

THE LIMITED IMPACT OF FINANCIAL SECTOR REFORMS IN ZIMBABWE

Charles Harvey

Summary

The post-independence Zimbabwe government did not interfere significantly with the operations of the banking system, despite the existence of a large government-owned commercial bank, and a commitment to socialist ideology and to reducing inequality. The government regarded the commercial banks as an integral part of the modern business sector, whose privileges it did not dare to attack for fear of outflows of capital and skilled labour. The commercial banks appeared to have kept pressures for corrupt lending within manageable limits, despite the widespread corruption elsewhere in the public sector.

Financial liberalisation achieved very little. Financial ratios declined during the 1980s, and this was not immediately reversed. The authorities did not licence indigenous commercial banks, despite extensive political pressure for the growth of African-owned businesses. Although locally-owned non-bank financial institutions proliferated, they did not lend significantly to small businesses. However, revised banking legislation was long delayed and bank inspections were not allowed under the existing banking laws, so licencing of indigenous commercial banks would have been premature. Competition increased among expatriate commercial banks, but mainly for corporate business so that it had little impact on retail banking services.

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1. Introduction

In most African countries² at the time of independence, there was no central bank and banking was dominated by foreign-owned commercial banks. After independence, new governments embarked on financial sector reform. This took a variety of forms, including nationalisation of foreign-owned banks, creation of new government-owned banks, and the use of a wide variety of instruments intended to alter the direction of bank lending and to increase the supply of longer term finance. The fundamental objectives were increased lending to Africans and African-owned businesses, including more long term lending, to correct the perceived bias of bank lending in the colonial period. The consequences of these interventions were frequently perverse, even in terms of their own objectives, and caused in the worst cases massive bad debts and insolvency [Harvey, 1991]. This made it very much more difficult to achieve the objectives of financial liberalisation, widely adopted as part of structural adjustment programmes in the 1980s and 1990s.

Only some of these generalisations concerning post-independence intervention fit the case of Zimbabwe at independence in 1980.³ By 1980, Zimbabwe had long had a central bank, and had a much more sophisticated financial sector than nearly all other African countries. After independence, remarkably little changed. The government did buy a majority share in one of the foreign commercial banks, and a minority share in a new foreign bank, but did not use its position in these two banks to influence their policies. They were allowed, indeed required, to be managed on commercial principles. The other foreign banks were not nationalised, and no new government-owned commercial banks were created.⁴

There was some pressure from the government on all the commercial banks, to lend on non-commercial criteria. However, this pressure was not significantly greater on the banks in which the government owned shares, and was apparently contained within manageable limits. The government did not direct the banks to lend to particular sectors or categories of borrower. The government did, however, retain its existing de facto degree of control over

¹ This paper considers only formal sector financial institutions, with the main emphasis on commercial banks.

² Anglophone Africa; this research project does not cover francophone or lusophone Africa.

³ Rhodesia made a Unilateral Declaration of Independence (UDI) in 1965, but this merely continued the status quo of minority government by white settlers; the banking system had always served the white settler minority and continued to do so after UDI.

⁴ The only other significant incident was that two American banks closed their representative offices in Zimbabwe in 1983 and 1984, having failed to get full banking licences.

the direction of credit through tight control over foreign exchange allocation. It also put pressure on the commercial banks to provide mobile bank services to rural areas; and interest rates were strictly controlled. The activities of the stock exchange were severely limited so that the number of brokers fell sharply, but the exchange did manage to survive. No locally-owned commercial banks were licenced. A new development bank (ZDB) was created, but the government only owned 51%; government deliberately maintained a low profile despite its majority position, as this was believed necessary to attract donor concessional finance; as a result, ZDB remained relatively independent of government influence [Maynard 1992: 251].

Overall, the banking system survived the post-independence period relatively well. Major rehabilitation of individual banks was not necessary, therefore, when the authorities embarked on structural adjustment and financial liberalisation in the 1990s; on the other hand, the system lacked effective competition, and had many of the negative characteristics of oligopoly.

The relative absence of government intervention in the financial sector after independence, especially the low degree of government ownership, was particularly remarkable, given the circumstances in which the new government assumed office in 1980. Government support derived from a majority of the black population, which was predominantly rural, self-employed and very poor. The people had supported the government party through a civil war, at great cost to themselves, in the expectation that victory would result in dramatic improvements in their lives - by removing the discrimination from which they had suffered under white minority rule. Bias against Africans in the allocation of credit was perceived to be part of that discrimination. In addition to these obvious political pressures to make changes in the banking system, the new government was strongly socialist in its ideology, describing itself officially as Marxist-Leninist. It was, therefore, naturally inclined to use centralised controls to manage the economy.

An important objective of this paper is to establish, if possible, why so few changes to the ownership of banks were made after independence in 1980, why the commercial banks (especially those owned by the government) managed to avoid or at least contain political pressure to lend on non-commercial grounds, why there was no sectoral direction of credit, and why no new African-owned commercial banks were licenced. Secondly, the paper investigates whether this made financial liberalisation easier, and whether the financial system was therefore able to provide the services needed to make a success of the structural adjustment programme launched in 1990.

The unusually early and extensive development of the financial sector in Zimbabwe is

described in Section 2. Section 3 then provides some explanations as to why so few (direct) changes were made to the financial system after 1980; banking continued much as before, with financial institutions remaining sound. There was no increase in competition, however, and financial deepening did not occur; on the contrary, ratios of money to GDP declined (Section 4). However, although the Zimbabwe financial system needed less radical reform in the 1990s than in countries which had, for example, badly decayed commercial banks, those reforms which were introduced had little effect: there was almost no increase in competition among commercial banks (other than that created by the takeover of one foreign bank by another) because the only new entries were non-bank financial institutions, and changes in interest rate policy did not appear to have their intended effects (Section 5).

2. Background: financial sector development before 1980

Zimbabwe was de jure a colony prior to 1980, but the white settler government always enjoyed a much greater degree of de facto independence from Britain than other colonies in Africa, including control over the police and the army. This was the case from the start of white settlement, and therefore long before the Unilateral Declaration of Independence (UDI) in 1965.

As concerns the financial sector, commercial banking was initially foreign-owned, as elsewhere in Africa. In other ways, however, the financial sector was more developed and more varied at an early stage. The country had a relatively sophisticated range of financial markets and institutions, which began to develop before the 1960s (the decade of African independence), and therefore many years before Zimbabwe's full independence in 1980.

A stock exchange opened as early as 1946; by 1963 there were thirteen brokers, and 98 quoted shares.⁵ Treasury Bills were first issued in 1952, enabling banks to acquire local liquid assets and providing the government with budget finance from funds which had previously been in foreign bank balances. A central bank was established in 1956 (against the advice of the Bank of England) for the Federation of Rhodesia and Nyasaland, of which Zimbabwe (then Southern Rhodesia) was the dominant member. The motivation was not, as with the later establishment of central banks in other African countries, a belief that a central bank would in some way redress the lack of credit for Africans, but a "desire for greater monetary autonomy and a recognition of the waste involved in a 100 per cent foreign exchange coverage against local currency" [Sowelem,1967: 30]. Two accepting houses were established in 1956 soon after the foundation of the central bank; and two discount houses

⁵ Note that there were three regional stock exchanges providing finance for mining from 1895, but they closed in 1924. The exchange which opened in the capital in 1946 was a national one.

were established in 1959. When the Federation broke up in 1963, the central bank simply changed from being the Bank of Rhodesia and Nyasaland to become the Reserve Bank of Rhodesia.

By 1960, therefore, Zimbabwe had both a variety of financial institutions, and established markets in government paper and equities.⁶ This did not, however, result in financial deepening, as measured by the ratio of money supply to GDP. This ratio declined between 1954 and 1963 from 27% to 21%. On the other hand, commercial bank lending increased slightly as a percentage of GDP, from 9% to 11%. What happened was that the commercial banks were able to increase their lending, despite their failure to mobilise increased deposits, by running down their balances with overseas banks (mainly their own overseas head offices).

