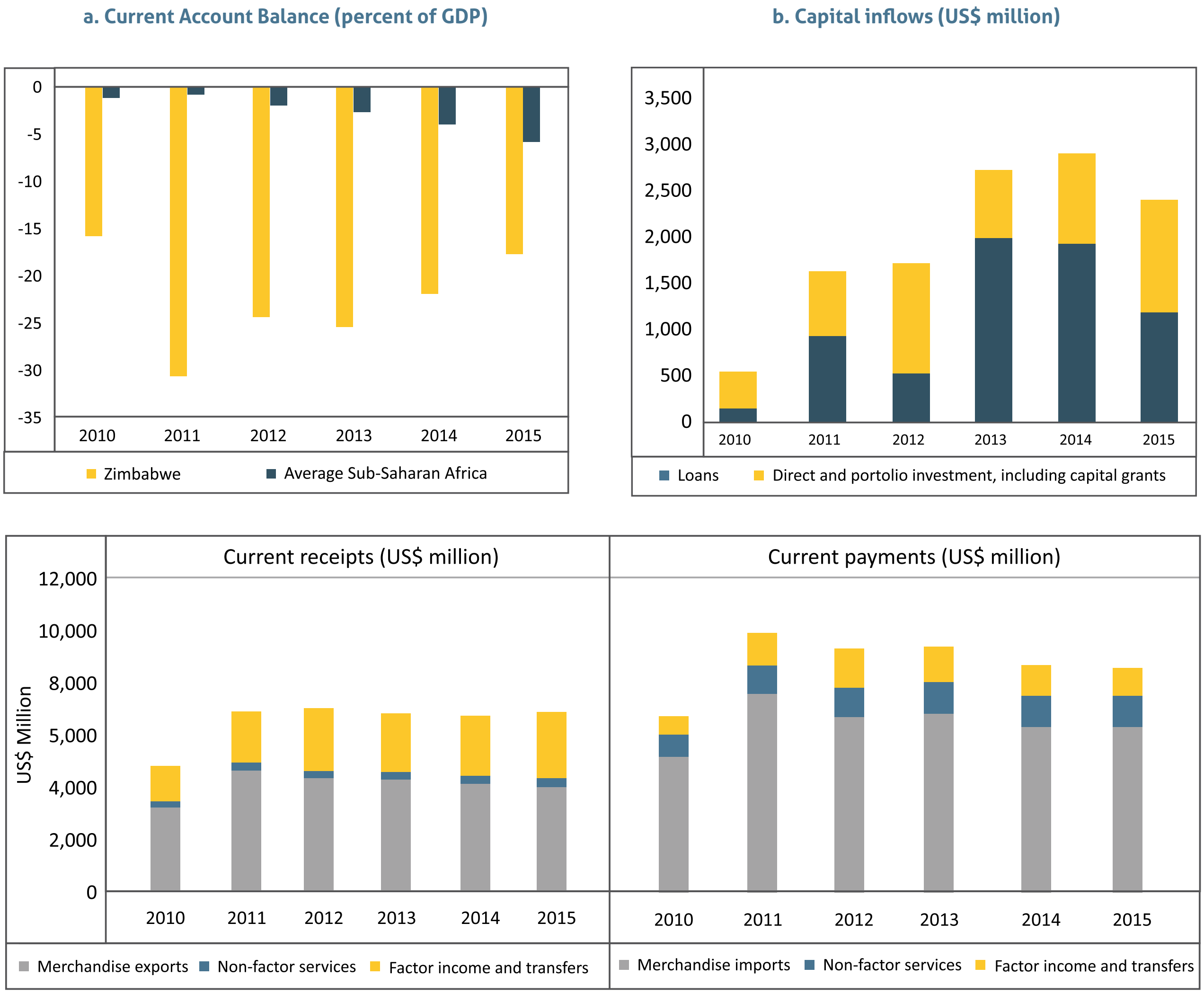
Source: Ministry of Finance and Economic Development and Zimstat

THE BALANCE OF PAYMENTS

Zimbabwe's current account deficit is substantially larger than the average for SSA countries, and its present level is unsustainable. The current account deficit was on average over 22 percent during 2010-14 and is estimated to be 17.4 percent of GDP in 2015. About two-thirds of the deficit is expected to be financed by external borrowing. Pressure to finance the capital account has contributed to a gradual narrowing of the current account deficit during 2014-15, mainly through a drop in imports, especially merchandise imports. Meanwhile, export revenues have declined gradually since 2011, as commodity prices have fallen and the US dollar has remained strong relative to the currencies of most of Zimbabwe's major trading partners. Transfers have risen modestly, driven by the growth of private remittances. Factor returns remain low, but income from non-factor services such as tourism has increased, albeit from a low base (Figure 4).

[6] Postal and Telecommunications Regulatory Authority of Zimbabwe (Potraz) (2015), Abridged postal and telecommunications sector performance report: Third Quarter 2015.

Figure 4: The Balance of Payments

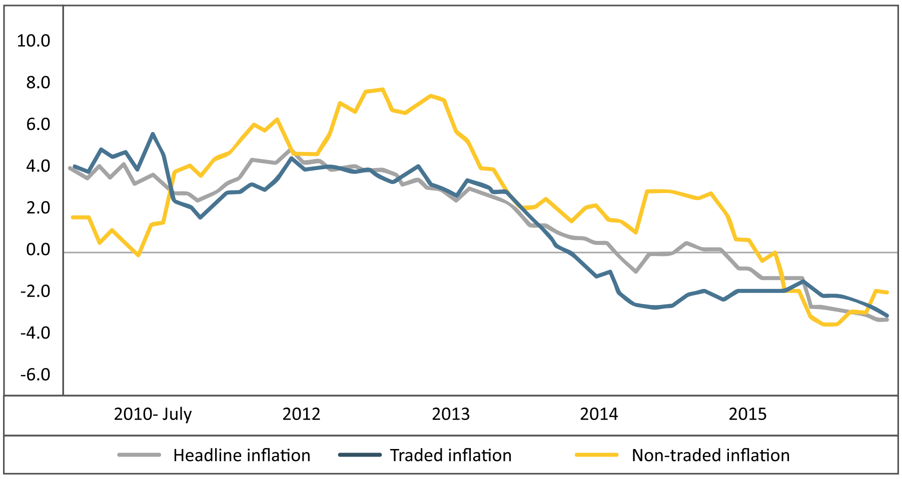


Source: IMF (2015) World Economic Outlook and Reserve Bank of Zimbabwe

INFLATION/DEFLATION

A difficult external environment is causing an uneven downward adjustment in domestic prices. Pressures to narrow the current account deficit have been reflected in higher interest rates on financial inflows, reducing domestic demand, compounding the effects of the South African rand's depreciation. From September 2013 to January 2015, deflation was limited to traded goods, but since January 2015, weak domestic demand reduced prices for non-tradable goods and services, especially education and communications. This combination of factors caused the headline inflation rate to fall to -2.5 percent at end 2015. This follows a period of significant inflation between 2009 and 2014, when prices increased by a cumulative 13 percent.

Figure 5: Inflation: Headline, Tradable and Non-tradable, 2010-2015 (percent)



Source: ZIMSTAT and World Bank Staff Calculations

MONETARY POLICY

Dollarization has left the authorities with few monetary policy instruments with which to counter deflationary pressures arising from the external accounts. Zimbabwe's recent deflationary trend has been combined with rapidly growing bank deposits. While policies have gone a long way toward, restoring confidence in the banking sector (Box 3), consumers and investors may also be deliberately delaying purchases in anticipation of a further decline in prices, and high real interest rates further incentivize savings. Despite conservative lending policies, bank lending is still projected to grow modestly over the year.

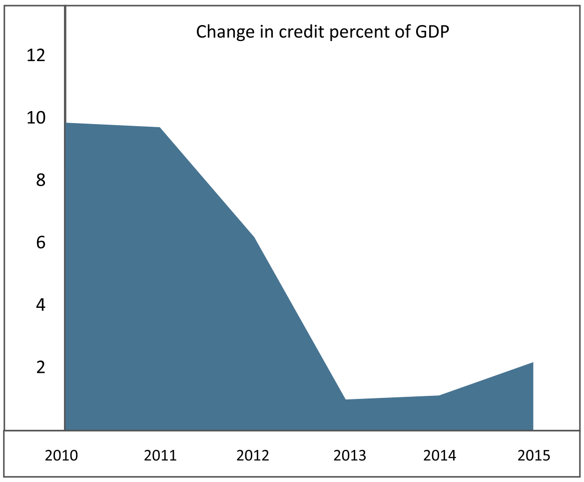
Box 3: Banking Sector Developments

Zimbabwe's banking sector is recovering from the impact of a credit boom in the years immediately following dollarization. After the authorities adopted the multicurrency regime in February 2009, bank deposits and lending rapidly increased, and net credit to the economy rose to nearly 10 percent of GDP during 2010-11. The share of NPLs began to increase steadily, reaching over 20 percent of the loan portfolio in September, 2014. Banks responded by tightening credit standards in 2013, dramatically reducing net credit to the economy and contributing to the deceleration of overall growth. They also increased interest rates and attempted to attract additional deposits. Nevertheless, interest-rate margins remain high, allowing banks to cover the cost of the NPLs while they strengthen their balance sheets and shore up their profit margins.

