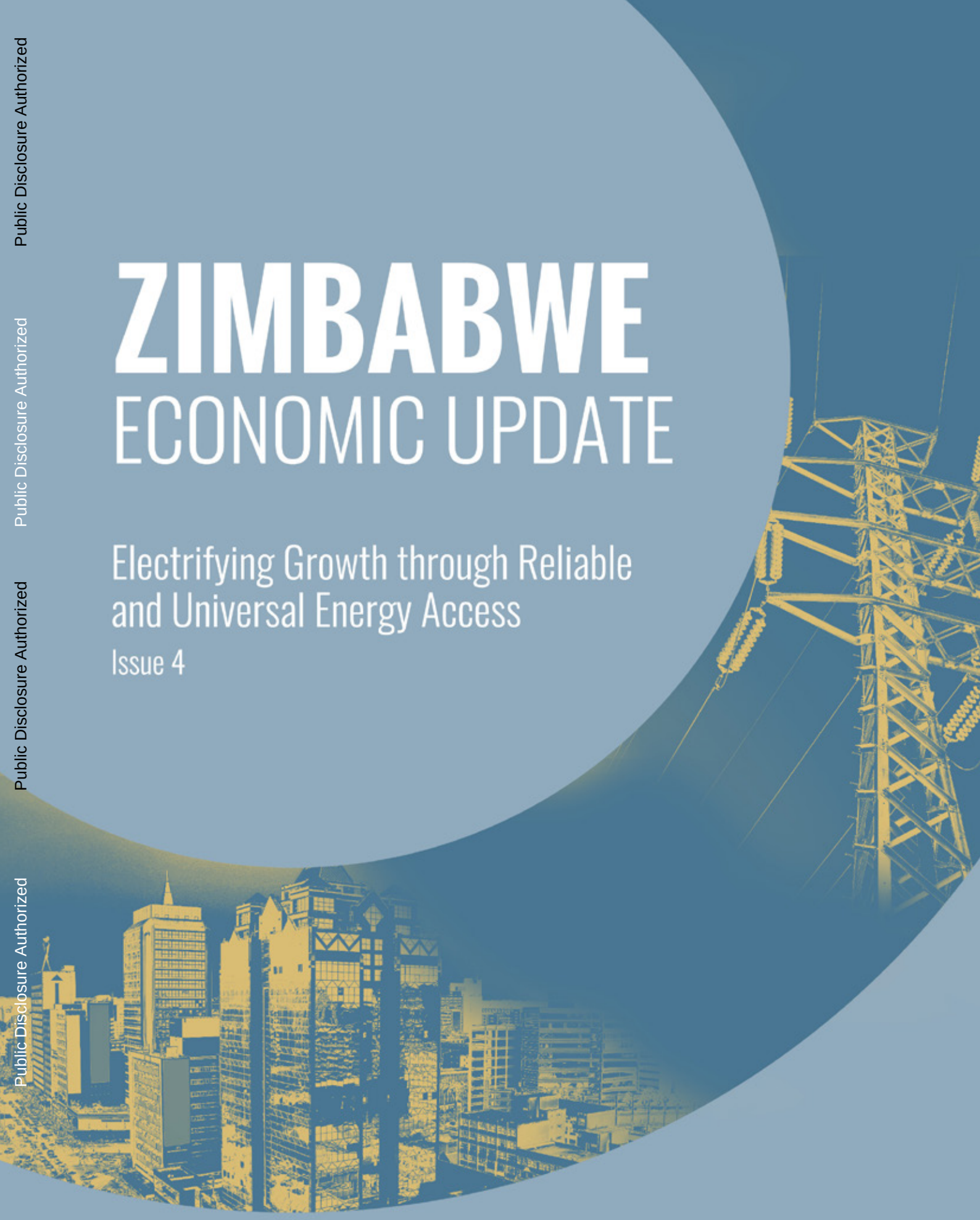
ZIMBABWE ECONOMIC UPDATE

Electrifying Growth through Reliable and Universal Energy Access

Issue 4



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CONTENTS

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ACRONYMS AND ABBREVIATIONS

COVID-19	Coronavirus Disease 2019
CZI	Confederation of Zimbabwe Industries
EMA	Environmental Management Agency
FDI	Foreign Direct Investment
FIES	Food Insecurity Experience Scale
GDP	Gross Domestic Product
GoZ	Government of Zimbabwe
GWh	Gigawatt Hour
IERMP	Integrated Energy Resource Master Plan
IPP	Independent Power Producer
kWh	Kilowatt Hour
MoFEDIP	Ministry of Finance, Economic Development & Investment Promotion
MW	Megawatts
NDS1	National Development Strategy 1
NPL	Non-Performing Loan
pp	Percentage Point
PPA	Power Purchase Agreement
PPP	Public-Private Partnership
PV	Photo Voltaic
QFO	Quasi-Fiscal Operation
US$	US Dollar
REA	Rural Electrification Agency
RBZ	Reserve Bank of Zimbabwe
SADC	South African Development Community
SAPP	Southern Africa Power Pool
SOE	State-Owned Enterprise
SSA	Sub-Saharan Africa
TWh	Terawatt Hour
VfM	Value-for-Money
ZERA	Zimbabwe Energy Regulatory Agency
ZESA	Zimbabwe Electricity Supply Authority
ZETDC	Zimbabwe Electricity Transmission and Distribution Company
ZIDA	Zimbabwe Investment and Development Authority
ZiG	Zimbabwe Gold-Backed Digital Token
ZimStat	Zimbabwe National Statistics Agency
ZPC	Zimbabwe Power Company
ZWL	Zimbabwe Dollar

EXECUTIVE SUMMARY

1. RECENT ECONOMIC DEVELOPMENTS AND OUTLOOK

Zimbabwe's economy has seen a strong rebound since the COVID-19 pandemic. While fiscal deficits are low, initial expansionary monetary policy had put pressure on inflation and the exchange rate. A recent policy tightening has improved macroeconomic stability.

Economic activity has accelerated in Zimbabwe, despite global challenges. Zimbabwe was one of the fastest growing economies in the Southern African Development Community (SADC) in 2021, 2022 and, so far, also in 2023. The economy grew by 6.5 percent in 2022, down from 8.5 percent in 2021, but still higher than in many SADC economies. In 2023, economic growth is estimated at 4.5 percent. These growth dynamics were driven by continued expansion in agricultural output due to abundant rains and resilience-building. The easing of COVID-19-related restrictions further supported economic activity, particularly in the tourism sector. Meanwhile, elevated commodity prices in 2022 and 2023 supported a resurgence in mining sector output. Yet, shocks from the war in Ukraine, supply chain disruptions, economic volatility, and power shortages have kept Zimbabwe's economic activity below its potential for both 2022 and 2023.

IN 2022,
THE ECONOMY GREW BY
6.5%
DOWN FROM 8.5% IN 2021

The economic rebound since the pandemic has helped to bring down the levels of poverty and food insecurity. On the back of the economic recovery and record maize harvests in the 2020/21 agricultural season, the extreme poverty rate fell by 6 percentage points to 43 percent in 2021 and then to 42 percent in 2022. The food insecurity rates also dropped from their highs of 2020 and early 2021. Nevertheless, poverty, vulnerability, and food insecurity rates remain high.

Fiscal adjustment needs to continue to durably reduce economic volatility. The Government of Zimbabwe (GoZ) kept fiscal deficits low, at 1.6 percent in 2022, down from 2.0 percent in 2021, despite rising spending pressures. Though the fiscal deficit has risen in the first 8 months of 2023, from 0.5 percent of GDP in 2022 to 1.2 percent, the full-year fiscal deficit for 2023 is estimated to be under 3 percent. Fiscal accounts benefited from higher-than-expected inflation and currency depreciation that helped to increase revenues in local currency, moderating the increase in the fiscal deficit.

Rising public wages remain a challenge. Wages rose to 5.4 percent of GDP in 2021 and 6.1 percent of GDP in 2022, and continued increase in 2023 presents a risk of an unsustainable wage bill. Wages are paid partly in foreign currency (fixed amount per month) and local currency to maintain the real value of wages. Higher wages may undermine economic policy by crowding out capital and social spending.

THE PUBLIC DEBT IN 2022 IS OVER

100%

OF GDP

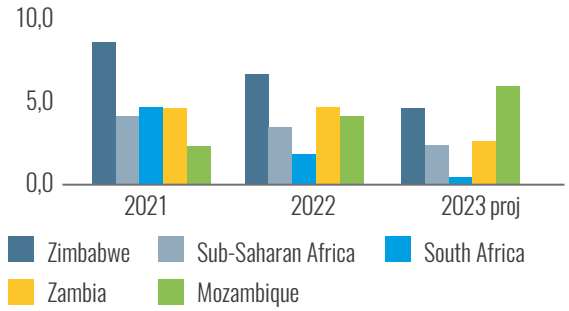
Zimbabwe remains in debt distress and while borrowing is limited, public debt has continued to increase that is driven by external arrears and legacy debt. The GoZ has taken over contingent liabilities of US$3.5 billion arising from compensation for a 2019 decision to impose exchange rate restrictions that blocked external payments to foreign suppliers and investors ("blocked funds"), and promised compensation to former farm owners from an early 2000s land reform initiative. While this is an important way to help redress historical policy missteps, it meant public debt rose to over 100 percent of GDP in 2022 and 2023. In response, the authorities launched a Structured Dialogue Platform in December 2022 with development partners to help address Zimbabwe's arrears clearance and debt resolution (see below).

ZIMBABWE REMAINS IN DEBT DISTRESS AND WHILE BORROWING IS LIMITED, PUBLIC DEBT HAS CONTINUED TO INCREASE THAT IS DRIVEN BY

EXTERNAL ARREARS & LEGACY DEBT

A snapshot of Zimbabwe's economic situation

Figure E.1. Zimbabwe's rapid recovery post-pandemic meant that it was a strong performer in SSA and growing faster than regional peers



Sources: World Bank staff calculations based on ZimStat, RBZ.

Figure E.2. The recovery also led to declining food insecurity rates, though they remain high

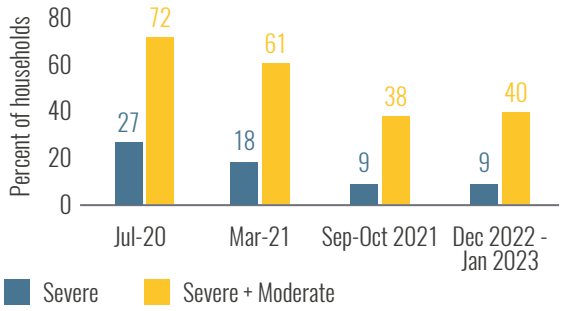
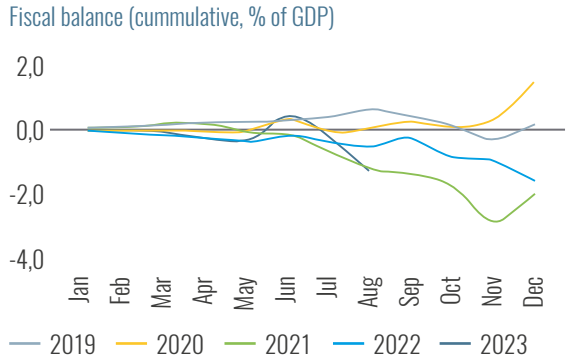


Figure E.3. Fiscal deficits have been contained due to successful mobilization of tax revenues and moderate expenditure increases



Sources: World Bank staff calculations based on ZimStat, RBZ.

Figure E.4. Public debt continues to rise, by accumulating external arrears and legacy debt....

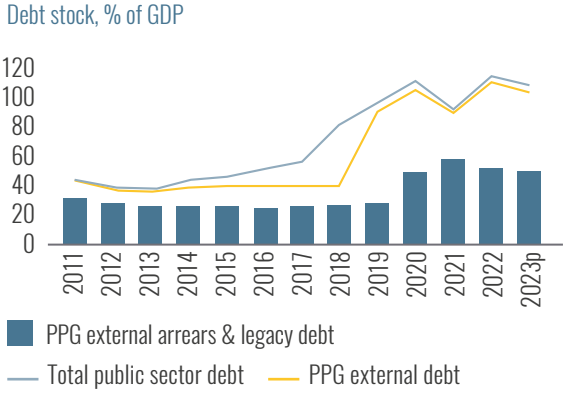
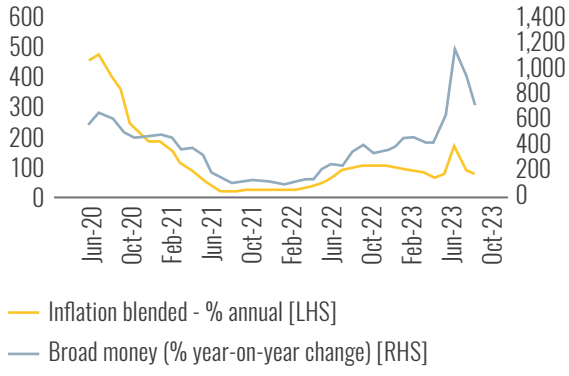
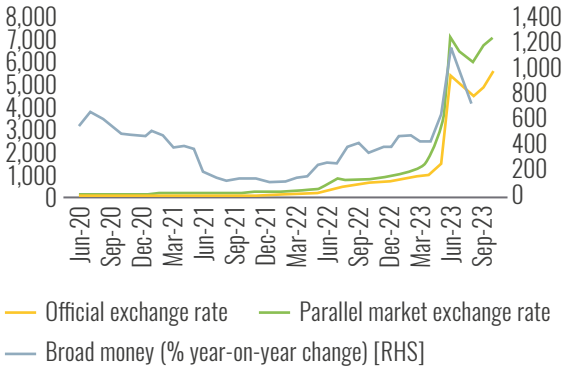


Figure E.5. But RBZ's quasi-fiscal operations have driven up inflation and volatility...



Sources: World Bank staff calculations based on ZimStat, RBZ.

Figure E.6. Introducing an interbank market improved exchange stability, but volatility remained partly due monetary expansion



While increased global turmoil and expansionary monetary policy had put initial pressure on inflation and the exchange rate, recent monetary policy tightening has limited volatility. Supply chain disruptions during the COVID-19 pandemic, together with the war in Ukraine, put considerable pressure on Zimbabwe's inflation. In addition, the RBZ has previously financed external debt service payments (liabilities) by printing money. The joint impact of global price rises and increased domestic money supply drove up inflation, with major peaks in August 2022 and June 2023. Yet since June 2023, the RBZ has been proactive in tightening monetary policy; increasing reserve requirements for the banking sector, and raising the bank policy lending rate. Furthermore, reserve money growth was curbed by issuing non-negotiable certificates of deposits (NNCDs) and Gold-Backed Digital Tokens to absorb excess Zimbabwe dollars. This has helped to bring down inflation and the parallel market premium. The Government has also extended the use of US dollars as legal tender until 2030, further reducing policy uncertainty.

SINCE JUNE 2023, THE RBZ HAS BEEN **TIGHTENING MONETARY POLICY**

The current account surplus continues to narrow, reflecting external headwinds. Higher import prices in the face of slowing exports already narrowed the current account surplus in 2022. But the surplus has been narrowing again in 2023, as the trade deficit widens in the face of slowing remittances. Rebuilding the RBZ's foreign exchange reserves will be essential if the impact of further global volatility on the economy is to be reduced. Yet, the RBZ has chosen to use Zimbabwe's gold assets to issue gold coins and gold-backed digital tokens (ZiG), to allow the wider public to have access to an instrument for store of value and to stabilize the ZWL. As such, it may prevent the build-up of international reserves, and the economy remains exposed to external shocks.

REBUILDING THE RBZ'S FOREIGN EXCHANGE RESERVES WILL BE ESSENTIAL TO REDUCE FURTHER **GLOBAL VOLATILITY** ON THE ECONOMY

Zimbabwe's economic outlook appears moderate, reflecting continued global headwinds, structural bottlenecks, weather-related shocks, and price and exchange rate volatility.

The economy is projected to slow to 3.5 percent in 2024, as agricultural output is expected to suffer from depressed global growth especially from China, predicted erratic and below-average rainfall caused by the El Niño weather pattern. The weaker global demand for minerals will reduce the contribution of the mining sector to economic growth. The continued implementation of economic reforms, including those outlined in the arrears clearance dialogue, will serve to cool down inflation and relieve exchange rate pressures.

The fiscal deficit is projected to moderate in 2024, though risks remain high. The transfer of the RBZ's external debt to the treasury means that interest payments from servicing debt are projected to increase significantly, posing liquidity risks amid limited access to concessional financing. A surging public wage bill will also squeeze fiscal space. Real allocations to the education, health and social sectors are likely to fall. Management of fiscal policy is likely to remain challenging due to public debt unsustainability. Overall, fiscal consolidation will be required to restore fiscal sustainability and economic growth.

FISCAL RISKS REMAIN HIGH FROM THE TRANSFER OF RBZ DEBT AND A SURGING WAGE BILL

Tightening of monetary policy will allow inflationary pressures to subside. Transferring of external debt from the RBZ to the Government's budget will enable the RBZ to constrain reserve money growth within acceptable limits and this in turn will enable the RBZ to better stabilize inflation. The transfer may stop RBZ from printing money to service debt payments on these foreign currency liabilities. Nevertheless, global volatility is expected to continue, keeping commodity prices (especially fuel) elevated.

The current account surplus is expected to continue narrowing in the medium term, reflecting a rise in imports and slowing export growth. Rising import costs will adversely affect Zimbabwe's terms of trade. A negative trade balance will be compounded by a softening of mineral commodity prices. With foreign exchange reserves at low levels, the economy is vulnerable to further trade shocks. External reserves are further complicated by the continued issuance of gold coins.

A NEGATIVE TRADE BALANCE WILL BE COMPOUNDED BY A SOFTENING OF MINERAL COMMODITY PRICES

The economy faces multiple downside risks. Prolonged global turmoil could result in a slowdown in global output, reduced trade and investment, increased volatility in commodity prices, and supply disruptions. Moreover, fiscal pressures may result in an expansionary economic policy. This could give rise to increasing economic volatility, impacting on private sector activity and growth. Finally, climate change shocks may also serve to lower economic output, particularly in the agriculture sector.

To sustain economic growth, Zimbabwe will need to continue tackling its macroeconomic challenges.

CLIMATE CHANGE SHOCKS MAY ALSO SERVE TO LOWER ECONOMIC OUTPUT PARTICULARLY IN THE AGRICULTURE SECTOR

Addressing price and exchange rate volatility and public debt arrears will be vital in supporting economic growth and job creation. Rising exchange rate distortions and high inflation have misallocated resources to sectors and firms with low productivity

and limited private investment. This has constrained economic growth and reduced the competitiveness of Zimbabwe's firms. While Zimbabwe has been able to maintain robust post-pandemic growth, sustaining such a level of growth will require to continue tackling the country's macroeconomic issues.

POLICIES IN THE ECONOMIC REFORM MATRIX ARE CRITICAL TO RE-ESTABLISH **MACROECONOMIC STABILITY**

The new Structured Dialogue Platform on arrears clearance and debt resolution between the GoZ and development partners identifies an important set of reforms and offers a resolution to Zimbabwe's pressing arrears and debt problems. Three working groups were set up to report to the dialogue platform, focused on: (i) economic growth and stability; (ii) governance; and (iii) land reforms. This edition of the Zimbabwe Economic Update re-affirms the importance and urgency of the policies set out in the Economic Reforms Matrix to re-establish macroeconomic stability, enhance growth, and protect the most vulnerable:

1. Successfully implement an IMF staff-monitored program (SMP).
2. Establish a market-determined and competitive foreign exchange rate regime;
3. End all quasi-fiscal operations (QFOs), and end all unbudgeted expenditures;
4. Strengthen revenue collection and expenditure management;
5. Maintain tight monetary policy and sound fiscal management; and
6. Improve access to inclusive social protection.