Some financial deepening did occur after 1963: the ratio of the money supplied to GDP (measured on the same basis as above) rose to 35% in 1980. While it was possible before UDI to use foreign resources to increase bank lending, this was no longer possible afterwards. The foreign balances previously accumulated by the domestic commercial banks were exhausted by 1960; and during the UDI period, borrowing abroad other than from South Africa was subject to sanctions. As a consequence, the commercial banks had to rely much more than previously on domestic resource mobilisation. This was made relatively easy because the government imposed stringent exchange controls to prevent capital flight. Evidence from other countries is that exchange controls on capital movements are usually only effective in the short run; eventually, people find ways to evade them, especially if they are considered to be unreasonable and unfair. The situation in pre-1980 Zimbabwe was that UDI had generated a degree of patriotic support among the white population. As a consequence, exchange controls were probably evaded less than in most countries, at least at first, contributing to the mobilisation of deposits by the banks.

3. The relative lack of banking reform after independence

3.1 Limited intervention after independence, despite socialist objectives

As already noted in the introduction, the newly elected government of ZANU (PF) made relatively few changes in the banking system after independence, less than might have been expected in the circumstances. The government derived its support from the African population, which had a strong sense of having been excluded from access to modern

⁶ The government issued longer term paper in addition to Treasury Bills, but this was nearly all held by official agencies and there was almost no trading on the Stock Exchange [Sowelem, 1967: 167-77].

services, including credit. Moreover, the government took office espousing a socialist ideology: "In ideology, ZANU is guided by the Marxist-Leninist principle. ZANU aims to achieve a socialist revolution. All the means of production and distribution will be publicly owned by the people of Zimbabwe."⁷ The Transitional National Development Plan [1982:1] reaffirmed this policy: "Lasting economic and political stability.... requires.... a deliberate and sustained process in the direction of social ownership of the means of production, equitable distribution of income, and popular participation in the management of development." However, the Plan had few specific proposals for implementing a socialist strategy, and Mugabe gave "...assurances to the white population and business community that any changes in policy will be implemented on a gradual basis" [Barclays Bank, 1990:1, quoted in Maynard, 1992:100].

With these conflicting pressures on the government, it was caution which predominated. Implementation of the government's socialist ambitions was very limited. Some new parastatals were created, but there was no widespread nationalisation. As early as 1984, an economic policy document from the ruling party congress made no mention of nationalisation.⁸ The financial sector received very little attention, and the commercial banks none, in the early development plans and other major statements of government economic policy. In 1981, the government said it would encourage savings institutions to extend services to rural areas; it also said that it would create a National Development Fund [Government of Zimbabwe 1981: 14-15], but this was not implemented. In both 1982 and 1983, a Money and Finance Commission was proposed, but this too was not implemented [GoZ 1982: 45; 1983: 22]. By 1986, financial sector reform was no longer on the agenda: the First Five-Year National Development Plan made no mention of it [GoZ 1986].

The limited increase in public ownership of banks, that did occur after independence, was not therefore apparently implemented in order to increase government control over resource allocation. Nor apparently was it done in order to divert credit to parastatals, using planning rather than commercial criteria, as occurred in some African countries.

The government bought 62% of the Netherlands Bank of South Africa (Nedbank), leaving the remainder in local private ownership. The price paid was 91% of the current share price on the stock exchange, which was said by a Nedbank official to be "very fair"; the remaining

⁷ Quotation cited in Maynard [1992:99], from an official ZANU statement in 1980. In 1984, Mugabe was still making speeches saying that the government would introduce full-blown socialism when it had achieved a one-party state, which was not legally possible until 1990 under the independence agreement with Britain. By 1990, Mugabe still wanted a one-party state, but was in a minority on this issue within the ruling party [EIU 1984/3].

⁸ ZAPU (1984) "Towards economic prosperity" cited in EIU 1984/4.

shares continued to be quoted on the local stock exchange as Zimbank.⁹ The reason for this transaction appeared to be more that the foreign owners wanted to withdraw, and that the government wanted to maintain confidence in the banking system, than because government wanted to control a commercial bank as a way of altering the structure of bank lending. This is further supported by subsequent policy towards Zimbank (see section 3.3 below).

The government also bought a 47% share in a new commercial bank, BCCZ, in partnership with an international bank, BCCI, which held the other 53%. Purchase of a large minority shareholding seems to reflect quite well the government's ambivalent attitude towards the private sector and foreign ownership. The government was prepared to leave the existing commercial banks in 100% foreign ownership, but was not willing to allow a new entrant the same ownership status. This policy continued into the 1990s (see section 5 below). When BCCI failed in 1991, the government bought the remaining shares, changing the name to Commercial Bank of Zimbabwe (CBZ). This somewhat accidental nationalisation was consistent with the de facto policy on public ownership after independence, namely that the government bought failing companies, mostly through the Industrial Development Corporation, in order to prevent closure and to preserve jobs. The government did not set out to nationalise companies from any strategic commitment to socialism and public sector ownership. CBZ lost some deposits when BCCI failed, and had to write off most foreign balances and items in transit. However, the central bank did a 12 day/12 person audit and issued a statement giving the bank a clean bill of health. The Minister of Finance also gave full support, senior management visited large clients in order to reassure them, and the bank advertised extensively. In the end, the bank lost a few clients only, with negligible impact on its operations. The confidence necessary for the bank's survival was helped by its being in government ownership.

3.2 Reasons for limited intervention in banking after 1980

The main explanation for the relative lack of intervention is that the government was wary of attacking the interests of the white business community, of which the commercial banks formed an important part. Zimbabwe was exceptionally vulnerable to a loss of white confidence. The economy had at independence in 1980 a very much more developed modern sector than nearly all other African countries. Because of the history of discrimination against African advancement, this modern sector was still almost entirely owned and managed by whites. For example, some 88% of marketed agricultural output came from

⁹ The sale took place on a willing buyer willing seller basis; the government's shareholding was later diluted, at first to 58% and later even further. By 1993, the government's share of Zimbabwe Financial Holding Limited, which held 100% of Zimbank, was reduced to 49.6% because government took up only 53% of a rights issue; however, some shares were held by parastatals [Finhold Annual Report 1992/93].

white-owned farms, which also accounted for between one third and one half of exports and 35% of formal sector employment. The manufacturing sector, which was an unusually high proportion of GDP (about 25%), was also mainly owned and managed by whites; moreover, much of it was dependent on the white-owned farms, because it processed locally produced agricultural raw materials.¹⁰

The new government was acutely aware, because of the relative lateness of independence, of the economic cost of inappropriate intervention. By 1980, it was very obvious that several economies in sub-Saharan Africa, including the Zambian economy immediately to the North for example, were in severe decline, and it was believed that inappropriate government intervention was the main cause.

Even more to the point, Mugabe, and many of his government colleagues, had spent the previous five years in Mozambique. Mugabe in particular had been deeply impressed by the devastating effect on the Mozambique economy of the departure at the time of Mozambique independence in 1975 of some 90% of the white population.¹¹ By all accounts, he was determined to prevent anything similar happening in Zimbabwe. The ZANU (PF) Manifesto for the independence election talked of socialist transformation, but also said that it would "recognise historical, social and other....practical realities....[including] the capitalist system....private enterprise will have to continue." It has also been argued that the IMF and the World Bank were influential in arguing against socialist economic policy; Zimbabwe borrowed from the IMF shortly after independence, and although relations between the IMF and the government broke down fairly quickly, the World Bank continued to lend throughout the 1980s and therefore to have some influence on policy [Stoneman 1989: 41].

A further factor restraining the new government from attacking the privileges and property of the white population was the risk of provoking intervention by South Africa. There was already in 1980 considerable evidence that these fears were justified. In the 1970s, the South African government pursued an active policy of destabilisation in countries to the North. Military support for opposition parties in the civil wars of Angola and Mozambique was very damaging. It forced a large number of countries to become almost wholly dependent on South African railways and ports, by preventing the use of Angolan and Mozambican transit routes. This policy continued after 1980, and was accompanied by more direct forms of

¹⁰ Over half of marketed agricultural output came from 10% of settler farms, so urban food supply, inputs to manufacturing, exports and employment all depended to a marked degree on a very small number of white-owned and managed large farms.