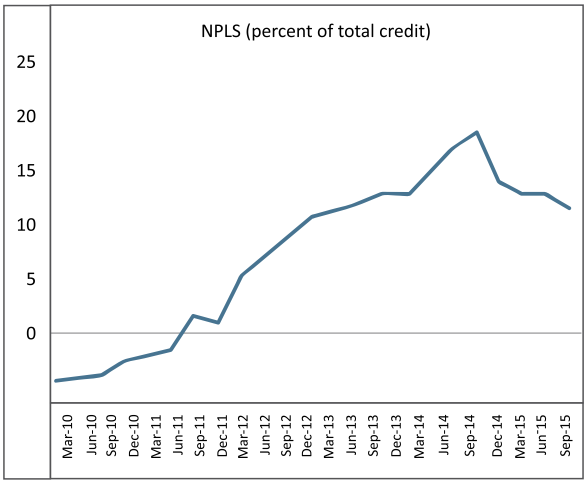
The Reserve Bank of Zimbabwe (RBZ) has played a key role in the transformation of the banking sector. The RBZ established non-binding guidelines for the Bankers Association of Zimbabwe and introduced four measures designed to reinforce financial stability. It set NPL targets for the banking sector, closed six banks with high NPL ratios and limited capital stocks, bought US$256 million in toxic assets (as of end-September 2015) through a dedicated debt-management unit (Zimbabwe Asset Management Company (ZAMCO), and required banks to tighten their risk-management and credit-appraisal practices with the support of a newly established credit bureau and credit registry. The new nonbinding guidelines for interest rates cover three different bands based on creditor risk, with indicative rates ranging from 6.5 to 18 percent per year. Finally, the RBZ again assumed its lender-of-last-resort functions as interbank lending resumed in March 2015, at an interest rate of 8.5 percent per year backed by a US$200 million guarantee from Afreximbank. This credit facility is helping to ease temporary liquidity challenges that banks may face.

Figure 6: Financial Sector Indicators, 2010-2015

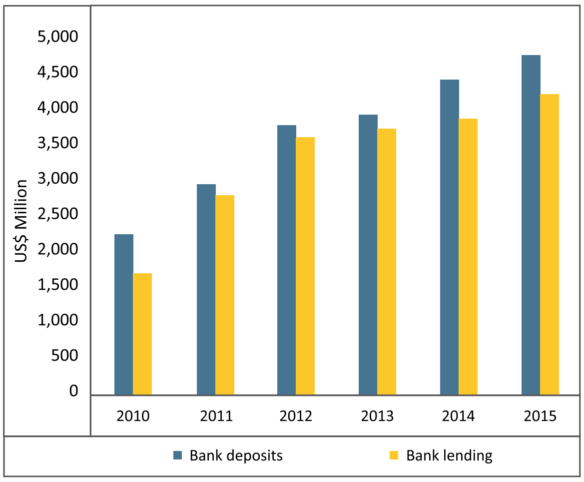
a. Net credit to the economy is recovering slowly from a collapse in 2013



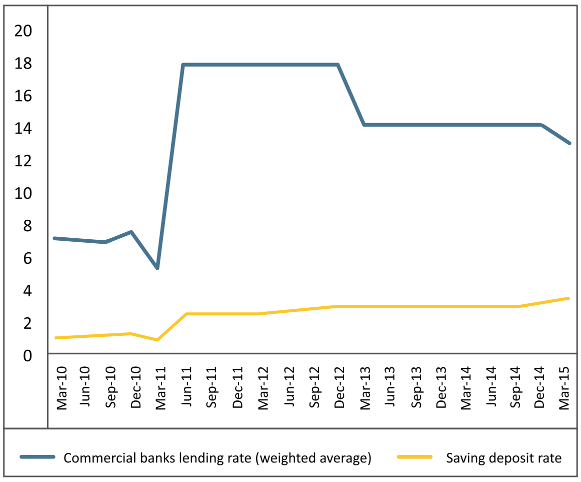
b. Credit had collapsed because of a rise in non-performing loans.



c. Bank deposits have continued to increase and banks have the financial muscle to lend.



d. And lending rates are starting to fall making borrowing from banks more attractive for customers



Source: Reserve Bank of Zimbabwe (RBZ)

FISCAL POLICY

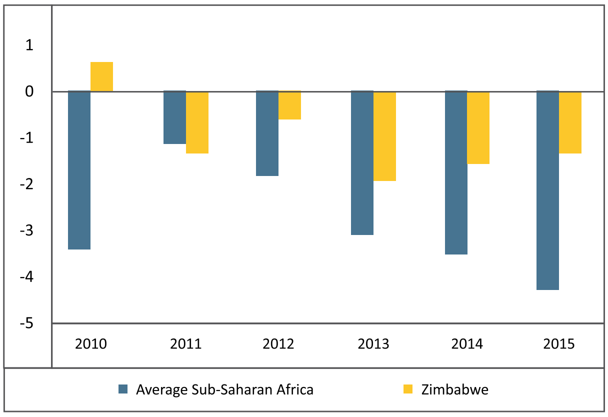
The discipline imposed by dollarization combined with a continued prudent fiscal policy in 2016 would support Zimbabwe's recovery despite a difficult external context. Dollarization and limited access to most international credit markets supported a return to fiscal discipline, and Zimbabwe's recent fiscal deficits have generally been below the average for SSA. Between 2011 and 2015, the authorities kept the primary budget deficit (cash basis) to below 3 percent of GDP. Expenditure cuts offset decline in public revenue in 2015, and the overall fiscal deficit is preliminary estimated at US$242 million, or 1.7 percent GDP. Zimbabwe's fiscal revenues grew at a robust pace over 2011-14 and remain among the highest in SSA. Limited access to credit prompted the authorities to focus on revenue mobilization, and while the average revenue-to-GDP ratio in SSA declined, Zimbabwe's rose. Even as growth slowed in 2015, the Government sustained its strong revenue performance; tax revenue remained broadly stable in nominal terms at US$3.5 billion and slid marginally as a share of GDP, from 26.6 percent in 2014 to 25.9 percent in 2015.

Government's tight fiscal stance since 2010, however, has done little to improve the efficiency of public spending, and public sector wages crowd out other critical expenditures. The developmental impact of both the expenditure containment and revenue-mobilization efforts has been diminished by an excessively large public sector wage bill, which represents over 75 percent of total expenditures during recent years. Wages crowd out spending on educational materials, prescription drugs and hospital supplies, as well as public investment (See Chapter 2). While Zimbabwe's public sector wages are not especially high by regional standards, public sector employment has grown steadily since the economy stabilized (Figure 7).

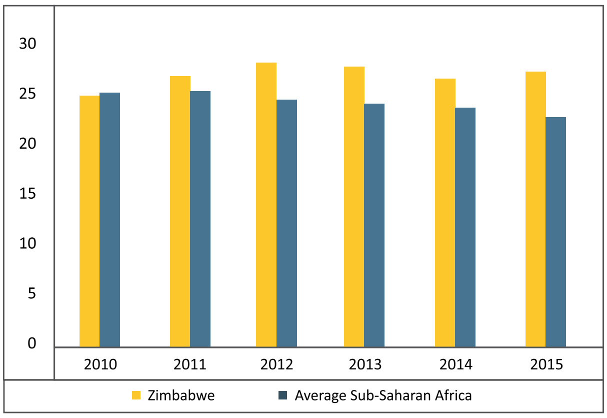
Faced with limited resources for non-wage expenditures, Government agencies and ministries have been allowed to mobilize their own resources, in effect expanding the size of an already large state and creating equity concerns. Public sector reforms in 1999 strengthened the legal basis for establishing user fees and charges for public services. As a result, many Zimbabwean schools, hospitals, roads and other services are financed by user fees which have increased over time. For example, school fees rose by 50 percent between December, 2009 and October, 2015. The equity implications of rising user fees in the health sector are discussed in Chapter 2 of this Economic Update.

Figure 7: Key Fiscal Indicators, 2010-2015 (in percent of GDP unless otherwise specified)

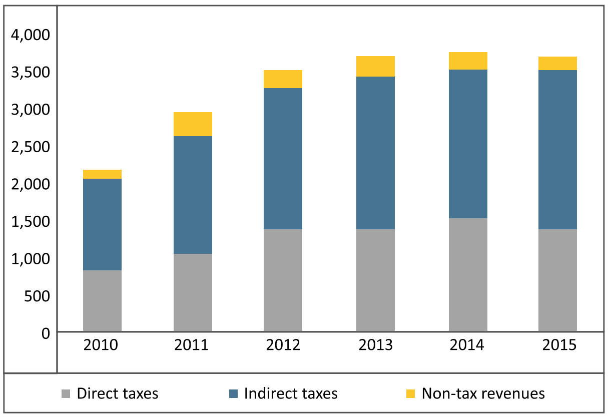
a. Zimbabwe has a smaller fiscal deficit than the average Sub-Saharan country.



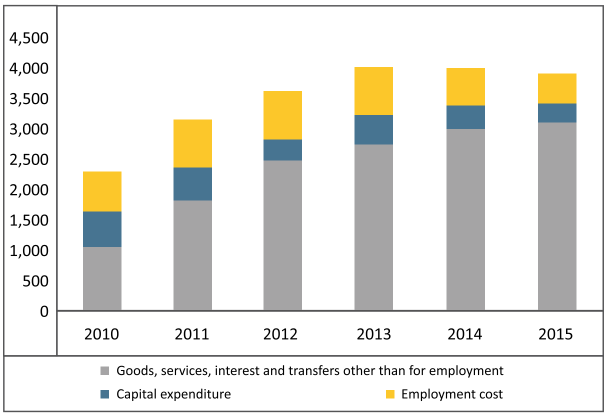
b. Since 2010, Zimbabwe has mobilized more revenues as a share of GDP than the average Sub-Saharan country.



c. Indirect taxes have continued to increase in US$ terms, while direct taxes may be levelling off (US$ million).



d. Employment costs dominate expenditure, leaving limited resources for non-employment expenditures (US$ million).



Source: Ministry of Finance and Economic Development; and IMF (2015) World Economic Outlook

THE MEDIUM-TERM OUTLOOK

After a difficult struggle to regain economic stability, Zimbabwe is poised to achieve rapid and inclusive growth, but seizing this opportunity will require addressing key policy and institutional bottlenecks to private sector development. Agricultural exports were a major engine of growth during 2010-14 and key driver of poverty reduction. The implementation of the FTLRP disrupted agricultural production, but as the program matured and stabilized, the agricultural sector has reorganized into a new configuration of value chains. But agricultural labor productivity remains very low at only a third of average labour productivity in Zimbabwe. By contrast, labor productivity in the service sector is high and Zimbabwe's record of robust public and private investment in education, has enabled its citizens to make important contributions to public and professional services both domestically and throughout the region.

