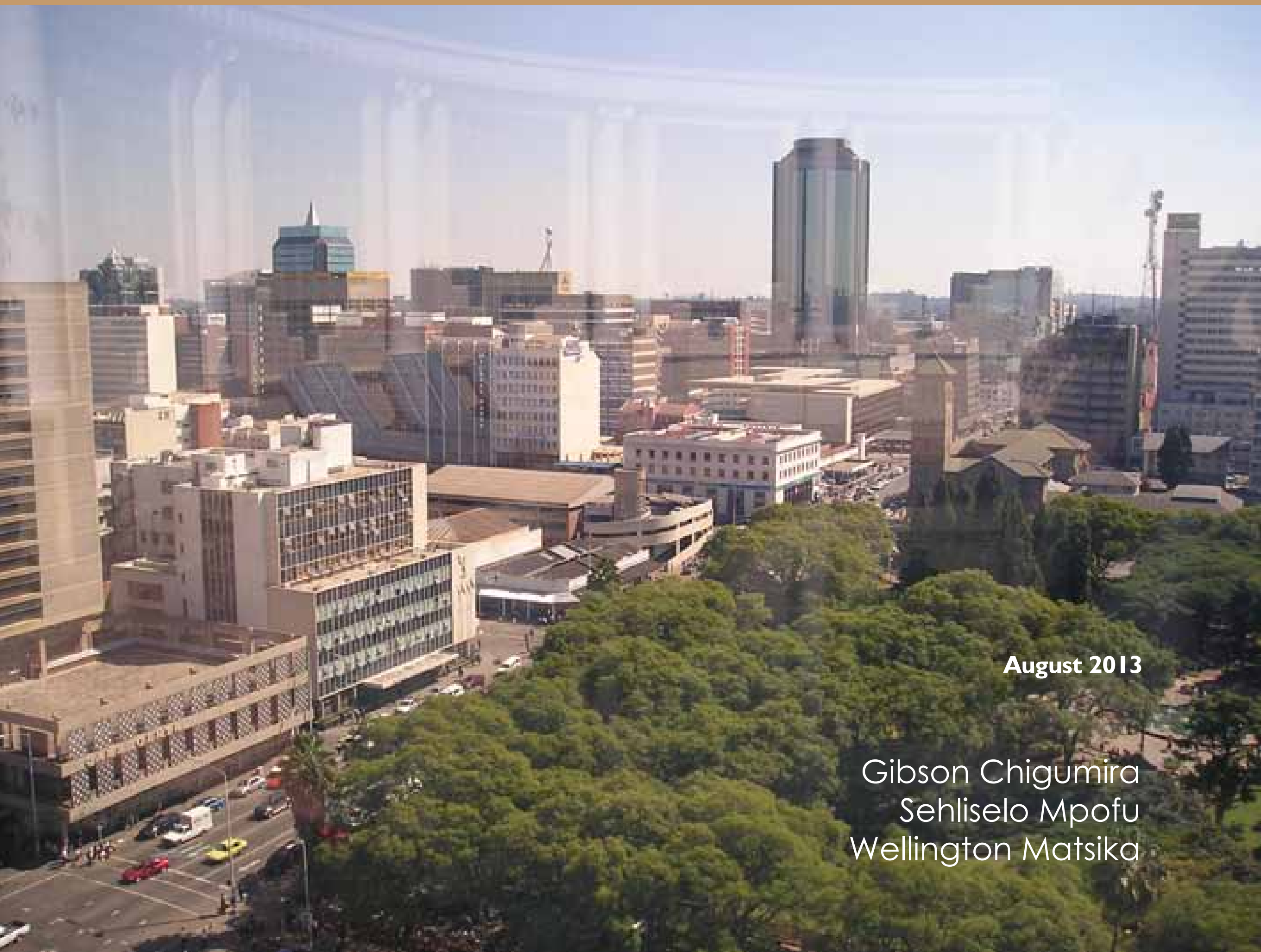
Zimbabwe Economic Policy Analysis and Research Unit