¹¹ President Machel of Mozambique was invited to speak at a Central Committee meeting in Maputo shortly before Zimbabwe's independence and his "... voice of moderation and pragmatism was decisive" [Smith and Simpson, 1981: 167 cited in Muzulu 1993: 100].

intervention in Zimbabwe itself. Most significant was support for violent opposition to the government in the South West, but there were a number of other attempts at destabilisation, including disinformation (large numbers of letters and anti-government leaflets in 1983 and 1984), assassination of South African liberation movement leaders in Zimbabwe, attempted assassination of Mugabe and other members of the Zimbabwe government in 1981, and attacks on military installations in 1981 and 1982 [Chimanikire 1990: 7-8; Hanlon, 1986]. Although these actions did not succeed in bringing down the new government, the government had good reason to fear in 1980 that intervention might have been greater, with more serious consequences. The most important likely cause of intervention was support for South African ANC personnel; Zimbabwe did allow an ANC presence but not the more provocative provision of training bases. However, intervention might also have been provoked by attacks on white economic interests.

A further reason, possibly the most important, for the lack of interference with banking after independence was that the new government inherited a highly developed system of economic controls from its predecessor. These controls were established during the UDI period, in response to international economic sanctions, and were further tightened during the five years prior to independence, when the civil war intensified.

Controls inherited by the new government included stringent control over the allocation of foreign exchange. There was a relaxation of control over foreign exchange immediately after independence, but the rapid growth of imports was unsustainable. It was based heavily on short term foreign borrowing on commercial terms [World Bank 1985: 3], which in turn caused the external debt service ratio to rise from 2.6% in 1980 to 24.6% in 1983. The government's response was to intensify import and foreign exchange controls. They remained in place, with degrees of severity which varied only marginally according to the short term availability of foreign exchange. An important side effect of control over foreign exchange allocation was that it provided de facto control over the allocation of credit. The allocation of foreign exchange to a producer effectively guaranteed profitability. Any firm unable to get foreign exchange was probably uncreditworthy, and would not have required credit because without a foreign exchange allocation it would have been unable to expand production. Directed credit was therefore unnecessary; exchange controls provided the government with effective control over most of the economy, for the purposes of both economic management and political control.

However, this power was not used in general to alter the economic structure inherited at independence.¹² Foreign exchange allocation was considerably less arbitrary than in other

¹² For example, it was said that even parastatals such as the Industrial Development Corporation and its

African countries with stringent exchange controls. Established users of foreign exchange got regular shares, and could apply ad hoc for extra allocations. Entry to the allocation system could be achieved by demonstrating net saving of foreign exchange. Successful ad hoc applicants could apply for regular status. Import licences went automatically to those allocated foreign exchange [Davies 1991]. The system gave some degree of certainty to producers, although cuts were periodically implemented at short notice across the board, because of fluctuations in foreign exchange availability. There were conflicting reports on foreign exchange allocation to emergent black businessman. On the one hand, they were said to receive preference; on the other hand, the bias towards established businesses made it difficult for new businesses to get established. Whatever preference was given, it was not on a scale sufficient to make a significant difference to the structure of ownership in the modern sector of the economy.

3.3 Post-independence policy towards government-owned commercial banks

The argument that the government's purchase of shares in Zimbank was not part of a socialist economic policy is consistent with subsequent government policy towards it, and with the policy of not nationalising the other large commercial banks. Zimbank was expected to be managed as a commercial enterprise, and was apparently treated by the authorities in much the same way as were the other commercial banks. Directors and senior managers tended to be appointed from the private sector; this contrasted with common practice elsewhere in Africa, where senior politicians and civil servants were appointed to be directors and managers of parastatal financial institutions. The banking business of non-financial parastatals had always been shared out among the commercial banks, and this practice continued after the government acquired a majority holding in Zimbank. For exceptionally large parastatal loans, credit was provided by a consortium of commercial banks, in which Zimbank played its part but not a disproportionate part. Generally, policy in Zimbabwe was to finance parastatal deficits from the central government budget or from the issue of marketable bills (as for the Agricultural Marketing Authority) [Government of Zimbabwe, 1989: 30].

These policies meant that Zimbank's solvency was not threatened by acquiring an excessive proportion of doubtful loans to loss-making parastatals. Such lending to parastatals as did occur was backed by explicit written government guarantees which were not called upon, but which were regarded as adequate by bankers. In this context, it is worth noting that Zimbabwe always met foreign debt service in the 1980s. This was an important part of a

subsidiaries were not given priority in the allocation of foreign exchange, although there was some disagreement on this point.

policy of building up a good financial reputation, and gave credibility to government guarantees on parastatal borrowing from the domestic banks. Zimbank did have responsibility for the banking requirements of the Posts and Telecommunications Corporation, which was expensive because large amounts of cash had to be transported around the country, including to remote areas, to supply the needs of Post Offices and the Post Office Savings Bank. Overall, Zimbank remained profitable, although possibly less profitable than if it had remained in the private sector. Its capitalisation was lower than that required by international standards: in 1993, shareholders' funds were 5.4% of risk assets, less than the other large commercial banks in Zimbabwe, and less than the 8% international standard set by the Basel Committee.

The question remains as to whether Zimbank was pressured by the government, using its power as majority shareholder, to lend to politically influential borrowers, and to allow them to avoid repaying their loans.

Prima facie, one would expect this to have happened. From the mid-1980s, there were innumerable reports of corruption in Zimbabwe. According to one report, corruption had been endemic since UDI in 1965 when secrecy became a patriotic duty, and was therefore tolerated officially to some extent [EIU, 1989/1]. During the 1980s, corruption increased (or possibly more of it became known) to the point where it became a major political issue, taken up by opposition parties and the subject of student and trade union protests.

Perhaps the best known example was the Willowvale scandal, which was exposed by a newspaper in Bulawayo in 1988. It involved the allocation of locally assembled cars to government ministers, who were able to resell them immediately for twice or more of what they had paid because of the extreme shortage of foreign exchange for imported cars. Another more recent example was the allocation to cabinet ministers of white settler farms which had been purchased compulsorily by the government for the land resettlement programme, and which were therefore officially intended for poor landless people from rural areas. Many other incidents of corruption became public.¹³ This happened even though much of the press in Zimbabwe was government-owned. The press retained some independence, and individual editors and journalists were undoubtedly courageous in the face of periodic government persecution. Nevertheless, it seems probable that far more corruption

¹³ Between 1985 and 1995, allegations of high level corruption were made against, inter alia, Air Zimbabwe, Affretair, the Army, Central Mechanical Equipment Department, DTZ, Metal Marketing Corporation of Zimbabwe, the Ministry of Education, the Ministry of Transport, the Ministry of Youth Sports and Culture, the Police (of 177 convictions for corruption between 1980 and 1988, one third were police officers), Posts and Telecommunications Corp., the Stock Exchange, Zimbabwe Inter-African News Agency, Zimbank, Zimbabwe Railways, Zimbabwe Congress of Trade Unions, and ZISCO [Economic Intelligence Unit Country Reports: various].

existed than was reported, either because those involved managed to keep it secret or because the government managed to prevent it being published in the press.

There were some instances where people were convicted, including a few cases of senior politicians, but there appeared to be many more examples of failure of the government to act against those implicated. There were also instances of convicted people being released immediately after conviction, and in some cases reinstated [EIU, various]. A leadership code was established in 1984, and strengthened in 1986, but it was widely ignored. Allegedly, Mugabe was unable to enforce it; too many of his senior colleagues were in breach of the code. Some of them openly said that they would resign if the code was enforced, because it set limits on their ownership of farms and businesses. In the 1990s, it was reported that the political system was becoming increasingly corrupt, and that the courts only occasionally convicted minor figures [EIU 1995/4].

Such a situation, where government's political and administrative powers were widely used to divert resources to politically powerful people, was exactly one in which corruption would be expected in government-owned banks, in both the allocation of loans and in allowing their non-repayment. If politically powerful people were using the opportunities created by government control over scarce resources to enrich themselves, it was extremely likely that they would try to use ownership, and therefore control, over Zimbank as one of the instruments of this corruption. Such evidence as there is from elsewhere in Africa suggests that government-owned banks suffered from this form of corruption extensively, and in some cases overwhelmingly.