Exports currently represent a modest share of total service sector output, and there is clear potential for further growth in service exports. Zimbabwe's considerable stock of human capital leaves it well positioned to export professional services. While skilled Zimbabwean workers often seek employment abroad and send remittances home, economic stabilization could enable these workers to remain in the domestic labor force and export their skills to international markets.

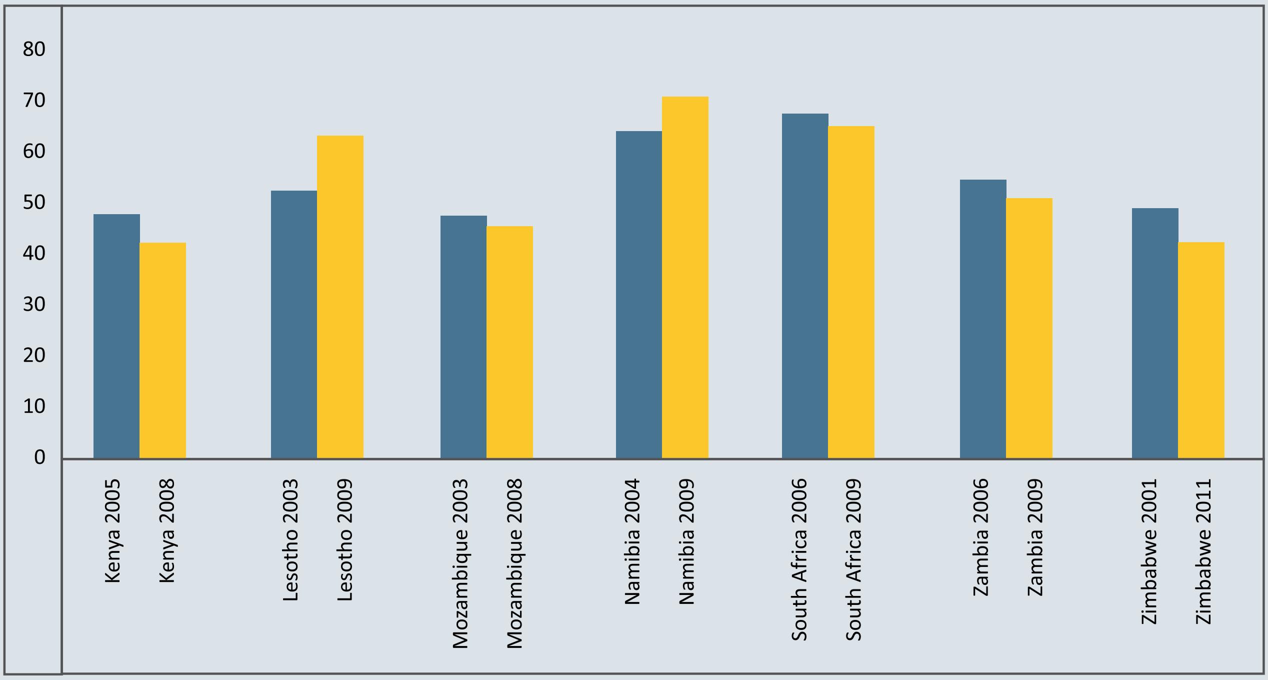
The prospects for mining and manufacturing exports, however, are less favorable. Over the past several years, manufacturing exports have declined and mining exports have grown slowly in spite of broadly favorable prices. While recent developments suggests that certain manufacturers serving niche markets may contribute to export growth over the medium-term, substantial regulatory burdens, high capital costs and deficient infrastructure present major obstacles to the sector's growth and diversification. These challenges are aggravated by the end of the commodity super cycle and the decline in commodity prices. The mining sector faces similar challenges, and its growth outlook varies by subsector.

Box 4: Poverty and Inequality in Medium-Term Perspective

Zimbabwe is emerging from a period of profound economic disruption that has fundamentally altered its poverty and inequality dynamics. Following years of accelerated land redistribution, the restructuring of major sectors, hyperinflation, capital flight and the large-scale emigration of skilled workers, Zimbabwe's income distribution is more equal than in 2001. Zimbabwe's Gini Index declined from 48.9 in 2001 to 42.3 in 2011. The country's 2011 Gini Index was among the lowest in the sub-region. This shift toward a more equitable distribution of income coincided with a substantial decline in the extreme poverty rate, which fell from 41 percent in 2001 to 23 percent in 2011.[7] Moreover, simulations of changes in (extreme) poverty during 2011-14 (see figure 2d) suggest that this trend continued until 2013. Chapter 2 describes how rising poverty rates extend to non-income poverty measures such as health indicators.

While robust growth will be critical to further improvements in income and poverty reduction, the nature of Zimbabwe's post-crisis recovery threatens its newfound equality. Zimbabwe's recent growth has been heavily concentrated in skill-intensive services such as finance, insurance, transportation and tourism. Meanwhile, agriculture and manufacturing which, employ less skilled workers continue to struggle. The authorities have demonstrated a credible commitment to broad-based growth, but without correcting key imbalances in both private sector and public sector service delivery, the recovery could take place in a way that is regressive and could compromise Zimbabwe's path toward a fair distribution of the gains from further economic growth.

The Evolution of the Gini Index, Selected Countries and Years



Source: Zimstat (2013), Poverty and Poverty Datum Line Analysis in Zimbabwe 2011/12

[7] Poverty rates in 2001 and 2011 may not be strictly comparable due to changes in the poverty-measurement methodology.

Macroeconomic, Fiscal and Trade Dynamics

Zimbabwe's short-term economic outlook is modest. Economic growth is projected to increase from 1.5 percent in 2016 to 2.7 percent and 3.1 percent in 2017 and 2018, respectively. After a difficult year in 2016, the agricultural sector is expected to resume its strong growth trend in 2017 and 2018, bolstered by the adoption of new climate-specific seed varieties and other measures to adapt to climate change. Meanwhile, after 2016 growth is also projected to accelerate in both the industrial and service sectors.

The industrial sector is expected to recover despite a difficult domestic environment. Mining sector output is projected to rebound as a number of important mines resume or increase production especially platinum production and growth in the ASM subsector continues. Similarly, manufacturing growth is projected to accelerate as certain subsectors complete their restructuring and the modest deflationary trend improves the sector's international competitiveness.

External trade will continue to be the engine of growth and employment creation. Mining and agriculture constitute a large proportion of Zimbabwe's tradeable goods and services, and a recovery in these sectors will support a broader improvement in the trade balance. Moreover, deflation is expected to put downward pressure on consumption as consumers defer spending in anticipation of rising purchasing power.

As a result, bank deposits are projected to continue increasing at their current pace while the growth of lending remains low. Rising deposits will boost liquidity, but bank lending will remain conservative due to NPLs that increased rapidly between 2013 and 2015. Meanwhile, deflation will continue to put upward pressure on real interest rates, further reducing the demand for new loans.

The Government's fiscal stance is expected to remain cautious over the medium-term. Revenues are expected to recover in 2016 and 2017, as the economy gains speed. Rising revenues will allow an increase in capital spending while maintaining responsible fiscal balances.

Expenditure pressures will need to be carefully managed in order to public service delivery. Expenditure cuts, including a reduction in the wage bill, are expected in 2016 and 2017 as the authorities attempt to rebalance expenditures. The Civil Service Commission has launched a personnel restructuring and rationalization program aimed at streamlining the size of the public service and better aligning staff resources with agency mandates.

Medium-Term Risks

While robust growth will be critical to further improvements in income and poverty reduction, the nature of Zimbabwe's post-crisis recovery could compromise the newfound equality. Zimbabwe's recent growth has been heavily concentrated in skill-intensive services such as finance, insurance, transportation and tourism. Meanwhile, agriculture and labor-intensive manufacturing continue to struggle. Zimbabwe has an opportunity to capitalize on its more equitable income distribution by promoting sectors with broad-based growth potential, but a regressive recovery could unravel these equity gains.

The Policy Context

Despite a challenging short and medium-term outlook, Zimbabwe's long-term growth prospects remain favorable, provided structural issues can be effectively addressed. The reorganization of the rural economy in the wake of land reform provides an opportunity for broad-based growth, but both the extent of this growth and its contribution to the public finances will hinge on the authorities' efforts to strengthen tenure security in the rural sector and create a stable investment climate for both large agribusinesses and smallholder farmers. Formal financial intermediation will be critical to strengthen agricultural value chains and tighten integration with international markets. Meanwhile, continued growth in the industrial and service sectors will require a more enabling business environment.

Reducing the country risk premium associated with investment in Zimbabwe is vital to accelerating economic growth. Many investors perceived the Country's accumulation of external arrears, and the manner in which it implemented land reform and indigenization programs to be sources of significant uncertainty. Given Zimbabwe's extended periods of isolation throughout its history, only clear and manifest improvements to the investment climate will help to reverse these perceptions and the risk premiums that they engender. Greater transparency and stability in the design and execution of public policies is essential to this effort.

The Government is now taking steps to reform the business climate. Zimbabwe's complex, and often outdated, regulatory structures are a key obstacle to investment, diversification and competitiveness. The authorities have recently launched a rapid results program to address some of these business process hurdles. In addition, work is underway toward clarifying the bankability of land leases that would lower capital costs in the agricultural sector and to modernize, reinforce stability and improve transparency in the mining sector's tax and licensing regime.

