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May 4, 2016

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Zimbabwe: Letter of Intent

April 14, 2016

The following item is a Letter of Intent of the government of Zimbabwe, which describes the policies that Zimbabwe intends to implement in the context of its request for financial support from the IMF. The document, which is the property of Zimbabwe, is being made available on the IMF website by agreement with the member as a service to users of the IMF website.

Letter of Intent

April 14, 2016

Ms. Christine Lagarde
Managing Director
International Monetary Fund
700 19th Street, N.W.
Washington, DC 20431
United States

Dear Ms. Lagarde:

We thank the International Monetary Fund (IMF) for its continued support of our economic reform programme and valuable technical assistance. This support has played a pivotal role in our efforts to transform our economy, normalize relations with the international community, and eventually access Fund financial resources.

Our continued engagement under the Staff-Monitored Programme (SMP) was critical in stabilising the macroeconomic environment. We are committed to our economic transformation program in preparation for clearing arrears with international financial institutions (IFIs) and full re-engagement. Economic difficulties have deepened, so time is of the essence. The El Niño-induced drought has hit our economy and the situation is expected to worsen with adverse impact on agricultural output, food security, and power generation. Moreover, lower commodity prices, the appreciation of the U.S. dollar, and insufficient external inflows still weigh on the economy.

Our commitment, with support from the private sector, civil society, and the general public ensured that the SMP remained on track. Despite substantial economic and financial difficulties, we have met all end-December 2015 quantitative targets. The floor on the primary cash balance was met with a wide margin. The floor on protected social spending, the targets for Poverty Reduction Growth Trust (PRGT) payments, net international reserves, and the ceiling on non-concessional borrowing were all met.

We have also met the remaining structural benchmarks:

a. We submitted to Cabinet amendments to the Public Finance Management Act. The bill has since been gazetted and submitted to Parliament. The amendments are geared towards strengthening Treasury's financial oversight of state owned enterprises (SOEs) and local authorities.

b. We submitted to Cabinet amendments to the Procurement Act to tighten the public procurement framework and make it more efficient and transparent.

c. In January 2016, we published the frameworks, procedures and guidelines of the Indigenization and Economic Empowerment Act. We have addressed challenges related to the policy to provide certainty and clarity.

In addition, we have pushed forward our reform agenda, particularly in the following areas:

i. We have started to implement measures to rationalize public expenditure and reduce public sector employment costs. We envisage the measures under implementation to generate savings of about 1 percent of GDP. These measures, as detailed in the 2016 Budget Statement, include reviewing the vacation leave policy in the education sector, withdrawing from non-core responsibilities and the rationalisation of employment structures across ministries. We have already reduced employment cost obligations for grant-aided institutions. Further, to the audit by the Civil Service Commission, the Police and the Judicial Service Commissions and the Health Services Board will complete salary and employment audits for their own sectors in 2016. These audits will inform our decision on the reduction of employment costs across government and related institutions

ii. We have finalised 2 forensic audits out of the 10 largest and most critical SOEs. Furthermore, forensic audits were conducted for ZBC and Allied Timbers. We also reduced employment costs in a number of SOEs (for Tel -One by 15 percent, and National Social Security Authority by 25 percent.). In addition, the Radiation Protection Authority of Zimbabwe reduced its overall costs by 30 percent.

iii. With the aim of improving transparency and accountability for natural resources, we have moved ahead with the consolidation of the diamond sector. We are accounting for diamond mining from extraction to sales and transfers of proceeds. We will timely publish audited financial statements of state owned mining entities.

iv. On the ease of doing business, we constituted various committees in 2015 to address the remaining bottlenecks. We started a pilot project on harmonising the City of Harare processes for business set up, including building permits through the assistance of the United States of America International Development (USAID) and the World Bank. We are in the final stages of operationalising the One-Stop-Shop for investment.