It is in the nature of such activities that evidence is seldom available, unless a major scandal is uncovered, and this leads to an official inquiry or a court case. Direct questioning normally results in simple denial. Moreover, the existence of loans on which interest and capital repayments are not being made can be indefinitely concealed, if bank supervision is inadequate as it was in Zimbabwe. Banks can simply record such loans as assets, and add unpaid interest to the balance sheet value of the loans.¹⁴ This practice should be uncovered by central bank supervision. However, the banking act in force in Zimbabwe since 1965 made no provision for the inspection of commercial bank files. On the contrary, for the banks to have allowed any such inspection was illegal, because it would have been a breach of their duty to maintain customer confidentiality. Bank supervision consisted of calculating ratios from statistical information supplied by the banks, without the supervisors having any means of checking its accuracy. There was, moreover, nothing in the legislation as to how

¹⁴ "It is not uncommon for the true level of non-performing loans to be some eight times larger than those which banks own up to in their published accounts" [Roe 1988: 4, citing Long 1987].

overdue debt service should be measured, nor how it should be treated in banks' accounts.¹⁵

Any assessment of the extent, if any, to which the commercial banks participated in the widespread corruption in Zimbabwe has inevitably, therefore, to be based on unconfirmed newspaper reports and other sources of rumour. There were relatively few reports of banking corruption. In 1990, Zimbank was accused of having Z\$80 million (then US\$32 million) in unsecured overdrafts, mainly to bogus companies; it was also alleged that police officers assigned to the case resigned and were employed by Zimbank [EIU 1990/4: 12]. In 1993, there was a report of a "six-year old scandal [concerning Zimbank] which implicated one of the country's two vice-presidents and several other ministers in dubious financial deals in Bulawayo" [EIU 1993/1]. These were the only references to corruption in the commercial banks in EIU reports.¹⁶

Other sources (mainly interviews), indicate that there was some pressure for commercial banks, not only Zimbank but also the other commercial banks, to lend to prominent people and for those borrowers to avoid repayment. Bankers interviewed tended to say that there had been no government interference in the direction of their own lending, but that other banks had been subject to pressure. There was, however, some implicit concession of banks having yielded to pressure in the past, for example in a statement that it had become easier to refuse to lend to prominent people in recent years, than it had been previously. It is also possible that the pressure on all the commercial banks, to increase their lending to small and medium scale enterprises (SMEs), was in part disguised pressure to lend to "bosses" (the popular term for senior political figures believed to be enriching themselves corruptly). This pressure increased sharply in the 1990s, and this could be because it became harder to pressure banks to lend to particular individuals.

Concerning BCCZ (the predecessor of Commercial Bank of Zimbabwe), it was alleged that the granting of a licence was the result of improper lobbying of politicians by the parent bank (BCCI). It was also alleged that BCCZ used political lobbying to obtain parastatal deposits. If true, this would have made it likely that BCCZ would also submit to pressure to lend improperly, possibly in return for political favours already received. However, the bank's soundness when the international parent bank failed, as attested by the Reserve Bank audit at that time, suggests that any corrupt lending which did occur had also been kept within

¹⁵ The government began preparing new banking legislation in about 1991, but it had still not been enacted by the end of 1995. The delay was caused initially by a dispute as to who should administer the act between the Ministry of Finance and the Reserve Bank of Zimbabwe. Agreement was reached in 1995, but enactment was further delayed by the act having to queue for parliamentary time.

¹⁶ It appears that neither of these cases was followed by an inquiry. There were (unconfirmed) rumours in 1996 that Zimbank was in trouble over \$300 million of loans to a small number of clients [personal communication].

manageable limits.¹⁷ When government bought the foreign shareholding of BCCZ, it appointed a chairman from the private sector who made it a condition of accepting that there would be no pressure to lend to people favoured by the government. This agreement was said to have been kept. Moreover, there were reports in 1995 that government planned to sell some or all of its shares in CBZ, which would be a further indication that government ownership was undertaken in order to sustain the bank's operations, rather than as a step towards directed lending.

Overall, while it is inherently impossible to be certain, it would appear that some "political" lending did take place, but that the amount was never large enough to threaten the solvency of the commercial banks. It would also seem that such pressure has diminished, partly perhaps because of the greater emphasis on market forces since the economic and structural adjustment programme (ESAP) which started in 1991.

It is worth noting that the scale of losses arising from non-commercial lending to individuals and their businesses, although large in terms of individual wealth, was likely to be less than the scale of losses incurred by lending to major loss-making parastatals, some of which can be large in macroeconomic terms.¹⁸ The figure of Z\$80 million, mentioned above in relation to Zimbank, compared with profit before tax in 1990 of Z\$33 million, and shareholders' funds of Z\$87 million. If the entire total of Z\$80 million alleged to be improper lending had had to be written off in that year, it would have made Zimbank unprofitable, but not insolvent. Given more than two years to write off that amount of bad debt, Zimbank could have absorbed it out of profits without having to draw upon reserves. To the extent that some of the amount mentioned was recoverable, the problem would have been smaller.¹⁹ In other words, at worst it would have been very serious, but not devastating in the way that lending to loss-making parastatals rendered government-owned commercial banks insolvent in several countries in Africa [Harvey, 1993a: 11].

While these calculations are very speculative, they do tend to support what was suggested above, namely that political interference with the lending of CBZ and Zimbank was contained within manageable limits. It seems unlikely that pressure on the other commercial banks was as great, given that they all remained in majority private sector ownership, and with one

¹⁷ Note, however, that Reserve Bank of Zimbabwe personnel lacked any experience of assessing the quality of the loan portfolio of a bank.

¹⁸ For example, lending by the main government-owned commercial bank in Tanzania to the crop marketing parastatals to finance their operating deficits peaked at some 64% of its total lending in 1987 [Collier and Gunning, 1991: 533].

¹⁹ The unconfirmed rumour that Zimbank might have Z\$300 million of doubtful debts in 1996, see above footnote 16, was of roughly the same order of relative magnitude, as a proportion of annual profits and shareholders' funds.

exception were 100% private sector owned. However, the amount of unsound lending on commercial bank balance sheets could not be known with even the limited degree of certainty which would have been possible from central bank inspections, because the latter were not done.²⁰

There were other factors which may have played a part in "protecting" the commercial banks from more government interference than actually occurred. The Reserve Bank of Zimbabwe, the central bank, had been established for 24 years prior to independence in 1980. This contrasts very markedly with the experience of most other African countries. As noted in section 1, post-independence attempts at reform of the banking system were undertaken at a time when most central banks had only just been created, and were thus in a weak position to defend the banking system from government interference. The Zimbabwe banking system enjoyed the backing of a central bank with experienced staff, an established reputation and a long history of commitment to market principles. In addition, by 1980 the general climate of development opinion had already shifted to support for market-oriented policies, whereas when most African countries became independent in the 1960s, world opinion was much more favourable to centralised development planning, and a dominant role for the public sector. However, although the strength of the Reserve Bank of Zimbabwe was significant, it apparently only played a supporting role to the general unwillingness of the government to risk an exodus of skills and capital from the large-scale modern sector of the economy.

The Reserve Bank's regulatory role was very little assisted by the banking legislation. As elsewhere in Africa, banking law was enacted at a time when all the commercial banks were foreign-owned, and were subsidiaries of large international banks. Prudential regulation appeared, therefore, to be unnecessary. The 1965 Banking Act contained no provisions on insider lending, nothing on the maximum ratio of shareholder funds that could be lent to any one borrower, no definition of risk assets nor therefore of the amount of capital required to support bank lending, and no provision (as already noted) for the inspection of banks except where a case could be made for an inquiry into fraudulent or other criminal activity.

