FINANCIAL SECTOR LIBERALIZATION AND THE POOR:

A CRITICAL APPRAISAL

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1. Introduction

The liberalisation of the financial sector in Zimbabwe was an integral part of the Economic Structural Adjustment Programme (ESAP), a programme which was introduced by the government in 1991. It was aimed at restructuring the economy from a predominantly state-interventionist type of economic management towards a more market-driven system. The adoption of the ESAP and its successor programmes, namely the Zimbabwe Programme of Economic and Social Transformation (ZIMPREST) for the period 1996-2000, was a notable trend in most African countries where the failure of 'socialist' experiments and other models of state management of the economy, led to a situation where countries had to resort to the World Bank and the International Monetary Fund (IMF) for financial support. The Structural Adjustment Programme (SAP) is typically the prerequisite for assistance from those two multilateral bodies.

Prior to the introduction of the reforms, the sector was very heavily controlled by the state. Interest rates were fixed by government, for example, lending rates to be charged by banks, deposit rates to savers, there were credit ceilings which channelled resources to specified sectors and there were restrictions as to who could carry out banking business. The sector was heavily segmented, with categories of institutions being confined to specified types of banking business, for example, that building societies could only engage in mortgage finance, commercial banks to provide short term funding for working capital, merchant banks for wholesale banking etc.

It is now widely accepted that the structural adjustment model has not worked in Zimbabwe. The reasons for the failure are varied and also controversial. But this is not the focus of this paper. The argument presented here relates more to the component of financial sector liberalisation. Contrary to expectations, liberalisation of financial markets has not improved access to credit by the poor and other marginalized groups. Indeed, there were a number of new entrants and players in response to the market signals of liberalised interest rates-both deposit and lending rates and the new opportunities to do business which resulted due to the opening up of the economy. However, competition was not total, as the regulatory environment perpetuated segmentation and also made it particularly difficult for small players to enter the market and hence enhance their capacity to service the lower end of the market.

Another reason for the general failure of financial sector liberalisation to improve the lot of the poor was the failure to harmonize monetary and fiscal policies. Persistently high budget deficits led to excessive borrowing by government, on the domestic market, and this made it difficult for interest rates to come down.

The paper argues fundamentally that in fact, financial sector liberalisation was not designed with ' poverty reduction' as its thrust. The design and implementation of the programme make it quite evident that in fact, under the circumstances prevailing in Zimbabwe, they were unlikely to benefit the poor and the marginalised. The market by its nature benefits those who already have access to resources (economic), to information and to those who are strategically positioned to take advantage of the opportunities offered by the market (those already gainfully employed, those residing in urban areas, or in the few rural communities well networked to benefit from national and international trade.

Overall, the paper argues whereas financial sector liberalisation in Zimbabwe did yield some benefits to some, in general, it did not really yield many positive results for most of the economically disadvantaged groups. A review of available literature showed that there is very little information available which could prove this point. And without extensive, systematic and structured field work (due to the paucity of resources on the part of the SAPRI programme), the conclusions made in the paper are largely based on inferences derived from analysis of for instance, published data from various bank reports and Reserve Bank of Zimbabwe (RBZ) publications. Some of the conclusions are also based on the findings of the SAPRI workshops at district levels which were conducted in the early phases of the project.

The experience of Zimbabwe with financial sector liberalisation points to the need to consciously establish financial institutions and markets designed to service the economically active poor. These should be an integral part of the formal financial system. It is worth noting that the emergence of the microfinance sector in Zimbabwe coincides most closely with the introduction of reforms. Microfinance has emerged as a response to the failure of the formal sector to meet the needs of the SMEs and the 'informal' sector. Unfortunately, until very recently, the support to the microfinance sector has been minimal and this has therefore compounded the problem of lack of access to credit and other financial services.

2. Background To Financial Sector Reforms

In classical thinking, banks are best able to perform the intermediary function within the context of a market system in which the supply and demand for credit rations credit among competing users. Interest rates are determined through the interplay of market forces and become the instruments for resource allocation. And for as long as the market is allowed to operate, the finance sector is able to play a positive role in fostering growth and economic development. Classical thought postulates that when the market is interfered with, then growth in inhibited. In the context of Zimbabwe, the failure of the finance sector to perform as expected has been largely attributed to the problems of interference by the state through imposition of controls such as interest rate ceilings, selected credit controls and directed credit. The liberalisation of the financial sector under the Economic Structural Adjustment Programme (ESAP) was intended to reintroduce the market with the hope that efficiency would be restored, savings mobilisation improved and investment increased

Prior to reforms, Zimbabwe's financial system comprised the Reserve Bank of Zimbabwe (RBZ), five commercial banks, two discount houses, four merchant banks, three building societies, six finance houses and the Post Office Savings Bank (POSB), a statutory corporation, prior to liberalization. The financial sector also included several institutions whose purpose has been to direct funds to specific sectors such as agriculture and industry. / [1]There were many pension funds and insurance companies whose assets were

[1]Included among these are the Agricultural Finance Corporation (AFC) the Industrial Development Corporation (IDC), the Zimbabwe Development Bank (ZDB), Credit guarantee Company and the Small Enterprises Development Company (SEDCO).

prescribed by the government. This prescription of assets rendered these institutions a captive market for government paper. Legal limitations were in place to delineate the sources of funds and kinds of activities which the various types of institutions are authorized to undertake. With the advent of financial liberalization, some of the delineations have become blurred and a number of new financial institutions have emerged.

As a result, the RBZ was able to arrest albeit temporarily, the surge in broad money during the first three quarters of 1996 because discount houses converted the bulk of their non-bank deposits into treasury bills. [2]However, the growth in broad money resumed but with deposits being channelled through commercial banks. Finance houses increased by one to six and building societies increased from three to five. / [3]Building societies are exempt from legal reserve requirements and enjoy special tax exemptions on their shares. However, they are required to keep 10 percent of their assets in short-term instruments and are subject to interest rate controls on mortgages to various categories of consumers. [4]In 1992, building societies ran short of funds for mortgages, and the government reacted by allowing them to raise funds by issuing Negotiable Certificates of Deposits (NCDs). Since then, building societies have invested heavily in the money market such that mortgage advances have become a much smaller proportion of their portfolios.

The POSB invests funds in central Government stock or stock issued by other public bodies. It mobilizes funds in the form of savings and fixed deposits from small savers throughout the country. Relative to building societies, this institution derives its competitive edge in attracting deposits because of the tax-exempt status of the interest earnings on deposits held with it.

Historically, the financial sector has had an oligopolistic structure. The government's intervention contributed to the emergence of financial repression which could have had far reaching effects on the saving and investment process but for the trade and exchange regime which existed. The import substitution strategy which was pursued during the

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[2]By mid 1996, broad money had peaked at 41 percent before declining to just over 10 percent in October and November as the changed accommodation policy took effect, but continued resumed the higher growth trend to yield an annual growth rate of 31 percent by December 1996. This increase was mainly due to domestic credit expansion, a major component of which was credit to the government.

[3]The Leasing Company of Zimbabwe is the new one and the others are Finance Corporation of Zimbabwe, Scotfin Limited, Stanbic Finance, Standard Finance and UDC Limited.

[4]Although other interest rates have been freed, rates on commercial and residential mortgage advances have not been deregulated.

sanctions era resulted in a high import content of investment which was undertaken. Accordingly, the level of investment became highly dependent on the availability of foreign exchange. This liquidity overhang was a result of government restrictions and the lack of foreign exchange needed for investment. Government restrictions were designed to ensure access to non-bank financing of budget deficits and these restrictions operated through statutory requirements which required non-bank institutions to invest specified proportions of their assets in government securities (asset prescription). / [5]The combination of weak credit demand and the lack of alternative investment opportunities often resulted in an over-fulfilment of this portfolio requirement.

Due to ceilings on lending interest rates and administrative controls on other interest rates, interest rates remained more or less at the same levels since 1965, the year of Unilateral Declaration of Independence (UDI) and were changed marginally in 1980 as the authorities sought a more active role for monetary policy. Even with the changes, real interest rates remained negative for most categories of savings deposits in different institutions and were positive for the bank rate (discount rate), treasury bills in 1993 and 1994, certificate of deposits and lending rates.

Special financial institutions were created for purposes of directing credit to specified sectors. Such allocative controls sought to direct financial resources towards projects and sectors which financial institutions shied away from either because of risks involved or long gestation periods. The measures included selective credit programs, compulsory investment requirements and preferential tax treatment. Apart from the second best argument, some of these policies could simply have been a means to cater for special interest groups. Through the foreign exchange allocation procedures, the authorities set up specific targets for credit to small-scale enterprises.

The Reserve Bank (RBZ) mobilized special funds through the issue of certificates of deposit (CDs) for on-lending to development institutions such as Zimbabwe Development Bank, SEDCO and the Credit Guarantee Company for small to medium-scale enterprises for approved projects. In addition, the RBZ used moral suasion to cajole banks to increase lending to new small and medium sized exporters, newly established and mostly black owned enterprises. Targets were set for commercial banks and those of them that achieved the targets qualified for access to special funds those which failed were to be penalized. In the environment before 1980, large scale and traditional exporters were assured of pre- and post-shipment credit at much lower rates from commercial and merchant banks.