Controlling fiscal expenditures will continue to represent the Government's primary policy challenge over the medium-term. While recent measures to contain expenditure growth have been largely effective, addressing the sizeable external public debt burden and managing balance-of-payments pressures will require a further fiscal adjustment. Revenues currently represent 26 percent of GDP, and the fiscal deficit is below 3 percent. However, the public sector wage bill, including pensions, accounts for 80 percent of on-budget expenditures, while many Government agencies and ministries finance non-wage expenditures through user fees. The authorities are gradually expanding the coverage of the budget, aiming to properly account for all revenues and expenditures.

Arrears clearance and reengagement with international creditors

The public debt burden, coupled with external arrears, has had a deleterious impact on the cost of capital and the economy. Zimbabwe's public and publicly guaranteed debt was estimated to be US$8.4 billion -60.2 percent of GDP of which US$7.1 billion was external debt, with external arrears occupying a large share at US$5.6 billion -79 percent of total external debt. The debt overhand and the external arrears, has limited Zimbabwe's access to financing for development and raised the cost to the private sector of accessing regular international capital markets.

A resumption of long-term, concessional financing from the World Bank and other multilateral institutions could help to raise the growth outlook and help cushion the impact of the ongoing adjustment. The authorities have recognized that clearing the multilateral arrears as well as, seeking a rescheduling of bilateral debts through the Paris Club would allow for a resumption of longer-term and concessional development financing for both investment in the economy and for buffering the impact of current shocks which, fall disproportionally on the poor and vulnerable. To this end, the Government has presented a strategy to clear Zimbabwe's arrears to multilateral institutions – IMF, World Bank and the African Development Bank, in 2016 using own resources and loan. This strategy was broadly supported at a meeting with Zimbabwe's international creditors during the 2015 annual World Bank-IMF meetings. If successful, this strategy will go a long way to lifting Zimbabwe's medium-term growth outlook and its prospects for reducing poverty

Table 3: Selected Macroeconomic Indicators, Estimated and Projected, 2013-2018

	2013	2014	2015	2016	2017	2018
GDP at constant prices	4.5	3.8	1.5	1.5	2.7	3.1
Private Consumption	6.4	1.1	2.1	0.1	1.2	1.5
Government Consumption	7.1	2.2	0.9	-2.3	-0.5	0.6
Gross Fixed Capital Investment	0.7	8.9	-7.6	2.4	3.0	3.7
Exports, Goods and Services	-5.4	-1.5	1.5	2.3	3.6	3.6
Imports, Goods and Services	-13.5	-9.2	-0.2	3.5	-2.2	2.5
Inflation (Private consumption deflator, annual average)	1.6	-0.2	-2.2	-1.7	1.0	1.0
Current Account Balance (% of GDP)	-23.9	-18.4	-17.4	-16.5	-15.6	-15.4
Fiscal Balance (% of GDP)	-2.5	-1.8	-1.7	-1.6	-1.6	-1.6

Source: Ministry of Finance and Economic Development, Zimstat and IMF for 2013 - 14 and World Bank Staff Projections estimates for 2015 and projections for 2017 - 18.

Chapter 2:
Using Innovative Financing Mechanisms to Increase Health Sector Efficiency

Substantial improvements in Zimbabwe's health indicators since 2009 underscore the country's potential to reclaim its former status as a leader in health outcomes in Sub-Saharan Africa. The economic crisis of the 2000s profoundly altered the financing structure of the health sector. An increasing reliance on user fees and the rapid growth of the wage bill had negative distributional and efficiency impacts, and donor support became critical to finance non-wage expenditures. After the economy started to stabilize in 2009, some of these trends began to reverse. Indicators have improved, and Zimbabwe now has a moderate efficiency advantage in healthcare spending. Further efficiency gains are critical given Zimbabwe's binding fiscal constraints and diminishing aid flows. Impact evaluations of recent innovations in Results-Based Financing for rural clinics revealed higher coverage rates, better quality of care and more equitable provision of key maternal and childcare services. These results suggest that Zimbabwe should consider expanding this financing approach to other aspects of the healthcare system.

Introduction

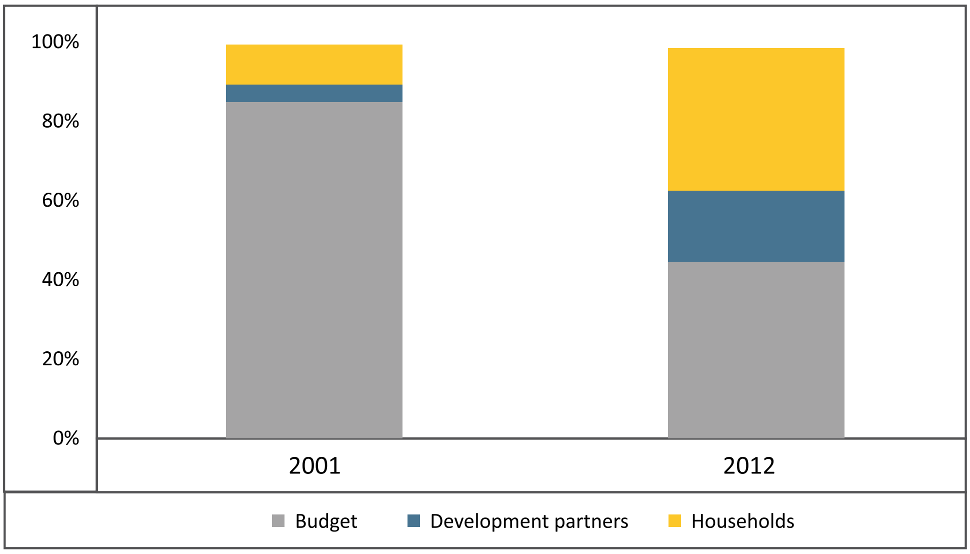
The following section explores the recent evolution of Zimbabwe's health sector and examines trends in key health indicators. While many areas of the Zimbabwean economy merit close attention, the health sector presents a number of especially important features that warrant its inclusion in the first edition of the Zimbabwe Economic Update. First, the sector's former status as a leading performer in Sub-Saharan Africa, its collapse during the 2000s and its incipient recovery in an altered context, illustrate Zimbabwe's broader macroeconomic trajectory. Second, the health sector's struggle to reclaim lost ground while coping with tighter fiscal constraints is emblematic of the challenges faced by agencies across the public administration. Finally, while the sector's expenditure efficiency has not yet returned to the performance levels observed in the 1990s, its success in adopting innovative strategies has enabled it to exceed the average performance levels of comparable countries. These strategies, including the Results-Based Financing (RBF) model, are designed to maximize the impact of limited resources. The experience of the health sector, may yield important lessons for Zimbabwean policymakers as they strive to advance an ambitious development agenda within a limited fiscal envelope.

Overview of Health Expenditures

The economic crisis of the 2000s profoundly affected both the level and the distribution of resources in the health sector. Prior to the crisis the Government financed the overwhelming majority of healthcare expenditures, supported by relatively modest contributions from international donors and Zimbabwean households. However, as fiscal revenues fell, Government healthcare spending was constrained. Donors stepped up their support, but Zimbabwean households were forced to assume a much larger share of the sector's financial burden (Figure 8). This rapid increase in the proportion of health spending financed by user fees has important equity implications and affected the sector's ability to serve poorer households. The rising trend in out-of-pocket expenditures ran contrary to the goals of Government's health strategy, which focused on promoting equitable access to high-quality services.

An increasingly heavy reliance on user fees may have negative distributional impacts on access to services and health outcomes. Higher-income households, who pay more both in absolute terms and as a share of household spending, receive better quality services and more sophisticated forms of care at private and referral hospitals, while the poor tend to rely on rural health centers and informal providers. Lower-income households are also much more likely to report unaffordability as a reason for not seeking care (Figure 9). As the Zimbabwean economy continues to recover, and health expenditures rise, moving from private out-of-pocket spending at the point of service to some form of prepaid risk-pooling will be critical to facilitate access to care among poor households and improve the overall efficiency of health spending.

Figure 8: Health Financing in Zimbabwe by Source, 2001 and 2012



Source: World Bank, 2015, Zimbabwe Health Public Expenditure Review, Report No. 97175-ZW

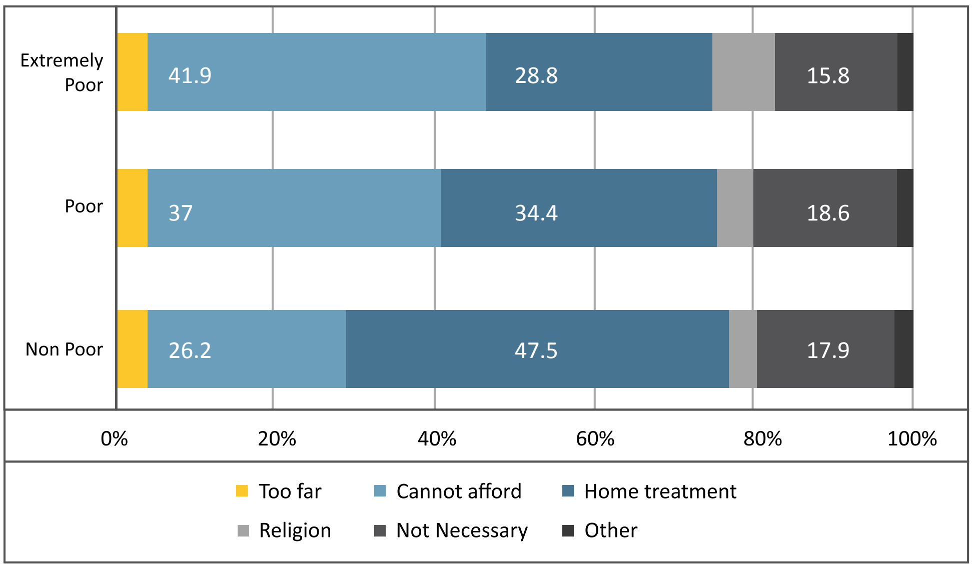
Table 4: Mean Out-of-Pocket Spending by Expenditure Quintile

	Mean Expenditure (US$)	% of Household Budget
Poorest quintile	0.39 (0.024)	0.48 (0.03)
Near poorest quintile	0.89 (0.047)	0.71 (0.04)
Middle quintile	1.86 (0.087)	1.07 (0.05)
Near richest quintile	4.20 (0.175)	1.64 (0.07)
Richest quintile	20.36 (1.360)	2.82 (0.11)

Source: Authors' calculations based on PICES 2011/12 data.