There was a further factor protecting the commercial banks from having to make loans against their commercial judgment, which could have led to the accumulation of bad debts. The banks were under relatively little pressure in the 1980s to lend to Small and Medium-scale Enterprises (SMEs). There was some pressure from the government from about 1984 to get more involved with the black African business sector, which meant largely retailing and

²⁰ The central bank issued guidelines on provisioning for doubtful debts in May 1995. It was reported that in 1995 that the banks were complying because they expected the requirements to become law, and because they perceived it was in their long-term interest.

farming. The large commercial banks, including Zimbank, did respond, but in a relatively limited way. It would be going too far to describe their responses as public relations exercises, but they did not result in significant increases in such lending.²¹ Partly this was because small business and small farm lending was catered for by specialised institutions set up with donor and government finance, and by direct lending by some (mainly international) NGOs. Partly it was because political pressure was greater for the provision of rural branches and mobile bank agencies; this did provide savings and money transfer facilities, but expectations of rural branches providing increased rural credit were unrealistic. And partly it was because the rural population's support for the government was sustained by large increases in the coverage of health and education services, and by effective support of consumption levels during droughts; this reduced the political need for more rural lending. Much of the SME lending that did take place was made easy by foreign exchange allocation, which ensured that "emergent black businessmen" receiving foreign exchange would be profitable.

Of these factors, arguably the most significant was the "ring-fencing", in specialised institutions, of the lending to indigenous small farms and businesses that the commercial banks might otherwise have been forced to undertake. Lending to agriculture was mainly undertaken by the Agricultural Finance Corporation (AFC), which was originally established to provide credit to white settler farmers. Its lending was extended in the 1970s to include loans to small scale African commercial farmers to whom the government granted freehold tenure in specially designated areas. After independence, the AFC further extended its lending to African farmers in the communal lands, on a big scale. There was an extremely rapid increase in the number of borrowers, for example from 4400 in 1980 to 70,000 in 1984. Although this still covered only a minority of the estimated 850,000 farming households, it was on a large enough scale to relieve the commercial banks of virtually any responsibility for such lending.

The credit needs of small and emergent businessmen were largely ignored until 1979, when the UDI government set up (very belatedly) a new parastatal financial institution, the Development Finance Company (DFC). Political pressure to lend quickly to large numbers of people, and to politicians themselves, overwhelmed the proper selection and administration of loans. Arrears quickly accumulated. So far, the story was similar to that of many similar development finance institutions in Africa. Unusually, remedial action was rapid. New lending was stopped in 1981, the board of directors was forced to resign, and

²¹ The banks would no doubt have argued that they were reaching all or most of the creditworthy SME borrowers, and indeed that extending their lending could only be done slowly because it could not be undertaken successfully without first getting positive results from the training and extension programmes that some of them established.

administration was taken over by the Industrial Development Corporation (IDC). Although debt service payments improved, DFC continued to make losses. It was wound up in 1985, although IDC continued to collect arrears. Its functions, and some assets, were transferred to a new organisation, the Small Enterprises Development Corporation (SEDCO) which began operations in 1984 [Maynard 1992: 241-2; IDC Annual Reports].

SEDCO was much better managed than DFC, setting out explicitly to avoid the latter's mistakes. Nevertheless, its profitability depended on the provision of concessional finance, and an annual government grant for administrative expenses.²² The grant also paid for the cost of extension work (provision of business advice to borrowers), and of short training courses for borrowers. These were developed because SEDCO could not find enough viable projects initially (as was common with similar institutions elsewhere), and were maintained as a way of improving the quality of applications and subsequent performance.²³ By the late 1980s, although some 70% of applications were being rejected, SEDCO could not finance all the borrowers it considered viable. Excess demand for loans was increased when politicians gave widespread and very public advice to would-be borrowers to apply to SEDCO. The resulting flood of applications initially created a large backlog, and affected the screening process, but charging a fee for application forms reduced applications to a manageable volume. Overall, SEDCO was able to meet a significant proportion of demand, so that it was plausible for the commercial banks to refer small business borrowers to SEDCO. Significantly, SEDCO recognised that pressure on DFC to lend to politicians had been a problem. SEDCO therefore set up a "managed fund" of Z\$500,000 in 1984 for such loans, intending that if the government put pressure on SEDCO to lend against its commercial judgment the loans should come out of this fund. The fund was financed directly by the government, so that the government would see that it was paying for non-commercial loans directly. In practice, it was said there had been no calls on this fund for its original purpose, which had therefore been used for seven very high risk projects, four of which survived.

A second facility, the Credit Guarantee Company (CGC), was set up by the Reserve Bank, with later participation by the commercial banks and a government-owned development bank.²⁴ The commercial banks provided the credit, and administered the loans, with applications vetted by both the banks and the CGC. In the 1990s, lines of credit at 5% were available to SME borrowers from CGC, at a time when commercial bank credit was costing

²² SEDCO was unable to cover administrative costs despite a generous margin: it borrowed from government at between 9 and 11%, on-lending at 21% and 25% for rural and urban borrowers respectively.

²³ Note that the cost of extension work was kept down by using volunteer retired businessmen, receiving modest expenses only, and by a 50% contribution by the client to a fee agree with SEDCO.

²⁴ Currently the Reserve Bank owns 50% of CGC, with the other 50% held equally by 5 commercial banks and the Zimbabwe Development Bank.

as much as 39% for prime borrowers, and more for SMEs. Although of course there was excess demand for the cheap credit, many SME borrowers preferred to queue for it rather than try to get expensive credit from the commercial banks.²⁵ This further reduced the pressure on commercial banks to lend more to SMEs.

A final point is worth mentioning. It can be argued that government-owned banks, both development banks and commercial banks, are less likely to be endangered by the accumulation of bad debts from non-commercial lending, if they were previously in the private sector, or if some private sector ownership remains. Zimbank fits both of these criteria, and CBZ fits the first, which suggests that these factors may have played some part in their remaining in a relatively sound condition despite varying degrees of government ownership.

4. Financial sector liberalisation in the 1990s

The main objectives of financial sector liberalisation, which formed part of the structural adjustment programme introduced in 1991, were to remove controls over the direction of bank lending, to establish positive real interest rates, and to liberalise the licencing of new banks so as to increase competition and improve banking services. The reasoning behind these changes is well known, namely that market forces, combined with efficient financial intermediation by banks, are believed to allocate resources better than the financial repression which they replace. Secondly, increased deposits, which should be mobilised by higher real interest rates, increase the credit available from banks to support the private sector development which is the ultimate objective of economic liberalisation.

4.1 Necessary pre-conditions for successful financial liberalisation

However, the theory depends on a set of underlying assumptions that do not always hold in Africa. For example, removing controls over the direction of bank lending requires banks to lend on commercial criteria. They may not have the capacity to do this after long periods of government directed lending, or of exchange and price controls, which effectively protected borrowers' ability to service their bank borrowing. Positive real interest rates are intended to attract additional deposits into financial institutions and thereby increase financial intermediation, but this also assumes that banks lend efficiently; in some countries where banking was or is dominated by decayed government banks, attracting more deposits into those banks would make matters worse rather than better. Licencing new banks as a way of

²⁵ There was a very strong incentive for round-tripping, borrowing at 5% and depositing at over 25%, but no evidence was available as to how much was occurring.

increasing competition assumes that new banks can attract competent management, and that legislation and bank supervision are adequate for preventing fraud, and ensuring that bank failures and financial crises are avoided. Moreover, newly licenced banks may only be able to compete with established banks over a limited range of banking services.

In contrast to some other African countries, the commercial banks in Zimbabwe, including those majority-owned by the government, were mostly (as far as can be ascertained) in sound condition when financial liberalisation started. As noted above, BCCZ was something of an exception, but the new management, installed by the government when the international holding company failed, was apparently able to restore it to a sound condition without having to use government resources.