[5]For example the Pension and Provident Fund Act stipulates that a registered fund shall at all times hold its assets in Zimbabwe and in a form that is realizable in Zimbabwe, it shall at all times hold not less than 35 percent of the value of its assets in local registered securities which are issued or guaranteed by the State or issued by a local authority or statutory body or in loans approved by the registrar to a local authority or statutory body. The Insurance Act states that insurance funds shall be held in prescribed securities as specified by the Minister of Finance who shall from time to time specify the proportions. According discretionary powers to the minister was convenient for purposes of tightening or loosening the requirement as needed for policy purposes.

The government used selective credit techniques including subsidized lending through non-price rationing systems. Preferential lending rates were set for what were considered productive activities while unproductive activities attracted penal interest rates. The RBZ extended credit to the government and parastatal organizations at preferential rates. The institutional framework, taxation of some financial assets and unequal reserve requirements were geared to promote the microeconomic objectives as indicated above.

Several types of financial sector controls which may generate distortions and a tax on financial intermediation are identified in the literature. [6] These include macroeconomic, allocative, structural, prudential, organizational and protective controls. [7] In Zimbabwe, the distortions originating from macroeconomic controls were associated with interest rate ceilings, liquid asset ratios, trade and exchange controls, portfolio restrictions on financial institutions (asset prescription), directed lending programs and selective credit policies. The Zimbabwean authorities used these direct controls to achieve their policy objectives.

3. Concerns About the Prereform Financial Sector

3.1 An Oligopolistic banking structure

Until the introduction of financial reforms in 1991, Zimbabwe's finance sector was a highly oligopolistic industry. A few large expatriate banks (notably Standard, Barclays) dominated the market and even today, their market share combined is above 40 percent. The imperfect market in which they operated was not conducive to the growth of the sector.

3.2 Urban bias of the sector

Consistent with the profit objective, most banks have continued to operate in urban areas where returns are relatively higher than rural communities and also because of the more developed infrastructure and markets. This has been inimical to the development of the rural communities.

3.3 Inadequate provision of services for certain groups and sectors in the economy

Zimbabwe's finance sector has contributed significantly to the development of the economy through provision of loans to agriculture (via the Agricultural Finance Corporation), mining and manufacturing sectors. The massive growth in credit to these sectors over the years testifies to this. However, the finance sector has not contributed significantly to the

[6] See Vittas (1992).

[7] The types of controls are not mutually exclusive since the actual measures deployed may service more than one type of control.

development of rural communities (especially communal areas), the urban poor and low-income groups, the informal sector and small-medium scale enterprises. The reasons for this are simple. Established banks have made it quite clear that lending to the above category of borrowers is risky since this category lacks collateral security. Banks have argued that as custodian of depositors' funds, they could not take the risk and invest with that group otherwise they would make losses and not be able to pay their depositors a reasonable return to their investments.

3.4 A highly restrictive regulatory environment

Regulations governing the financial sector have for a long time ensured restricted entry into the market. High minimum capital requirements for setting up a bank for example made it difficult for potential entrants especially the indigenous groups to enter the market. The liberalisation of the sector actually made this worse as the minimum capital requirements were raised further. Until the recent amendments, the Banking Act created a highly segmented market which hindered the creation of a more competitive and efficient financial sector.

3.5 Controls on interest rates were inimical to savings mobilisation as returns to savers were low -sometimes the real interest rates were low. Low rates on lending did not encourage the growth of the sector particularly since inflation was on the rise. Reforms were therefore meant to rectify some of these

3.6 The absence of a clear-cut policy to integrate the finance sector into broader national development strategy.

One of the most serious shortcomings of the operation of Zimbabwe's financial system lies in the absence of a clear-cut policy which integrates the financial sector into the whole development process.

4. BROAD OVERVIEW OF ESAP

OBJECTIVES

According to Government, the main objective of the Economic Structural Adjustment Programme implemented in Zimbabwe in 1990 was to improve the living standards of poor Zimbabweans through the enhancement of real economic growth. In the document ' A Framework for Economic Reform 1991-95' (1991), the Government spells out the objectives of ESAP, thus:
' The fundamental objectives of economic reform in Zimbabwe is to improve living conditions, especially for the poorest groups. This means increasing real incomes and lowering unemployment, by generating sustained higher economic growth. In order to achieve this primary objective, the economy needs to be transformed to make it more competitive and productive.' (p. 4)

The Government aimed to achieve this rate of economic growth through a number of macroeconomic policies and in essence, via a shift towards the market system. The Framework document puts it as:

' This transformation entails moving away from a highly regulated economy to one where market forces are allowed to play a more decisive role, while concurrently taking steps to alleviate any transitional social hardships which may arise from this transition.' (p. 4). Key elements of this market reform include:

a. Price deregulation

Until the introduction of ESAP, the Government had maintained an extensive system of price controls which unfortunately had resulted in shortages and inefficiency and the emergence of parallel markets. Price decontrol was to reduce these controls on a number of commodities in order to stimulate supply responses and thereby solve the problem of shortages.

b. Fiscal and Monetary Policy reforms

This would entail the financial liberalization and deregulation of banking and financial sector. Market determined interest rates, it was hoped, would stimulate growth in savings mobilisation, encourage banks to provide more credit needed to boost growth and overall, create an environment in which more competition in the sector would take place. Adjustments in fiscal policy would allow an increase in resources for the productive sector. The budget deficit would be reduced in order to release resources for more productive activities.

c. Trade and Exchange Rate Liberalization

The main thrust of this policy was to shift away from the system of excessive controls on foreign exchange to a more market - based system. Imports were to be liberalized. Most items were to be imported through the OGIL system, which previously was very restricted. The introduction of a more favourable structure was part of the reforms - i.e. a tariff structure that would enhance the competitiveness of industry.

d. Agricultural Pricing and Marketing Deregulation

Market reform in this area was to allow more players in the marketing of grain in order to improve efficiency. Producer prices were also going to be liberalized to stimulate production and improve farmers' incomes. Subsidies to marketing agencies such as the GMB were also to be reduced.

e. Labour Market Reform

This was to introduce collective bargaining in place of direct Government intervention in wage setting. Amendments in the Labour Relations Act would be made in order to streamline the procedures for hiring and firing of individual employees.

f. Investment deregulation

This was aimed to promote the growth of both local and foreign investment. Easier terms of dividend and profit repatriation were to be introduced. The process of investment approval was to be simplified through the introduction of a single window (the Zimbabwe Investment Centre (ZIC)), which would have the final authority to sanction projects below Z$ 10 million. Criteria for approval of investment projects were to be reviewed to include project feasibility rather than just foreign exchange earned or saved over a period.

g. Parastatal reforms

These reforms were to promote the privatization and commercialization of parastatals. The reduction and ultimate phasing out of subsidies to these enterprises would have substantial fiscal benefits through reduced expenditure. Programmes to improve efficiency and commercialization were to be targeted to enterprises like ZISCO, Air Zimbabwe, PTC, ZESA, ADA, and AMA.

h. Poverty Alleviation

The implications of adjustment on poverty are spelt out under the section on the social dimensions of adjustment. It recognizes that the envisaged reforms were likely to result in unemployment and inflation and hence, a decline in living standards. To mitigate these adverse social effects, Government proposed to pay compensation to retrenched civil service workers and also to put a mechanism for the private sector to pay some compensation to any employees it made redundant. Other provisions to mitigate the social effects of adjustment were through an equitable system of cost recovery where for example those earning below Z$150 per month would be exempt from paying for health services.

i. Specific Targets

In order to achieve the broad objectives of economic growth and poverty reduction, specific targets were set. The major ones are as follows:

a.Economic growth to go up by 5% per annum by 1995
b. Industrial growth by 5.8%
c. Agriculture by 3.2%

d. Service by 5% by the same fiscal year.
e. Investment to grow at the rate of 25% of GDP by the fiscal year 1994/1995.
f. Real income per capita to grow by 2% p.a by 1995.
g. Central Government deficit to be reduced to 5% of GDP (Excluding official grants) by the year 94/95. This could be achieved through cost recovery, removal of Government subsidies on some consumer goods and on parastatals, reduction of the civil service bill from 16.5% of GDP in 1990/1991 to 12.9% 1n 1994/1995. Furthermore, there would be a 25% reduction in the number of civil servants (excluding education).
h. Reducing the current account deficit to 4% of GDP by 1995.
i. Reducing inflation rate to 10% by 1995.
j. Complete liberalisation of the foreign exchange rate and trade regime by 1995.
l. Elimination of subsidies, reduction of social expenditures and levying of the cost recovery rates on social services.
m. Rationalisation of some public enterprises and privatisation of others.
n. Liberalisation of prices, interest rates and exchange rates by 1995.
o. Liberalisation of foreign investment regulations.
p. Deregulation of the labour market.