The GoZ has made important and significant progress across several areas of the Economic Reform Matrix, that will help to stabilize the macroeconomy. Key measures (among others) include:

- To move towards a market-determined and competitive foreign exchange rate regime, the government has improved the willing-buyer, willing-seller market for foreign exchange, and is proposing to remove the limit of 10 percent trading margin above the interbank rate.

- To help end all quasi-fiscal operations (QFOs), the GoZ announces that US$1.8 billion of RBZ's $3.6 billion external liabilities has been transferred to the treasury in 2023. In addition, a statutory instrument prevents the RBZ from taking on additional external debt without Treasury agreement.

US$1.8 BILLION OF RBZ'S
$3.6 BILLION
EXTERNAL LIABILITIES HAS BEEN TRANSFERRED TO THE TREASURY IN 2023

- To increase domestic revenue mobilization, several new measures have been announced to help the treasury absorb the RBZ's external liabilities and service external loans.

- Tight monetary policy has been observed post-June 2023. The new GoZ budget proposes a fiscal deficit of 1.5 percent of GDP. This suggests a non-inflationary monetary and fiscal policy going forward.

- The Government has formally requested an Staff Monitored Program (SMP) in June 2023. An IMF staff visit in October 2023 has served as a key input into preparing the new SMP, which is planned to start in 2024.

A NEW IMF STAFF MONITORED PROGRAM IS PLANNED TO START
IN 2024

The World Bank commends the government on the important progress made so far in implementing the reforms. Resolute progress on these three reform platforms (economic, governance and land) may help to durably restore macroeconomic stability. It also provides a promising opportunity for the GoZ to end its long-standing external debt arrears, which will help to provide access to affordable external credit lines and stimulate much-needed public and private sector investment to boost growth.

2. SPECIAL TOPIC: ELECTRIFYING ZIMBABWE'S GROWTH THROUGH RELIABLE AND UNIVERSAL ENERGY ACCESS

Despite recent achievements, Zimbabwe's electricity sector still faces power supply deficits and slowing progress toward universal electricity access.

The GoZ has set itself ambitious targets for 2030 to ensure reliable energy supply and significantly expand electricity services to most of the population. The National Energy Policy 2012 initially aspired to achieve universal access by 2030 (GoZ, 2012), and its Vision 2030 aims to significantly improve electricity reliability and expand households' access to electricity.

IN 2020, THE AVAILABLE GENERATION CAPACITY WAS
1,585 MW
COMPARED WITH PEAK DEMAND OF
1,900 MW

However, despite some recent achievements, Zimbabwe's electricity sector still faces major challenges. The country still suffers from significant power deficits. In 2020, the available generation capacity was 1,585 MW compared with peak demand of 1,900 MW, forcing power outages of 12–14 hours a day. While the Government commissioned an additional 600 MW at the Hwange power station in 2023, installed capacity is currently still insufficient to meet demand, and rolling blackouts give rise to a significant burden on Zimbabwe's economic growth and competitiveness. Zimbabwe has seen notable improvements in access to electricity, but the pace of rural electrification has slowed down. Between 2014 and 2020, overall energy access expanded from 32 to 53 percent, driven by a rapid rise in access in rural areas (from 8 up to 37 percent). Nonetheless, the overall pace of expansion is slowing and there is a need for significant investment to achieve universal access by 2030.

Power shortages have a significant adverse impact on the productive sector and result in higher costs for Zimbabwe's economy. Electricity deficits are particularly damaging for the mining sector, given its highly energy-intensive characteristics, so that unreliable and expensive electricity supplies reduce the margins of existing operations and weigh heavily on the feasibility evaluations for expansions and new projects. Power shortages also significantly hurt the agriculture and agro-processing sector by undermining irrigation, together with cold chain and storage facilities. Tourism is also affected as hotels, resorts and tourist attractions face disruption of essential services. Overall, these effects translate into lower economic growth and lower household incomes. World Bank estimates suggest that Zimbabwe's power shortages cost the country a total of 6.1 percent of GDP per year, comprising 2.3 percent of GDP in generation inefficiencies and excessive network losses, and 3.8 percent of GDP on the downstream costs of unreliable energy. If Zimbabwe hopes to achieve the high growth rates needed to move toward upper middle-income status by 2030, it will be critical to realize stable and reliable electricity access.

ZIMBABWE'S POWER SHORTAGES COST THE COUNTRY A TOTAL OF

6.1%

OF GDP/YEAR

Going forward, peak electricity demand is projected to grow substantially. Achieving universal electricity access by 2030 will require large investments, especially in solar power and grid expansion. Medium-term World Bank projections suggest that electricity demand will grow from 1,950 MW in 2022 up to 5,177 MW by 2030, driven primarily by growing demand from the mining and agriculture sectors. Achieving universal access by

2030 will require annual connections to increase from 25,000 in 2020 to about 537,000 per year. Estimates for least-cost generation expansion indicate that, in the short-to-medium term (2024–26), utility scale home solar systems would be the fastest units to provide additional capacity, adding more than 1,500 MW that would ensure the system can meet growing demand. Subsequently, generation expansion efforts would comprise gas power plants and hydropower, in addition to more solar. The associated grid network expansion to 2030 is estimated to cost a total of US$4.4 billion.

ELECTRICITY DEMAND WILL GROW FROM **1,950 MW** IN 2022, UP TO **5,177 MW** IN 2030.

The Government is planning to expand electricity access through various sources, but it remains unclear how the investment needed will be financed. The biggest planned increase in electricity supply comes from the Batoka Gorge Project along the border with Zambia (1,200 MW for Zimbabwe) projected for completion after 2034, and the Devil's Gorge (1,200 MW) to be completed by 2040. This is complemented by additional energy projects in solar, wind, mini-hydro and geothermal. The National Renewable Energy Policy of 2019 is targeting an additional 2,100 MW by 2030 from renewables, mainly solar PV. This would be complemented by storage at the Kariba reservoir and battery energy storage systems. As such, while there are significant opportunities to expand electricity generation, it remains unclear how this expansion will be financed going forward. Financing electricity expansion from domestic resources alone will be challenging, so there is an urgent need to involve more private investors together with the international development community.

THE NATIONAL RENEWABLE ENERGY POLICY OF 2019 IS TARGETING AN ADDITIONAL **2,100 MW** BY 2030

Zimbabwe's interconnected problems of electricity supply and access are ultimately driven by three underlying issues: (i) weak financial performance of energy companies; (ii) insufficient central planning and coordination; and (iii) limited private sector participation.

The weak financial state of Zimbabwe's electricity companies is the most significant issue driving the country's power supply deficits and slowing the expansion of universal access to electricity services. Energy tariffs do not reflect the financial costs of energy generation and distribution, leading to significant losses for power companies. This is complicated by the inefficiencies of the utility companies. Energy companies are also burdened by high debt servicing costs. Insufficient revenues and high debt lead to cashflow shortages, which in turn constrain

ENERGY COMPANIES ARE ALSO BURDENED BY **HIGH DEBT SERVICING COSTS**

the companies from: (i) investing in new generation, transmission, and distribution assets, including in access expansion; (ii) attracting private sector investment and commercial financing for the sector's investment plan; (iii) adequately maintaining existing assets; and forcing them to (iv) consistently import power from neighboring countries to satisfy electricity demand.

The energy sector is also hindered by a lack of centralized oversight in monitoring implementation, insufficient coordination, and inadequate planning capacity. The National Development Strategy 1 (NDS1) spells out many essential interim targets and strategies for electricity generation, transmission network expansion and access expansion during 2021–2025, but limited progress has been made on their implementation. The National Energy Policy and the National Renewable Energy Policy are also consistent with international best practice and need consistent implementation. However, the energy sector is comprised of many regulatory agencies, energy companies, and implementing agencies, and this has resulted in a weakening of centralized planning and implementation of government strategies. Limited regulatory independence is also causing planning uncertainties and unpredictability. The energy sector also suffers from policy inconsistencies, arising from conflicting operational decisions and strategies.

THE NDS 1 SPELLS OUT MANY ESSENTIAL INTERIM TARGETS AND STRATEGIES FOR ELECTRICITY GENERATION

Finally, limited private sector participation is also holding back the Government's ability to ensure reliable energy supply and expand access. Overall opportunities for private sector investment have expanded. By January 2020, the regulator had issued generation licenses to projects with a combined total of 6,500 MW and, by December 2022, 27 independent power producers (IPPs) with an estimated total capacity of 1,000 MW were recommended for government support. Despite this, many of the licensed projects fail to reach financial closure, suggesting financing constraints and/or inadequate risk mitigation instruments for investors and lenders. As a result, grid supply from IPPs still remains modest, at just 3 percent in 2022. Private investment in energy is held back in part by insufficient technical regulations and incentive structures that have limited distribution licenses. The system also suffers from challenges around licensing for investors and operators of small-scale energy investments (e.g., mini-grids) that lead to uncertainty and hold back investments. Lastly, Zimbabwe's macroeconomic instability raises investors' risks and limits financing.

IN 2022, GRID SUPPLY FROM IPPs REMAINED MODEST, AT JUST

3%

How to transform the energy sector to attain reliable supply and universal energy access

Attaining the Government's ambitious targets to achieve reliable and universal energy access by 2030 will require a combined focus on strengthening the energy sector's financial situation, improving planning and coordination, and encouraging and de-risking private sector participation. This report provides some recommendations in the short-term (next 12 months) and medium-term (12-36 months):

DEVELOP AN **ENERGY ROADMAP** COVERING STRUCTURAL, POLICY AND UTILITY REFORMS

1. Sector and economy-wide reforms to support the energy sector:

Short-to-medium term:

- Develop and implement a roadmap covering structural, policy and utility reforms to achieve sustainable financial viability, and affordable, and reliable universal access to electricity for economic and social development.
- Adopt the necessary macroeconomic stabilization reforms (see section 1 of this report) to improve price predictability and currency convertibility. This will support the financial performance of power companies and help to reduce financial risks to encourage private energy investments.

2. Strengthen the financial performance of the power sector:

ENSURE ELECTRICITY PRICING POLICY RESULTS IN **FULL COST RECOVERY** OF (EFFICIENT) SERVICE PROVISION

Short-term:

- Implement electricity pricing policy for full recovery of efficient costs of service provision.
- Allow below-cost (cross-subsidized) energy tariffs for vulnerable consumers, but based on more targeted and rigorous needs-assessments.
- Develop a plan for efficient operational performance of the power companies, with a specific focus on the reduction of technical and commercial losses.
- Implement an off-balance sheet debt service mechanism for the power companies' legacy debt.

Medium-term:

- Improve access to capital markets through mechanisms such as initial public offerings in electricity utilities and / or issuance of bonds.
- Expand the sources of financing for access expansion beyond the current levy on power sales, to include climate change

and concessional funds.

- Increase financing for expansion of electricity connection services to vulnerable households through GoZ capital expenditure and development partners' funding.

3. Strengthen technical planning and institutional coordination.

Short-term:

- Strengthen the institutional and technical capacity for power system expansion planning, implementation, and monitoring at the level of the Ministry of Energy and Power Development (MoEPD).
- Adopt and publicize the sector's least-cost expansion plan, including regular updates.

ADOPT AND PUBLICIZE THE SECTOR'S **LEAST-COST EXPANSION PLAN**

Medium term:

- Develop a capacity building program and enhance planning procedures of key agencies involved in access expansion planning (MoEPD, Zimbabwe Electricity Transmission and Distribution Company (ZETDC) and Rural Electrification Fund (REF).
- Increase and diversify sources of energy to improve security of supply and mitigate against climate change impacts.

4. Promote private energy sector investments.

Short-term:

- Issue a public statement to emphasize and clarify GoZ's support for private sector participation in Zimbabwe's electricity sector.
- Streamline regulations for small-scale energy investments, and coordinate across regulatory agencies to ensure consistent, light-handed regulatory approach across all projects.
- Strengthen consistency of enforcement of licensing obligations for investors and operators.

STRENGTHEN CONSISTENCY OF ENFORCEMENT OF LICENSING OBLIGATIONS FOR **INVESTORS & OPERATORS**

Medium-term:

- Pilot the use of competitive bidding and risk allocation frameworks for development of solar PV capacity and mainstream their use.
- Prioritize implementation of net metering of private solar PV installations (residential and commercial) to channel surplus energy into the grid during daylight hours and improve energy storage capacity of the Kariba dam.

PART 1

RECENT ECONOMIC DEVELOPMENTS AND OUTLOOK

1.1 REAL SECTOR

Economic prospects have improved, despite increasing global economic turmoil

Despite increasing global turmoil, economic activity has accelerated in Zimbabwe. In 2022, the economy grew by 6.5 percent. Continued expansion in agricultural output due to abundant rains and effective resilience-building, coupled with the easing of COVID-19-related restrictions, supported economic activity, particularly in the tourism sector. Meanwhile, elevated commodity prices seen in 2022 supported a resurgence in mining sector output, while the ending of lockdowns enabled private consumption to remain positive in 2022. However, supply chain disruptions, economic volatility, and power shortages slowed economic activity in 2022. The war in Ukraine also elevated commodity prices, especially fuel prices, constraining demand and economic activity. Economic volatility moderated in 2023, as supply disruptions eased while exchange rate depreciation slowed. Economic growth grew year-on-year by 4.5 in Q2 2023 and is also estimated to grow by a total 4.5 percent across the full year 2023 (Figure 1.1).

The country was one of the fastest growing economies in the South African Development Community (SADC) in 2022 and 2023. With economic growth of 6.5 percent in 2022 and 4.5 percent in 2023, Zimbabwe eclipsed many economies such as South Africa, Zambia and Mozambique. Moreover, the economy's growth performance exceeded the average growth rate in Sub-Saharan Africa (SSA) in 2022, and closely matched it for 2023 (Figure 1.2).

Figure 1.1. A rapid recovery in economic output, post pandemic...

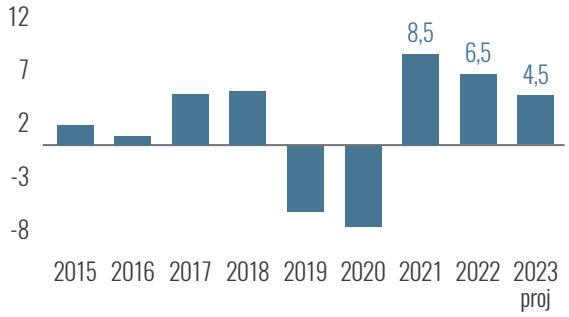
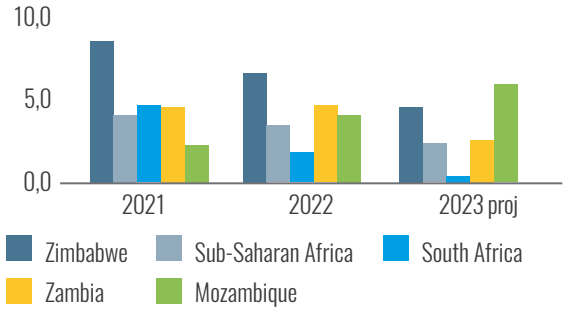


Figure 1.2. ...meant Zimbabwe was a strong performer in SSA and growing faster than regional peers



Source: ZimStat, World Bank. Note: SSA = Sub-Saharan Africa.

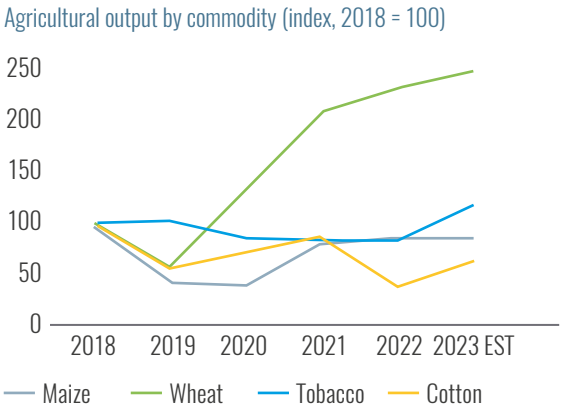
Growth has been broad-based, covering agriculture, industry and services

The agriculture sector has seen growth in wheat and sorghum, but overall production remains volatile and suffers from repeated climate shocks. Decades of under-investment in irrigation and developing climate resilience has meant that the agriculture sector has become particularly sensitive to changes in the climate. The intensification of climate shocks in the past decade has markedly increased agricultural output volatility (Figure 1.3). In 2022, the agricultural sector experience 4.9 percent growth, driven in part by higher wheat yields. In 2023, agricultural production continued to increase and is estimated to have grown by over 6 percent, driven by tobacco, wheat, and maize. Nonetheless, some crops are still operating below potential. Maize production is still 15 percent below its levels from 2018, while cotton production is also still 37 percent lower since 2018.

The revival in industrial output growth has been reinforced by resurgent mining and construction sectors, but was hindered by electricity shortages. Industrial growth has notably increased in recent years, expanding by 6.4 percent in 2021 and 5.5 percent in 2022. Rising commodity prices and export incentives supported a rapid increase in mining output (particularly gold and diamonds), with growth of the sector at 10.5 percent in 2022 (Figure 1.4). Mining capacity utilization also increased from 48.8 percent in Q1 2023 to 51.1 percent in Q2 2023. The electricity sector has been volatile – while power generation in 2022 exceeded the average monthly rate in 2019-2021, it dropped significantly

in 2023 (Figure 1.5). This is driven in large part by droughts that have reduced hydroelectric power generation. Electricity generation declined by 38.2 percent in Q1 2023 year-on-year, and by 20.6 percent on a quarterly basis. Electricity supply shortages has limited manufacturing activities, with load shedding going for 12-14 hours a day (see chapter 2). Manufacturing sector remained subdued, with growth remaining below 3 percent partly due to, electricity shortages, global volatility, and domestic economic turbulence. A recent Zimstat Business Tendency Survey shows that combined (small and large) manufacturing capacity utilization remain depressed in 2023, with respondents citing three major constraints to production as shortage of power, cash flow challenges and uncertainty towards the economic environment (Figure 1.6).[1]

Figure 1.3. The agriculture sector has been volatile and some crops have been affected by repeated climate shocks



Source: ZimStat.