Note: Standard error in parentheses.

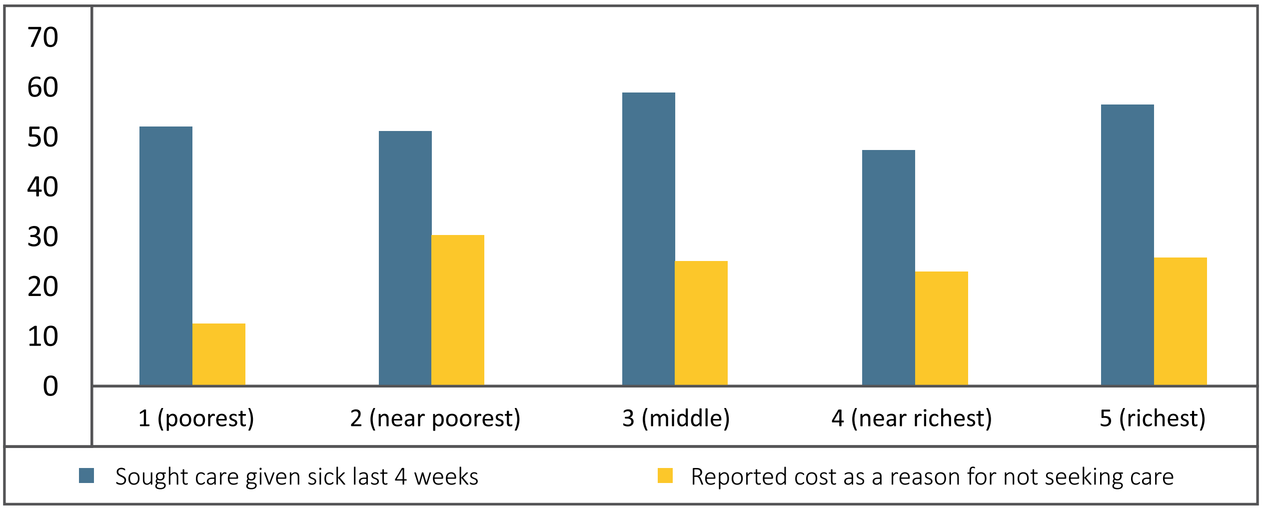
Figure 9: Most Commonly Cited Reasons for Not Seeking Medical Treatment



Source: Zimstat (2012) and PICES Survey 2011/12

In a 2014 household survey of 32 districts in 8 rural provinces, 40-50 percent of respondents reported that they did not seek formal healthcare when ill (Figure 10), of which about one-fourth cited cost as the main reason. There were no significant differences across quintiles, except in the poorest quintile where affordability was given as the main reason by 13 percent of respondents. About half the households in the survey lived in districts where user fees were supposed to have been removed for services as part of an RBF program. This may explain why affordability appeared to be a less prominent constraint than in national surveys. In addition, the fact that the poorest respondents did not cite cost as the main reason, may indicate that they are more likely to go to facilities that do not charge user fees.

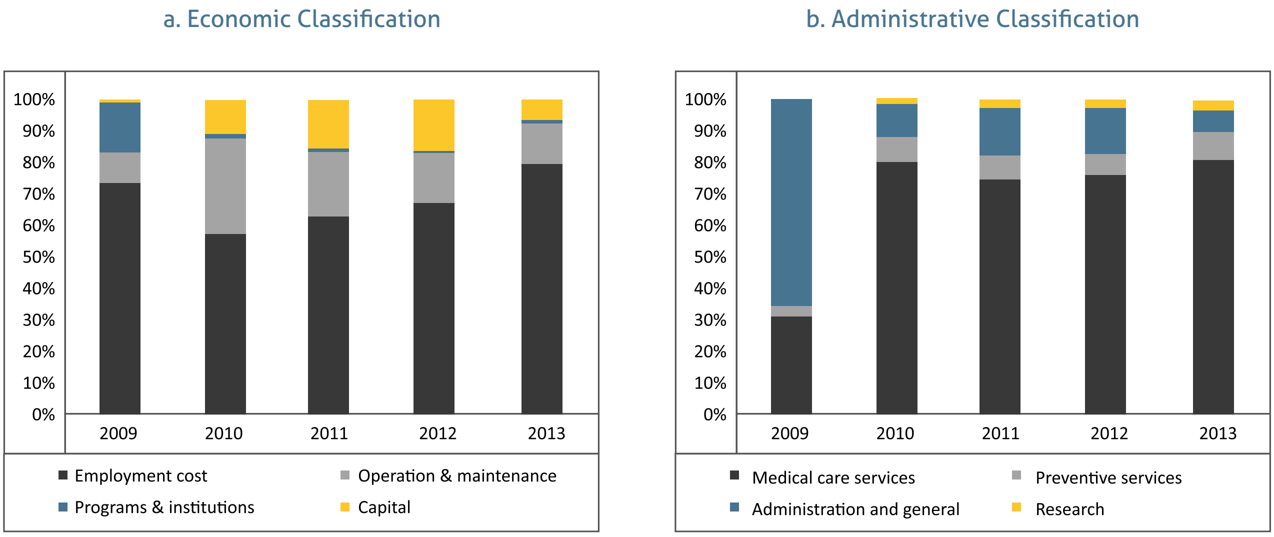
Figure 10: Health-Seeking Behavior across Quintiles: Evidence from Rural Areas, 2014



Source: Authors' analysis of 2014 RBF impact evaluation household survey data.

The economic crisis substantially altered the allocation of public resources. Following the large-scale exodus of skilled workers, including public sector healthcare professionals, during 2006-08, Government increased health sector wages in 2009 in order to retain doctors, nurses, administrators and other key personnel. This trend continued through 2012 even as overall spending declined. The result is an outsized wage bill that now dwarfs other major expenditure categories (Figure 11) in the sector. Capital investment and non-wage current expenditures are low both in absolute and relative terms.

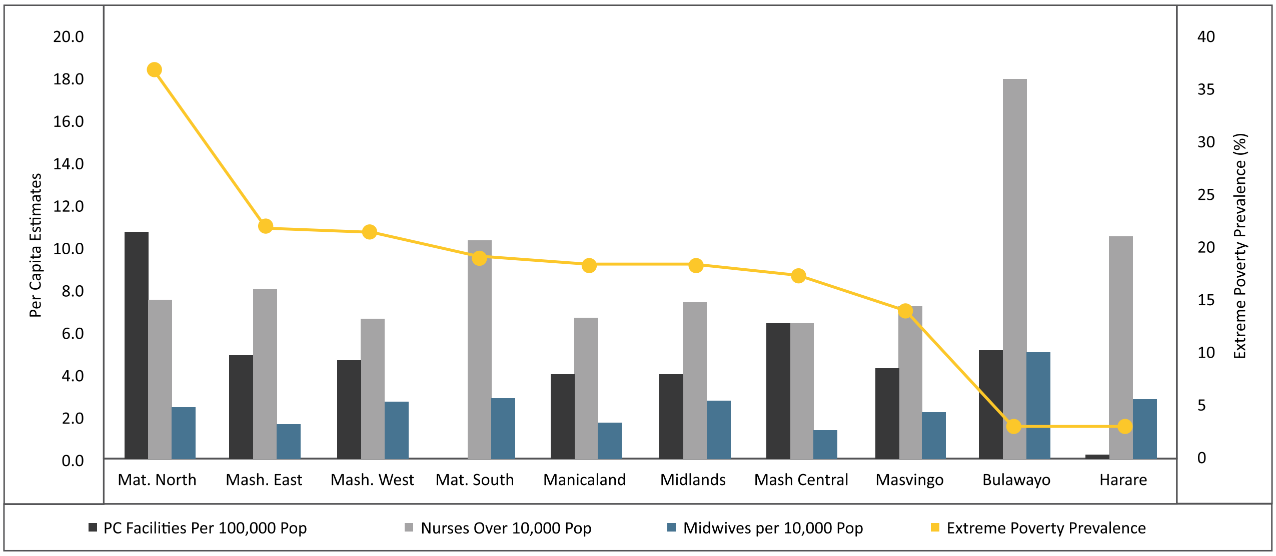
Figure 11: Ministry of Health and Child Care (MOHCC) Expenditures by Economic Classification (US$ millions)



Source: Ministry of Finance and Economic Development, staff calculations

Also, an unequal distribution of skilled healthcare workers negatively impacts the range and quality of health services in poorer areas of the country. While there are more healthcare facilities per capita in provinces with higher poverty incidence, reflecting policymakers' pro-poor sector investment strategy, the skilled health personnel are more concentrated in wealthier areas with lower poverty rates (Figure 11).