The key elements of financial liberalisation are spelt out in the Government policy document, Framework for Economic Reform (1991-95):

- 'Active steps will be taken to make the financial sector an efficient instrument of development in a competitive economy. To this end, new legislation will be put into place during 1991, which will lay the legal foundation for the emergence of new money market instruments and financial services, and will set effective prudential norms for banks and other financial institutions. The legislation will also aim to eliminate credit market segmentation supervisory mechanisms' (paragraph 35)
- 'While the efficiency of the financial sector will be considerably enhanced by the entry of new banks and other financial institutions, both domestic and foreign, a gradual approach will be adopted. The focus up to 1993 will be on increasing domestic competition between financial institutions and the introduction of a limited number of new entrants. As experience is gained and as a supervisory mechanism is put firmly in place, Government will move towards an open entry policy ' (paragraph 36)
- 'The government will develop further the Stock Exchange Market. To undertake appropriate and close monitoring of trading on the Stock Exchange, a Security Exchange Commission will be set up, in 1991, as a regulatory body' (paragraph 37)

In line with the proposals in the policy document, financial liberalization has been effected using the following measures:

a. The decontrol of deposit and lending rates and the removal of credit controls. However, one must hasten to add that this has not been completely liberalized as the minimum bank deposit rates on POSB deposits, building societies' rates on savings and owner-occupied residential mortgages still remain in place.

b. Removal of barriers to entry into the money and financial markets

c. Relaxation of foreign exchange controls to allow banks greater freedom in the control and use of foreign currency.

d. The introduction of Foreign Currency Denominated Accounts (FDAs). This measure has allowed individuals to freely deposit and transact in foreign exchange at determined rates.

e. The opening up the capital market to allow foreign participation. With effect from June 1993, foreign investors were allowed to buy up to 25 percent of the equity of any company listed on the Zimbabwe Stock Exchange. The figure has since been revised upwards to 40 percent.

f. Foreign investors were also permitted to participate at the primary issue of the stocks and dividends from these investments qualify for 100 percent remittance.

g. Removal of restrictions on the use of surplus funds and the interest cap on them, freeing such funds for investment in the market at the ruling market price.

h. Lifting of restrictions on domestic borrowing by non-resident companies from 40 percent of shareholders' funds before 1994 to 100 percent beginning 1994.

i. Revision of the Reserve Bank Act in order to eliminate segmentation and to increase competition in the market (in progress) Financial reforms occurred simultaneously with other reforms such as trade liberalization, price deregulation and the liberalization of agricultural and labour markets.

J. The reduction in the prescribed asset ratios of insurance companies and pension funds from 60 to 55 percent was also some effort to reduce control of the financial market. Cognisant of the likely problems after removal of barriers to entry, the Reserve Bank moved swiftly to raise initial capital required to open up a commercial bank from $ 15 million to $ 50 million and from $ 5 million to $ 25 million for building societies.

k. The relaxation of exchange control regulations. This has resulted in the introduction of foreign currency deposits (FCAs) in June 1993. These accounts increased from $ 120.8 million at the end of 1993 to $ 2315.5 million in June 1997. Furthermore, the Reserve Bank of Zimbabwe abolished the two-tier exchange rate system and hence moved to a market determined exchange rate.

So, when we evaluate the success or failure of financial sector reforms, we have to relate to this broader objective.

5. The Impact of Financial Sector Reforms

The banking and financial sector is one of the few sectors which experienced growth as a result of the reforms. However, closer scrutiny will indicate that the benefits of that growth have not spilled over to the poor and other marginalized groups in Zimbabwe.

Financial sector reforms have been successful in terms of improving the mobilisation of savings. The banking and financial sector was among the few sectors which consistently experienced growth under ESAP. Table 1 indicates this. For instance, whereas all other sectors (except mining and quarrying), were experiencing negative growth, the finance sector grew at 3 percent per annum. Prior to that, rates were much higher except in the drought years.

Table 1 Gross Domestic Product by Industry at Constant (1990) prices: Annual Growth Rates (%)

Error! Bookmark not defined.**Industry**	**1990**	**1991**	**1992**	**1993**	**1994**	**1995**
Agriculture, Fishing, Hunting	**12.1**	**1**	**-23.2**	**27.2**	**7.3**	**-3.7**
Mining and Quarrying	**3.9**	**0.2**	**-2.8**	**4.9**	**3.3**	**5.5**
Manufacturing	**5.9**	**2.9**	**-8.5**	**-7.8**	**10**	**-11.0**
Electricity and Water	**3.3**	**-5.9**	**-2.2**	**11.6**	**9.7**	**-6.5**
Construction	**5.4**	**0.6**	**4.2**	**-1.8**	**0.2**	**-6.5**
Finance and Insurance	**10.2**	**3.3**	**-0.5**	**15.0**	**6**	**3**

Source: Income, Consumption and Expenditure Survey (ICES), 1995 Table 2.2 (c)

There were many new entrants in the sector, particularly the commercial and merchant banking sector, building society business, leasing and insurance. This resulted in a massive mobilisation of savings. The decontrol of interest rates boosted this process. Liberalisation of the sector also created a more competitive environment although the market is still largely imperfect because of desegmentation of the market. Competition has improved the range of services provided by the sector. It has led to new innovations - the introduction of ATM machines, computerisation, all of which have improved services to the consumer albeit in a limited manner.

The liberalisation of the sector has led to a rapid growth in the assets and liabilities of the banks as shown in Table 2.

Table 2: Growth in Assets and Liabilities of the Financial Sector Since 1994

Error! Bookmark not defined.**Institutions**	**1993 (millions)**	**1994 (millions)**	**1995 (millions)**	**1996 (millions)**	**1997 (millions)**	**1998 (October) (millions)**
Discount houses	1347	1675	3781.8	3160.9	3191.3	2045.8
Commercial Banks	14900	20275	24668.6	32647.6	48647.5	61966.2
Accepting houses	6126	7756	10361.3	17051.4	24331.5	32212.6

Finance houses	1498	1908	2865.9	4269.8	5937.6	6969.6
Building Societies	3892	5808	10088.2	13842.8	18287.8	18059.7
POSB	2977	3662	4465.5	6226.9	7638.7	6643.7

Source: RBZ Quarterly Economic and Statistical Review (September - December 1998).

The growth in the assets and liabilities of the above assets and liabilities are given in Table 3 below and these have been found through calculating the percentage changes from one year to the other. Basically all the major categories of financial institutions experience increases in their asset base over the period until about 1996.

Table 3: Growth Rates of bank assets and liabilities 1994-1998

Error! Bookmark not defined.**Institutions**	**1994 (%)**	**1995 (%)**	**1996 (%)**	**1997 (%)**	**1998 (%)**
Discount houses	24.3504	125.8195	-16.4181	0.961751	-35.8945
Commercial Banks	36.0738	21.67484	32.34476	49.00789	27.37797
Accepting houses	26.6079	33.59421	64.56815	42.69503	32.39052
Finance houses	27.3698	50.22015	48.98636	39.06038	17.38076
Building Societies	49.2292	73.70687	37.21774	32.11056	-1.24728
POSB	23.0097	21.94822	39.44463	22.6726	-13.0258

The critical question to ask though is how did the poor benefit from all this ? One of the difficulties researchers experience is the aggregated nature of financial sector data. Published statistics do not break down the information on liabilities according to income groups or categories of enterprises and so it becomes difficult to determine the relative shares in terms of access to financial services. A survey becomes the only available option but given the limited funding base of SAPRI, no survey was possible and so a lot of the conclusions reached here are based on a critical appraisal of available aggregate data and to a limited extent, to small surveys which unfortunately were not national in coverage.

The high interest rates from the reforms have increased savings mobilisation by a number of institutions. They have also made loan portfolios more attractive. This is reflected in the growth of the asset base of a number of institutions. Estimates based on figures from several Reserve Bank Quarterly Economic and Statistical Bulletins indicate that the combined asset base of the whole banking system of Zimbabwe has increased from the low figure of $ 4.4 billion in 1985 to $ 11.0 billion in 1990 and further to $82.1 billion by June 1997. For insurance companies and pension funds, the asset base is estimated to have increased from $5.8 billion in 1990 and $ 38.1 billion in 1996 (NSSA included). Projections indicate that the figure is likely to rise even further to $ 44.1 billion in 1997.

Although no extensive econometric study has made a conclusive link between the rise in interest rates and growth in deposits (savings mobilisation), there certainly appears to be some link, on the face of it. Total deposits of the financial institutions rose from $ 3.8 billion in 1985 to $ 9.7 billion in 1990 and further to $ 47.2 billion in June 1997. On average, savings with financial institutions have been growing at 12 percent. Savings from financial institutions have been growing from $ 2.9 billion in 1985 to $ 7.0 billion in 1990 and further to $ 32.3 billion in June 1997. This trend bodes well for investment in that this could help raise target investment levels from 15 percent of GDP to 25 percent.

Another significant development is the increase in the lending by many of these institutions. Total financial institution lending (including POSB) increased from $ 2.7 billion in 1985 to $ 6.9 billion in 1990 and further to $ 32.0 billion in June 1997. On average, lending by financial institutions increased by over 15 percent over the period 1985 to 1996. The fact that lending by this sector increased by 47.2 percent in 1991, the highest over the period 1985 to 1996 may be a strong pointer to the impact of reforms. The published statistics do not break down the lending according to size of enterprises or even the income status of the borrowers. However, from the feedback received from the SAPRI consultations with rural and disadvantaged urban communities, the general response was that people had not benefited from the reforms. Rather, the high interest rate environment had spilled over into the informal sector, with money lenders charging even higher interest rates than the banks.