Figure 1.4. Mining output growth has been driven by gold, platinum and diamonds

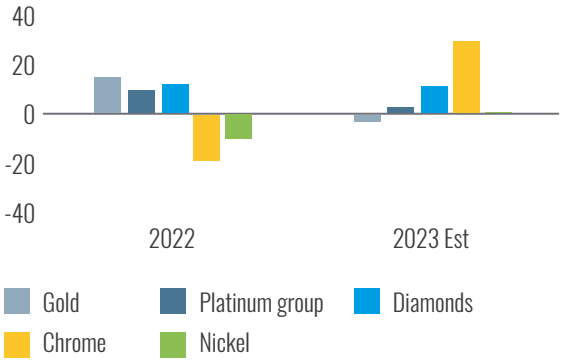
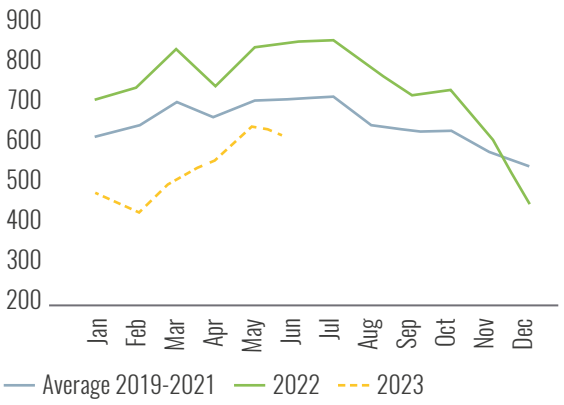
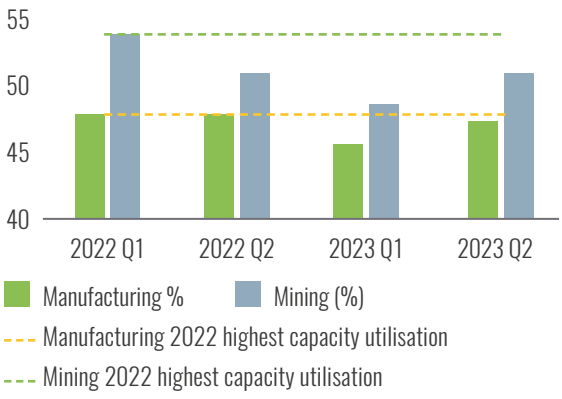


Figure 1.5. Output of the electricity sector has grown in 2022, but is declining in 2023



Source: ZimStat.

Figure 1.6. Capacity utilization of the manufacturing sector is subdued in 2023



[1] Another measure of capacity utilization of the manufacturing sector is based on the Confederation of Zimbabwe Industry's (CZI's) annual survey of manufacturing firms. The 2022 annual survey noted capacity utilization (proxying large companies) had picked up and exceeded 50 percent for the first time since 2011. However, results should be interpreted with caution since it is a qualitative survey and reflects less than 9 percent of the total sector.

Robust services sector growth has underpinned Zimbabwe's economic recovery, but there is still potential for further recovery of the tourism industry following the end of lockdowns and other COVID-19-related restrictions. Output of services rose sharply by over 7 percent in 2022 and projected to increase by 4.9 percent in 2023. The accommodation and food services subsector registered double-digit growth in both 2022 and 2023, as tourism numbers grew from their pandemic low point in 2021. There is potential for further expansion as the tourism sector is still to return to its pre-pandemic level (Figure 1.7).

Despite the robust economic recovery, informality levels remain elevated in Zimbabwe. High inflation, exchange rate distortions, and a difficult business environment have raised the cost of doing business for the formal sector, triggering a rise in informal activity. Zimbabwe's large informal sector has lowered fiscal revenues, constrained competitiveness, and made it more difficult for the authorities to manage the economy. Informality is pervasive across the economy, particularly in agriculture and the wholesale and retail trade (Figure 1.8). Conversely, the number of informally employed workers has decreased for agriculture, wholesale and retail, and manufacturing in the period from Q4 2021 to Q4 2022. Formal employment only grew in education, for activities of households as employers, and transport. The authorities intend to tackle this with a suite of policies to reduce barriers for firms to formalize and grow. The package of policies will aim to prioritize focused support for the informal sector, targeting better access to finance, training, and access to markets.

Figure 1.7. International tourist arrival numbers have started to recover but are still below pre-pandemic levels

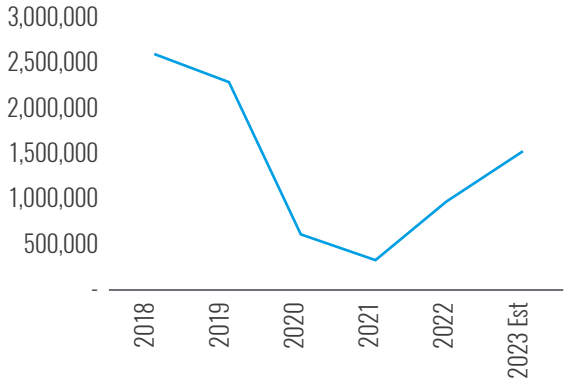
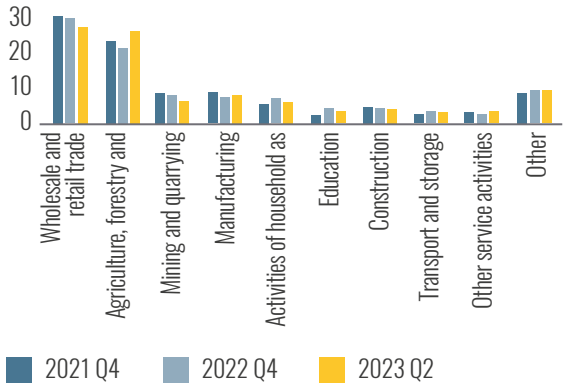


Figure 1.8. Informal employment levels remain elevated across most sectors



Source: Zimbabwe Tourism Authority 2022, ZimStat 2022: Labour Force Survey.

Sustaining economic growth will require Zimbabwe to tackle its macroeconomic and structural challenges. Addressing price and exchange rate volatility and public debt arrears will be vital in supporting economic growth and job creation. Rising exchange rate distortions and high inflation have misallocated resources to sectors and firms with low productivity and limited private investment. The accumulation of debt arrears has limited Zimbabwe's access to external financing and kept public investment at low levels, further negatively impacting growth. On the structural front, significant support to agriculture in the form of agricultural inputs, cross-subsidies on electricity, and loan guarantees has meant less public finance for human capital development and public infrastructure.

Inadequate electricity supply is another major structural challenge that is hampering growth (see section 2 of this report). Power shortages have a significant adverse impact on the productive sector and result in higher costs for Zimbabwe's economy. In 2020, the available generation capacity was 1,585 MW compared with peak demand of 1,900 MW, forcing power outages of 12–14 hours a day. Electricity deficits are caused by outdated infrastructure, and inefficient power transmission and distribution, coupled with an over-reliance on volatile hydroelectric power. Overall, this is highly damaging for the private sector, as unreliable and expensive electricity supplies reduce the margins of existing operations and weigh heavily on potential economic expansions. World Bank estimates suggest that Zimbabwe's power shortages cost the country a total of 6.1 percent of GDP per year, comprising 2.3 percent of GDP in generation inefficiencies and excessive network losses, and 3.8 percent of GDP on the downstream costs of unreliable energy. If Zimbabwe hopes to achieve the high growth rates needed to move toward upper middle-income status by 2030, it will be critical to realize stable and reliable electricity access.

1.2 FISCAL DEVELOPMENTS

Fiscal adjustment needs to continue in order to durably reduce economic volatility

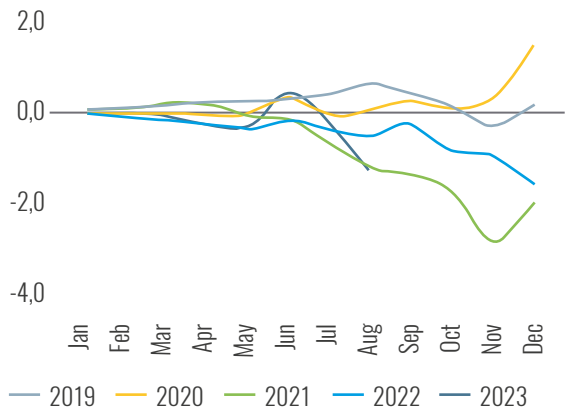
Despite rising spending pressures, the Government has made important strides to stabilize the economy by keeping the fiscal deficit low. Inflationary pressures pushed up expenditure and revenue. Public spending increased noticeably from 18.2 percent of GDP in 2022 to 19.0 percent of GDP in 2023.

Nonetheless, despite this increase, the Government managed to keep fiscal deficits low, at 1.6 percent in 2022, though pressures have emerged in 2023 (Figure 1.9). The fiscal deficit was under 3 percent of GDP since 2019. However, the fiscal deficit has more than doubled (year-on-year) during the first 8 months of 2023 (from 0.5 percent of GDP in 2022, to 1.2 percent of GDP in 2023). The fiscal deficit is estimated at 2.3 percent in 2023, driven by the high wage bill, election-related spending, and high interest payments from absorbing the Reserve Bank of Zimbabwe's (RBZ) external loans (see the section on monetary developments).

Successful mobilization of tax revenues in conjunction with higher proceeds from the mining sector supported a significant expansion in revenues. Revenue collection effort rose further to 16.6 percent of GDP in 2022, up from 15.1 percent in 2021 (Figure 1.10). The strong revenues performance in 2022 stemmed from bracket creep, as inflation pushed salaries and incomes into higher tax brackets. As a result, income tax revenue rose from 5.7 percent in 2021 to 6.6 percent in 2022. Similarly, higher royalties from the mining sector supported an increase in non-tax revenue to 0.8 percent in both 2021 and 2022. Finally, the depreciation of the Zimbabwe dollar (ZWL) raised revenues denominated in US dollars. Full potential was, however, undermined by a wider exchange rate premium. Excise duties in 2022 recorded the highest increase compared with 2021, rising to 2.0 percent of GDP. A similar trend was observed in the first 8 months of 2023, as customs duty and excise tax increased compared with the same period last year, following the currency depreciation. Despite this, intermediate money transfer tax decreased, showing further informalization and dollarization during this period.

Fiscal consolidation measures, implementation of public procurement policies and value for money audits helped to contain expenditure in the face of high inflation and local currency depreciation. Most government suppliers were using exorbitant forward pricing in the face of high inflation and exchange rate depreciation. Government responded by slowing down payments on large contracts and introduced value-for-money audits that helped to keep capital expenditure constant in 2022. The authorities also implemented several reforms to improve fiscal policy. Fiscal reporting has been enhanced with a performance framework that underpins program budgets, improved reporting on debt, and the strengthening of internal audit.[2]

Figure 1.9. Fiscal deficits have been contained...



Source: ZimStat, World Bank.

Figure 1.10. ...as revenues increased...

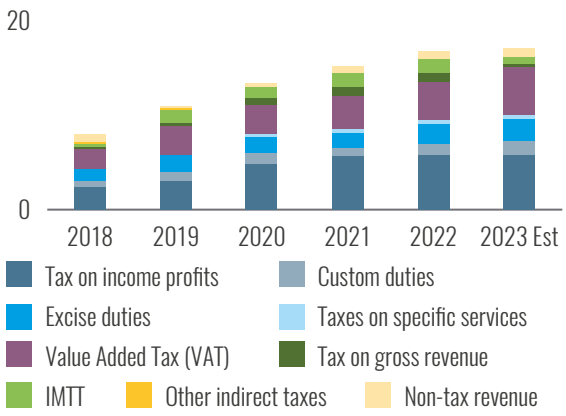
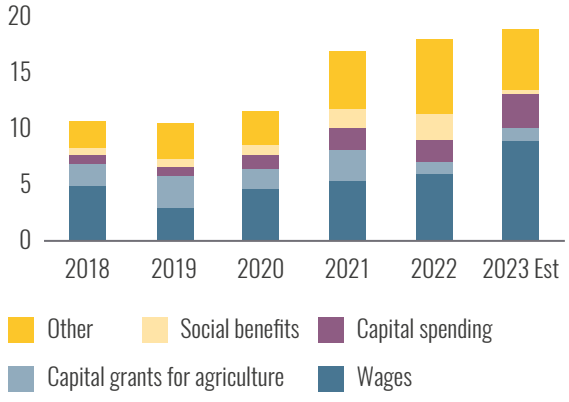
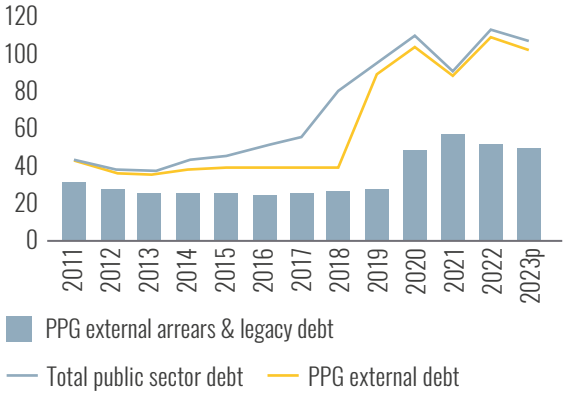


Figure 1.11. ...with expenditure increasing as wages increased at the expense of capital spending



Source: ZimStat, World Bank.

Figure 1.12. ...while public debt continues to rise, by accumulating external arrears and legacy debt



[2] From international budget open survey report of Zimbabwe, 2021- https://internationalbudget.org/open-budget-survey/.

Rising public wages and debt remain a challenge for the authorities

The surge in public expenditure has been driven by rising employment costs, while capital expenditures have remained constant. Wages rose to around 5.4 percent of GDP in 2021 and 6.1 percent of GDP in 2022 (Figure 1.11). Wages are estimated to have increased significantly in 2023, as they are partly paid in foreign currency (increased and fixed at US$300 per month) and local currency. This is partly to maintain the real value of wages. The increase in wages is however, at the expense of undermining economic policy by crowding out capital and social spending.

Public debt has continued to climb, driven by external arrears and legacy debt (Figure 1.12). Zimbabwe's public debt is in distress and unsustainable, constraining access to international finance. Public debt rose to over 100 percent of GDP in 2022 and 2023. While a sharp depreciation of the Zimbabwe dollar helped to keep domestic debt low, external debt increased sharply. This is partly driven by debt arrears, as the GoZ stopped servicing external debt in 2000. With Zimbabwe resuming token payments in 2021 to multilateral creditors, its external arrears accumulated to US$6.6 billion in 2022. In addition, the GoZ has taken over contingent liabilities arising from: (i) compensation for a 2019 decision to impose exchange rate restrictions that blocked external payments to foreign suppliers and investors ("blocked funds")[3] amounting to US$3.5 billion; and (ii) compensation to former farm owners from an early 2000s land reform initiative that added another US$3.5 billion to debt. While this is an important way to help redress historical policy missteps, this meant the total cost of external arrears and legacy debt has shot up from 26 to 52 percent of GDP between 2018 and 2022 (Figure 1.12). The Government's options for debt financing are also increasingly restricted. Domestic debt financing of the budget has been minimal, given recent economic volatility. Meanwhile, external financing options have been severely inhibited by external arrears. To service these debt payments, RBZ has been relying on expensive loans from the African Export-Import Bank (Afreximbank) and the printing of money.

To move towards a pathway to clearing external arrears and to resolve its unsustainable public debt, the authorities launched a dialogue platform with development partners in December 2022. The platform hosted by the African Development Bank offers a forum to discuss key thematic

EXTERNAL ARREARS ACCUMULATED TO

US$6.6 BILLION

[3] The blocked funds arise due to government policy, the RBZ decided to compensate stakeholders for losses on cash flows that could not be repatriated due to foreign currency shortages following 2019 policy on converting all foreign currency account to local currency.

issues between senior government officials, development partners and multilaterals. Three working groups were set up to report to the dialogue platform, focused on: (i) economic growth and stability; (ii) governance; and (iii) land reforms. Measures in the economic reforms matrix focus on liberalizing the exchange rate, transferring the RBZ's external liabilities that arose from quasi-fiscal operations (QFOs) to the treasury, strengthening domestic revenue mobilization, ensuring fiscal and monetary policy is non-inflationary, and improving access to inclusive social protection. Finally, it calls for a IMF staff-monitored program, to help further define and implement strategies from the economic reform matrix (see section 1.7).

In line with the Economic Reform Matrix, the Treasury has announced the transfer of the RBZ's external liabilities to the treasury. In May 2023, the Minister of Finance announced that the treasury will adopt all foreign currency debt and external loans from the RBZ from June 2023 onwards, as a means to help stabilize the macroeconomy. The treasury's public debt report suggests RBZ external liabilities add up to $3.6 billion. The GoZ announced that US$1.8 billion of these liabilities has been transferred during calendar year 2023. To prevent future increases in public debt from RBZ, the government also announced that RBZ cannot take on additional external debt without explicit agreement of the Treasury.[4]

To absorb these liabilities and service external loans, the Treasury also announced measures to mobilize additional revenues. The new measures introduced in May 2023 include introduction of 1 percent tax on all foreign payments, a requirement to pay excise duty on fuel in foreign currency, and VAT charged on manufacturing products for export (but refundable after exporting). Treasury will also absorb the Zimbabwe dollar component of foreign currency surrendered by exporters (25 percent of export proceeds). In addition, in October 2023 the government announced that the mining sector will no longer be able to claim tax incentives in the special economic zone.[5] Finally, the budget announcement in November 2023 also announced various new tax measures (see box 1.1). The precise impact of these revenue measures is not yet clear.

1.3 MONETARY DEVELOPMENTS

Initial expansionary monetary policy had put pressure on inflation, but policy has recently tightened

Increased global turmoil and supply chain disruptions contributed to rising energy and food prices, and contributed to high inflation. Supply chain disruptions during the COVID-19 pandemic, together with the war in Ukraine, put considerable pressure on Zimbabwe's inflation. Driven by the impacts on war in Ukraine, in 2021, energy prices rose 80 percent, while food prices went up over 30 percent. Similarly in 2022, energy prices went up 60 percent, while food prices increased another 18 percent (Figure 1.13).

[4] Statutory Instrument 108 of 2023 amends the Reserve Bank of Zimbabwe act by inserting the proviso that "the Bank shall only borrow foreign currency on behalf of the State at the instance of the Minister, and not on its own behalf". If such borrowing affects the requirements to have sufficient foreign reserves to cover 100 percent of its liabilities to the public, "the Minister may suspend, for a period not exceeding sixty days, the reserve requirements there mentioned, and may extend such period for further periods not exceeding sixty days".

[5] See Section 3(5) of Statutory Instrument 226 of 2023, "Zimbabwe Investment and Development Agency (Special Economic Zones) Regulations, 2023".

Box 1.1. New tax measures introduced in the 2024 Zimbabwe national budget.

On 30 November 2023, the Minister of Finance presented a new national budget, "Consolidating Economic Transformation". This budget proposes a rise in expenditure (from 19 percent of GDP in 2023, to 19.8 percent of GDP in 2024), driven in part by an increase in capital expenditure (from 3.3 percent of GDP in 2023, to 4.2 percent of GDP in 2024), and by higher proposed allocation to service its debt for former farm owners, "blocked funds" and the transfer of RBZ external liabilities to the treasury. To help finance this, the budget includes a range of tax measures, with the aim of increasing revenue (from 17.8 percent of GDP to 18.3 percent in 2024). Jointly, this means a planned fiscal deficit of 1.5 percent of GDP. A selection of new tax measures is highlighted below:

New progressive tax measures

- 30 percent duty surcharges on luxury cars, above $US 120,000 in value.
- Annual wealth tax of 1 percent on properties valued above $100,000; for owners below the age of 70.
- 15 percent tax on jurisdictional profits for large multinationals (Domestic Minimum Top-Up Tax), in line with the Global Minimum Tax.

Mining sector

- Introduction of 1 percent levy on gross proceeds of lithium, black granite and other stones and quarry stones.
- Introduction of capital gains tax for transfer of mining ownership. For foreign holders of mining rights, this will result in an effective 50 percent capital gains tax.
- Establishment of a register of mining rights (record of applications, grants, variations, dealings, assignments, transfers, suspensions and cancellation of rights) to improve mining tax administration.

Informal economy

- Lowering the VAT threshold from US$40,000 to $25,000 in annual revenue, to encourage informal traders to join the formal retail sector.
- Traders needs to be VAT payers before they can buy from a manufacturer, although they can still buy from a wholesaler if they pay the rest of their taxes.
- Adoption of a digital platform to improve compliance on local duties (especially for cigarette producers).