Figure 12: Provincial Distribution of Facilities, Nurses, and Midwives, 2012

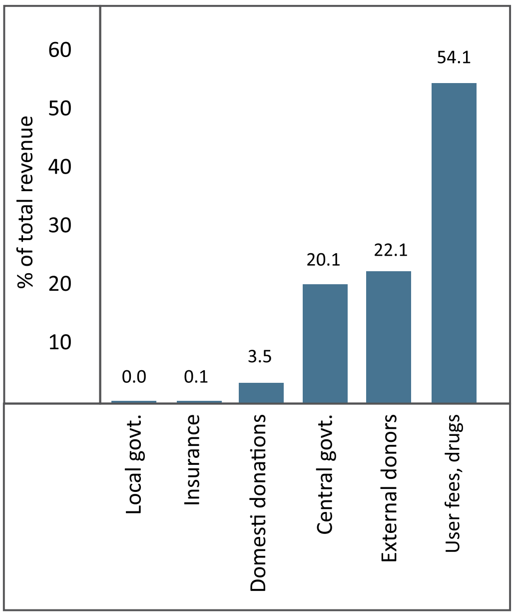


Source: MOHCC, National Health Profile 2012 and ZIMSTAT

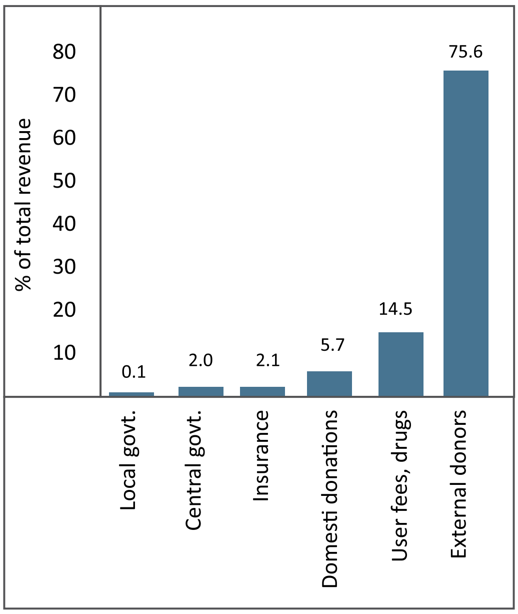
While donor funding for healthcare in Zimbabwe is lower than in other countries in the region, it exceeds Government funding in all categories except wages. Zimbabwe currently receives about US$12 per capita in annual donor support for health expenditures, less than half of the allocation for Zambia and lower than the allocations for Tanzania, Mozambique and Malawi.[8] Two-thirds of donor financing is devoted to HIV/AIDS, tuberculosis and malaria programs. With the exception of HIV/AIDS programming, donor funding exceeds Government funding in all non-wage expenditure categories. For example, donors provide three-quarters of rural health center revenues net of personnel costs (Figure 13). Despite Government's focus on maintaining competitive wage rates, the attrition of qualified workers has also prompted donors to establish programs to augment the salaries of healthcare workers directly engaged in service delivery.

Figure 13: Share of Sources of Revenue in Hospitals and Health Centers, 2012 (percent)

a. District, Rural, and Mission Hospitals



b. Rural Health Centers



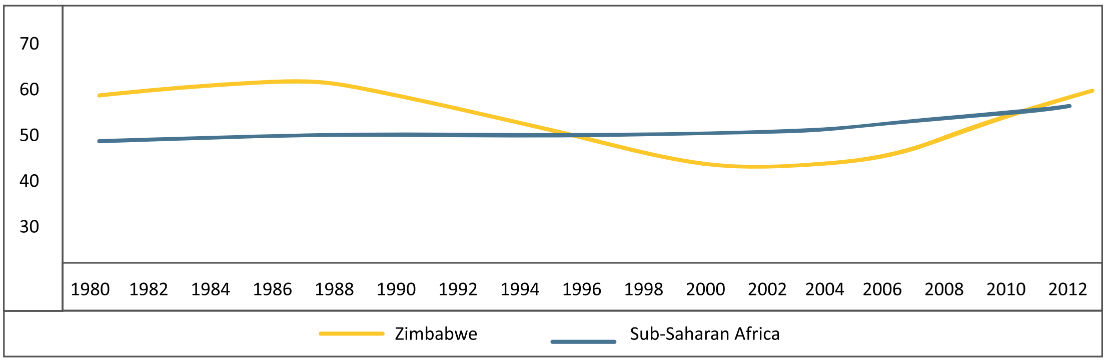
Source: Authors' analysis of 2014 RBF impact evaluation facility survey data.

[8] World Bank, 2015, Zimbabwe Health Public Expenditure Review, Report No.97175-ZW

Trends in Service Delivery and Health Sector Outcomes

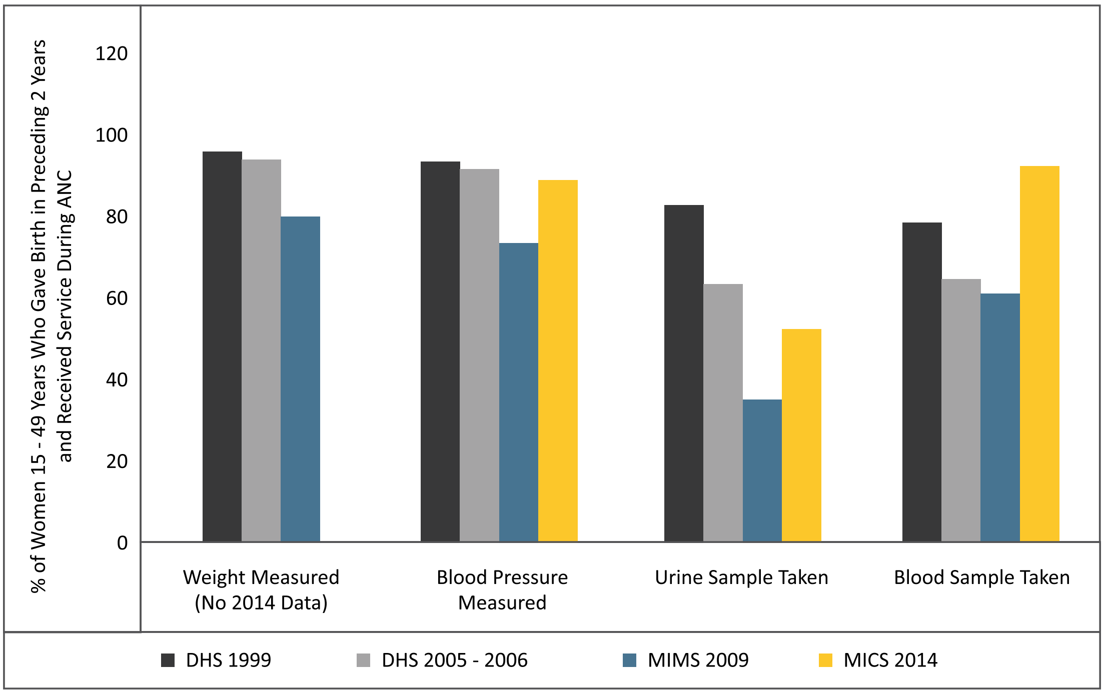
Zimbabwe's public health indicators deteriorated rapidly between the 1990s and 2008, but by the end of the decade the sector had begun to reverse this trend, and both output and outcome indicators have recently improved. Life expectancy has significantly increased and once again exceeds the average for Sub-Saharan Africa (Figure 14). Meanwhile, surveys conducted between 1999 and 2014[9] reveal the rapid decline and subsequent recovery of key output indicators. While a number of results indicators that worsened between 1999 and 2009 have since partially recovered (Figures 15, 16 and 17), policymakers should pay close attention to quality of care, which poses a more complex, and multi-dimensional challenge. Sustainably improving the quality of care requires coordinated efforts by multiple actors, including the Government, private service providers and international development partners.

Figure 14: Life Expectancy at Birth, 1980-2013, Zimbabwe and Sub-Saharan Africa



Source: World Development Indicators (WDI)

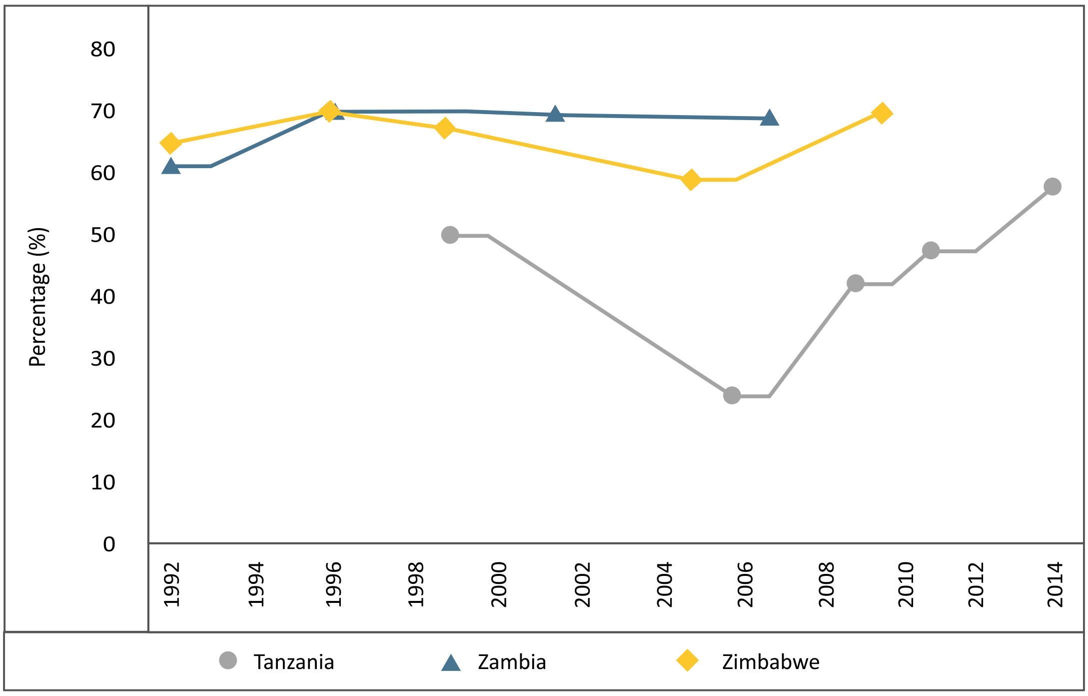
Figure 15: Output Indicators for Antenatal Care, 1999, 2005/06, 2009 and 2014