The market reforms in the financial sector have brought up new business opportunities. Removal of barriers to entry mean that anyone (well, not exactly) but anyone with the required initial capital amounts to start a bank can do so. New banks have also started operations in the commercial banking, merchant banking, building society, finance house, and discount house businesses. New entrants into the banking sector include four new discount houses from 1991 to 1997, two new building societies from 1992 to 1996, and six new merchant banks from 1993 to 1997, although with two mergers in 1997 and also two new commercial banks in 1997 together with one finance house in 1996 (Reserve Bank Quarterly Economic and Statistical Reviews, 1992-1997). A women's bank OMA had been planned but failed to take off due to what was widely believed to be 'in-fighting and governance difficulties'.

Venture capital companies (such as the Venture Capital Company of Zimbabwe (VCCZ)) and Takura Investments) were for the first time introduced.

The entry of new banks has increased competition which is a healthy development for the efficiency and profitability of the sector. The competition has certainly made many financial institutions to be more innovative (for instance, the introduction of Automated Teller Machines (ATMs) linked to ZIMSWITCH, has drastically improved service provision to the urban populace. Although there are problems, commercial banks have improved their efficiency due to the increased competition. It should however be pointed out that competition is still incomplete as evidenced by the high degrees of concentration in the banking sector.

Table 4 shows some of the developments in regard to new entrants into the sector

Table 4: Financial Institutions in Zimbabwe

Error! Bookmark not defined.Category	**Names of financial institutions**	**Total number**

Commercial Banks	Barclays Bank of Zimbabwe Limited, Commercial Bank of Zimbabwe limited, Stanbic Bank Zimbabwe limited, Standard Chartered Bank Zimbabwe limited, Zimbabwe Banking Corporation limited, Metropolitan Bank Zimbabwe limited, First Bank Corporation limited and Time Bank Corporation limited.	8
Finance Houses	Fincor Finance Corporation limited, Stanbic Finance Zimbabwe limited, Standard Chartered Finance (Zimbabwe) limited, Scotfin limited, UDC limited, Leasing Company of Zimbabwe, Kingdom finance Corporation and ZDB financial Services limited.	8
Discount Houses	Bard Discount house limited, Intermarket Discount house limited, Kingdom securities limited, National Discount house limited, the Discount Company of Zimbabwe, Prudential Discount house limited, Rapid Securities limited and Tetrad Securities limited.	8
Accepting Houses (Merchant Banks)	First Merchant Bank Zimbabwe limited, Heritage Investment Bank limited, Merchant Bank of Central Africa limited, National Merchant Bank of Zimbabwe limited, Standard Chartered Merchant Bank Zimbabwe limited, Syfrets Merchant Bank limited, Trade and Investment Bank limited, Trust Merchant Bank limited and Universal Merchant Bank Zimbabwe limited.	9
Building Societies	Beverley Building Society, Central Africa Building Society, Founders Building Society and Zimbabwe Building Society.	4
Insurance companies, Professional Reinsurers, Brokers and Pension Funds	Many	Over 80
Development Banks	Zimbabwe Development Bank and Post Office Savings Bank.	2
Bureaux De Change	Many	Over 50
Unit Trusts The Zimbabwe Stock Exchange	ZIMRE, Barbican, Kingdom, Old Mutual, Syfrets, Bard and TETRAD unit trusts Many companies (excludes the many small businesses)	8

Was this of any significance to the poor? Not really.

The liberalization of the Z$ against major currencies (US$, DM, the British Pound Sterling etc), was one of the most significant changes introduced by the reforms. Prior to reforms, the exchange rate was controlled and regulated by the Central Bank. A fixed exchange rate system was in place.

In the harsh macroeconomic environment of the mid-nineties, liberalization of the exchange rate was destabilizing. On November 14, 1997, a day popularly dubbed ‘ Black Friday’, the Z$ fell sharply from Z$ 11 to the US$ to around Z$ 25 to the US$. Since then it has further slided to 38 and now stands at Z$ 50 to the US$. It is still largely managed (parallel rates are around Z$ 60 to the US$.

The movements in the exchange rate has hit hard the business sector because their heavy reliance on imports. The high costs of importing have generally been passed on to the consumer and in fact, in some cases, even those industries which do not heavily on imports have used the fall of the dollar to justify their raising of commodity prices sharply. Most notable was the crisis in the milling industry in 1998 when they raised maize meal prices sharply on account of the fall of the Z$ from November 1997. The increase in the price of maize meal, a basic staple, hit hard on the poor especially, and this group was already suffering from other effects of reforms-rising transportation costs, increase in health and education fees, increase in building costs and so on.

For the SME sector, the fall of the Z$ also had a negative impact. Coupled with measures to open up industry to external competition, a number of companies closed down and retrenched workers in the process. The textile industry was one of the hardest hit.

For informal sector businesses, the fall of the Z$. Coupled with high interest rates, high inflation rates also created problems of viability. The volumes of women travelling to neighbouring countries such as Botswana and South Africa, declined sharply as the Pula and the Rand became more expensive.

It has also been noted that the reforms contributed to financial distress and even insolvency as borrowers' indebtedness is worsened. Highly leveraged companies experienced serious financial problems because of the high interest rates and many of them went bankrupt. The situation quickly changed from one of foreign exchange constraints to bank credit constraints.

SMEs and the poor also suffered a blow when the United Merchant Bank (UMB), an indigenous bank under the directorship of the late Roger Boka, collapsed. It is widely accepted that the reason for the failure of that bank was poor risk management, that the bank had been licenced more on political rather than sound economic and banking criteria. The bank is alleged to have loaned heavily to politicians who failed to pay (or perhaps simply refused to) The collapse of the United Merchant Bank (UMB) in 1996 was largely attributed to the absence of an effective regulatory and supervisory framework in a sector which has seen radical changes since the introduction of economic reforms. Although the Reserve Bank had been aware of the developments at the UMB prior to its collapse, the problem was basically that it was not legally empowered to take required action except to advice the Bank, which they in fact did. The market has heavily criticized the act that the Ministry of Finance is the licensing authority, an arrangement which they argue, is not entirely free from ‘politics’. Others argue that the RBZ cannot be the licensing authority and the supervisor at the same time.

Thus, the problem of non-performing loans was another challenge of the reforms. In another case, an indigenous building society almost collapsed. It was providing cheap mortgage loans to low-income communities. The default rates were high and perhaps, also coupled with poor portfolio management, the bank was in distress. It had to be placed under judicial management under the guidance of the Reserve Bank and currently, the Central Bank is continuing with the rescue operation. Recently, there have been rumours in the press about more financial institutions in distress. This would not be very surprising because of the political and economic crisis which the country has experienced in recent months. The ‘ invasion’ of farms by the ‘war veterans’ –(refers to the people who fought for the liberation of Zimbabwe), has greatly disturbed farm operations and will inevitably affect farmers (who are heavily indebted) in terms of capacity to service their debts.

The failure of indigenous owned financial institutions has further weakened the position of SMEs and the poor. Boka’s collapse and failure as an indigenous businessman has further cast some doubts on the capacity of indigenous businesses to service their debts and to manage businesses in general. The collapse resulted in massive withdrawals of deposits from UMB to the more traditional multinational banks such as Barclays, Standard, and Stanbic. This has undermined indigenous capacity.

The failure of some of the financial institutions as described above has also raised questions about the preparedness of Zimbabwe for reforms-that these measures were introduced before a comprehensive and adequate supervisory and regulatory framework was in place. It has threatened
the viability and stability of the banking and financial sector.

The high profits generally reported in the financial sector have motivated entry by new players. A few indigenous players have come in. A serious problem however, is posed by the regulatory framework prevailing during reforms. Under the amendments of the Reserve Bank and Banking Acts, a tighter regulatory framework has been put into place. Although justifiable from the point of view of stability and prudence of the system, it has made it more difficult from smaller players to participate in the sector and it is also limiting competition. A good example of the challenges/limitations posed by the new regulatory framework is the minimum capital requirements for setting up a bank. The amount has been raised from Z$ 20 million to Z$ 100 million, and this makes it difficult for a microfinance institution, for example, to enter the formal banking sector thereby making it possible to mobilise public deposits (currently, the law does not allow them to do so until they obtain a banking licence, which as noted above has become more difficult to qualify for)

There were some inherent conflicts within some aspects of programmes of financial liberalization and deregulation. The Economic Development Institute (EDI, 1996) of the World Bank highlights this issue. For example, whereas high interest rates usually result from liberalizing financial markets, and are in fact good for the money market, they are

not necessarily so for the various companies and businesses in both the public and private sectors. Since interest rates are a cost to the various borrowers, high interest rates can stifle investment into productive sectors.
Distorted interest rates have also the undesirable effect of siphoning scarce funds from the productive sectors into the non-productive money market

In Zimbabwe, high money market rates have led to a shift in resource flows from the long-term capital market (Stock Exchange) to the short-term money market. Why is this significant? The long-term market mobilises resources for productive investment with a greater capacity for job creation whereas the short-term is more for speculative purposes. This anomaly has raised questions about the allocative efficiency of the reform of the financial sector.

High interest rates have made even viable productive businesses become insolvent-leading to the de-industrialization. They have increased systemic risk, which has further created difficulties of access for SMEs and the poor generally. High interest rates-borrowers faced difficulties which led to defaults-or non-performing assets as borrowers fail to service their debts

Some estimates by ZCTU (1995) indicate that 20 000 jobs were lost in mining and manufacturing during 1993. Between 1993 and 1994, non-agriculture employment increased by 54 000 jobs. Manufacturing contributed 23 100, distribution, restaurants and hotels contributed 8 100, mining 5 600 and other services 6 800.