Other key tax measures

- Increase in fuel excise by US$0.03 (diesel) and US$0.05 (petrol) per litre.
- Increase in toll fees for Harare-Beitbridge and Plumtree-Mutare roads.
- Levy on sugar-sweetened beverages of US$0.02 per gram of sugar (comparable to South Africa).
- Raising tax-exempt threshold on withholding tax on agricultural commodities from US$1,000 to US$5,000.
- Raising tax-free threshold on income tax to ZWL$750,000 a month with a ZWL$7.5 million tax-free threshold for bonuses, so more taxpayers are below the personal income tax threshold.

In sum, this budget aims to finance an increase in capital expenditure and debt servicing, by adopting a progressive way to increase domestic revenue mobilization (including via an annual wealth tax, a duty surcharge on luxury cars, and a tax on large multinationals). The measures also focus on addressing tax gaps and tax compliance challenges in the mining sector, and the informal sector. Finally, several other measures aim to broaden the tax base, focused on raising excise taxes on fuel and sugar-sweetened beverages. To help cushion the impact on low-income households, the tax-free thresholds on personal income taxes has been raised.

Source: Government of Zimbabwe - national budget statement, presented on 30 November 2023.

The RBZ's quasi-fiscal operations have also driven up inflation. Limited access to external financing, combined with a tight fiscal policy resulted in a situation where RBZ directly financed external debt servicing payments (liabilities) by printing money. In previous years, the RBZ also made transfers to the real sector through agricultural subsidies, support for state-owned enterprises (SOEs), and incentives for gold production. In 2022, the RBZ's payments on these QFOs accounted for 2.5 percent of GDP (World Bank-IMF DSA, 2023). These resulted in an expansionary monetary supply and a deterioration in the RBZ's balance sheet. Broad money growth duly rose from 55 percent in September 2021 to over 1,000 percent in June 2023. The joint impact of global price rises and increased domestic money supply drove up inflation, with major peaks in August 2022 and June 2023 (Figure 1.14).

But recent monetary policy tightening has limited volatility. Since June 2023, the RBZ has been proactive in tightening monetary policy; increasing reserve requirements for the banking sector, and raising the bank policy lending rate.[6] Furthermore, reserve money growth was curbed by issuing non-negotiable certificates of deposits (NNCDs) and Gold-Backed Digital Tokens[7] to absorb excess Zimbabwe dollars. While inflationary pressures have started to abate, the ability of the authorities to contain further price shocks will rest on whether the Government is able to accommodate QFOs within fiscal accounts. For now, Zimbabwe's prices remain elevated, eroding purchasing power, and putting many goods and services out of the reach of most households.

The Government has also extended the use of US dollars as legal tender until 2030, further reducing policy uncertainty. The use of US$ was initially planned to end in 2025. The extension may help to bring certainty on the use of foreign currency and help financial sector to continue lending in US$. Given the extension, there is need for clear roadmap on reaching the mono-currency economy by 2030.

Increased dollarization of the economy and changing measurement standards have complicated the tracking of inflation. Zimbabwe's macroeconomic instability has progressively pushed up the use of US dollars, and foreign currency deposits increased from about 20 percent in 2019 to almost 80 percent by August 2023 (Figure 1.15). In turn, in February 2023, the Zimbabwe National Statistics Agency (ZimStat) moved to a "blended" inflation measure that captures the relative shares of US dollars and Zimbabwe dollars in inflation estimates,[8] and stopped the publication of local currency inflation data. In September 2023, Zimstat went further and shifted from an "arithmetic aggregation" to a "geometric aggregation" method to estimate inflation, which further reduced the headline estimated inflation rate (Figure 1.16). Interpretation of a blended inflation indicator without using

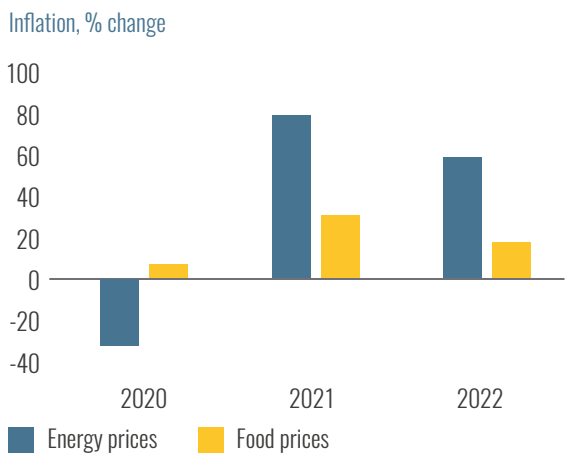
[6] In September 2022, banks' statutory reserve requirements were raised to 10 percent for ZWL demand and call deposits and 2.5 percent for savings and time deposits. Similarly, statutory reserve requirements for foreign currency were raised to 5 percent for call deposits and 2.5 percent for time and savings deposits. In September 2023, the statutory reserve requirements for both foreign and local currency deposits were standardized at 15 percent, and for savings and time deposits at 5 percent. Moreover, the policy lending rate was raised from 80 percent to 200 percent per year in May 2022 (lowered to 150 percent since February 2023 and further lowered to 130 percent in October 2023).

[7] The launch of the Zimbabwe Gold-Backed Digital Token (ZiG) was completed in October 2023 as another means of payment for domestic transactions. The value of the digital currency will be at par with the value of the physical Mosi-oa-Tunya gold coin (introduced in 2022) and will remain informed by the international gold price.

[8] To do this, ZimStat collects US dollar and Zimbabwe dollar prices for its basket of selected goods and services, and weights these according to use.

a Zimbabwe dollar inflation indicator is likely to be difficult, since it only provides a partial picture and understates changes in prices, especially for earners of incomes in the local currency.[9]

Figure 1.13. Rising global commodity prices contributed to high inflation...



Source: ZimStat, World Bank.

Figure 1.14. ...RBZ's quasi-fiscal operations (QFOs) have driven up inflation until June 2023...

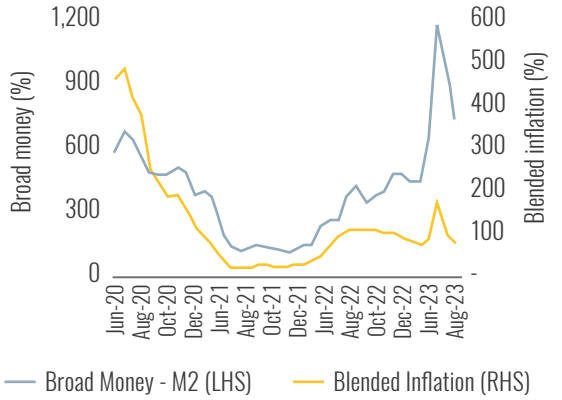
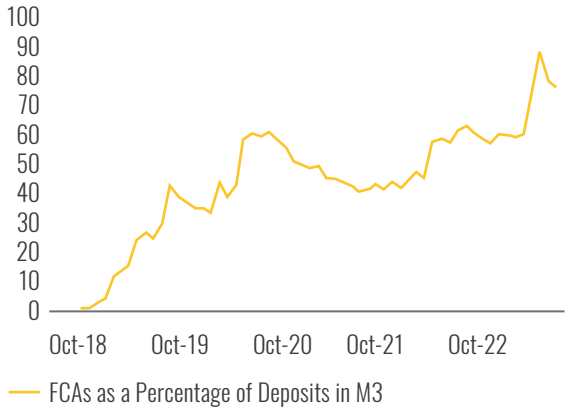
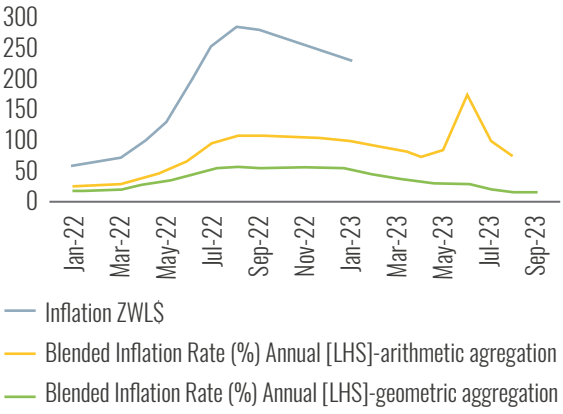


Figure 1.15. Dollarization has increased and pushed up the use of foreign currency in domestic transactions...



Source: ZimStat, World Bank.

Figure 1.16. ...resulting in ZimStat stopping the publication of Zimbabwe dollar inflation data and switching to a blended inflation measure



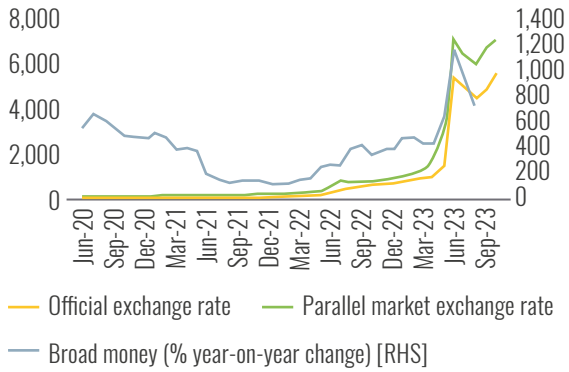
[9] Under such a reporting arrangement, decision-making is likely to be sub-optimal. Public resources may be misallocated across the economy. Labor in Zimbabwe is still partly paid in Zimbabwe dollars, and therefore are likely to be inadequately compensated. In addition, sectors and regions may receive an inadequate allocation of public resources. Furthermore, the application of tax policies could be ineffectual, adversely impacting on public revenues. Finally, the conduct of monetary policy by the RBZ may be impaired and outside external scrutiny, compromising the efficacy of economic policy.

The introduction of an interbank market and tighter monetary policy helped reduce parallel market premiums from their May 2022 and June 2023 peaks. In April 2022, the RBZ created a willing-buyer willing-seller interbank market for foreign exchange, which helped to move towards a more market-based allocation of foreign exchange. This market, combined with a significant devaluation of the official exchange rate,[10] considerably reduced exchange rate volatility and reduced the parallel market premium from a high of 154 percent to around 19 percent by September 2022 (Figure 1.17; Figure 1.18). Exchange rate volatility increased again in 2023, in part due to expansionary monetary policy (see above), and the parallel market premium widened to 124 percent in May 2023. Yet with the RBZ's tightening of monetary policy in June 2023, the premium also declined again to around 30 percent in October 2023.

The proposed removal of the limit of 10 percent trading margin above the interbank rate will further help move to a market-based exchange rate. In recent years, GoZ has strictly enforced companies to issue their pricing so that their US$ and ZWL prices do not exceed the official US$-ZWL exchange rate plus a maximum 10 percent margin.[11] Yet, the persistence of a premium between the official and parallel market premium has resulted in a situation where informal shops (which often only accept US dollars) charge lower US$ prices than formal shops (that have to adhere to the official exchange rate). This, in turn, has contributed to increased informalization, and meant any ZWL inflation pushes up US$ inflation in Zimbabwe. In October 2023, RBZ therefore recommended removing this limit, and once adopted, will present an important step to further liberalization of the foreign exchange market.

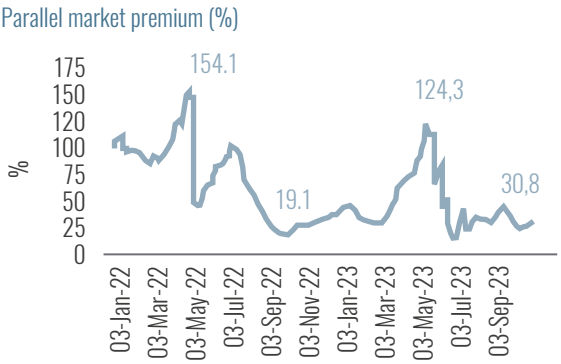
Finally, the financial sector remains adequately capitalized, with non-performing loans (NPLs) at very low levels. The financial sector has significant capital reserves[12] and is able to withstand unexpected shocks or losses. Banking institutions remain compliant with the prescribed minimum capital adequacy ratio of 12 percent and tier 1 ratio of 8 percent, although the recapitalization of all

Figure 1.17. Introducing an interbank market improved the stability but exchange rates remain unstable, partly due monetary expansion...



Source: ZimStat, World Bank.

Figure 1.18. The interbank market and tight monetary policy helped reduce parallel market premiums from May 2022 and June 2023 peaks



[10] Annual depreciation of the parallel rate declined from 443 percent in July 2022 to 344 percent in December 2022.
[11] Failure to comply has resulted in the RBZ's Financial Intelligence Unit issuing fines or closing companies' bank accounts.
[12] The capital adequacy ratio rose from 32.86 percent in December 2021 to 37.15 percent in December 2022.

banks has still to be completed. Average NPLs remain minimal, estimated at 1.58 percent of banking sector loans in December 2022, but this is against limited bank intermediation.

1.4 EXTERNAL SECTOR

External sector prospects remain demanding, with growing global turmoil

External headwinds have contributed to a narrowing of Zimbabwe's current account surplus. Zimbabwe's current account surplus fell to 1.1 percent of GDP in 2022 (Figure 1.19). Exports grew by 10.5 percent in 2022, with rising commodity prices increasing exports of minerals and metals, particularly gold (Figure 1.20). At the same time, rising commodity prices in 2022, particularly for fuel and fertilizers, led imports to grow by 13.9 percent in 2022 (Figure 1.21). The rising trade gap was partly counteracted by a surge in remittances, which rose to US$1.97 billion in 2022, together with tourism receipts. The current account surplus narrowed further during the first half of 2023, as the widening of the trade deficit outpaced growth of remittances. The merchandise trade deficit increased by 6 percent during the first 8 months of 2023 compared with the same period in 2022, reflecting a decline in mineral exports and an increase in imports.

Rebuilding the RBZ's foreign exchange reserves will be essential if the impact of further global volatility on the economy is to be reduced. Foreign exchange reserves remain at low levels. Allocation of the IMF's Special Drawing Rights (SDR) quota to Zimbabwe increased the level of foreign exchange reserves to around 1.5 months of goods and services in 2021 (Figure 1.22). However, a considerable proportion of the SDR quota was subsequently utilized in 2021 and 2022 to support economic recovery. Consequently, by 2022, foreign exchange reserves of the RBZ had fallen back to around just 0.52 months of imports. Yet, the RBZ has chosen to use Zimbabwe's gold assets to issue gold coins and gold-backed digital tokens (ZiG), to allow the wider public to have access to an instrument for store of value and to stabilize the ZWL. This may prevent the build-up of international reserves. The use of gold in the form of gold coins and the recently introduced Gold-Backed Digital Tokens may also prevent the build-up of international reserves. As such, the economy remains considerably exposed to external shocks.

Figure 1.19. The current account surplus continues to fall

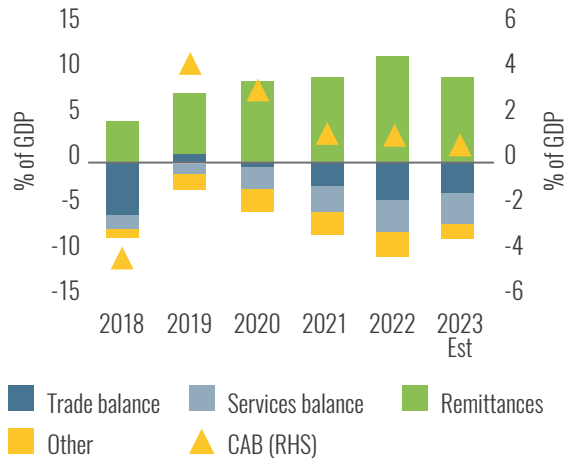
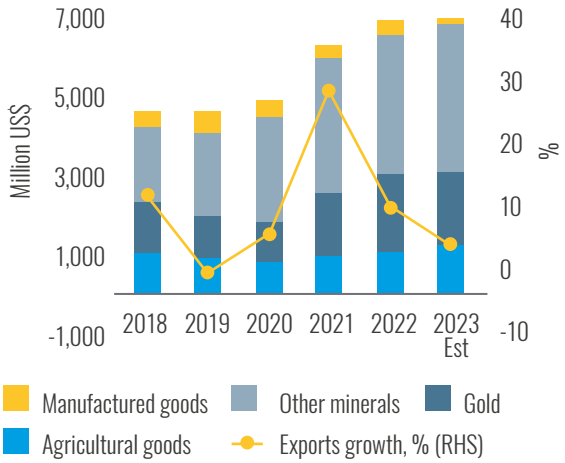


Figure 1.20. Export growth has been driven by gold and minerals



Source: ZimStat, RBZ, World Bank.

Figure 1.21. Import growth has been driven by demand for machines and fuels

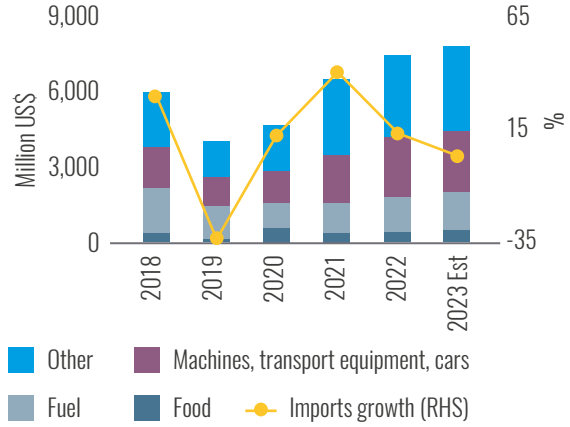
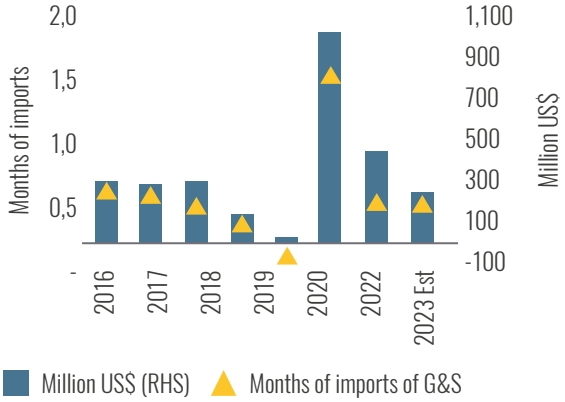


Figure 1.22. Gross international reserves remain low



Source: ZimStat, RBZ, World Bank.

1.5 POVERTY IMPLICATIONS

The economic rebound since the pandemic has helped to bring down the levels of poverty and food insecurity

The economic rebound following the COVID-19 pandemic has helped to bring down the levels of poverty and food insecurity. On the back of economic recovery and record maize harvests in the 2020/21 agricultural season, the extreme poverty rate fell by 6 percentage points to 43 percent in 2021 and to 42 percent in 2022. The food insecurity rates also dropped from their highs of 2020 and early 2021. In late 2021, 38 percent of households were moderately or severely food insecure, while the proportions of households that were either severely and moderately, or severely, insecure declined from 61 and 18 percent, respectively, from a few months earlier in March 2021 (Figure 1.24).[13]

Nevertheless, poverty, vulnerability, and food insecurity rates remain worryingly high. Despite robust economic growth in the period following the pandemic, the share of the population living in extreme poverty and food insecurity remains worryingly high. There may be several reasons why economic growth has failed to translate into lower poverty rates. It may indicate that the poverty elasticity of agricultural growth may is low because the farm production of smallholder farmers has been limited by the increase in fertilizer prices. In addition, further high inflation has eroded purchasing power, limiting both income and consumption growth.