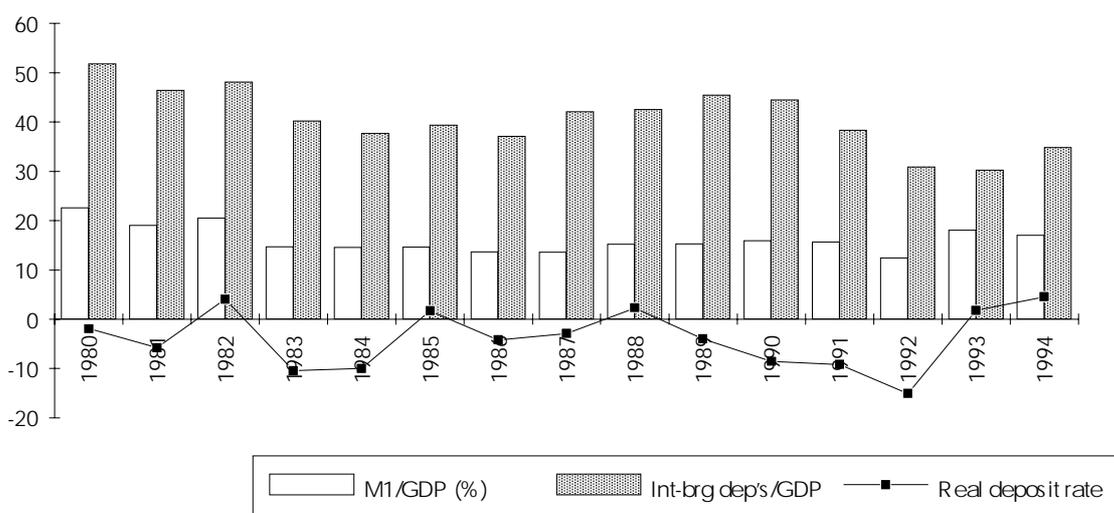
The other commercial banks seemed to have maintained the management capability necessary for lending on commercial criteria, without the support of foreign exchange allocations and price controls as a guarantee of borrower profitability. When foreign exchange allocation ended without being replaced by any alternative system of credit control, banks did not have to develop alternative commercial lending criteria from scratch. They had never relied exclusively on foreign exchange allocation as an indicator of creditworthiness. There was, therefore, a reasonable prospect of the banks being able to survive the change of policy successfully, and relatively little danger of the changes making matters worse rather than better. Most crucially, to the extent that higher real deposit rates succeeded in attracting additional resources into the banks, they had the capacity to on-lend them successfully, that is, to provide efficient financial intermediation. However, even in these relatively favourable circumstances, not all the objectives of financial liberalisation were realised.

The liberalisation of the foreign exchange market effectively removed the main instrument of official control over bank lending. Previously, as noted above, tight control over foreign exchange allocation provided de facto control over bank lending. Those allocated foreign exchange were profitable and therefore able to borrow without exposing the commercial banks to significant risk. Those not allocated foreign exchange were probably not creditworthy, and were anyway unlikely to want to increase their borrowing. It appeared, therefore, that commercial banks were able to manage this transition, although the absence of bank inspections by the supervisory authority meant that it was not possible to be certain that commercial banks were not concealing the extent of bad and doubtful debts in their portfolios.

4.2 Financial shallowing and the need for positive real interest rates

The need for positive real interest rates was less obviously apparent than in many other African countries. Between 1980 and 1991, the deposit rate²⁶ was above the rate of inflation in three out of the twelve years, and never below inflation for more than two consecutive years until the final three years (1989 to 1991 inclusive). The average gap between the deposit rate and inflation was only modestly negative, at -4.1%, and was never worse than -10.4% in any one year. This should have prevented inflationary expectations from becoming too firmly established, in contrast to Zambia, for example, where the negative gap increased steadily from -4.9% in 1980 to -117.3% in 1989, and remained heavily negative (at -85.4%) in the following year. Other African countries had similar experiences. Nevertheless, not only was there no financial deepening in Zimbabwe, but the reverse occurred: monetary ratios declined. The ratio of interest-bearing deposits to GDP fell, with some fluctuations, from 52% in 1980, to 38% in 1991 (see Figure 1).²⁷

Figure 1. Monetary ratios and real deposit rates 1980-94



Part of the explanation may be that these calculations of the "real" interest rate do not take account of the taxation of the interest paid on deposits. Because depositors were liable to different rates of tax, it is not possible to calculate the post-tax return on interest-bearing

²⁶ There were of course many different deposit rates, for different financial institutions, different types and maturity of deposit, and different banks within the same category; those quoted are from IMF *International Financial Statistics*, line 601. In 1990, for example, deposit rates ranged between 7% and 12% [Reserve Bank of Zimbabwe, 1995:S24], while *International Financial Statistics* quoted an average rate of 8.8%.

²⁷ Fluctuations in the real value of interest-bearing deposits, and fluctuations in the ratio of interest-bearing deposits to GDP, were quite well correlated with the gap between deposit rates and inflation, but this fails to explain the secular decline.

deposits. However, marginal tax on interest of between 17% and 28% would have eliminated the difference between the nominal or pre-tax interest on deposits and inflation in the three years when nominal deposit rates were higher than inflation. These were well below the higher marginal tax rates on personal income,²⁸ and the corporate tax rate.²⁹ As a consequence, real *after-tax* returns on deposits were negative for the large depositors who must have accounted for a high proportion of interest-bearing deposits. Smaller scale depositors in commercial banks, who tended to have savings accounts, received significantly lower rates than those available on the larger scale time and other deposits. Real after-tax returns on deposits with financial institutions were, therefore, negative for most depositors, despite nominal deposit rates being above inflation in some years. The exceptions were tax-exempt depositors such as pension funds.

After 1991, positive real interest rates proved at first to be more, not less, difficult to achieve, despite significant increases in nominal rates. The average deposit rate³⁰ rose from 8.8% in 1990 to 14% in 1991, and ranged between 24% and 35% thereafter. Initially, however, the rate of inflation rose even more sharply, because the currency was devalued without the budget deficit being significantly reduced. The negative gap reached a high of -15.1% in 1992. Nominal rates rose above inflation thereafter, and interest-bearing deposits as a proportion of GDP recovered with a one-year lag. It may be, therefore, that the long downward trend in monetary ratios was reversed after 1993, but several years of positive growth would be needed to be confident that financial deepening was occurring.

While negative rates of return on deposits may provide some explanation of falling ratios of interest-bearing deposits to GDP, other factors were probably also important.³¹ Crucially, there was net out-migration, mainly of the relatively wealthy white population who must have held a substantial proportion of personal bank deposits. The white population is estimated to have fallen from about 200,000 in 1980, to about 120,000 in 1985. Thereafter out-migration was much less, averaging less than 700 per year. Much of the fall in the deposit ratios occurred after 1985, but this could be explained by the delaying effect of exchange controls. Although exchange controls in Zimbabwe set low limits on remission of emigrants' savings, it is well established that such exchange controls are only effective in the short run, and may be one of the factors actually inducing capital flight [Chuka, 1992; Edwards, 1980; Williamson

²⁸ The top marginal rate of personal income tax in 1992 of 60% applied to taxable income above Z\$45000, or just under US\$7000.

²⁹ Corporate tax rates ranged between 42.5% and 58.2% during the period, with surcharges of up to 17.5% in some years.

³⁰ As in IMF *International Financial Statistics*.

³¹ Note that the ratio of non-interest-bearing deposits to GDP also fell, from 22.6% in 1980 to a low of 12.4% in 1992 (see Figure 1).

and Lessard, 1987].

4.3 The absence of increased competition: the non-appearance of local banks

Indigenous commercial banks, meaning private sector commercial banks started, owned and managed by local people or institutions, have appeared in a number of African countries including for example Kenya, Nigeria, Uganda and Zambia, yet there were still no indigenous commercial banks in Zimbabwe fifteen years after independence. This requires some explanation, because there were several factors making the appearance of indigenous commercial banks more rather than less likely in Zimbabwe.

The white settler population and white settler owned businesses may have been satisfied by their access to banking services, including credit; this could explain the absence of settler-owned indigenous commercial banks prior to 1980, when the licencing of new banks was entirely controlled by the white settler government. However, one of the principal motives for establishing indigenous banks elsewhere in Africa, was a belief that the foreign-owned commercial banks excluded black people and black-owned businesses (especially small scale businesses) from access to credit. Zimbabwe was no exception to this belief, which makes the absence of indigenous banks after 1980 particularly in need of explanation.