v. We have made substantial progress to place the financial sector on a stable and sound footing. The sector is rid of troubled banks, the banks are adequately capitalised, and non-performing loans are now down to 10 percent. As of end February 2016, mortgage-backed loans amounting to $357 million had been acquired by the Zimbabwe Asset Management Company (ZAMCO) of which US$210 million loans were restructured into long term loans, US$40 million into preference shares and US$35 million into ordinary shares. This has assisted in restructuring firms in strategic sectors of the economy such as agriculture and mining. ZAMCO is now self-sufficient in terms of funding its operating expenditures. We have launched a National Financial Inclusion Strategy aimed at broadening access to and use of financial resources with a view to improve social and economic development.

vi. We conducted a midterm review of our economic blueprint, ZIM ASSET. The outcome of the review suggests that we need to mobilize more financing and prioritize projects. To finance some of our projects, we have resorted to nonconcessional loans, especially in the area of infrastructure investment, development partner support as well as statutory funds. In 2015, a total of $431.9 million, 3 percent of GDP, was channelled toward priority infrastructure in the water, energy, transport, ICT, irrigation, housing, social services, and the agriculture sector, which falls short of our substantial needs.

vii. We are moving ahead with land audits to expose any irregularities with the implementation of past land reform. We have submitted to Parliament a bill to establish the Land Commission in line with the Constitution. In collaboration with the European Union and the United Nations Development Programme, we started mapping and evaluating farms and devising modalities for compensation. The draft bankable 99-year lease is being finalised and is awaiting submission to Cabinet. This will go a long way in providing security of tenure to the beneficiaries of the land reform programme and consequently boost agriculture by facilitating access to financing and investment.

On the basis of our strong performance against programme targets and our continued commitment to sound macroeconomic policy management, we request that the third and final review under our 15-month SMP be completed.

The Government believes that the economic and financial policies set forth in our Letter of Intent (LOI) and Memorandum of Economic and Financial Policies (MEFP) of November 3, 2014, supplemented with the LOI of April 17, 2015 and that of September 30, 2015 were adequate to meet the objectives of the SMP. The measures outlined in this updated LOI are geared towards maintaining the momentum of economic transformation that began with the SMP and set the stage for an eventual full re-engagement, including arrears clearance to the IFIs, a Fund-financial arrangement, and debt treatment under the Paris Club.

Continuing with our commitment to transparency in government operations, which we believe is essential for good governance and keeping our citizens abreast of our policy intentions, we consent to the publication on the IMF website of: the IMF staff report, all SMP-related documents, and the debt sustainability analysis performed by IMF and World Bank staff. In addition, we have published our arrears clearance strategy presented in Lima last year and we will publish our forthcoming economic transformation programme on both our websites.

POLICIES FOR THE REMAINDER OF THE YEAR AND BEYOND

The end of the SMP in December 2015 concludes the monitored part of our economic and social transformation programme. We remain committed to the spirit of the agenda we began with the two successive SMPs and the objectives contained therein. Most importantly, we are implementing the broader reforms outlined in our arrears clearance strategy presented at the Lima meetings. In this context, resolving Zimbabwe’s external arrears remains our highest priority. Our debt overhang and overdue obligations impede Zimbabwe's access to external financing, and hamper our economic and social transformation agenda. We expect the successful resolution of Zimbabwe’s external payment arrears to send strong signals to the international community, reduce the perceived country risk premium, and unlock affordable financing for government and the private sector. Our objectives are to achieve sustained economic development through economic transformation, to improve living conditions for the people of Zimbabwe, and reduce poverty.

These objectives cannot be achieved without the bold measures outlined in Table 1. We believe that these measures, together with arrears clearance, will pave the way for full re-engagement with the international community and set the stage for strong private sector-led growth. Our economic transformation agenda is based on our ZIMASSET, the 10 point plan announced by the President on August 25, 2015 and the Sustainable Development Goals.

We will continue with the productive and fruitful dialogue we have had with the IMF. Should any need for substantial non-concessional external borrowing arise, we will hold timely consultations with IMF staff on the possible terms to ensure that such borrowing strengthens confidence in macroeconomic management and does not jeopardize our arrears clearance strategy and debt sustainability.