[13] Food insecurity is calculated using the Food Insecurity Experience Scale (FIES) collected from household phone surveys.

Figure 1.23. Extreme (food) poverty rate declined after the pandemic

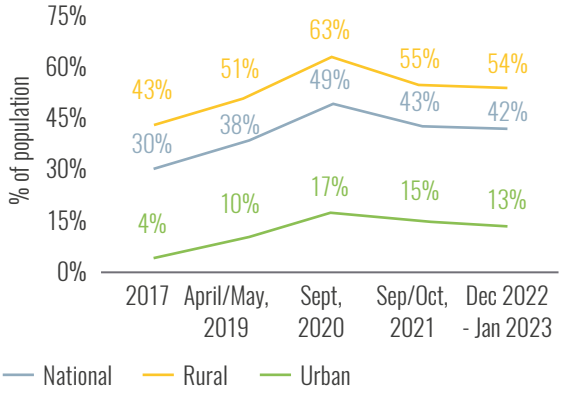
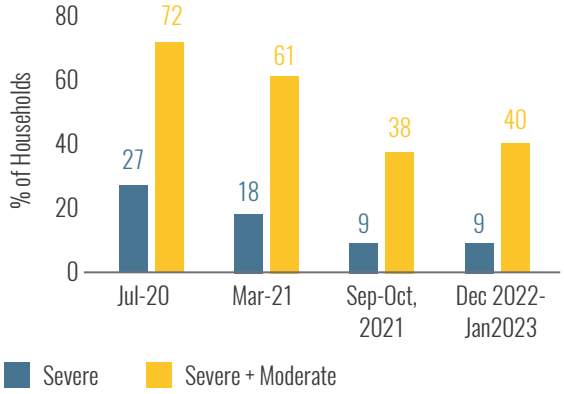


Figure 1.24. Food insecurity rate (% of households) is declining, though it remains high



Note: The data sources for the 2017 and 2019 poverty estimates are the Poverty, Income, Consumption, and Expenditure Surveys (PICES) conducted in 2017 and 2019 (Mini-PICES), respectively. The 2020, 2021, and 2022/23 estimates are based on high-frequency household monitoring phone surveys conducted after the COVID-19 pandemic.

1.6 NEAR AND MEDIUM-TERM OUTLOOK AND RISKS

The economy is projected to slow in 2024, as both domestic and external shocks continue to affect growth (see table 1.1)

Continued global headwinds, structural bottlenecks, wealth-related shocks, and price and exchange rate volatility will continue to weigh down on economic prospects in 2024. Growth is projected to slow in 2024, as agricultural output is expected to suffer from predicted erratic and below-average rainfall caused by the El Niño weather pattern. The high cost of seeds and fertilizers, coupled with financing issues, will further limit agriculture potential. Nonetheless, domestic demand is expected to increase as inflationary pressures ease. Continued implementation of economic reforms, including those outlined in the arrears clearance dialogue, will help cool down inflation and exchange rate pressures.

The fiscal deficit is projected to moderate in 2024, though risks remain high. Interest payments from servicing QFOs debt are projected to increase significantly, posing liquidity risks amid limited access to concessional financing. The fiscal deficit is projected to decline to under 2.0 percent in 2024 and 2025. Management of fiscal policy is likely to remain challenging due to public debt unsustainability. Fiscal consolidation will be required to restore fiscal sustainability and economic growth.

A surging public wage bill will squeeze fiscal space. Employment costs are forecast to remain around 9.0 percent of GDP in 2024. As a consequence, public investment will remain low amid limited financing. Meanwhile, real allocations to the education, health and social sectors are likely to fall.

Tightening of monetary policy will enable inflationary pressures to subside. Transferring of QFOs from the RBZ to the Government's budget (catered through tax revenues) will enable the RBZ to constrain reserve money growth within acceptable limits. It will enable the RBZ to better stabilize inflation. Nevertheless, global volatility is expected to continue, keeping commodity prices (especially fuel) elevated.

Table 1.1. Selected economic indicators for Zimbabwe (annual percent change unless indicated otherwise)

	2020	2021	2022	2023e	2024f	2025f
Read GDP growth, at constant market prices	**-7.8**	**8.5**	**6.5**	**4.5**	**3.5**	**3.5**
Private Consumption	-2.3	1.5	4.9	3.0	3.4	3.4
Government Consumption	-23.8	142.1	31.3	26.8	2.1	1.7
Gross Fixed Capital Investment	-18.2	12.8	22.3	-21.6	0.9	0.8
Exports, Goods and Services	-48.9	47.0	43.9	3.0	1.5	3.4
Imports, Goods and Services	-44.1	61.5	54.6	2.0	1.1	2.5
Read GDP growth, at constant factor prices	**-7.7**	**8.4**	**6.4**	**4.5**	**3.5**	**3.5**
Agriculture	4.1	17.5	6.2	6.3	-4.0	7.2
Industry	-8.2	6.4	5.5	2.9	4.5	2.8
Services	-9.6	7.7	7.0	4.9	4.2	3.7
Current Account Balance (% of GDP)	2.9	1.0	1.0	0.8	0.5	0.4
Net Foreing Direct Investment Inflow (% of GDP)	0.7	0.7	1.0	1.4	1.5	0.5
Fiscal Balance (% of GDP)	1.5	-2.0	-1.6	-2.3	-1.6	-1.2
Debt (% of GDP)	51.2	58.4	100.8	89.0	87.0	85.0
Primary Balance (% of GDP)	1.6	-1.9	0.2	-2.3	-0.3	0.0
International poverty rate ($2.15 in 2017 PPP)[a,b]	43.9	41.4	39.6	38.7	37.8	36.9
Lower middle-income poverty rate ($3.65 in 2017 PPP)[a]	68.1	65.8	64.2	63.4	62.8	61.5
Upper middle-income poverty rate ($6.85 in 2017 PPP)[b]	86.9	85.6	85.0	84.6	84.3	83.9
GHG emissions growth (mtCO2e)	-1.4	1.2	1.4	0.5	1.0	1.6
Energy related GHG emissions (% of total)	11.3	12.5	13.2	14.4	15.4	16.6

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.
Notes: e = estimates. f = forecast. Poverty data are expressed in 2017 PPP versus 2011 PPP in previous editions - resulting in major changes. See pip.worldbank.org
(a) Calculations based on 2019-PICES. Actual data: 2019. Nowcast: 2020-2022. Forecasts are from 2023 to 2025.
(b) Projections using neutral distribution (2019 with pass-through = 0.87 (Med (0.87)) based on GDP per capita in constant LCU.

The current account surplus is expected to continue narrowing in the medium term, reflecting a rise in imports and slowing export growth. Rising import costs will adversely affect Zimbabwe's terms of trade. A negative trade balance will be compounded by a softening of mineral commodity prices. Meanwhile, foreign direct investment (FDI) is forecast to remain subdued at around 0.7 percent of GDP. With foreign exchange reserves at low levels, the economy is vulnerable to further trade shocks. Reserves are further complicated by the continued issuance of gold coins and gold-backed digital tokens.

Risks may increase economic volatility, reducing growth prospects in the medium term

There are considerable downside risks, which could lower future economic growth. Economic growth in the medium term could be additionally impacted by several downside risks. Prolonged global turmoil could result in a slowdown in global output, reduced trade and investment, increased volatility in commodity prices, and supply disruptions. Moreover, fiscal pressures may result in an expansionary economic policy. Continued power cuts will increase cost of production as more companies use diesel generators, push up prices and limit private sector activities. This could result in increasing economic volatility, impacting on private sector activity and growth. Finally, climate change shocks may serve to lower economic output, particularly in the agriculture sector.

Upside risks to the outlook are dependent on the advancement of economic and political reforms. The implementation of substantial economic reforms would eliminate economic volatility and improve the business environment. There is a need for continued implementation of the arrears clearance dialogue. Moreover, the implementation of comprehensive spending reforms would ensure a more optimal allocation of public spending. While ambitious, a wide-ranging reform agenda coupled with a robust economic policy would increase investment and trade flows within Zimbabwe, and substantially increase economic output.

1.7 POLICY OPTIONS TO SUPPORT MACROECONOMIC STABILITY AND STRENGTHEN GROWTH

Sustaining economic growth will require Zimbabwe to tackle its macroeconomic challenges. Exchange rate distortions and high inflation offer considerable challenges to Zimbabwe's private sector, misallocating resources to sectors and firms with low productivity and limiting private investment. The accumulation of debt arrears has limited Zimbabwe's access to external financing and kept public investment at low levels, further negatively impacting growth. As such, addressing price and exchange rate volatility and public debt arrears is a necessary condition for economic growth and job creation.[14]

The new Structured Dialogue Platform between the GoZ and development partners identifies an important set of reforms and offers a resolution to Zimbabwe's pressing arrears and debt problems. Three working groups were set up to report to the dialogue platform, focused on: (i) economic growth and stability; (ii) governance; and (iii) land reforms. Resolute progress on these three platforms will help to re-establish macroeconomic stability. The dialogue also provides a promising opportunity for the GoZ to end its long-standing external debt arrears, which will help to provide access to affordable external credit lines, and stimulate much-needed public and private sector investment to boost growth.

[14] See also World Bank (2022c) Zimbabwe - Country Economic Memorandum: Boosting Productivity and Quality Jobs.

This edition of the Zimbabwe Economic Update re-affirms the importance and urgency of the policies set out in the Economic Reforms Matrix to re-establish macroeconomic stability, enhance growth, and protect the most vulnerable. It also commends the government on the important and significant progress made across several areas of the matrix (Table 1.2):

Table 1.2. Economic Reforms Matrix - Priority reform areas, key strategies and government action to date

Reform	Strategies	Government action to date
Successfully implement an IMF Staff Monitored Program	• An SMP will help with further defining and implementation of economic reforms highlighted in the rest of this matrix.	• GoZ has formally requested an SMP. • A IMF staff visit has served as key input into preparing for new SMP. • The SMP is planned to start in 2024.
Establish a market-determined and competitive foreign exchange rate regime	• Removal of restrictions on forex trade by banks, authorized dealers and on business transactions. • Implementing regulations that allows the market to set the exchange rate.	• Adoption of willing-buyer, willing-seller market in April 2022. • Proposed removal of the limit of 10 percent trading margin above the interbank rate.
End all quasi-fiscal operations, end all unbudgeted expenditure	• All of RBZ liabilities to be formally moved to the treasury's books, ending all QFOs. • All government transactions to be carried out at market rate, unless on-budget subsidies/ guarantees.	• Announcement that US$1.8 billion of RBZ's $3.6 billion external liabilities has been transferred to the treasury in 2023. • Issuance of SI preventing RBZ from taking on additional external debt without Treasury agreement.
Strengthen revenue collection and expenditure management	• End retention of foreign exchange of exports. • Raise domestic revenue collection to absorb RBZ's liabilities. • Strengthen the capacity of the MoFED to conduct financial analysis of SOEs. • Publish conclusions of the value for money review of significant procurement contracts. •	• Announcement of revenue measures (1 percent tax on foreign payments, fuel excise duty, VAT on manufacturing and exports in foreign currency), new tax measures in 2024 GoZ budget • MoF absorption of foreign export surrenders. • Exclusion of mining sector from claiming SEZ tax incentives.
Maintain tight monetary policy and sound fiscal management	• Maintain appropriately tight monetary policy. • Use interesting-bearing certificates of deposits for mopping up surplus liquidity. • Non-inflationary fiscal policy, while ensuring sufficient and timely funding of social protection, health, and education.	• Observed tight monetary policy post-June 2023. • The 2024 GoZ budget proposes a fiscal deficit of 1.5 percent of GDP.
Improve access to inclusive social protection	• Establish a single registry of vulnerable people and management information system for social assistance program. • Consolidate multiple, fragmented programs into a few focused programs.	• Pilots on single registry completed in two districts.

Source: Government of Zimbabwe, March 2023. Note: SMP = Staff Monitored Program. MoFED = Ministry of Finance and Economic Development. RBZ = Reserve Bank of Zimbabwe. SOEs = State-Owned Enterprises. QFO = quasi-fiscal operation SEZ = Special Economic Zone. VAT = Value Added Tax.

[14] See also World Bank (2022c) Zimbabwe - Country Economic Memorandum: Boosting Productivity and Quality Jobs.

1 ***Successfully implement an IMF staff-monitored program (SMP).*** An SMP will help with further defining and implementation of economic reforms highlighted in the rest of this matrix.

- **Government action to date:** The Government has formally requested an SMP by June 2023. An IMF staff visit in October 2023 has served as a key input into preparing the new SMP, which is planned to start in 2024.

- **Recommendations:** The World Bank recognizes the constructive and open discussions, transparency and data sharing observed during the IMF mission. Continuation along this way will be important to help support the reengagement, arrears clearance and debt resolution.

2 ***Establish a market-determined and competitive foreign exchange rate regime:*** Strategies to realize this include removing restrictions on the exchange rate at which banks, dealers, and businesses can transact; and implementing regulations to allow markets to set the exchange rate.

- **Government action to date:** The Government started liberalizing the foreign currency market through the willing-buyer, willing-seller market (adopted in April 2022). The proposed removal of the limit of 10 percent trading margin above the interbank rate will also further help move to a market-based exchange rate.

- **Recommendations:** The parallel FX market premium remains large at above 30 percent, and so additional efforts are likely needed to shift towards a market-determined forex market by allowing more flexibility in the official exchange rate through a more transparent and market-driven price discovery. There may also be a need to develop a roadmap to stabilize the ZWL and help attain the government's policy of a mono-currency economy by 2030.

3 ***End all QFOs and end all unbudgeted expenditures:*** The matrix calls for all RBZ liabilities to be formally moved to the treasury's books, and for all government transactions to be carried out at market rate (unless via on-budget subsidies). It also calls for the ending of forex retention policy.

- **Government action to date:** In May 2023, the Minister of Finance announced that the treasury will adopt all foreign currency debt and external loans from the RBZ from June 2023 onwards. The GoZ announced that US$1.8 billion of the $3.6 billion of RBZ's external liabilities has been transferred during calendar year 2023. To prevent future increases in public debt from RBZ, the government also issued an SI that prevents RBZ from taking on additional external debt without explicit agreement of the Treasury.

- **Recommendations:** To ensure price stability and budget transparency, it is critical that RBZ completes transfer of these external liabilities to the Treasury (to be serviced through tax revenue which does not increase money supply), and that all government transactions are conducted at market rates (or otherwise explicitly reported as a subsidy). While the imposition of a 25 percent forex retention policy currently helps to distribute foreign currency to strategic non-generators of foreign currency and sustain the dual currency environment, it acts as a tax on the tradable sector. As such, in the medium-term there is a need to end the forex retention policy to improve the competitiveness of Zimbabwe's exporters.

4 ***Strengthen revenue collection and expenditure management:*** To absorb RBZ's forex liabilities on its budget, the GoZ will need to raise additional domestic revenue. It may also have to rationalize expenditures, which can be done by improving spending effectiveness via financial analysis of state-owned enterprises (SOEs) and value-for-money (VfM) reviews for procurement contracts. The benefits would be even greater if the results of the VfM analysis are published.

- **Government action to date:** In May 2023, the Government announced new measures to mobilize additional revenues, which include introduction of 1 percent tax on all foreign payments, a requirement to pay excise duty on fuel in foreign currency, and VAT charged on manufacturing products for export (but refundable after exporting). Treasury will also absorb the Zimbabwe dollar component of foreign currency surrendered by exporters (25 percent of export proceeds). In addition, in October 2023 the government announced that the mining sector will no longer be able to claim tax incentives in the special economic zone. Finally, the budget announcement in November 2023 also announced various new tax measures (see box 1.1). The precise impact of these revenue measures is not yet clear.

- **Recommendations:** To raise additional domestic revenue, GoZ may wish to consider rationalizing tax expenditures, increasing Zimbabwe's mining revenue, and raising excise tax on products that negatively impact public health. Strengthening revenue administration to improve collection (especially for high net-worth individuals) provides further options. There may also be options to rationalize expenditures by improving spending's efficiency, effectiveness, and equity. To explore these options further, the World Bank and GoZ are engaged in a Public Finance Review with preliminary findings and recommendations to be drafted throughout 2024.

5 ***Maintain tight monetary policy and sound fiscal management:*** The matrix calls for the maintenance of appropriately tight monetary policy, and the use of interesting-bearing certificates of deposits to mopping up surplus liquidity.

- **Government action to date:** The GoZ has made important strides to tighten monetary policy post-June 2023. The proposed budget is also prudent, by a proposed deficit of 1.5 percent of GDP.

- **Recommendations:** It will be critical to uphold this momentum, resist renewed (fiscal) pressures, and maintain the GoZ's non-inflationary policy stance.

6 ***Improve access to inclusive social protection:*** To improve the effectiveness of social protection, government could consider consolidating multiple, fragmented programs into a few focused programs, and strengthening the targeting toward the most vulnerable people.

- **Government action to date:** The GoZ and World Bank completed a pilot in 2022 to establish a single registry of vulnerable people in two districts.

- **Recommendations:** The GoZ could work together with the World Bank and other development partners to jointly scale up a single registry of vulnerable households across Zimbabwe as a whole, and use this to improve targeting for all its social protection programs and other subsidies (e.g. on agriculture and electricity) to vulnerable households.

PART 2

SPECIAL TOPIC: ELECTRIFYING ZIMBABWE'S GROWTH THROUGH RELIABLE AND UNIVERSAL ENERGY ACCESS

2.1 INTRODUCTION

The GoZ has set itself ambitious targets for 2030 to ensure reliable energy supply and significantly expand electricity services to most of the population. The National Energy Policy 2012 initially aspired to achieve universal access by 2030 (GoZ, 2012). More recently, Zimbabwe published its "Vision 2030: Towards a Prosperous and Improved Upper Middle-Income Society by 2030". It has three main energy priorities. First, achieve optimal generation of electricity (from non-renewable and renewable energy sources). Second, expand households' access to electricity from 52 percent in 2017 to 72 percent by 2030 (95 percent urban and 60 percent rural). Third, expand involvement of the private sector in energy supply and access expansion through public-private partnerships (PPP), joint ventures, and independent power producer (IPPs) (GoZ, 2018). ***This "Special Topic" considers Zimbabwe's recent developments in the energy sector and looks at ways to help attain the Government's targets.***

IN 2020, THE AVAILABLE GENERATION CAPACITY WAS

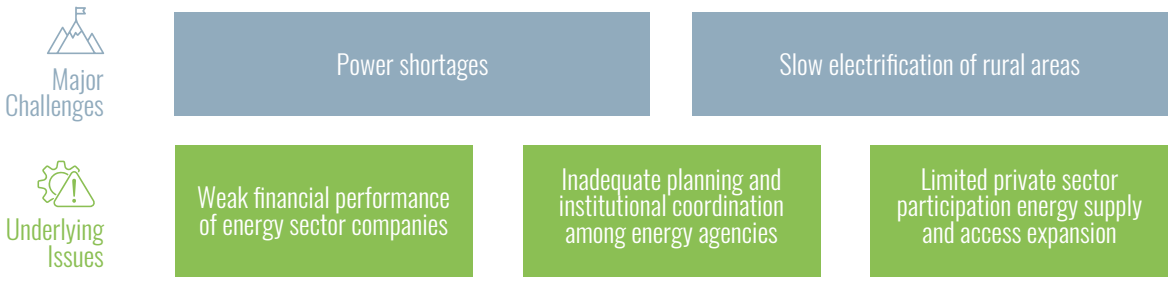
1,585

MEGAWATTS

Despite some recent achievements, Zimbabwe's electricity sector still faces power supply deficits and the slowing of progress toward universal electricity access (Figure 1). The country still suffers from significant power deficits. In 2020, the available generation capacity was 1,585 MW compared with peak demand of 1,900 MW, forcing the country to implement load-shedding of 12–14 hours a day. While the Government commissioned an additional 600 MW at the Hwange power station in 2023, installed capacity is currently still insufficient to meet demand, and rolling blackouts give rise to a significant burden on Zimbabwe's economic growth and competitiveness. Zimbabwe has seen notable improvements in access, but the pace of rural electrification has slowed down. Between 2014 and 2020, overall energy access expanded from 32 to 53 percent, driven by a rapid rise in access in rural areas (from 8 to 37 percent), while urban areas saw a minor rise (from 83 to 86 percent). However, the overall pace of expansion is slowing down, and there is a need for significant investment to achieve universal access by 2030.