During the pre-ESAP period of 1980 to 1990 employment grew at an average rate of about 2.4% per annum. In 1991, it was even as high as 4.4 percent due to private sector optimism over the reform programme, the removal of restrictive labour laws, minimum wages, decontrol of prices, availability of imported raw materials due to trade liberalization and also due to an increase in capacity utilization. This trend in employment however, was reversed throughout the ESAP period when the growth rate of employment fell on average growth rate of 1.6% per annum. (Kanyenze, G., 'Workers' Employment Conditions Under ESAP' in ZNCC Conference Proceedings on "Forging A Common Vision Under ESAP 2" 10-12 October, 1995.)

Key sectors such as manufacturing, construction, education, health, mining experienced a decline in employment. This reflects the decline in GDP growth. The high rate of company closures during the ESAP1 period also explains the growth in unemployment. 15 companies were liquidated in 1990, 8 in 1991 and 6 in 1992. In addition, a number of companies were struck off the list of the registrar of companies: 44 in 1991, 564 in 1992, 129 in 1993, 78 in 1991 and 48 in 1995. (CSO, 1996)

Closures and liquidations reflected the failure of these companies to cope with the intense foreign competition brought about by a post 1990 outward looking economy. They could also have been due to the general international economic recession of the period 1992-1993 and the droughts which occurred during the period.

The micro-scale enterprises (MSE) in Zimbabwe are dominated by small manufacturers. According to the 1991 GEMINI survey, almost 70% of all MSE in Zimbabwe fall into the manufacturing category, while 23% can be classified as traders and only 3% in the service sector.

Some nationwide surveys on micro and small-scale enterprises were carried out in 1991 and 1993 (Gemini Technical Reports Nos 25 & 71) with the support of USAID. The 1993 report showed that the sector consisted of approximately 942 000 enterprises employing some 1.65m people. This represented an 8.5% increase in the number of people employed by this MSE sector. However, the proportion of MSE in manufacturing declined from 1990. The 1991-93 Gemini surveys showed that most frequently cited problems facing especially the very small enterprises were lack of markets, inputs and finance. The vast majority of them depend on own resources and savings. The report showed that only 0.7% of MSE in 1993 received credit from a formal credit institution and 0.3% in 1991. The survey also showed that of the firms that had title deeds, only 2.4% received credit from the formal sector compared with 0.4% of firms without title deeds thus the rural folks were most disadvantaged in this area. For the same rural entrepreneurs, travel costs to and from the towns where financial agencies are located are not worth the toil because they don't often secure the loans.

ESAP generated a strong stimulus for increased domestic and foreign trading on the Zimbabwe Stock Exchange (ZSE). Portfolio investment inflows through the stock exchange have, thus, risen from nil in 1992 to Z$835 million (US$83.5 million) in 1996.Supported by 11 stock brocking firms, the number of listed companies on the ZSE, which had plummeted to 55 in 1985, has since increased. Total market capitalization, which in 1992 was Z$8.2 billion (US $1.5 million) has since soared to Z$69.2 billion (US $6.1 billion). In terms of market capitalization ZSE has become the second largest stock market in Africa after the Johannesburg Stock Exchange (JSE).[8]

It must be acknowledged here that the rise in rates is not strictly attributable to reforms but to the government's borrowing on the money market to finance its budget deficit.

Thus, reforms have not improved access to credit for the very people for whom reforms were meant to assist.

As a result, many small borrowers are resorting to Microfinance schemes, which are more sympathetic to their plight, but then the problem is that those institutions do not have enough resources to meet the demand.

The increasingly competitive environment created by reforms has led to a much tougher approach by banks especially in terms of lending to the poor. It has always been hard for this group to get loans from banks. It is now even more difficult. Collateral requirements have been maintained if not actually made stiffer in some cases as banks perceive the environment to be

[8]Quarterly statistical and economic review - RBZ 1997 (page 25)

riskier. Even development banks, which used to be more flexibly and would look at project viability rather than short-term profitability, now tend to look at profitability. The Small Enterprise Development Corporation (SEDCO), which for years provided small development type loans is in the process of being commercialised. Whereas this is alright in terms of economic efficiency, one foresees that many emerging small-scale entrepreneurs will not get credit.

A study by Chipika et al (2000), (see table in the Appendix), established that financial reforms had a largely negative impact on agricultural credit. For example, in the four districts which were surveyed, Guruve, Gutu, Chivi, and Matopo), the results indicated that:

- Decrease in access to credit
- An increase in the cost of credit
- Personal sources of finance continued to be the main sources of finance (over 86 percent of total household finance).

The results obtained from the study showed that quite clearly, financial sector reforms did not improve access to credit, they also increased the cost of credit, and individuals continued to rely to a large extent on own personal sources of finance.

Few banks have been innovative enough to come up with products, which are suitable for the small borrower. Although many banks have set up Small Business Units (SBUs), the lending conditions imposed by those units has precluded many small and poor borrowers. Only one commercial bank has initiated a community-based lending scheme. The Commercial Bank of Zimbabwe (CBZ) has started such a scheme and at the moment, it appears to be doing well, providing small loans on a group basis. Although this is a good initiative, it is not sufficient to meet the huge demand for loans by small and informal sector businesses.

Given that many women operate in the informal sector, it is clear that in terms of gender, financial sector reforms have not done much to advance gender equity and reduce poverty.

The high interest rate environment has created a disturbing trend whereby most investors now put their money in the money market instead of investing in the more risky and now relatively lower return capital market. Interest returns in the money market are around 33-37 percent, way above what returns one could ever hope to get from the stock market. Capital has therefore been moving from the capital to the money market. This actually means that productive sectors are denied an easier and cheaper source of capital. The capacity of industry to generate jobs can only be curtailed under these circumstances.

The policies failed to address more fundamental issues such as:

a. Improving access to land to poor communities
b. Creating opportunities for gainful employment for people so that they could afford to borrow or even acquire property which could be pledged as collateral

c. The policies did not create new institutions which would be more suitable for smaller borrowers-the kind of structures which CBZ for example, has come up with. It is clear that there is need in future to develop such institutions which could operate viably.

d. Like all other adjustment policies, there is no evidence to show that communities were ever consulted in regard to what kind of financial reforms would most be useful to them.

e. High interest rates on the market have arisen not just because of adjustment, but the failure by government to reduce its borrowing from the sector in order to finance its huge deficit. Without some serious commitment to fiscal discipline, it is clear that goals of financial reforms can easily be defeated.

Since interest rates are a cost to the various borrowers, high interest rates have stifled investment into productive sectors. They caused financial distress and even insolvency as borrowers' indebtedness is worsened. Some countries have experienced the insolvency and virtual collapse of banks and in cases this was followed by the takeover of banks by the government, thus reversing altogether the objectives of liberalisation. High interest rates in an environment of macroeconomic instability (high inflation rates, large budget deficits, poor portfolio management by banks, an inadequate regulatory and supervisory framework, among others, has retarded any potential gains from reforms)

The commercialisation of the former AFC under the new bank, AGRIBANK, whilst understandable from an efficiency point of view, has created a problem for the large number of smallholder and communal area farmers whose portfolio has been transferred to a new institution, the Agricultural Development Assistance Fund (ADF) The problem is that ADF is under capitalized and is currently making efforts to raise funds from the donor community. The Government has been unable to meet its funding needs due to its own budgetary problems.

The constraints faced by ADAF, unless some funders can be more forthcoming, will most negatively affect the thousands of small farmers across the country.

The commercialisation exercise at SEDCO and the ZDB, also raise concern in terms of how lending terms will be rationalized. Speculation is that these institutions are now under pressure to put more emphasis on collateral-based lending as a lending criteria, rather than previous practice where the viability of a proposed project was the basis for extending credit.

Although Commercial banks have set up loan windows to meet the needs of SMEs (under the Small Business Units (SBUs), there have been complaints by entrepreneurs that it is still difficult to access credit from those units, that application procedures are complex, that regrets are given to applicants without any reasons being given, and so on.

The issue of access to credit by the poor can also be analyzed in terms of how financial sector reforms have impacted the microfinance industry which historically has been much more accessible to the poor and some of the small businesses.

Whereas the liberalization process has ushered in a lot of changes for the traditional financial sector, there have not been substantive changes in terms of the regulatory environment for microfinance. Under the above legislation, the interest rates which they can charge for their lending are capped and to this day, they are below market rates despite the fact that their costs (operational, administrative, cost of money etc), have gone up. This is one of the fundamental problems facing the microfinance industry in Zimbabwe. Another problem is that fact that they are not allowed, under the same regulations, to mobilise deposits from the public. Rather, they can accept deposits from their clients or members (Unions, cooperatives) and use the savings to extend credit to the same.

Microfinance institutions have always had difficulty raising funds on the local market because it is a sector which is regarded as high risk because of the domination of the poor on the portfolio of the industry. This has not changed with reforms. If anything, traditional banks are now going into microfinance themselves because they are beginning to see the opportunities. One would have thought that they could rather enter into strategic partnerships with the more promising MFIs (who have gathered expertise over the years in terms of lending to the poor) and provide indirect financial support.