Secondly, as already noted, Zimbabwe's domestic financial sector developed earlier and more extensively than in most African countries. This early progress meant that, by 1980, there was a supply of skilled people with lengthy experience who had worked for many years in the existing financial institutions, including educated black managers (the University of Zimbabwe was established in 1957, and was multiracial from the beginning). The supply of suitably skilled and experience people was therefore less of a constraint in Zimbabwe than elsewhere in Africa.

Thirdly, there was a marketing opportunity for new banks to become successfully established, particularly as far as attracting deposits was concerned, because the existing commercial banks provided relatively poor services at the retail level.³² There was no systematic evidence of the low quality of retail banking services, although it was to be expected in a situation of long-established oligopoly. There was plenty of anecdotal complaint, but this is normal in nearly every country. More significantly, the existing commercial banks admitted privately that their services to individual customers were poor [interviews 1995]. When Standard Bank of South Africa bought Grindlays (in 1991), there was some increase in

³² The poor level of customer service provided by established banks played a significant part in the ability of new indigenous commercial banks to attract customers in Uganda, for example [interviews, Kampala, 1992].

competition, but it was mainly for large-scale corporate business and therefore did not lead to improved retail banking services. Such attempts as were made to improve customer services concentrated on investment in new technology (notably Automated Telling Machines, ATMs), which had the advantage for the existing banks of increasing the cost of entry for new banks (and of shifting queues out of the banks and into the street, as one banker remarked).

It is inherently difficult to explain why something did not happen. However, some reasons for the absence of indigenous commercial banks were apparent.

Firstly, licencing policy was deliberately conservative. The licencing authorities were acutely aware of problems with indigenous commercial banks elsewhere in Africa. The Registrar of Banks, located in the Ministry of Finance, has had applications to open new banks, both local and foreign. The Registrar examines the proposed capital, the composition of the Board of Directors, the quality of the senior management, the business plan, and how the bank hopes to mobilise resources. The analysis looks at a worst-case and a normal scenario, in order to see how the bank might survive, for example, a drought year. The application then goes to a committee with representatives from the Inspector of Banks and the Economics Division at the Reserve Bank, from various departments of the Ministry of Finance, and from the Accountant General. These arrangements provide plenty of opportunity to reject applications, given that official policy tended to give greater weight to caution than to any desire to promote local banks or to increase competition.

Secondly, the licencing authorities applied a much higher minimum starting capital requirement than provided by the 1965 banking legislation. The latter required Z\$0.5 million, a figure rendered increasingly meaningless by the inflation which occurred since the 1965 Act was passed. The authorities exercised their right to require starting capital above the legal minimum; in 1995 they were reported to require Z\$15 million. This was slightly more than would have been required to maintain the same real value of minimum capital as in 1965 (prices increased approximately 27 times between 1965 and 1995). At least one local application failed because its sponsors could not raise enough capital to reach this requirement.³³

Thirdly, it was much easier for would-be commercial bank entrepreneurs to start other financial institutions. The existence since before independence of private sector merchant

³³ It was also alleged that white and Asian businessmen did not apply for banking licences in the belief that they would be refused, while African businessmen found it difficult to raise enough capital and to meet other licencing requirements.

banks, discount houses, stock brokers, finance houses and building societies meant that the necessary skilled and experienced cadre of managers was available. Moreover, there was an institutional precedent for both the entrepreneurs and their customers; the entrepreneurs did not have to develop a new institutional form from scratch, nor did they have to market a new type of financial service. It is easier to market the services of a new financial institution when others of the same type already exist; although that requires the newcomer to compete with established institutions, it also means that the whole concept does not have to be sold to customers. The cost of starting a non-bank financial institution was also lower than the cost of starting a commercial bank. The authorities required only Z\$10 million initial capital for merchant banks (also known as accepting houses), and Z\$5 million for discount houses, compared with the Z\$15 million required for a commercial bank; in addition, it was possible to start a merchant bank or a discount house with a rented upstairs office and a telephone, fewer managers and supporting staff, and no need to deal in small sums of money which is very costly. A commercial bank would require banking premises for customer use, in order to provide the minimum of normal commercial banking services, and be obliged to deal in small (retail) amounts of money. The new merchant banks and discount houses tended to have rented first and second floor accommodation in the cheaper parts of Harare, thereby further reducing their overheads. These factors reduced the risk in starting a non-bank financial institution, and reduced the time before new financial institutions could expect to make a profit, as compared with starting a commercial bank.

The authorities also appeared to regard new non-bank financial institutions as less risky from the official point of view, both because of the smaller risk of failure, and because they solicited almost no deposits from individuals. Large institutional depositors could be expected to be able to protect their interests, whereas the authorities have more of a duty to protect the safety of deposits by the less well informed general public. Furthermore, the new non-bank financial institutions invested mainly in government paper and deposits with other financial institutions, which meant that the risk of their accumulating portfolios of doubtful debts, which the central bank had no powers to supervise, was apparently less than would be the case for commercial banks.³⁴ These factors explain why licencing policy was more liberal for merchant banks and discount houses than it was for commercial banks.

It is not possible to say which of these reasons was more important than the others. The consequences were clear, however, namely a rapid increase in the number of non-bank financial institutions, but no new commercial banks. At the end of 1995, five of the ten merchant banks had started up in the previous two years; while two of the five discount

³⁴ Note, however, that four local non-bank financial institutions were rumoured to be in trouble in 1996, allegedly because of insider lending [personal communication].

houses opened for business in 1995, and a third started in 1991. All of these new financial institutions were locally owned.

From interviews in 1995 with four of the new local financial institutions, it appeared that they mostly fitted the profile implied by the above arguments. All had recruited senior managers from existing financial institutions;³⁵ this had not provoked hostility, because the new institutions had small staffs in relation to the established ones, and because they had recruited gradually over time and taken care not to recruit exclusively from any one institution. Generally, they had attracted staff without having to offer significantly higher salaries; people were attracted by the opportunity of working for a new institution, having been frustrated by lack of opportunities in their previous employment.³⁶ Although this may have excluded the very best people, at least in the eyes of the established financial institutions which would have promoted those considered the best, there was no apparent evidence of the new employers having to depend on people sacked for incompetence or fraud.

The new institutions all claimed that they were able to attract deposits by offering a better service than the longer established banks. It was difficult to attract deposits initially, but this problem was overcome by active marketing: circulating balance sheets and the central bank's formal licencing approval, together with personal visits to potential depositors. In some cases, better service and active marketing were enough; in other cases, higher interest rates on deposits were also necessary. Yet in only one case did this lead to the institution trading at a loss initially; the other new financial institutions all claimed to be trading profitably, in some cases within a few months of starting operations. With these opportunities for profitable investment, the incentive to take the greater risk of trying to establish a successful commercial bank, however potentially profitable, was greatly reduced.

There are considerable potential benefits to having indigenous commercial banks. These include better retail banking services which arise because new banks compete for deposits in this way, and may induce established banks to improve their services in response to the competition (as happened, for example, in Uganda). Secondly, indigenous commercial banks may increase the supply of credit to smaller scale borrowers, because their smaller capital base excludes them from lending to large corporations and because they may have better knowledge than the established banks, especially those with foreign management, of the smaller scale business sector. These potential advantages are endangered, however, if reckless or fraudulent behaviour is not controlled by actively supervised legislation. This

³⁵ Unusually, one managing director had not only worked previously for a discount house in Zimbabwe, but had started the first discount house in Ghana prior to moving back to Zimbabwe to start another.

³⁶ One new financial institution said that it received an average of four unsolicited job applications every day from people working in other financial institutions.

argument was not used to explain the authorities' caution in licencing indigenous banks, so the fact that none were licenced before the new law was enacted was largely fortuitous. Other African countries, including for example Uganda and Zambia, made this mistake and suffered the costs of indigenous bank crises as a result.

4.4 The absence of additional foreign banks

Financial liberalisation was supposed to result in more competition from additional foreign banks as well as from the licencing of local banks. Some increase in competition did in fact occur, but not from any net addition to the number of foreign-controlled banks which actually fell by one. The government takeover of the foreign share (53%) of ZCCB occurred because of external events, as did the purchase of Grindlays by Standard Bank of South Africa (which simply substituted one foreign bank for another). Neither had anything to do with changes in financial sector policy in Zimbabwe. As already noted, Stanbic, as Grindlays became, did inject an increase in competition into the corporate finance sector; but if anything this made the whole commercial banking sector less rather than more willing to improve retail banking services at the branch level.