Three underlying issues are constraining the energy sector (Figure 2.1). The energy companies are in a weak financial condition, which means that they have insufficient funds to maintain the existing generation, transmission, and distribution infrastructure, or to finance new projects to expand access. In addition, there is limited capacity for planning and coordination among agencies, resulting in inconsistencies and the slow implementation of energy policies. Finally, regulatory hurdles are limiting private investment in energy generation and in the electricity grid, further reducing the potential for reliable supply and access expansion. We will discuss each challenge and underlying issue in turn and conclude with potential options to address them.

Figure 2.1. Major challenges and underlying issues to realizing Zimbabwe's Vision 2030 energy aspirations



Source: Authors' elaborations.

2.2 RECENT DEVELOPMENTS AND CHALLENGES IN THE ENERGY SECTOR

While energy access has improved, power deficits continue to hinder Zimbabwe's economic growth and competitiveness. The pace of rural electrification has slowed down.

Electricity supply shortages

Zimbabwe's total energy consumption has declined significantly due to insufficient generation capacity, aging transmission lines, and insufficient funding for maintenance and capacity expansion. Over the past two decades, energy consumption has dropped by 20 percent, from a high of 10,493 GWh in 2000 to 8,439 GWh in 2020 (Figure 2.2). As a result, Zimbabwe's per capita electricity consumption has almost halved in the past decade. This decline has been driven mostly by supply constraints. Inadequate installed generation capacity, frequent breakdowns of aging coal-fired power plant equipment, and reduced hydropower production in dry years result in insufficient available generation capacity to meet electricity demand. Unplanned electricity outages are also caused by failures of aging transmission and distribution equipment. Insufficient funding is also driving blackouts, as energy companies are too financially constrained to adequately maintain their existing power plants or invest in the generation of new capacity.

While the Government has made notable achievements to improve energy supply, deficits remain. Since 2018, the Government has invested in expanding the country's total energy capacity by 900 MW. In 2018, 300 MW in hydropower was installed at Kariba South. In 2023, two units (300 MW each) were installed at the Hwange coal power station. Despite these investments, average dependable capacity increased to just over 1,800 MW, which is insufficient to bridge the supply deficit due to increasing demand. As such, existing available capacity is not sufficient to support domestic demand and economic competitiveness.

Insufficient power supply has resulted in power outages of 12–14 hours a day, which has significantly increased the operating costs of businesses and reduced Zimbabwe's competitiveness. Surveys of members by the Confederation of Zimbabwean Industries reveal that: (i) in the past several years, electricity has only been available for an average of 6 hours for extended periods of time, despite businesses needing at least 18 hours of electricity availability to operate efficiently; and (ii) the costs of outages, which included procurement and operation of diesel generators, lost output, and raw materials ran into hundreds of millions of US dollars for their respective sectors (ZEPARU, 2011). Power outages have also reduced Zimbabwe's competitiveness, as its firms rely more on generators than its peers in the region (Figure 2.3). Recent empirical evidence also confirms that power outages are a major drag on firms' productivity, and hamper competitiveness and employment of countries across Africa (Box 2.1).

Existing available capacity is not sufficient to support domestic demand and economic competitiveness

Figure 2.2. Total energy consumption has declined significantly across two decades due to insufficient generation capacity

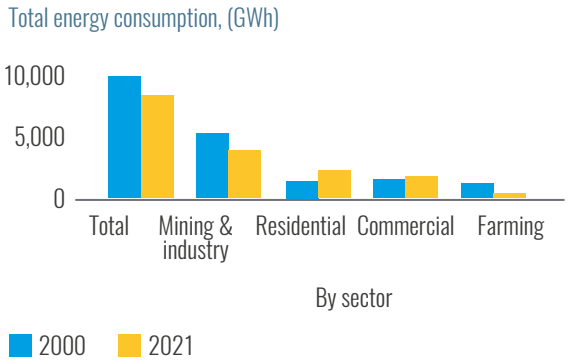
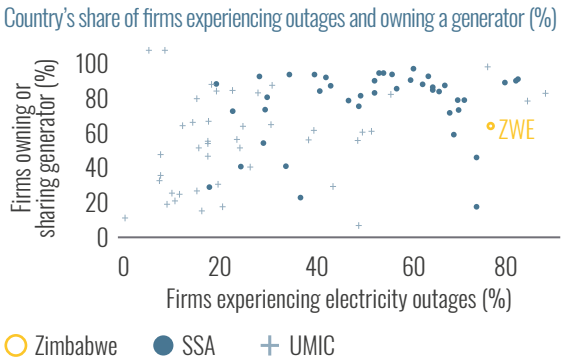


Figure 2.3. Power cuts have reduced Zimbabwe's competitiveness, as a high share of firms rely on generators



Source: ZERA, ZETDC, ZPC reports and authors' estimates (Figure 1). World Bank staff calculations based on the WBES (Figure 2). Notes: ZWE = Zimbabwe. UMIC = Upper middle-income country. SSA = Sub-Saharan Africa. WBES surveys for Zimbabwe were conducted in 2016.

Box 2.1. Power outages are a major hindrance on firms' revenue, productivity, and employment in Africa

A study by Justice Mensah (2018) suggests that electricity outages have a major impact on African firms. The author uses a combination of cross-country analysis and case studies to estimate the impact of electricity outages on existing firms' performance, new firms' entry and investment, and employment:

Shortages in electricity supply exert an adverse impact on firms' sales and productivity, given that electricity is an important factor of production. To estimate its effect, the author conducts cross-country analysis[15] using data from 29 African countries (including Zimbabwe). Mensah finds that shortages in electricity supply exert adverse impact on firms' productivity and profit given that electricity is an important factor of production. *For every 1.0 percent increase in the frequency of outages experienced by firms, there is a 1.2 percent decline in sales, a 1.3 percent decline in sales per worker, and a 2.3 percent decline in value-added per worker (Figure B.1).*

Persistent outages also reduce firms' entry and investment by discouraging potential entrepreneurs (investors) from establishing (investing in) businesses that would otherwise have employed people. Using the author's cross-country analysis, Mensah finds that across Africa, moving from a district with (fully) reliable supply of electricity to one with an unreliable supply reduces the number of firms operating in the district by 20 percent. To explore this further, he conducts a case study of severe power rationing in Ghana between 2013 and 2016 (the "Dumsor" crisis).[16] His analysis shows that this crisis resulted in a significant decline in *the*

[15] The author adopts an instrumental variable strategy, which exploits plausibly exogenous variations in incidence of outages induced by variations in lightning strikes across space and time, which are known to lead to over-voltage and destruction of power infrastructure thereby causing outages.

[16] Mensah exploits plausibly exogenous variations in exposure to the power crisis using a difference-in-difference design.

number of manufacturing firms operating. In addition, the number of FDI projects in the non-energy-and-construction sectors declined by about 12.3 percent per year (Figure B.2). As such, electricity outages also reduce the entry of new firms through a reduction in firms' density and FDI.

Impacts on firms' performance, in turn, lead to very sizable negative effects on employment, especially in non-agriculture and skilled sectors. From the cross-country analysis in Africa, Mensah finds that outages reduce employment by about 13.5 percentage points (pp) (Figure B.3). These effects are driven entirely by the effect on employment in non-agriculture sectors (13.5 pp), and is found to be statistically insignificant for agricultural jobs.[17] Interestingly, the analysis also suggests that skilled workers are more affected than non-skilled workers. *Power outages are associated with a 19 pp reduction in the number of skilled workers, but has a statistically insignificant effect on unskilled workers.* This evidence gives credence to the theory that the persistence of electricity outages can constrain efforts toward economic transformation by reducing skilled-sector employment.

Figure B.1. Power outages result in reduction of sales and productivity...

Impact of percent increase in frequency of outages firm performance (p.p.)

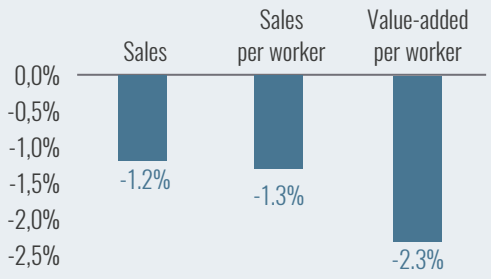


Figure B.2. ...but they also discourage the entry and investment of new firms

Estimated "gap" in Ghana's non-energy-and-construction FDI due to power crisis, (number of greenfield FDI projects)

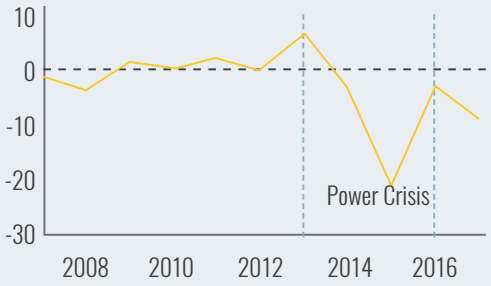


Figure B.3. Jointly, this significantly reduces formal employment in Africa

Average impact of outages on Africa's employment (p.p.)

Source: Author's data adjusted from Mensah (2018).

[17] There are at least two possible reasons for this. Africa's agriculture sector often has low technology intensity. As a result, the potential effect of electricity outages on production in the sector may be minimal. Alternatively, employment in the Afrobarometer is defined as having a "cash paid" job. The sample of employed individuals is heavily skewed toward the non-agricultural sectors (94 percent), which may explain the null effect.

In Zimbabwe, electricity deficits are particularly damaging for the mining sector's current operations and potential expansion. The mining sector is highly energy-intensive, which means that unreliable and expensive supplies reduce the margins of existing operations and weigh heavily on feasibility evaluations for expansions and new projects (World Bank Group, 2023). Despite a growing mining sector, energy consumption declined by almost 25 percent between 2000 and 2021 (Figure 2.2). As such, the demand-supply gap in electricity provision to the mining sector is high and growing. Actual electricity usage by the mining sector in 2022 is estimated to have been 3,000 GWh, against estimated grid supply of 2,000 GWh, with the difference accounted for by back-up supply installed at mine sites and processing plants (World Bank Group, 2023). In early 2023, mining companies were experiencing load-shedding of between 12 and 14 hours a day. Diesel generators are the default power backup mechanism, but many mining operations are no longer financially viable if generators have to run for more than 25 percent of the time (World Bank CCDR, 2023). Persistent load-shedding has also undermined pumping, which has led to flooding and lost productive hours for high-value mines such as gold, diamond and platinum. Overall, electricity deficits are considered to be the single biggest brake on the expansion of mining and mineral processing (World Bank Group, 2023).

Supply shortages are costing Zimbabwe an estimated 6.1 percent of GDP per year. Rapid improvements are needed if Zimbabwe is to achieve upper middle-income status by 2030. Power shortages have a significant effect on the productive sectors (most notably mining, agriculture and tourism, as shown in Table 1). This translates into lower economic growth and lower household incomes. Evidence from the World Bank's Infrastructure Sector Assessment Program suggests that the total cost of 6.1 percent of GDP per year comprises generation inefficiencies and excessive network losses (2.3 percent of GDP), and downstream costs of unreliable energy (3.8 percent of GDP) (World Bank, 2021a). If Zimbabwe hopes to move toward upper middle-income status by 2030, it will be critical to realize stable and reliable electricity access.

Table 2.1. The impact of power shortages on selected sectors

Mining	Agriculture and agribusiness	Tourism
• Mining, and mineral processing especially, are energy-intensive, so that unreliable and expensive supplies reduce profit margins.	• Irrigation and commercial agriculture are impacted by lack of adequate energy supply and access to electricity in rural areas. Expensive energy mix also undermines the horticulture subsector.	• Disruption of essential services at the hotels, resorts and tourist attraction sites occur due to energy shortage and lack of reliable alternative energy source.
• High-value mines such as gold, diamond and platinum flooded, due to poor pumping because of persistent electricity load-shedding and lost productive hours of production.	• Cold chain and storage facilities undermine the potential of the horticulture, dairy and livestock sub-sectors.	
• The cost of self-generated electricity is far higher than cost of grid electricity, making firms uncompetitive.	• Warehouse and post-harvest losses in storage units arise from unpredictable power outages, mainly due to aged infrastructure	

Source: World Bank Group (2023).

To meet demand amid shortages, Zimbabwe is relying on costly energy imports and independent power producers (IPPs). Power imports from the Southern Africa Power Pool (SAPP) countries have helped reduce the demand-supply gap. This has resulted in a doubling of the import bill in four years (Figure 2.4). However, this is costly as average electricity imports cost about U$0.08/kWh—far higher than ZPC's variable cost of production of about US$0.017/kWh for thermal and US$0.003/kWh for hydropower. Electricity imports remain an important component of the total supply but the potential for further increases is constrained by general shortages in the region, the Zimbabwe Electricity Transmission and Distribution Company's (ZETDC) ability to pay for the imports, and transmission capacity constraints. The Government has also taken steps to offer opportunities for private sector investment and, by January 2020, the regulator had issued generation licenses to unsolicited projects with a combined total of over 6,500 MW, comprising 5,050 MW coal, 1,152 MW solar PV, 345 MW gas and 33 MW mini-hydro. Nonetheless, grid supply from IPPs still remains relatively small (Figure 2.5). As such, more work is needed to promote private energy investments.

Rising electricity demand have resulted in reliance on costly imports of electricity

Figure 2.4. To deal with increased demand, the energy import bill has doubled in four years

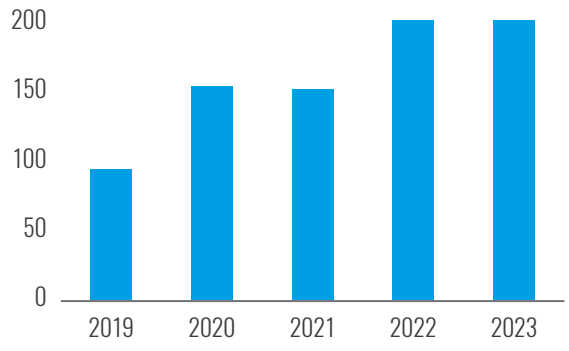
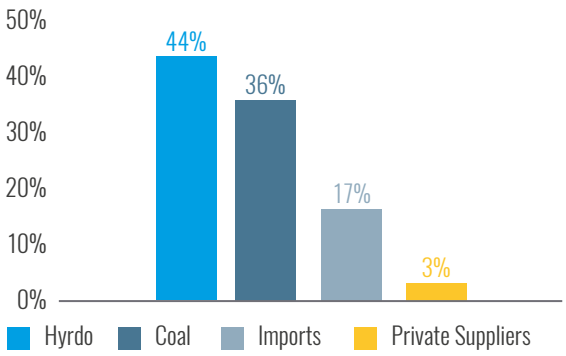


Figure 2.5. Private suppliers (IPPs) make up only a very small share of the grid



Source: Zimbabwe National Statistical Agency (ZimStat).
Notes: 2023 annual figures are projected.

Electricity access and expansion

Zimbabwe made significant gains in increasing the national electrification rate up to 2012, but disparities persist in rural areas and the pace of electrification has slowed. Between 2014 and 2020, overall energy access expanded from 32 to 53 percent, driven by a rapid rise in access in rural areas (from 8 to 37 percent), while urban areas saw a minor rise from 83 to 86 percent (Figure 2.6). The reasons for the early success of the rural electrification program were: (i) the passage of the Rural Electrification Fund Act in 2002, creating a dedicated funding mechanism for financing rural electrification; (ii) establishment of a Rural Electrification Agency (REA) as an executing agency for rural electrification schemes; and (iii) a financially viable sector and a strong utility that partnered with the REA in implementing rural electrification schemes. Nonetheless, the overall pace of expansion is slowing. In the decade up to 2010, Zimbabwe's electrification rate was the same as the average electrification rate for other lower middle-income countries in SSA, but it has since fallen behind.

In 2019, the customer connection rate was only 25,000 per year compared with an annual target of 50,000, and there were more solar home systems than ZETDC customers. By 2020, the overall access rate in Zimbabwe was 53 percent, compared with 61 and 79 percent in lower and upper middle-income countries, respectively (Figure 2.7).

Rising electricity demand have resulted in reliance on costly imports of electricity

Figure 2.6. Significant gains have been made to improve energy access in rural areas, yet disparities persist...

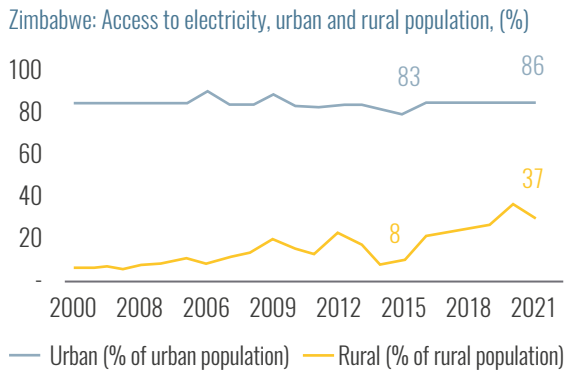
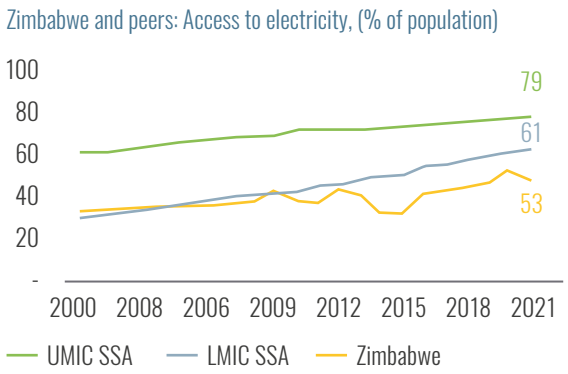


Figure 2.7. ...and Zimbabwe has also started lagging behind other lower middle-income countries in SSA



Source: World Bank WDI.
Notes: UMIC = Upper middle-income country. LMIC = Lower middle-income country. SSA = Sub-Saharan Africa.

Going forward, peak electricity demand is projected to grow substantially. Achieving universal electricity access by 2030 will require large investments, especially in solar power and grid expansion. Medium-term World Bank projections[18] suggest that electricity demand will grow from 1,950 MW in 2022 up to 5,177 MW by 2030 (Figure 2.8, World Bank, 2022a). This is driven primarily by growing demand from the mining and agriculture sectors, and results in a considerable widening of the power deficits. To reach universal access by 2030 will require annual connections to increase from 25,000 in 2020 to about 537,000 per year. Estimates for least-cost generation expansion indicate that in the short term (2024–26) utility scale solar power plants would be the fastest units to provide additional capacity, adding more than 1,500 MW that would ensure that the system can meet growing demand. Subsequently, generation expansion efforts would comprise gas and hydropower power plants, in addition to more solar (Figure 2.9). The associated grid expansion to 2030 is estimated to cost a total of US$4.4 billion (Figure 2.10). An indicative financing plan envisages that the GoZ would finance 85 percent of this cost, while consumers and the private sector would finance 11 and 4 percent, respectively (World Bank, 2022b).