In fact, it is interesting to note that the microfinance industry actually mushroomed or took off much more rapidly during the reform period. Th e hardships of ESAP (unemployment, deteriorating living standards, deepening poverty and so on), pushed the poor, the unemployed to go into informal sector or self-employment activities. But with increased difficulty of obtaining credit from the banks, many resorted to microfinance institutions who were largely donor funded.

Budgetary allocations for microenterprise development were miniscule. The MicroEnterprise Development Programme under the SDF, had as one of its objectives, to provide capacity building of the microfinance sector (jointly with UNDP-MicroStart Programme). However, the Programme itself had very limited capacity and its impact has been limited.

Other studies, (notably by EDI, 1996, African Development Bank, 1997), underscore the issue of the adequacy of the regulatory and supervisory framework in existence to supervise and monitor financial sector reforms.

The absence of an adequate and effective supervision and regulatory framework led to the deterioration in the quality of loan portfolios of the financial system.

A fundamental issue which needs to be investigated and analyzed extensively is whether in fact the interests of SMEs and the poor (development in general) can be compatible with the concept of market-based economic reforms. Over the years, it appears that despite a lot of lobbying for greater financial sector support to SMES and the poor, this has not materialized. If anything, prospects for that happening appear to have further diminished under the reform programmes. Instead, the microfinance sector has emerged as an alternative source of support. However, without much support from the formal financial sector, from Governments, donors, service providers and so on, the capacity of the microfinance sector to service small scale and informal sector entrepreneurs and the poor, is very limited. There is therefore a real need to explore the microfinance sector and promote it to improve its capacity to support those sectors in question.

Furthermore, the reforms have not promoted the microfinance sector which has responded to the needs of small-scale entrepreneurs and the poor.

A review of the factors which determine the success or failure of financial liberalisation measures: lessons from other LDC's

A survey of a number of African, Asian and Latin American countries shows that the following factors are key in determining the success of financial sector reforms:

The macroeconomic environment

The World Bank (IBRD, 1989) has made it clear that financial liberalisation cannot succeed in an unstable macroeconomic environment characterised by high and unstable inflation, balance of payments crises and external debt.

The state of the fiscus

1. In a number of developing countries, high budget deficits have contributed to the failure of economic reforms. This is because these deficits are largely monetized. They are cause for excessive monetary expansion which fuels inflationary pressures. High budget deficits will also be a drain on the resources mobilised through reform measures. Clearly, financial liberalisation should be accompanied by fiscal reforms.

The adequacy of a regulatory and supervisory framework

Financial reforms entail the entry of many new players in the market, most of which are deposit taking institutions and some of whom are involved in extensive lending activities. To curb excessive monetary growth which has the potential to fuel inflation, there is a need for an effective regulatory and supervisory mechanisms to check on the quality of loan portfolios, the adequacy of capital and soundness of bank management. Regulatory reforms should aim at enhancing the safety and efficiency of the financial system.

The pace of reforms

The implementation of reforms can be swiftly and drastically or they could be introduced gradually. Evidence shows that too swift a pace of change can create problems especially because economic agents are not given sufficient time to adjust. In countries where interest rates were reforms were rapid and simultaneous (e.g. domestic stabilisation, opening up of capital account), problems of inflation, bank runs and supervision problems were experienced. Changes which saw interest rates skyrocket overnight resulted in problems of adverse selection and moral hazard.

The sequencing of reforms

It is generally agreed that the reforms should be gradualistic, commencing with measures that stabilise the economy and then followed by the opening up of the capital account. Premature opening of the capital account (i.e. when the domestic capital market is still repressed and interest rates are fixed at low levels) may generate macroeconomic instability through destabilising capital flows. Massive inflows or outflows of capital have substantial effects on domestic inflation, exchange rates, interest rates, depending on whether the country operates under a fixed or flexible interest rate. Thus, the capital account should be opened only after both liberalising of the domestic financial sector and opening the current account in the balance of payments.

The political sustainability of the reforms

Economic reform is a political decision and so its success also depends on the political sustainability of the reforms. The adequacy and efficiency of the planning mechanisms for the reforms, the political will to execute the reforms through, and also popular acceptance of the reform process are crucial elements.

Credibility of reforms in the eyes of the public

Popular acceptance and support for the reform process is a crucial element in the success of such policies.

Existence of complimentary policies

Financial liberalisation alone does not guarantee competition in the financial sector. There is need for accompanying legislation to promote competition in order to avoid the creation of carteld in the setting up of interest rates-a role that would have been relinquished by the government.

Factors in the global/external environment

A favourable international environment (e.g. favourable terms of trade for a country's exports, absence of trade barriers etc) are important factors to consider when implementing reforms.

Exogenous factors

The vicissitudes of weather and global markets can either promote or militate against the success of reforms.

In light of the above factors, how do we see Zimbabwe? First of all, the macroeconomic environment has been unstable since the onset of ESAP and has remained so for most of 1996/97. Inflation levels above the double-digit levels (over 20 percent) have tended to be the norm against esap targets of 7 percent by year 2000. Interest rates remained high for most of the post-1990 period though they have slightly come down. Budget deficits hovered around 11 percent as a proportion of GDP although that too dropped in the 1996/97 period. Average economic growth remained at the low rate of about 0.2 percent per annum over the esap period. The pursuit of tight monetary policies to curb inflationary pressures has caused interest rates to remain high and many in the private sector have complained that this has crowded out private sector investment. Defaults by Small-to-Medium Scale (SMEs) were rampant due to financial distress. Some of the company closures and retrenchments of labour which took place at the height of ESAP were attributed to the fact that these enterprises had borrowed cheap in the '80s and were now having to repay at more than triple the rates. Thus, high interest rates mean that banks are lending expensive money so the chances of default are high. Furthermore, in an environment where economic reform focused on promoting investment and increased production, the high interest rates, coupled with exchange rate adjustments in 1991, greatly increased the cost of capital for both domestic and foreign investment, negatively affecting returns on capital and forcing the postponement and cancellation of numerous investment projects.

The high nominal interest rates also adversely impacted on the operations of long term lending institutions as investors, attracted by higher rates of return on the short-term money market, switched portfolios to the higher-yielding money market instruments. Building societies, finance houses, and the Zimbabwe Stock Exchange experienced outflows of funds as savers switched to portfolios to that market. The impact was so bad that around 1992, building societies had to suspend mortgage activities. Activity on the Exchange declined drastically with the industrial index falling from a peak of almost 2000 points in 1991 to just below 900 points by December, 1992.

The portfolio shift described above also brought a serious challenge to monetary management-namely the high excess liquidity on the money market. As a result, the central bank has been adjusting clearing and settlement arrangements in order to try and push this excess money out of the money market.

Regarding the supervisory and management capacity, over the years the Reserve Bank has demonstrated its ability to reign on inflation through tight monetary policies. It has been able to control the activities of the banking and financial sector, imposing reserve and liquid asset ratios, stipulating minimum capital requirements for the various institutions and overall monitoring the compliance of all institutions. However, the slow pace of addressing the legal issues surrounding reforms (for example, there was a long delay in the amendment to the Banking and Reserve Bank Acts. Furthermore, not much research seems to have been done on crucial issues such as the monetary implications of the reforms and what would be the most appropriate policy response to deal with those challenges.

The absence of complimentary policies such as the much awaited law on competition also means that the liberalisation of the financial sector will remain incomplete for some time until that matter is addressed.   For most LDCs, financial reforms are not very successful because of the limited diversification of the domestic financial system which are mostly oligopolistic in structure. In Zimbabwe, it is hoped that the proposed amendment to the Banking Act will, among other things, address this issue.

An important issue is that our sequencing of reforms has not been all that good. Granted, there has been a lot said in key policy documents (Framework for Economic Structural Adjustment, ZIMPREST) about the need to stabilise before liberalisation. On the ground though, efforts to stabilise have been inadequate, with tight monetary policy expected to do the job whilst fiscal policy has virtually proceeded in the opposite direction, hence defeating some of the objectives of reforms. Furthermore, the liberalisation of the exchange and trade regimes has seen huge inflows of capital from offshore borrowing and private sources causing excessive monetary expansion. This led to the adoption of a tight monetary policy by the Reserve Bank, resulting in high nominal rates.

Even if the Reserve Bank could come up with an efficient and workable structure for prudential supervision and control, as long as high budget deficits persist, the macroeconomic environment will remain unstable and the Bank will be forced to continue on the current path of tight monetary policies, a factor which could fuel inflation indirectly through the impact of high interest rates on the productive sectors.

6. Monetary Policy and Financial Reforms

The pursuit of a tight monetary policy has worsened problems for SMEs and the poor. The monetary policy stance of the Reserve Bank of Zimbabwe has tended to be dictated by the need to contain inflation which became endemic once the reform programme began against an increasingly unstable macroeconomic environment.

The introduction of reforms in the 1990s led to the unprecedented high levels of inflation (which rose from 17 percent in 1990 to 30 percent in 1992 and to 50 percent in August of 1993.) The rise in inflation reflected in large part the deregulation of the historical administrative controls on business activity and decision making coupled with the removal of subsidies on basic consumer goods.

The pursuit of a tight monetary policy in Zimbabwe was to curb monetary growth which was largely attributed to persistent high budget deficits. Unfortunately because of the passive nature of fiscal policy, Reserve Bank policies to curb monetary expansion have led to high interest rates, which in turn have been blamed for the poor performance of investment.