There was reported to have been some interest from other foreign banks in establishing themselves in Zimbabwe. The main barrier, it was reported, was the government's policy that all foreign banks should have a minimum 30% local shareholding. Would-be new foreign banks were reported to find it difficult to identify suitable local partners and anyway did not like the requirement.³⁷ In several cases, the Registrar of Banks referred the foreign applicant to a potential local partner, but nothing resulted. The Registrar was also cautious about more than one multinational African bank on the grounds of over-rapid expansion, correctly in the case of Meridien (which collapsed shortly afterwards) and probably correctly in another case. The government's cautious policy on licencing, of both local and foreign commercial banks, has much to recommend it; the dilemma is that too much caution results in no increase in competition.

The already established foreign banks were allowed to continue in 100% foreign ownership, despite the official policy that established as well as new foreign banks should have 30% local ownership. Barclays was the only one to respond to this requirement; it issued 34% of its share capital on the stock exchange, although the management claimed this decision was taken independently of the new policy requirement.³⁸

³⁷ "Firstly, they cannot find a local partner, and secondly, they don't want to" [interview 1995].

³⁸ Note that a government-owned non-bank financial institution, the Agricultural Finance Corporation, was planning to convert itself into a commercial bank in 1996. The AFC had a large number of rural branches, but no experience of lending other than to agriculture. It was reported to have a relatively sound portfolio, but

5. Conclusions

Financial institutions in Zimbabwe, and in particular the commercial banks, were apparently in sound condition at the end of the 1990s, so that the rehabilitation of unsound banks was not a necessary component of the structural adjustment programme. In part, this was because the new government in 1980 introduced few financial sector changes. Some were announced, but disappeared fairly soon from the policy agenda. The commercial banks were regarded as part of the highly valued modern business sector, whose position the government did not dare challenge from fear of a large scale withdrawal of capital and skills. Some difficulties might have been expected when the foreign exchange market was liberalised, because this removed an indirect guarantee of the creditworthiness of borrowers. However, the banks appeared to manage the shift to assessing their borrowers' creditworthiness in a less controlled economy. These promising initial conditions meant that any additional deposits attracted by raising interest rates above inflation, when that was eventually achieved, would be made available for lending by sound banks using proper commercial criteria. However, it was too soon to know whether this was happening; one year of improved financial ratios is insufficient to establish a trend.

It could be seen as disappointing that the commercial banks changed so little, in particular in not extending credit to a wider range of borrowers. On the other hand, Zimbabwe avoided the extremely damaging and expensive insolvency of government-owned commercial banks which occurred in some African countries.³⁹

For many years, government pressure on the commercial banks was mainly for them to open more branches in areas not previously served, rather than to lend more to smaller scale borrowers. There appeared to be some pressure to lend to influential people, but as far as can be ascertained in the absence of bank inspections, any resulting damage was not large enough to threaten bank solvency.

Pressure to lend to smaller scale borrowers increased in the 1990s. At the same time interest rate policy was liberalised, which should in theory have made such lending more attractive by enabling banks to match the increased risk with higher reward. However, neither change made much difference. Partly this was because the 1990s also saw a rapid growth of subsidised credit schemes, for various categories of borrowers perceived as being

nevertheless seemed unlikely to attract deposits without some form of government guarantee. Its conversion would, however, reduce pressure on other commercial banks to open rural branches

³⁹ For example, the cost is estimated at 11% of GDP in Tanzania, with every likelihood that the cost will eventually be higher [Brownbridge and Gayi, 1996].

unreasonably excluded from commercial bank credit. These schemes made it easier for banks to refer marginal loan applicants to subsidised schemes. They also reduced the demand for commercial bank credit, because it was so much more expensive. The subsidy on borrowing rates made commercial bank loans unattractive, hugely unattractive in the more extreme cases such as the government's Z\$400 million facility at 5% when the cost of borrowing from commercial banks was above 30%. Moreover, there was increasing evidence that recovery rates from subsidised lending schemes were nearly all very low, with little follow-up on defaulters.⁴⁰ This made the subsidised schemes even more attractive to borrowers, and probably also reinforced commercial banks' unwillingness to move further into this area of lending.

Liberalisation should have increased the supply of credit to small and medium scale enterprises in another way, by allowing the licencing of local banks. Such banks would be forced to focus on smaller scale businesses, and might have the better information necessary for such lending to be profitable. However, it would have been very risky to licence local banks before new banking legislation had been enacted, and before bank supervision experience had been developed. As it happened, cautious licencing policy (and the diversion of would-be local bankers into the less risky opportunities provided by establishing other financial institutions) meant that no local commercial banks were licenced, even though the absence of adequate legislation and supervision seemed not to be the reason. There was no evidence of local non-bank financial institutions lending to smaller scale borrowers.

Because evidence from elsewhere is that expatriate commercial banks manage to resist pressure to behave in ways they would prefer to avoid,⁴¹ it is entirely possible, indeed likely, that additional pressure would have had little effect. For the same reason, it is probably pointless to apply such pressure in the future. If new forms of lending are profitable, the long established commercial banks will probably exploit such opportunities; if it is not, then pressure will not be effective, and probably should not be effective judging from its results elsewhere in Africa in causing the insolvency of government-owned commercial banks.

That still leaves open the question as to what can or should be done about increasing the availability of credit to those currently excluded. It should be noted that in Zimbabwe, as is common elsewhere, producers finance most of their needs (some 70%) internally.

⁴⁰ Evidence on bad and doubtful debts is not precise, and not comparable among lending institutions because they were not centrally supervised. Default rates were reported in 1996 to be typically above 50%, and ranging as high as 97% for the Social Development Fund which was used most extensively for political patronage (private communication).

⁴¹ For an account of the failure of government attempts to change commercial bank behaviour in Botswana, see Harvey [1993b].

Nevertheless, whatever the significance of commercial bank credit to stall scale producers, political pressure will undoubtedly continue so that it will be difficult to ignore the problem.

Subsidised loan schemes, especially when they charge 30 or more percentage points less than commercial lending and enable a majority of borrowers not to service their debts, are extremely damaging and expensive. If it is impossible to do nothing, then damage limitation suggests allocating limited amounts of capital, while also doing everything possible to minimise the cost of administration, and to minimise bad debts and the forgiving of failure to repay.

In addition, once new banking legislation and improved bank supervision are in place, it should be possible to licence some indigenous commercial banks with only minimum risk of bank failures. Evidence from elsewhere in Africa [Brownbridge, 1996] is that even where banking legislation and supervision are inadequate, some indigenous banks establish themselves successfully. Moreover, most bank failures appeared to have been easily avoidable if the simplest of rules had been followed: adequate capital and careful supervision of rules on insider lending, excessive lending to individual borrowers, provision for bad and doubtful debts and other obvious precautions. There is also evidence that competition from local banks improves retail banking services in the old oligopolistic banks. It should therefore be possible to licence local commercial banks with an acceptably low level of risk of failure, once new banking legislation is passed and some experience of banking supervision has been acquired.⁴²

Overall, financial liberalisation in Zimbabwe achieved very little. Higher real interest rates did not stimulate more lending to small and medium scale enterprises; nor did they cause financial deepening. Meanwhile, caution combined with insistence on local partnership with new foreign banks overcame the government's stated intention of licencing more commercial banks. The growth of local non-bank financial institutions, although useful in itself, did not contribute to the objectives of financial liberalisation. While the results of financial liberalisation were therefore minimal, Zimbabwe already had a considerably more developed and sophisticated financial system than other African countries, with the exception of South Africa; the system survived the post-independence period relatively unscathed, which was a major advantage and made financial liberalisation less important.

⁴² By definition, no experience exists in Zimbabwe of supervising small new locally-owned commercial banks, and indeed there is no current experience of bank inspections. However, the new non-bank financial institutions were being closely supervised, with daily returns to the central bank, and foreign expertise could be acquired temporarily.

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