[18] These demand forecasts target universal access by 2030. They assume that the GDP composition and electricity energy intensities remain unchanged – 19% Agriculture using 0.36 GWh/MUSD, 9% Mining using 0.94 GWh/MUSD, 17% Industry using 1.4 GWh/MUSD and 55% services using 0.26 GWh/MUSD. Population is expected to grow at 1.5% per year, which is the rate observed over the past decade. Power and energy demand is expected to grow to 3,800–4,400 MW and 25–30 TWh by 2030.

Universal power access by 2030 will require large investments, especially in generation, grid expansion and off grid solar systems

Figure 2.8. Projected peak demand by 2030

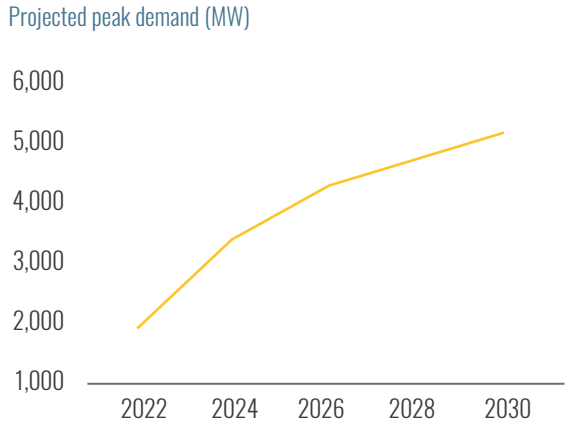


Figure 2.9. Lowest-cost estimates suggest a focus on solar systems and grid expansion

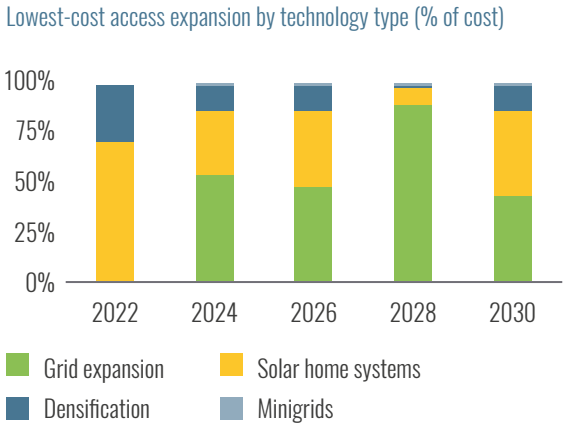
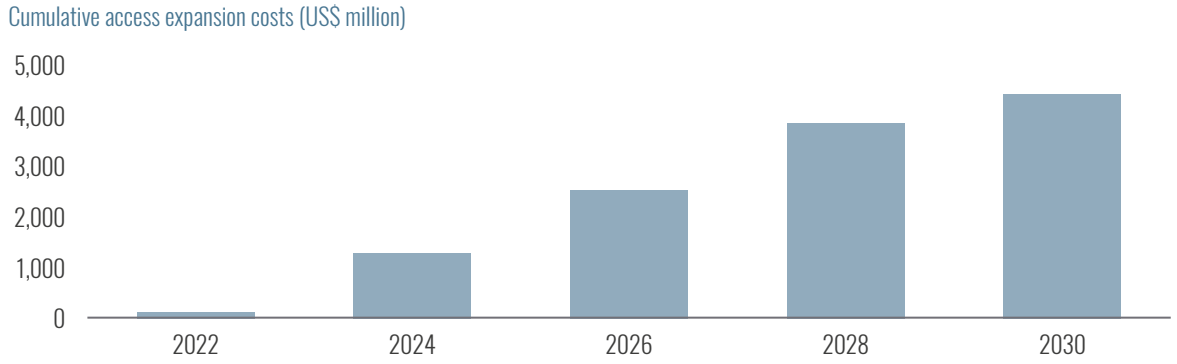


Figure 2.10. Projected cost of full access to electricity by 2030



Source: World Bank (2022a; 2022b).

The Government is planning to expand electricity access through various sources, but it remains unclear how these investments will be financed. The biggest planned increase in electricity supply comes from the Batoka Gorge Project along the border with Zambia (2,400 MW in total, or 1,200 MW for Zimbabwe) projected for completion after 2034, and the Devil's Gorge (1,200 MW) to be completed by 2040. This is complemented by additional energy projects in solar, wind, mini-hydro and geothermal. The National Renewable Energy Policy of 2019 is targeting an additional 2,100 MW by 2030 from renewables, mainly solar PV (1,600 MW). This would be complimented by storage at the Kariba reservoir and battery energy storage systems. Stronger regional integration is planned with the Mupanda Nkuwa Project (800 MW) and an extension of Cahora Bassa (495 MW), both in Mozambique. As such, while there are significant opportunities to expand electricity generation, it remains unclear how this expansion will be financed going forward. The projected amounts will be challenging to raise from domestic resources alone, and there is an urgent need to involve more private investors and the international development community to help accommodate the financing needs.

2.3 UNDERLYING ISSUES HOLDING BACK THE ENERGY SECTOR.

Zimbabwe's interconnected problems of electricity supply and access are ultimately driven by three underlying issues: weak financial performance of energy companies, insufficient central planning and coordination, and limited private sector participation

Weak financial performance of energy sector companies

The weak financial state of electricity companies is the most significant issue driving Zimbabwe's power supply deficits and slowing the expansion of universal access to electricity services. Insufficient revenues and high debt lead to cash shortages, which in turn constrain the companies from: (i) investing in new generation, transmission, and distribution assets, including in access expansion; (ii) attracting private sector investment and commercial financing for the sector's investment plan; (iii) adequately maintaining existing assets; and forcing them to (iv) consistently import power from neighboring countries to close the demand-supply gaps when they occur.

Zimbabwe's power generation (ZPC) and transmission and distribution (ZETDC) companies are both loss-making. While the companies were (almost) fully recovering their costs between 2015 and 2018, both saw large financial losses in 2019 and 2020. These reached 2.5 percent of GDP for ZPC, and between 3.4 and 4.7 percent for ZETDC (Figure 2.11). The losses were driven by the same factors for both companies. These include tariffs that do not fully recover costs and have failed to keep pace with rapid changes in the US$/ZWL exchange rate, as well as the high cost of servicing foreign currency-denominated debt amid substantial exchange rate depreciation (see below). The sector also suffers from operating inefficiencies, which include transmission and distribution system losses[19] (Figure 2.12), low availability factors of thermal power plants and high overheads and administration costs. Finally, power shortages also impacted the Zimbabwe Electricity Supply Authority (ZESA) through reduced sales and revenues, thus contributing to the sector's financial viability problem and reducing available power for access expansion.

Figure 2.11. Financial losses have been piling up for Zimbabwe's power and transmission companies....

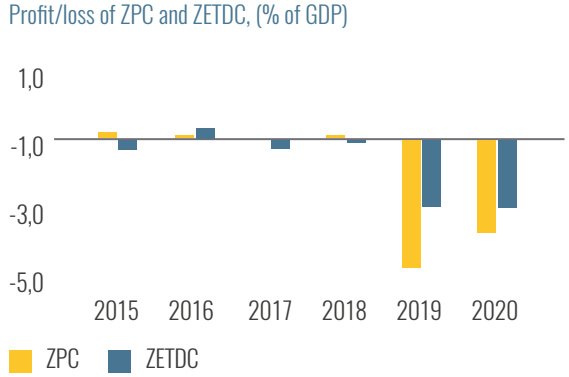
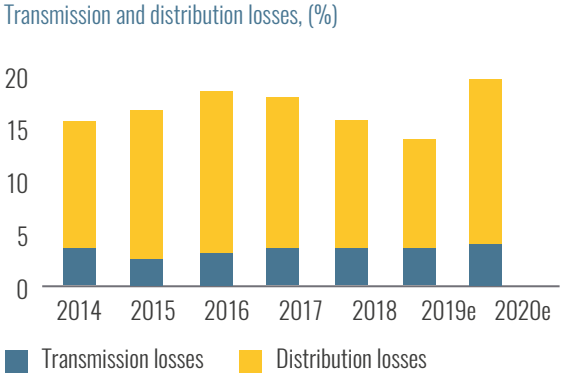


Figure 2.12. ...which are caused in part by high transmission and distribution losses



Source: World Bank (2022b).
Notes: ZPC = Zimbabwe Power Company. ZETDC = Zimbabwe Electricity and Transmission Distribution Company.

[19] Transmission losses refer to the total amount of electricity lost caused by resistance of the conductors (friction). Distribution losses occur because of potential overloading of the cables and transformers, meter tampering, and billing anomalies.

A benchmarking of ZESA's performance to other utilities in SSA reveals that it performed worse than median performers on all key financial indicators (profitability, cost recovery, liquidity, capital structure). ZESA's operational performance was higher than median performers with respect to collection of trade debtors, availability of hydro power plants (but low for coal power plants) and system losses were similar to median performers (World Bank, 2021b). The benchmarking was undertaken based on data for the years up to 2018. However, since then, ZETDC's transmission and distribution losses have worsened..

The biggest problem is that energy tariffs do not reflect the efficient costs of electricity services provision. A World Bank cost-of-service study estimated annual tariffs for full recovery of efficient costs of service provision in US dollars for the Zimbabwe power sector. With tariffs substantially below these efficient cost recovery levels ZETDC experienced a significant revenue-cost gap in 2020 and 2021 (exceeding US$200 million at its peak in 2020, Figure 2.13). ZPC experienced an even larger revenue-cost gap between 2019 and 2021, peaking at almost US$1 billion in 2019 (Figure 2.14). The revenue-cost gap was especially wide during period of rapid currency depreciation and narrowed with the introduction of the forex auction market in 2021.

Figure 2.13. Tariff deficit in ZETDC shows a large gap between revenues and costs in 2020

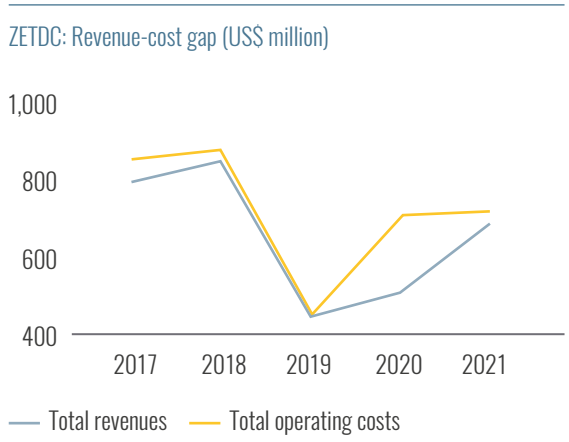
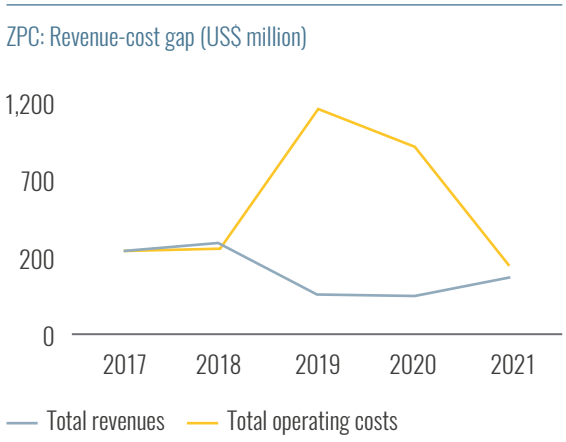


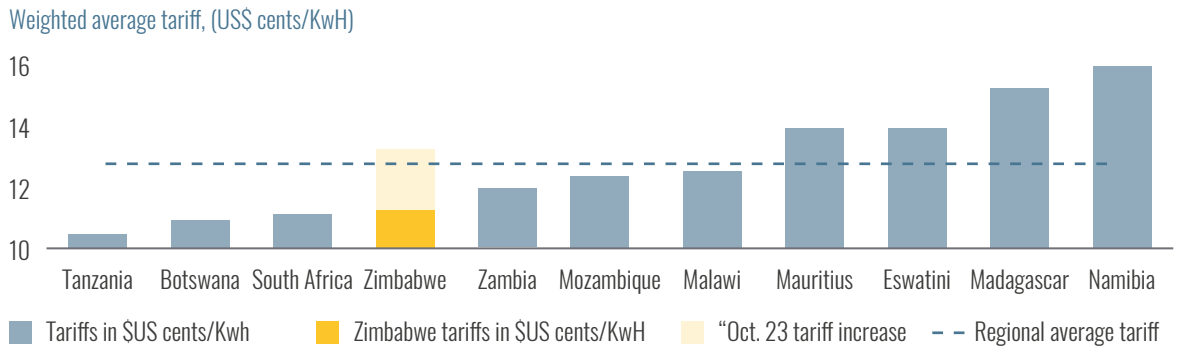
Figure 2.14. Tariff deficit for ZPC was more impacted by the currency depreciation in 2019 and 2020



Source: World Bank (2022b).

Zimbabwe's energy tariffs was lower than the regional average, but has recently increased. The energy subsidies used to pay for low tariffs are both expensive and inequitable. Before the latest recently announced increases Zimbabwe's electricity tariffs were some of the lowest in Southern Africa, and about 12 percent below the regional average (US$11.3 cents versus US$128 cents). Because the tariffs were very low, electricity in Zimbabwe was heavily subsidized and its post-tax electricity subsidies in 2015 were equivalent to 20.5 percent of GDP, an outlier not just among SSA countries but in the world (Sharma et al., 2022). At the same time, most benefits go to the non-poor. While 32 percent of the total population benefited from electricity subsidies, only 4 percent of the extremely poor did, therefore making these subsidies highly inequitable (Sharma et al., 2022). Fortunately, an announcement in October 2023 raised tariffs in line with regional average (Figure 2.15).

Figure 2.15. Zimbabwe's electricity tariffs were previously low, but a recent tariff increase aligns them with the regional average



Source: ZETDC data, Sunday Mail 2023 and Zambia Energy Regulation Board.
Notes: Zambia's tariffs are proposed rates from April 2023.

Although the GoZ made sustained efforts to adjust tariffs frequently in 2022, these often lagged exchange rate dynamics and so did not reflect full recovery of efficient costs of service provision. To illustrate, Figures 2.15 shows the multiple tariff increases implemented between May and October 2022. However, when these same tariffs are presented in US dollar terms, they show that the real value dropped almost 18 percent below cost-recovery in August 2022 (US$0.087 cents/kWh versus US$0.106 cents/kWh). This illustrates the challenge of maintaining tariffs constant in real terms in an environment of hyperinflation and exchange rate instability. It is thus very difficult to eliminate financial deficits in the absence of stabilization of the monetary and exchange rate environment.

Tariff adjustments in 2022 often lagged exchange rate dynamics, resulting in tariffs that did not reflect real costs

Figure 2.16. While the Government frequently adjusted the official electricity tariffs in ZWL....

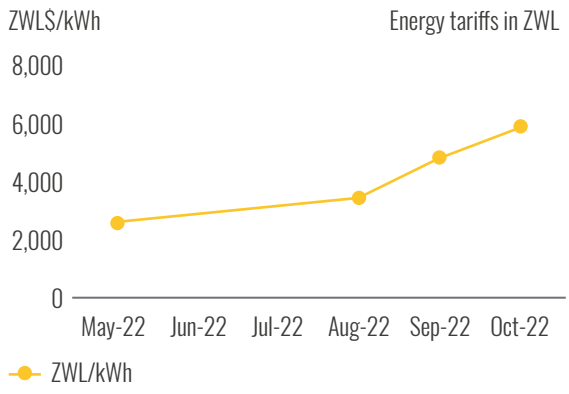
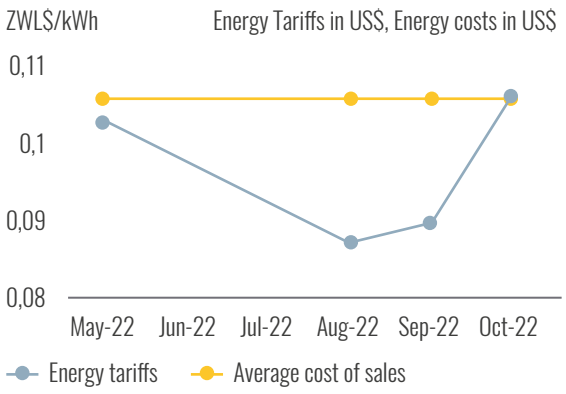


Figure 2.17. ...in US$ terms these often remained well below efficient cost recovery levels



Source: ZERA tariff schedules and World Bank (2022b).

The Government has recently announced tariff increases, but there is a need for an automatic tariff adjustment mechanism. In recent months, ZETDC is believed to have been buying electricity at a tariff of US$0.12 cents/kWh but selling to customers at average tariff of US$0.10 cents/kWh thus falling short of the cost of production and contributing to rising debt for ZETDC. Fortunately, in October 2023, ZETDC applied for an increase of electricity tariff up to US$0.1263 cents/kWH, which would help to maintain constant power supply. While allowing utilities to implement automatic tariff adjustment mechanisms to cater for volatility in key cost variables is an effective industry

practice, its efficacy is limited when changes in cost variables are huge as has been the case with the exchange rate deprecation in Zimbabwe. Nonetheless, ZETDC should be allowed to implement an automatic tariff adjustment mechanism within defined bands to minimize the gap between actual tariffs and efficient cost of service-based tariffs. In addition, there is a continued need for the Zimbabwe Energy Regulatory Agency (ZERA) to undertake periodic cost-of-service tariff studies to support tariff formal adjustments.

Finally, energy companies are also burdened by high debt servicing costs. The costs of servicing legacy debt have ballooned due to currency depreciation and interest rate increases, which have reduced net profits and imposed liquidity constraints. Over 86 percent of legacy debt is payable to external suppliers with payments of 90 days or more (World Bank, 2022b). Arrears to both long-term debt providers and trade creditors lead to even higher financing costs and reduced profitability/higher net losses, thus creating a vicious circle. The energy sector both owes money to local suppliers, and is also owed considerable domestic funds. Many arrears are to local suppliers, ranging from 27 to 1 percent for delayed payments above 30 days, and 16 percent for delayed payments above 90 days (Figure 2.14). ZESA is also owed significant amounts of money, and a total of 38 percent of arrears owed to ZESA are from local authorities, parastatals, and public sector (Figure 2.15).

Arrears to suppliers and escalating debt reduce opportunities for investment

Figure 2.18. ZESA is in arrears to local suppliers, which are significant in size...

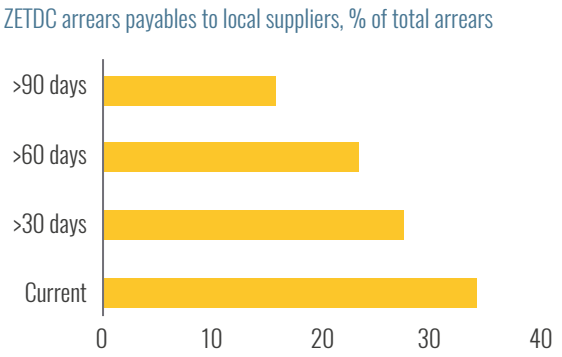
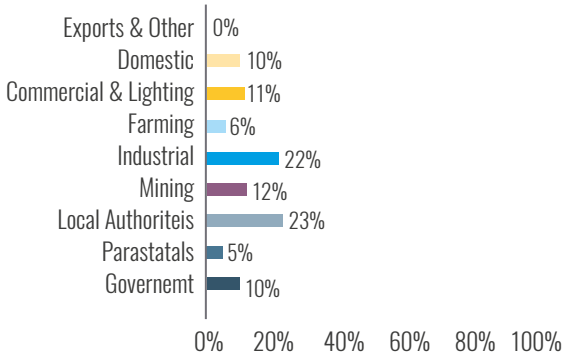


Figure 2.19. ...while ZESA is also owed significant amounts of money, especially from the public sector



Source: World Bank, 2022b).