Source: WDI 2013; MICS 2014

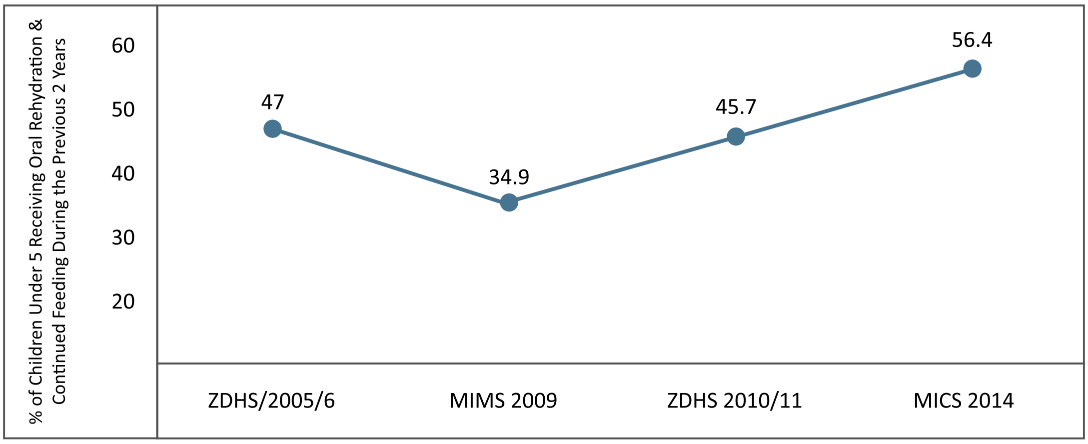
[9] These include the 1999 and 2005/06 Demographic and Health Surveys (DHS), the 2009 Multiple Indicator Monitoring Survey (MIMS), and the 2014 Multiple Indicator Cluster Survey (MICS).

Figure 16: Children with Acute Respiratory Infection Symptoms Taken to Healthcare Provider (in percent)



Source: WDI 2013; MICS 2014

Figure 17: Rates of Anti-Diarrhoeal Treatment in Children Under 5



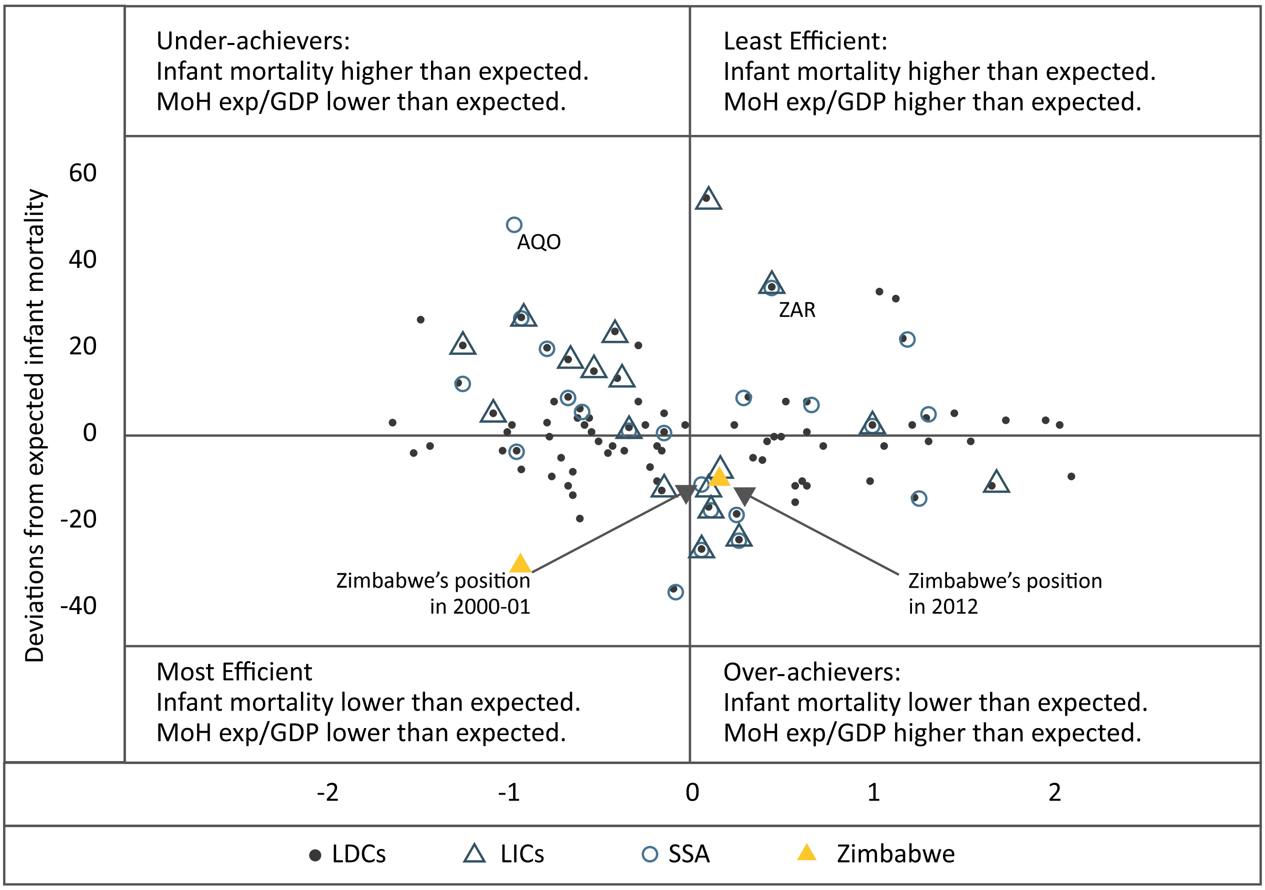
Source: WDI 2013; MICS 2014

Health Sector Expenditure Efficiency in the Pre and Post Crisis Periods

An analysis of public health expenditures and infant, child and maternal mortality rates indicates that healthcare spending in Zimbabwe has become less efficient over time, yet despite the impact of the crisis, Zimbabwe maintains a moderate efficiency advantage over comparable countries.[10] Based on the health outcomes and domestic public health expenditures of 177 countries and accounting for differences in structural characteristics, including per capita income, Zimbabwe had the most efficient health expenditures of any low-income country in Sub-Saharan Africa in 2000, when its infant and child mortality rates were far lower than what its health spending levels would have predicted (Table 5, Figure 18). However, Zimbabwe's health sector performance deteriorated during the economic crisis and by 2012 it had lost its advantage, with outcomes broadly in line with what its income per capita would predict and expenditures slightly elevated. This analysis indicates that in order to improve health outcomes, focus should not only be on increasing health spending but also improving the efficiency of spending.

[10] While the expenditure efficiency analysis is an internationally respected tool to assess outcome efficiency of Government expenditures, like other analytical tools, the method has limitations (see World Bank, 2015. Zimbabwe - Health public expenditure review. Report No.97175-ZW for a description of the method and associated caveats).

Figure 18: Healthcare Expenditures and Infant Mortality Rates, Zimbabwe and Comparators, 2000-01 and 2010-12



Predicted values based on OLS regression on PPP GDP and its square, population, size, income group and region for (LDCs) - the per capita GDP values are used to predict health outcome, providing a better fit.
Data sources: WHO NHA (GHED) data for expenditure variables except for Zimbabwe: MoF (unaudited executed expenditure), IMF data for income variables, World Bank HNP databases for the rest.

World Bank (2015), Health Public Expenditure Review Zimbabwe", May 2015, Washington, DC.

Table 5: Changes in Zimbabwe's Efficiency Advantage, 2000-01 and 2010-12

	2000-1 (a)	2010-1 (a)	Difference (b)
Infant mortality	-2.07	-0.65	1.42
Maternal mortality	-0.45	0.55	1.00
Child mortality	-1.98	-0.37	1.61
MOHCC expenditure/GDP	-0.94	0.12	1.06
MOHCC expenditure per capita	-0.13	-0.10	0.02

World Bank (2015), Health Public Expenditure Review Zimbabwe", May 2015, Washington, DC.

(a) Measures Zimbabwe's deviation from expected value of the outcome relative to the standard deviation in the sample. For all dimensions presented here, a negative number indicates an efficiency advantage and the more negative the greater the advantage.
(b) A positive number indicates a reduction of the advantage (or a reversal if the 2010-12 value is positive)

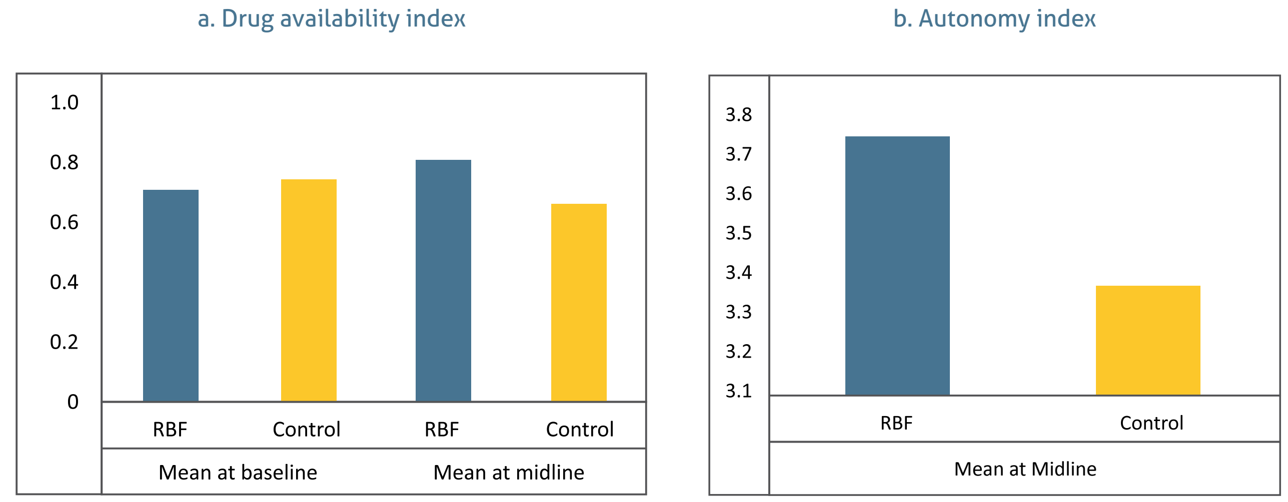
Results-Based Financing: An Innovative Strategy for Maximizing Expenditure Efficiency

Efficiency gains are especially critical given Zimbabwe's binding fiscal constraints and limited external support. Efficiency improvements not only have the potential to improve health outcomes, but may also boost official development assistance, as donors are inclined to support successful reformers. In this context, Zimbabwe's RBF program may offer important lessons on leveraging the impact of a modest resource envelope. The RBF program aims to reduce consumer costs and strengthen service delivery with a focus on supply-side effectiveness. It supports the implementation of the government's Results-Based Management Strategy, disbursing funding based on the quantity and quality of services delivered by healthcare providers.