Growth in money supply in 1989 largely reflects general credit growth demands by the private sector of the economy in order to cover increased production costs, as investment remained repressed due to the foreign exchange constraintsduring the quarter ended September 1989, both the narrowly-defined money (m1) and the broadly defined money supply (m2) expanded. Over the year to September 1989, m2 grew by 20.1%.

Persistent growth in pure private sector borrowing continued on to exert expansionary pressures on money supply growth**.** Expansion in credit to the private sector of $1057.7 million was the single factor responsible for the 8.8% expansion in m2 during the second quarter of 1991. This growth in private sector borrowing more than offset the contractionary effects of decreases of $386.8 million in net foreign assets, arising from a tight balance of payments situation, $144.4 million in net other assets and $133.7 million in net claims against government coupled with a $71.2 million increase in fixed deposits. The 40.4% expansion in m2 over the year to September, 1991 largely reflected increased recourse to the banking system by the pure private sector for financing against a backdrop of improved foreign exchange availability for some sub-sectors, rising production costs and a rapidly depreciating Zimbabwe dollar.

Available statistics indicate that on a year-on-year basis the broadly defined money supply (m2) rose by 23.3% in December 1991, compared to 21% in 1990. The 23.3% growth in m2 reflected a significant reduction from the 40.6% recorded in September 1991. The reduction in money supply growth was mainly achieved by the restrictive monetary policy measures announced by the Reserve Bank in September 1991 which resulted in higher interest rates . [9]

During the first quarter of 1992, government increased its borrowing from the banking sector. Statistics showed that the net claims against the government during the quarter, were $665.2 million. This trend crowds out private sector investment and is also inflationary since it fuels money supply growth.[10] Monetary conditions in the economy generally remained tight during the whole of 1992, as the authorities continued to fight against inflation. Money supply growth (m2) rose from just 21.4% at the beginning of the year to a 35.5% in June 1992 against the background of the temporary reduction of reserve requirements in march because of the injection of financial resources by the government in the market as it sought to finance emergency food imports as a result of severe drought. The rise in money supply growth and the accompanying inflationary pressures necessitated further tightening of monetary policy, with the authorities severely limiting the level of accommodation available to the market while interest rates hardened.[11]

7. EMERGING POLICY ISSUES

The failures of financial sector reforms in regard to improving the access to credit of the small borrower, the poor and marginalized, calls for a different approach to the role of the finance sector.

Firstly, we believe that there is need to restore macroeconomic stability in the economy. There needs to be complimentarity between monetary and fiscal deficits. This could result in the lowering of the current high interest rates and also reduce inflation to single digit levels. This would provide a more conducive atmosphere for banks to expand their activities and perhaps even venture into once neglected areas of activity.

More importantly, there is a need to promote those institutions which have a potential to meet the gaps in the system, for example, the promotion of microfinance, venture capital, and leasing activities. These are described in greater detail in the next section.

It is also imperative that the government should chart a very clear policy framework for the development of the finance sector-one that would ensure both the growth as well as the development of the financial sector. Incentives to encourage banks to play a more developmental role could be introduced.

[9] ZIMBABWE ECONOMIC REVIEW, MARCH 1992 (ZIMBANK), Pp8

[10] Ibid, pp8

[11] See QESR, RBZ, MARCH-DECEMBER, 1992, Vol. 13 Nos.1-4, pp5

ERROR! BOOKMARK NOT DEFINED.**Complementary strategies:**

Integration of microfinance into the nation's development strategy.

There are now close to a 100 microfinance institutions in Zimbabwe. The following list indicates some of the major ones:

- Zambuko Trust Pvt Ltd.
- Self Help Development Foundation (SHDF)
- Nissi Project Finance
- Zimbabwe Ecumenical Church Loan Fund (ZECLOF)
- Organisation for Rural Associations for Progress (ORAP)
- Women Development Credit Scheme (Harare)
- Pundutso
- Collective Self Finance Scheme
- Masvingo Credit Against Poverty (M-CAP)
- Women in Business
- Phakama
- Small Enterprise Development Corporation (SEDCO)
- The Commercial Bank of Zimbabwe Community Banking Scheme

Most of the institutions are based in urban areas, with head offices mainly in Harare. A large number of the new institutions (emerging in the 90s) are money lending schemes which tend to charge very high (and often above market rates).

Zambuko is about one of the largest MFIs. It has 6 regional offices in Harare, Bulawayo, Gweru, Mutare, Masvingo and Chinhoyi and has close to 20 branches across those regions. This was part of its policy of decentralisation. It has no rural branches as yet. Three quarters of Zambuko's clients are women, and in the Trust Bank Programme, it is 100 percent. ORAP is one of the largest rural based MFIs, operating largely in Matabeleland.

These organisations have made their mark in terms of offering opportunities to numerous small-scale entrepreneurs and the poor. They have achieved this in a difficult environment where the regulatory environment has not always been supportive. Demand for their services has increased and most of them have indicated that they simply cannot meet the demand. Zambuko, for example, has adopted a policy that they will simply not advertise their services in the press because they would not be able to satisfy the demand. The organisation advertises itself by word of mouth as clients who feel that they have benefited from the programme share the experience with their friends and relatives.

Integration of Microfinance into Financial Markets of an economy

Policies should be designed in order to eradicate the largely negative perceptions about this sector. Policy should adopt a more positive and supportive strategy which recognizes that microfinance is in reality an integrated part of the development process. Programmes should be designed to strengthen the sector and to integrate into mainstream economic policy and planning. For example, budgetary policies could be used to allocate resources to improve the capacity of the MFIs to service the needs of microentrepreneurs. The creation of wholesale institutions by governments is possible vehicle to achieve this goal.

In Zimbabwe, there is a real need to change the negative perception of formal institutions against MFIs. Firstly, this can be achieved by improving the performance of the sector so as to make it attractive to them. Banks must see opportunities in the sector before they are prepared to forge linkages with the sector. One would like to argue that in fact, there are benefits, which banks can reap from supporting microfinance. In Zimbabwe, most clients of MFIs actually maintain accounts (savings) with formal banks despite that they are refused access to their loans. We have observed that in many MFIs, there is an increasing number of clients who are becoming successful, having received a couple of repeat loans. In fact, most of them grow so big that they actually have to be 'weaned' by the lender institution and they are referred to formal banks for larger loans and other services. Thus, microentrepreneurs will grow to become bigger and would require different services than those offered by MFIs. There is therefore all the more reason for formal institutions to be more actively involved in microfinance, much more so in the increasingly competitive environment ushered by financial liberalisation measures. Tax incentives could be introduced for those institutions which support the sector.

Creation of An Enabling Environment

Financial institutions lending to small borrowers must be profitable. They must also earn enough money to cover the cost of funds and recurrent operational and administrative costs. To achieve this, MFIs should be able to charge appropriate rates of interests. The regulatory environment should permit this.

There is a need to review rules on zoning, registration, access to land, taxation and fees so that they are designed in a way which promotes rather than obstructs microfinance.

A particularly important approach to the issue of regulation of the microfinance sector is the promotion of strong associations of the MFIs which would design appropriate regulations for the sector rather than have these imposed from Central Banks. The ILO Interdepartmental Project on the Informal Sector carried out a study on four pilot cities globally (including Dar-es-Salaam in Tanzania), and results showed that such associations could create a regulatory environment which is conducive to the growth of the sector. In Zimbabwe, such a process could be supported through ZAMFI (Zimbabwe Association of MicroFinance Institutions), an umbrella organisation of some MFIs in the country.

Capacity Building

Microfinance in Africa would benefit from comprehensive programmes of capacity building. Critical areas to benefit from capacity building would include: human resource development to improve productivity of staff, the design of management information systems (MIS) which network all branches of an MFI and thereby improving loan tracking and repayments, efficiency and accuracy of accounts.

There are some capacity building initiatives on the ground but currently, most Zimbabwean MFIs cannot benefit. For instance, Zimbabwe is not among the countries benefiting from the Africa Development Bank facility which was set up to assist MFIs in various parts of Africa. The programme is known as the African Development Bank Micro-finance Initiative for Africa, (AMINA) It was set up to improve the access of the poor to financial services through capacity building of MFIs. AMINA's strategy is to focus on long-term capacity building of MFIs through coordinated programme of technical assistance, creating linkages between MFIs and commercial banks, helping MFIs to develop productive activities. It will serve as a 'mechanism to increase horizontal linkages between microfinance practitioners and to engage governments, regulatory agencies and donors in a policy dialogue on those issues of concern to microfinance institutions' (Aryeetey, 1998) AMINA will also issue financial guarantees to commercial banks who establish refinancing facilities for microfinance institutions.

There is need to expand this programme so that other African countries could also benefit.

There are also some NGO – based capacity building initiatives which could be supported so that they can assist the MFIs. For example, the Southern Africa Microfinance Capacity Building Facility (SAMCAF), a regional facility for the capacity building of microfinance institutions, was set up by national microfinance associations to provide training and technical assistance to MFIs. The facility was set up with the financial support from the Swedish International Development and Cooperation Agency (Sida) in 1999. SAMCAF's experience shows that whilst there is a tremendous demand and need for supporting MFIs, most of them cannot afford to pay fees that would sustain institutions such as SAMCAF. Furthermore, in order to service the whole region adequately, SAMCAF would require other donors to assist the work which the organisation is doing.