Fiscal discipline remains a priority. In the short term, even in the presence of additional spending needs to mitigate the impact of the drought, we will strive to achieve a primary cash balance of close to zero, because of lack of financing. This heightens the urgency of re-engagement that, by eventually unlocking financing, will allow us to deal with adverse shocks and plan for much needed social and capital outlays. We will finalise the Public Finance Management (PFM) Reform Plan and promulgate PFM regulations. Meanwhile, we will accelerate the on-going SOE reform.

A crucial element of our fiscal policy is a strategy that lowers the combined wage bill of the central government and grant-aided institutions to 50 percent of total expenditure by 2019. To achieve this reduction, we will work on the size and remuneration of the public service. Based on current economic growth and expenditure forecasts, this will mean that the employment and salary freeze will have to remain in place for at least the next three years.

The service commissions of government will implement the recommendations of their employment audits. We will conduct a review of allowances to identify savings and efficiency gains. We will enhance service delivery by redeploying underutilized employees and we intend to retrench staff that cannot be redeployed.

We will continue to improve the business environment, including in areas where resources are needed to strengthen governance and to address administrative bottlenecks. The Office of the President and Cabinet is now driving the process under the Rapid Results Approach and we envisage a significant improvement in our doing business rankings.

We are ready to clear the outstanding arrears with IFIs, as outlined in the Lima meetings. With the reform agenda outlined in Table 1, we believe that after clearing these arrears, we will be in a position to present a comprehensive and ambitious reform programme that could be supported by a Fund financial arrangement in close collaboration with other IFIs. As part of this process, we will seek a debt treatment by the Paris Club. We aim at maintaining a sustainable debt burden after arrears clearance which will be instrumental in maintaining macroeconomic stability.

We will continue to monitor progress in implementing our strategy at both the technical and political levels. At the political level, the monitoring is coordinated by the Office of the President and Cabinet. The technical monitoring committee comprising officials from the Ministry of Finance and Economic Development, Ministry of Economic Planning and Investment Promotion, the Reserve Bank of

Zimbabwe, the Zimbabwe National Statistics Agency, and the Zimbabwe Revenue Authority will continue to meet regularly. The quadripartite committee (comprising the African Development Bank, IMF and the World Bank, the Ministry of Finance and Economic Development and the Reserve Bank of Zimbabwe), will also continue to provide input into the process.

As we set out for normal cooperation with our partners, it remains crucial that institutional deficiencies are attended to. During this phase, we will continue to request technical assistance from the Fund particularly in tax policy and administration, PFM, financial sector issues, and statistics.

Yours sincerely,

/s/	/s/
Hon. Patrick A. Chinamasa, Minister of Finance & Economic Development Government of Zimbabwe	John P. Mangudya, Governor Reserve Bank of Zimbabwe

Table 1: Zimbabwe—Economic Transformation Matrix
Area
1. Alignment of all Acts to the Constitution
2. Land Reform a) Remapping of farm boundaries b) Valuation of improvements on the farms c) In the case of BIPPA farms that were gazetted, valuation of land and improvements d) Modalities for compensation of farmers e) Granting of property rights to beneficiaries of the land reform
3. Develop a medium term debt management strategy
4. Reduce the primary fiscal deficit (on a cash basis) to achieve balance
5. Rationalize public sector employment
6. Formulate policies to lower the civil service wage bill to GDP ratio from current levels to about 50 percent of total expenditure by 2019
7. Increase the proportion of social and capital spending in total outlays
8. Step up revenue mobilization efforts by ZIMRA through strengthening tax policy and administrative measures to increase revenue, which include among others: a) measures to strengthen VAT administration; b) the design of the tax system to support economic growth; and c) Improve infrastructure and customs management at all border posts.
9. Reduce domestic debt and improve service delivery
10. Develop a comprehensive Public Finance Management (PFM) reform strategy and finalize an action plan to strengthen forecasting capacity
11. Develop a fiscal risk management system, which will focus on revenue collection risks and financial liabilities arising from the operations of parastatals
12. Ensure debt and fiscal sustainability
13. Continue to make payments to multi-lateral institutions in line with the *pari passu* requirement