Under the program, primary and secondary healthcare facilities sign contracts to deliver a specified package of essential maternal and child health (MCH) services. Facilities are paid on a fee-for-service basis by measuring the quantity and quality of services rendered in a given period. Additional design components of Zimbabwe's RBF program include: (i) the clear separation of functions between the Ministry of Health and Child Care (MOHCC), healthcare facilities and the purchaser/fund-holder;[11] (ii) decentralized planning and the autonomy of individual facilities over investment decisions; and (iii) community involvement in health planning.

Following positive outcomes in the two pilot districts in 2011, the RBF program was expanded to 16 additional districts in March, 2012,[12] financed by US$35 million from the Health Results Innovation Trust Fund[13] and US$6 million counterpart funding from the Government of Zimbabwe as part of the funding for the RBF Program. In order to better target the poor, all RBF districts have thus far been rural or low-income urban areas. To date the program has covered 4.5 million people, or approximately 33 percent of the national population. Under the program, user fees are partially removed for a defined set of services in participating facilities. These fees are replaced with a financing system based on 16 service indicators defined as priorities by the MOHCC, which include the number of new outpatient consultations, measures of MCH and family planning services and other metrics. Performance is monitored through a statistical scorecard covering multiple dimensions of care. MOHCC district and provincial supervisors record scores. The quantity of services reported by facilities is verified by the purchaser/fund-holder prior to payment. Quarterly surveys gauge patient satisfaction and authenticate the patient and service data reported by facilities. Financing is determined each quarter as a function of RBF quantity indicators, scorecard assessments and patient satisfaction surveys, with the latter representing 20 percent of the facility's overall quality score.

Figure 19: The Impact of the RBF Pilot at the Facility Level, Select Indicators



World Bank (2015), Health Public Expenditure Review Zimbabwe", May 2015, Washington, DC.

The Government, with the support of development partners under the Health Transition Fund scaled up the RBF program to an additional 42 rural districts at the primary level of care in 2014. However, impact evaluation results highlighted in this chapter are based on evidence from the intervention in 18 rural districts supported by the Health Results Innovation Trust Fund.

[11] Cordaid and Crown Agents serve as implementing agencies for the RBF project in Zimbabwe.

[12] The following evaluation results are derived from World Bank household and health facility surveys.

[13] This trust fund is financed by the Governments of Norway and the United Kingdom.

To determine the RBF project's impact on healthcare quality, treatment districts were compared with control districts selected for similar characteristics, including geography, facility type, staffing levels, demographics and current rates of healthcare utilization. Baseline and final evaluations were conducted at both the facility and household levels. Difference-in-difference estimation was used to compare the changes in these indicators during RBF rollout in the treatment districts compared with the controls. Clinics in the RBF districts scored significantly higher on the availability of key drugs and infrastructure, as well as on administrative autonomy (Figure 19).

The RBF clinics scored higher than the control on multiple aspects of service quality, with the greatest increases observed in MCH indicators (Table 6). The share of deliveries attended by a skilled healthcare provider rose by 15 percentage points, and the share of deliveries in a healthcare facility rose by 14 percentage points. There are also indications that the RBF program may have improved the number and quality of antenatal visits, but these differences are not statistically significant. In terms of the distribution of health gains among the population, the share of births attended by a skilled healthcare worker increased by 21 percentage points among mothers with primary education or less who accessed the RBF facilities. The gains among more relatively educated mothers, while positive, was less in magnitude. While few impact estimates are statistically significant across subgroups, impact-point estimates suggest that the RBF pilot was at least moderately pro-poor.

Table 6: The Impact of the RBF Pilot at the Facility Level, Select Indicators

	Mean at baseline		Mean at midline		Impact estimate	P-Value
	RBF	Control	RBF	Control		
Balanced scorecard for quality[1]						
Administration and planning score	6.62	5.71	8.14	6.85	0.54	0.697
Outpatient score	3.65	3.86	3.86	3.70	0.41	0.223
Family and Child Health score	13.29	14.46	12.69	11.15	2.64*	0.053
Infection control and waste management score	2.03	2.50	2.31	2.15	0.83	0.274
Facility survey						
Drug availability index[2]	0.71	0.75	0.80	0.66	0.17**	0.020
Equipment availability index[3]	0.82	0.82	0.84	0.83	0.02	0.710
Infrastructure index[4]	0.77	0.83	0.83	0.78	0.12*	0.081
Autonomy index[5]	n/a	n/a	3.74	3.37	0.36***	0.006

World Bank (2015), Health Public Expenditure Review Zimbabwe", May 2015, Washington, DC.

Note: Results are for rural health centers, including district-level controls. Standard errors are clustered at district level
* $p<0.1$ ** $p<0.05$ *** $p<0.01$

[1] Scores created from the facility survey tool by mapping similar variables and assigning same scores as the RBF quality supervision checklist (balanced scorecard).

[2] Drug availability index constructed out of the following drugs: tetracycline eye ointment, amoxicillin, paracetamol, cotrimoxazole, iron and folic acid, vitamin A, ORS.

[3] Equipment availability index constructed out of the following equipment: children's weighing scale, height measure, tape measure, adult weighing scale, blood pressure instrument, thermometer, stethoscope, fetoscope, otoscope, ambubag.

[4] Infrastructure index constructed out of the following variables: uninterrupted supply of power, water, communication, disinfectants; provision of sharp disposal and basin with soap and water in outpatient room; and provision of biomedical waste disposal.

[5] Autonomy index includes ability to allocate resources and tasks effectively within the facility as reported by the facility in charge.

Impact evaluations revealed higher coverage rates, better quality of care and more equitable provision of key MCH services in RBF districts. Qualitative evidence suggests that RBF facilities have more effective monitoring and reporting mechanisms and better staff coordination and motivation than non-RBF facilities. In a number of RBF facilities payment policies were revised to include performance-based bonuses for improving working conditions and encouraging households to use healthcare facilities. The impact evaluations show that while Zimbabwe made overall gains in health outcomes between 2009 and 2014, progress was significantly faster in RBF pilot districts.

Conclusions and Policy Recommendations

Zimbabwe's substantial improvements in health indicators since 2009, underscore the Country's potential to reclaim its status as a leader in health outcomes in Sub-Saharan Africa. Its recent gains, illustrate the importance of Government leadership in laying out a clear vision and framework for health in MCH and combatting HIV/AIDS and in galvanizing international development partners and private firms to help realize that vision. However, Zimbabwean policymakers face a complex set of challenges, including the persistence of communicable diseases and the rising incidence of non-communicable diseases.[14] In a context of limited fiscal space, constrained aid flows and modest private sector health investments, the Government must maximize the efficiency of sectoral resources in the short-term, while progressively reforming the sector to address its evolving long-term needs.

Improving the allocation of public health spending could yield gains in both service quality and outcome efficiency, and steps should be taken to reduce the relative size of the wage bill. In the early 2000s, Zimbabwe's health sector was among the most efficient in Sub-Saharan Africa during 2000-08 performance deteriorated but since 2010, its performance has shifted back toward the middle of the pack. While Zimbabwe's health outcomes still exceed what its level of health spending would predict, further improving the sector's efficiency will require spending increases targeting non-wage and capital investment. In order to safeguard the sector's fiscal sustainability, growth of the wage bill must be contained.

The emerging evidence on the effectiveness of RBF in Zimbabwe suggests that the MOHCC and the country's development partners should consider expanding this approach. RBF services could be broadened beyond the core MCH package to cover communicable and non-communicable diseases. The World Bank and key development partners could assist the capacity of the MOHCC and the Ministry of Finance and Economic Development (MOFED) to execute purchasing and fundholding functions with a view to transferring responsibilities to the Government in the medium-term, while still respecting the core RBF principle of separate functions. The resource-pooling system could be further consolidated and augmented by a virtual purchasing system in which MOFED and Zimbabwe's development partners commit to a package of services for a defined period of years based on sound costing data. The retention allowances for healthcare workers at the local and national levels could be directly linked to service delivery. Finally, technical and financial support from development partners could be better harmonized and aligned with a strategy for scaling up the RBF program.

The Government and its development partners should work together to ensure the short- and medium-term sustainability of the RBF program. The authorities should begin by completing the cost-effectiveness analysis commissioned by the MOHCC in June 2015, with funding and technical support from the World Bank, and using the results to further adjust the identified drivers of program costs. Based on thorough empirical analysis, the Government and its partners should develop a medium-term plan for establishing RBF as a part of national health financing strategy and policy for Zimbabwe.

Finally, the Government should estimate the medium-term costs of the RBF strategy and agree on financing scenarios that include incremental Government funding based on economic growth trends and national budget performance. In a context of constrained fiscal space and limited aid, flows it will be essential to enforce cost-monitoring and containment measures without diluting the outcome orientation of the RBF approach.

[14] Around 31 percent of total deaths were caused by non-communicable diseases in 2012, placing Zimbabwe around the median of Sub-Saharan African countries. For example, diabetes prevalence, estimated at 9.7 percent in 2012, is far higher than among regional peers, which have rates of about 4-5 percent.

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