Limited capacity for planning and institutional coordination among energy agencies

The National Development Strategy 1 (NDS1) sets out a critical set of energy strategies, but it remains limited so far in the progress that has been made in implementation. The NDS1 builds on the Vision 2030 to spell out interim targets and strategies for electricity generation, and transmission network expansion and access expansion during 2021–2025. To increase electricity supply, the NDS1 calls for the preparation of an Integrated Energy Resource Master Plan (IERMP), the implementation of least-cost investments consistent with the IERMP, and the development of renewable energy sources to improve the electricity generation mix and the scaling-up of regional integration. It also advocates for the regular review of electricity policies to ensure full recovery of efficient costs of electricity services, and comprehensive restructuring of ZETDC to strengthen its capacity to enter

into power purchase agreements (PPAs) with IPPs. These are all essential recommendations, but limited progress has been made to date in terms of implementation. The National Energy Policy, the National Renewable Energy Policy, and the energy laws are consistent with international best practice and just need consistent implementation.

Hindering progress is the lack of centralized oversight in setting energy policies and targets, monitoring implementation, and strengthening agencies' planning capacity. The energy sector is regulated not only by ZERA but also includes other regulatory agencies, the most impactful of which are the Environmental Management Agency (EMA), the Zimbabwe Investment and Development Authority (ZIDA), the RBZ and the government ministries to which these agencies report for policy guidance. The various energy companies (such as ZESA and ZETDC) and implementing agencies (such as the Rural Electrification Fund – REF) also have considerable autonomy, resulting in limited control to align activities.

As a result, the various energy agencies struggle with poor coordination. What is lacking is coordination of the substantive issues, such as the need for light-handed regulation by all agencies for small-scale projects (World Bank CDPS, 2023). The Ministry of Energy and Power Development (MoEPD) has re-established its Planning and Policy Division to support these responsibilities but will require capacity building on systems planning and modeling. The REF will need to rely more on technical and economic-based tools for medium and long-term planning instruments, such as the 2016 Rural Energy Master Plan. ZETDC will also need to set and use annual targets for grid extensions.

Limited regulatory independence is also causing planning uncertainties and unpredictability. An independent regulatory agency could help to minimize uncertainties due to conflicts of interests. However, when regulatory decisions are subject to nontransparent ratification under the guise of policy guidance, the result is a lack of predictability that can compromise project viability. This is particularly a problem with pricing and subsidy decisions (World Bank Group, 2023).

The sector also suffers from policy inconsistencies, arising from conflicting operational decisions and strategies. For example, the National Energy Policy of 2012 provides for the unbundling of the generation, transmission and distribution businesses. Nonetheless, the ZESA Board has been directed to re-bundle the businesses. This compromises the regulator's ability to enforce the different licensing conditions for energy companies. A case in point is the inability of generation business to be paid for delivery of energy to the transmission and distribution businesses. This results in the vicious circle where the generation business is then unable to maintain the plant to the expected standards (World Bank Group, 2023).

ZETDC TO SET AND USE ANNUAL TARGETS FOR **GRID EXTENSIONS**

Limited private sector participation in energy supply and access expansion

The Government has liberalized the energy market to enable private participation. Through the enactment of the Electricity Act and the Rural Electrification Fund Act, the Government formally ended the monopoly of the national utility ZESA in 2002, and provided for the unbundling of its regulatory, rural electrification, generation, transmission, distribution, and supply of electricity. This reform aimed to increase private sector investment and competition and complement the Government's limited investment capacity in the energy sector.

Overall opportunities for private sector investment have expanded, but IPP grid supply remains small. By January 2020, the regulator had issued generation licenses to unsolicited projects with a combined total of over 6,500 MW, comprising 5,050 MW coal, 1,152 MW solar PV, 345 MW gas, and 33 MW mini-hydro. More recently, 27 IPPs with an estimated total capacity of 1,000 MW were recommended for government support in December 2022. The Government guaranteed economic tariffs to qualifying IPP solar projects. The Government also announced a standardized Government Implementation Agreement (GIA)[20] for all solar IPP projects. Nonetheless, many of the licensed projects fail to reach financial closure, suggesting financing constraints and/or inadequate risk mitigation instruments for investors and lenders. As a result, grid supply from IPPs still remains small at 3 percent in 2022 (Figure 2.5).

While many private firms are investing to improve their energy efficiency, off-grid renewable energy investments are limited and few firms are providing on-grid renewable energy. An IFC survey suggests that Zimbabwe's firms have invested in energy efficiency—72 percent in efficient lighting and 65 percent energy efficient machinery—but only 28 percent have invested in renewable energy. Barriers to investment in renewables include currency exchange restrictions, import taxes on equipment, and tax rules on off-setting renewable energy investments against company revenues. Only one-quarter of firms believed there were government incentives to invest in greening their manufacturing processes or for investing in renewable energy. Those firms that had made investments in renewable energy had not yet managed to put 'net metering' into practice due to engineering and administrative reasons (WBG, 2023).

Encouraging private sector power-to-mine investment will be critical to meet future energy demand, and will help free up public investments to grow the grid. The mining sector is expected to significantly increase energy consumption up to 21 TWh by 2040 (World Bank, 2023). This would require massive investment, and the NDS1 plans for most of this investment to be made by the private sector. This opens an opportunity to transition mining to renewable energy through power-to-mine investments, which could also support broader renewable energy scale-up. Encouraging such off-grid renewables would also free up public investment in growing the grid to meet the current deficit and future demand, and provide an important off-grid solution both as a medium-term transition and a long-term solution to electrification.

[20] The GIA has three major components, namely Project Development Support Agreement, Power Purchase Agreement and Reserve Bank of Zimbabwe Undertaking for Foreign Currency Convertibility and Transfer.

Nonetheless, off-grid renewable investments are held back by insufficient technical regulations and incentive structures that have limited distribution licensees. The draft mini-grid framework produced by ZERA falls short of provisions required to promote private sector and community-owned utilities. The regulations for mini-grids need to clarify service standards, clarify provisions for main grid interconnection, and minimize financial and other risks. Grid-connected customers suffer from deteriorating quality of service due to increasing frequency and duration of generation and network outages, and poor responses to service requests. This undermines the effectiveness of grid electrification, as consumers connect to a network that does not deliver.

The system also suffers from challenges around licensing for investors and operators of small-scale energy investments (e.g., mini-grids) that lead to uncertainty and hold back investments. Challenges around licensing include the following (World Bank Group, 2023):

- Licensing based on unsolicited projects – This results in most of the licenses being conditional subject to confirmation upon fulfilment of basic requirements such as buyer/off-taker arrangements. Many licenses end up being issued to speculators rather than serious investors.

- Increased costs for developers – Developers of unsolicited generation projects may be located far away from the utility grid and therefore face the additional cost of paying for the transmission and distribution infrastructure to connect.

- Failure to enforce licensing conditions – Many conditional licenses should have been cancelled for non-performance but the failure to enforce results in the accumulation of licensed but unimplemented or unimplementable projects.

- Failure to enforce operational performance obligations of licensees – The concept of licensing the different businesses, such as generation, transmission, distribution, bulk, and retail supply, is to create opportunities for the entry of many players into the industry. To protect the interests of customers and investors, inefficient licensees should lose their licenses to more efficient operators.

Finally, private energy investment is also held back by Zimbabwe's general challenges of macroeconomic instability. At the macroeconomic level, the issues related to the instability of the local currency, the lack of an efficient official foreign currency market that operates through registered financial institutions, and persistent hyperinflation heavily impact the ability of the sector to attract investors due to the absence of a local capital market that can offer the terms and conditions that are consistent with the long-term nature of power investments (World Bank Group, 2023).

The Government is providing encouraging signs that it is keen to support IPP agreements for renewable energy and to strengthen licensing arrangements. In 2022, the GoZ introduced legislative changes to support IPP agreements for renewable energy to grid investments. This legislation included exemptions for repatriating foreign currency. However, this legislation did not include similar incentives for off-grid investments, which would be an interim step in resolving the current electricity shortage. Firms requested the removal of barriers to off-grid renewable energy expansion (IFC, 2023; World Bank CCDR, 2023). The Ministries of Finance and Energy, and the regulator ZERA have already embarked on the process to seek technical assistance from the African Development Bank and the World Bank to

introduce licensing based on a competitive bidding process. In this process, barriers and risks already identified will be mitigated. The Ministry of Finance and the RBZ have also recently taken steps to establish a more market-based exchange rate for the local currency.

2.4. How to transform the energy sector to attain reliable supply and universal energy access

Attaining the Government's ambitious targets to achieve reliable and universal energy access by 2030 will require a combined focus on broad sector- and economy-wide reforms, strengthening the energy sector's financial situation, improving planning and coordination, and encouraging and de-risking private sector participation (Table 2.2).

1 *Sector and economy-wide reforms*

There is urgent need for a roadmap incorporating a comprehensive technical, institutional, and financing plan to achieve the GoZ's universal access ambition and targets, as proposed in the National Energy Policy (2012) and NSD1. A roadmap covering structural, policy and utility reforms to achieve sustainable financial viability, affordable, and reliable universal access to electricity for economic and social development would provide a framework for addressing the key sector challenges of power supply deficits and slow access expansion. Key components of such a roadmap include:

a. Policies and targets: Drawing from the National Energy Policy (2012), the National Renewable Energy Policy (2019), the Vision 2030 (2018) and its two five-year medium term development strategies (NDS1 and NDS2, the latter when complete). Clarifying the time frames for specific targets.

b. Technical approach: Specifying electrification approaches according to geographical areas, i.e., network densification, extension, mini-grids, home solar systems, etc.

c. Institutional arrangements: For planning, procurement, implementation, coordination, monitoring and evaluation, regulation, investing and operations.

d. Financing plan: Including broadening the financing options to include the private sector (IPPs, community-owned schemes and others), connection costs, the establishment and operationalization of the Green Fund provided for under the National Renewable Energy Policy, and other incentives included therein.

The Government has prepared a draft roadmap. The GoZ may want to consider seeking stakeholder inputs, including from development partners.

There is also need for macroeconomic and foreign exchange rate stability, to support the achievement of financial viability and facilitate private sector investment. Adopting the necessary macroeconomic stabilization reforms to stimulate pricing predictability and currency convertibility (see section 1 of this report) will significantly help the energy sector. It will support the financial performance of power companies and help to reduce financial risks that encourage private energy investments.

Table 2.2. Short and medium-term recommendations to strengthen Zimbabwe's reliable energy supply and expand access

Priority Area	Short-Term (12 months)	Medium-Term (12-36 months)
Sector- and economy-wide reforms	• Development and implementation of a roadmap covering structural, policy and utility reforms to achieve sustainable financial viability, and affordable, and reliable universal access to electricity for economic and social development. • Improve macroeconomic stability (price predictability and currency convertibility), to support the sector's financial performance recovery and encourage private investment.	
Strengthen financial performance of energy sector	• Implement electricity pricing policy for full recovery of efficient costs of service provision. • Allow below-cost (cross-subsidized) energy tariffs for vulnerable consumers, but based on more targeted and rigorous needs-assessments. • Develop a plan for efficient operational performance of the power companies, with a specific focus on the reduction of technical and commercial losses. • Implement an off-balance sheet debt service mechanism for the power companies' legacy debt.	• Improve access to capital markets through mechanisms such as initial public offerings in electricity utilities and /or issuance of bonds. • Expand the sources of financing for access expansion beyond the current levy on power sales, to include climate change and concessional funds. • Increase financing for expansion of electricity connection services to vulnerable households through GoZ capital expenditure and development partners' funding.
Strengthen energy sector planning and technical coordination	• Strengthen institutional and technical capacity for power system expansion planning, implementation, and monitoring at the level of the MoEPD. • Adopt and publicize the sector's least-cost expansion plan, including regular updates.	• Develop a capacity building program and enhance planning procedures of key agencies involved in access expansion planning (MoEPD, ZETDC, REF). • Increase and diversify sources of energy to improve security of supply and mitigate against climate change impacts.
Promote private energy sector investments	• Issue public statement emphasizing and clarifying GoZ's support for private sector participation in Zimbabwe's electricity sector. • Streamline regulations for small-scale energy investments, and coordinate across regulatory agencies to ensure consistent, light-handed regulatory approach across all projects. • Strengthen consistency of enforcement of licensing obligations for investors and operators.	• Pilot the use of competitive bidding and risk allocation frameworks for development of solar PV capacity and mainstream their use. • Prioritize implementation of net metering of private solar PV installations (residential and commercial) to channel surplus energy into the grid during daylight hours and improve energy storage capacity of the Kariba dam.

2 *Strengthen financial performance of the power sector*

To strengthen the financial performance of power sector companies, it will be critical for the Government to adopt an electricity pricing policy that requires charging of tariffs based on full recovery of the efficient costs of service provision. The costs of service provision could be determined through periodic costs of service studies (at 3–4-year intervals) and for billing purposes the established costs would be translated into ZWL based on market exchange rates. This will ensure that revenues billed are broadly consistent with the tariff in US dollar terms. To ensure that tariffs are maintained as close as possible to cost of service levels, ZETDC would be allowed to implement automatic adjustments between ZERA's periodic reviews to cater for volatility in key cost variables within set bands.

Below-cost (cross-subsidized) energy tariffs may still be required vulnerable consumers, but should be based on more targeted and rigorous needs-assessments. To protect poor consumers, especially households, it will be important to allow below-cost tariffs. Yet, there is a need for improved targeting and a more rigorous needs-assessment (potentially aligned to a national registry of vulnerable people).

There is also need for the development of an efficiency improvement plan with special emphasis on reducing technical and commercial losses. This would strengthen the financial performance of power companies and also improve the capacity availability of the thermal power plants.

There is also a need to develop an off-balance sheet mechanism for the power companies' legacy debt to improve their credit standing and enable them to access commercial financing and to partner with IPPs as energy off takers. This would involve cleaning up ZPC and ZETDC's balance sheets by hiving off their legacy debts and depositing them in a special purpose vehicle (SPV) from which the Government would assume responsibility for repayments to creditors. The restructuring of these companies' balance sheets would also help to make them more attractive to lenders and investors. In turn, this will help them access commercial financing, and enter into power purchasing agreements with credible investors.

In the medium-term, efforts will be required to improve the energy companies' access to capital markets by using instruments such as initial public offerings and issuance of bonds. To reach this stage will require improvements in financial performance, production and publication of financial and operational information and an improvement in sector viability prospects.

Expanding financing resources for access expansion is critical for progress towards the GoZ's universal access objective. There is a need to broaden the sources of financing for access expansion beyond the existing levy on electricity, sales which are inadequate and to include low-cost funds. These could include concessional donor funds, fiscal allocations and possibly climate change funds. From the expanded financing sources, opportunities could be identified for increasing financing subsidized connection costs for poor households. International experience suggests countries that have made significant advances in access expansion have subsidized connections costs for their poorest populations either through own resources or using concessional donor financing.

3 *Strengthen technical planning and institutional coordination*

The GoZ should consider strengthening the institutional and technical capacity of MoEPD to lead in setting sector policies and targets, power system expansion planning and monitoring of implementation. This would entail MoEPD:

a. Taking the lead role in power system generation and transmission expansion planning, and for electrification planning.

b. Building appropriately skilled and experienced staff for sector setting sector policies, planning.

c. Ensuring the participation of key stakeholders in the preparation of the least cost expansion plans, their regular updating,

d. Securing approvals of least cost expansion plans at an appropriately high level of GoZ and making them publicly available.

e. Ensuring proper coordination among agencies, such as the planning of rural schemes between the REF and ZETDC. This could also focus on accelerating the implementation of the National Renewable Energy Policy.

f. Ensuring that planning processes and procedures are in place for all investment planning activities in the sector and that adequate capacity is built at the relevant agencies.

g. Monitoring program implementation planning and instituting adequate processes and procedures.

The GoZ's adoption of a least-cost power expansion planning approach and a competitive bidding framework would help to reduce the capital costs of projects and facilitate their recovery through efficient cost-based tariffs.

In the medium-term, a comprehensive capacity-building program for energy agencies would be important to ensure a higher quality of planning, implementation efficiency, and monitoring and evaluation. The Government may need to seek technical assistance to build the capacity of the MoEPD, ZERA and ZETDC to discharge their roles as outlined in the National Energy Policy and National Renewable Energy Policy. The MoEPD has re-established its Planning and Policy Division to strengthen planning responsibilities but will need to build the capacity of the team, including the training and provision of state-of-the-art modeling tools for system planning. The REA/REF will need to rely more on technical and economic-based tools for medium and long-term planning instruments, such as the 2016 Rural Energy Master Plan and not be overly dependent on stakeholder consultations. ZETDC will also need to set and use annual targets for grid extensions.

Finally, there is a need to start planning for the increase and diversification of energy sources to improve security of supply and mitigate against climate change impacts.

4 *Promote private energy investment*

Consider issuing a public statement to emphasize and clarify the GoZ's support to private sector participation in Zimbabwe's electricity sector. Although Zimbabwe ended ZESA's monopoly many years ago perceptions of restrictions on private sector participation in the sector remain. Given that private sector participation in the sector is one of the key strategies for implementation of the NDS1, a public statement emphasizing GoZ's commitment for private sector participation in the electricity sector, and clarifying the various regulations that shape energy investments may be important. In addition, information on available incentives can be disseminated, while decisions should be made on legally approved but not implemented incentives.

Consider streamlining the regulation for small-scale energy investments. ZERA needs to review the framework for light-handed regulation applicable to small-scale energy investments such as mini-grids, and coordinate with other regulatory agencies such as ZIDA and EMA to ensure that consistency of the same regulations and light-handed principles are applied to all small-scale energy investments. For mini-grids the technical regulations of most interest would be those related to the quality of service and grid connection rules. The technical regulations being prepared by ZERA could be consulted with potentially interested parties before they are finalized to ensure their broad appeal to potential investors.

ZERA also needs to consistently enforce licensing obligations for investors and operators. This will help ensure that customers receive adequate and reliable energy services at competitive costs. Conditional licenses issued to investors should be canceled when licensees fail to fulfil the conditions. Product and service standards for operators need to be established and published, as well as enforced.

In the medium-term, it would be useful to pilot the use of competitive bidding and risk allocation frameworks for the development of solar PV capacity, and to mainstream their use. GoZ could use the recently developed competitive bidding process to develop one or two solar power projects. If successful, it could mainstream the approaches to support implementation of the solar component of component of the least cost expansion plan which is a short-term priority for achieving reliability of power supply. The GoZ has announced a Government Implementation Agreement which possibly incorporates competitive bidding and risk allocation frameworks and could be used in the development of solar projects.

Finally, going forward the government may wish to further prioritize the implementation of net metering of private solar PV installations (residential and commercial). This would allow it to channel surplus energy into the grid during daylight hours and improve energy storage capacity of the Kariba dam.

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