PORTFOLIO DIVERSIFICATION

MFIs also have to diversify their portfolios in order to reduce lending risk. This could be achieved by avoiding sectoral concentration or over emphasis on lending in areas vulnerable to natural calamities or external shocks
This also entails measuring delinquency, how to handle delinquency and how to interpret delinquency measures

Skills training of MFI clients

There is also the need to improve the basic education, technical skills and managerial training of clients as well as staff of MFIs. The introduction of training packages such as community based training, skills development for self-reliance can be used for this.

Organisations such as EMPRETEC and ZOICE (Zimbabwe Organisation In Community Enterprise), BESA (Business Advisory Services) have an important role to play and efforts should be made to ensure that their training programmes are tailor made to meet the needs of microentrepreneurs. Whereas EMPRETEC offers some very high quality training, the cost of its practice tends to be beyond the reach of most MFI clientele. This is another area where capacity building initiatives could target by providing resources (scholarships) to enable those who cannot afford the fees to participate all the same. It should also be mentioned at this stage that the area of training has been badly handled by microfinance institutions. Each one appears to be handling their own training instead of networking and identifying organisations which are best equipped and qualified to train their clients. There is a need for networking and closer cooperation amongst MFIs in this regard.

The technological capabilities of small entrepreneurs requires improvement, both in terms of quantity as well as quality. Labour productivity in the sector could be improved through the use of appropriate technology in the sector and by improving the skills base of entrepreneurs.

Capitalisation of MFIs : Role of Social Funds

One of the most serious challenges faced by MFIs is the lack of funds for on lending. They cannot tap into commercial markets because of the way they are perceived by bankers. For this reason, in other parts of the world like Asia, governments, private sector and the donor community are playing an important role by making available some funds which are channelled into independently managed Social Funds for microfinance development. Such funds are needed as part of a strategy to foster the development of the microfinance sector. In Zimbabwe, the recent initiative by the government to allocate Z$ 200 million into a MicroCredit Fund (Budget 2000/2001), is a very important development. What is critical is to ensure that the Fund is managed professionally so as to ensure accessibility by the very community for which it was set up.

Sustainability: Need For A Corporate Culture In Microfinance

Microfinance institutions need to achieve sustainability by providing services to small to medium entrepreneurs and the poor, on a profitable basis. Most MFI's are loss making and depend on donors for support. They need to improve on recoveries and be able to cover loans from this source. Best practices in microfinance indicate that for MFIs to be sustainable, they need to be

- Independent
- Impose strict recovery conditions
- Search flexibility on collateral requirements
- Charge positive real interest rates
- Offer deposit facilities
- Maintain a diversified portfolios
- Effective risk management
- Effective training programmes for clients
- Effective and regular monitoring of clients and cultivating a close and personal relationship with clients

VENTURE CAPITAL: Opportunities for small to medium scale businesses

Venture capital refers to the provision of equity finance by an venture capital company (the investor) to a business (the investee) for purposes of raising capital. Such capital may be required for start-ups, expansion of an existing concern and also for privatization purposes. It may also be for buy-outs. Unlike banks and financial institutions, venture capitalists specialise in providing equity and other forms of long-term capital to enterprises, generally without much of a track record but which promise exceptional profit growth.

The equity participation of a venture capital investor in a business offers a number of benefits which are discussed in a later section in this report. Although venture capital companies are still few in Zimbabwe and perhaps not quite as well - known as long-established banks and financial institutions, they are a very important vehicle of company finance especially for Small to Medium-Scale Enterprises (SMEs). The 1996/97 budget announcement by the Minister of Finance that venture capital companies will be exempt from tax may well result in a mushrooming of these companies. Thus, SMEs should be aware of this important source of finance. In developed countries such as Britain, venture capital finance played a very significant role in the restructuring the country's industrial base, in particular, nurturing the creation and early growth of wealth and job creating enterprises.

The nature of venture capital finance in Zimbabwe

- There are very few companies which are engaged in this type of business. These include:
- Venture Capital Company of Zimbabwe (VCCZ)
- Industrial Development Corporation (IDC)
- Continental Ventures (Finhold)
- Takura Investments (Commonwealth Development Corporation) (in formative stage)
- Hawk Ventures (operating under the Anglo Group)

Venture capital finance takes the following forms:

- Equity subscription in which the investor subscribes to the shares issued by the business client.
- Loan capital. At the end of the stipulated period of equity participation when the venture company disinvests from the client's business, its shareholding can be converted into a loan.
- Preference share capital in which the investor buys the preference shares issued by the investee.
- Debenture capital which is quasi-equity.
- A combination of the above

In Zimbabwe, the equity participation of venture companies remains a minority share, ranging from 20 to 49 percent. Minimum and maximum amounts of capital they can subscribe to vary from company to company. For example, one well-known company offers a minimum of Z$ 250 000 and a maximum of Z$ 2 million. Another which is soon to start operations will be offering a minimum of Z$ 2 million and a maximum of Z$ 15 million.

Advantages of venture capital finance

There are a number of advantages from using this type of finance. These include the following:

- Equity finance does not require collateral security from the applicant. This is a real advantage for most SMEs whose immovable properties may be of very limited value to provide adequate security.
- It does not attract interest. The investor has a share in the client's profits through dividends.
- Equity participation implies that risk is shared between the business and the venture company.
- The venture company has a self-interest in ensuring the success of the client's business since, as a shareholder, it is entitled to the investee's dividends. In this regard, it will assist as much as possible to make the client's business successful. It offers managerial, financial and technical skills and other necessary support to ensure that the business succeeds.
- The venture capital company will disinvest from the client's business after a certain period of time. Again this varies from company to company. In general, it ranges from 3 to 10 years, a period after which the client is deemed to be enough to stand on their own.
- At the time of disinvestment, the equity participation can be converted into a loan. The terms of repayment tailored to suit the client's cashflows. Interest rates charged are well-below market levels.

Shortcomings

Most of the institutions which currently provide venture finance to small firms do so to a very limited extent, and often fail to reach to the very smallest, who are in most need of finance. For example, a micro-enterprise requiring capital in the region of Z$150 000 or less, is not able to get assistance with these companies. A majority of very small businesses both in the formal and in the informal sector may thus be excluded from these schemes because they have insufficient security, track record, or financial expertise. The other problem perhaps has more to do with a clients' attitude to venture capital rather than venture investors themselves. The experience of countries such as the United Kingdom shows that the majority of small firms tend to resent any external holding of their equity, which they regard as a loss, both of control in the firm and of the justified rewards of their enterprise. In Zimbabwe, it may be too early to reach such a conclusion as the industry is still largely in its infancy. On the whole though, the advantages of this scheme of finance appear to outweigh these problems.

<u>Enhance the role of the development banks</u>

Zimbabwe already has development banks such as the Zimbabwe development bank and the small enterprises development corporation. These need to create special windows to be able to meet the development needs of smaller clients.

<u>Creation of rural banks and financial institutions</u>

Urban based microfinance institutions need to be given incentives to go into rural communities and assist with provision of cheap credit. Mechanisms to encourage banks to invest in rural communities should also be tried. For instance, recently, the governor of the Reserve Bank, Dr Tsumba, issued a statement urging banks to channel some of their resources into the rural sector. This could be followed up with an incentive structure which recognizes that, given the potential losses, a bank would still be motivated to try.
Special incentives must be provided for initiatives such as the CBZ community bank programme which has taken banking to low-income urban communities. Economic reforms encouraged competition although to a limited extent (due to the legal framework) and this led to new entrants on the market. The sector was able to increase more deposits. However, there was no evidence of new entrants going into hitherto unserviced communities such as rural areas.

The high interest rates which have prevailed due to the unstable macroeconomic environment, the high budget deficits maintained by government over the period, have made the cost of borrowing prohibitive for most SMEs and other economically active low-income groups.

Financial sector liberalisation did not change the attitudes of formal institutions towards risk. They continued to insist on availability of collateral security as the basis for advancing credit. This alone has precluded many potential poor borrowers. Even the Small Business Units (SBUs) which were set up primarily to target SMEs, have not been able to reach out to many.

There was no strategy at national level to deal with the challenges which were likely to be posed by the liberalisation of the financial sector. Instead, there emerged a new industry, the microfinance sector, which was a response to the failure of the market to serve the needs of those on the lower end of the scale. But without a national policy to support this initiative, most MFIs had to resort to the donor community to get the financial support they needed to lend out to disadvantaged communities. But donor funding is not sustainable and is not always readily available as Zimbabwe has learnt. There is a fundamental anomaly that a financial market that has emerged and is better able to serve the poor receives little or no support from the key players in the economy, government and private sector. Microfinance is like a parallel market instead of being integrated into national development policy.

8. CONCLUSION

In conclusion, the experience of Zimbabwe with financial liberalization suggests that there is a need to develop strategies which will cater for the development needs of some groups within society and that the market by its nature, cannot be relied upon to perform such a role. People's financial markets, now embodied in the emerging and growing microfinance sector need to be supported by national governments, private sector and the donor community. These are markets which can grow and actually, their clients also tend to grow to a level where in fact, they become eligible for formal bank lending. This interrelatedness of formal and informal or developed and underdeveloped markets needs to be recognized and nurtured.

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