ZEPARU

CAPITAL ACCOUNT RESTRICTIONS IN ZIMBABWE IN THE MULTICURRENCY PERIOD



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ABSTRACT

In 2009, the Government of Zimbabwe partially liberalized the capital account. However, in the multicurrency system that was adopted in February 2009, some restrictions on the capital account have remained in place. This study investigated the effectiveness of the capital account restrictions on business operations and the effectiveness of these restrictions in ensuring that individuals and corporates keep money onshore. In doing this investigation, a desk review of the catalogue of exchange controls, other capital account restrictions and policies that are still in place was done. Key stakeholder views were obtained through face-to-face interviews (See appendix1for the list of respondent institutions). The outcomes of the investigations suggest that while controls are beneficial in keeping money in Zimbabwe, for some business sectors, these controls have hindered access to investment diversification and product offering, have increased risk concentration and reduced competitiveness. It could be concluded that given the prevailing macroeconomic and political conditions in the multicurrency period, Zimbabwe is still not ready for full capital account liberalization. High levels of political risk and uncertainty, in particular relating to the implementation of the indigenisation and economic empowerment law with regard to company ownership, and the on-going process leading to national elections, continue to act as a major disincentive to inflows of foreign investment and an incentive for the externalisation of domestic savings. In the short-term, full liberalisation of capital controls would almost certainly lead to a capital outflow that would reduce the funds available for investment and could jeopardise the stability of the banking system. Zimbabwe needs extensive policy reforms that will improve the economic and business environment, addressing for instance, the prevailing fiscal challenges, the foreign debt burden, banking sector fragility, the underdeveloped capital market, and strengthening security for property rights. Capital account liberalisation should form part of this reform process, and be implemented gradually to integrate Zimbabwe into regional and international capital markets at the same time as improving investor confidence.

Key Words: Capital account liberalization, offshore investment, stock markets.

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The views and findings of this study do not necessarily reflect the views of Government of Zimbabwe, ACBF, USAID-SERA or ZEPARU. The contents of this paper, as well as any errors or omissions, remain the sole responsibility of the authors.

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LIST OF ACRONYMS

ACBF	African Capacity Building Foundation
BAZ	Bankers Association of Zimbabwe
CBZ	Commercial Bank of Zimbabwe
COMESA	Common Market for Eastern and Southern Africa
ECRC	Exchange Control Review Committee
JSE	Johannesburg Stock Exchange
IPEC	Insurance and Pensions Commission
LSE	London Stock Exchange
MCR	Multicurrency Regime
MTP	Medium -Term Plan
NSSA	National Social Security Authority
RBZ	Reserve Bank of Zimbabwe
SADC	Southern African Development Community
SECZIM	Securities Commission of Zimbabwe
SERA	Strategic Economic Research and Analysis-Zimbabwe
USAID	United States Agency for International Development
ZAPF	Zimbabwe Association of Pension Funds
ZIA	Zimbabwe Investment Authority
ZEPARU	Zimbabwe Economic Policy Analysis and Research Unit
ZSE	Zimbabwe Stock Exchange

DEFINITION OF KEY TERMS

Capital Account:
The capital account in a country's balance of payments covers a variety of financial flows, mainly Foreign Direct Investment (FDI), portfolio flows (including investment in equities), and bank borrowing, which have in common, the acquisition of assets or liabilities in one country by residents of another.

Nostro Account:
It is an account held by a particular domestic bank in a foreign bank. Nostro accounts are usually in the currency of the foreign country. This allows for easy cash management because currency does not need to be converted.

Vostro Account:
It is an account held by a foreign bank in a domestic bank. Vostro accounts are usually in the currency of the country where it is domiciled. This allows for easy cash management because currency would not need to be converted.

Free Funds:
These are funds circulating in the domestic market but not arising from the sale of domestic natural resources e.g. Non-Governmental Organization's funds, Diaspora remittances, receipts from the export of other commodities. Non-free funds include money from the extraction and sale of minerals.

ZSE Share Full Fungibility:
Applies to companies whose primary listing is in Zimbabwe. The Reserve Bank of Zimbabwe, through its Exchange Control Department prescribes the minimum number of shares that should be maintained on the Zimbabwean share register at all times ("non-fungible" shares). Foreign investors are allowed to buy the fungible portion of the shares in the company and transfer them to the secondary listing market's share register *(ZSE, www.zse.co.zw, accessed on 9 May 2013)*.

ZSE Share Partial Fungibility:
Where the primary listing is not in Zimbabwe, shares can only be moved to the Zimbabwean register. Subject to exchange control approval from the Reserve Bank of Zimbabwe, shares can only be moved from the Zimbabwe register to a foreign investor where the transfer relates to capital-raising activities *(ZSE, www.zse.co.zw, accessed on 9 May 2013)*.

1. INTRODUCTION AND BACKGROUND

Zimbabwe is still recovering from the economic crisis that characterized the period 2000-2008, in which the economy contracted by an estimated cumulative figure of over 40% (MTP, 2011). Since the introduction of the multi-currency regime (MCR) in February 2009, economic growth has returned to positive levels. The economy grew by 5.4% in 2009; 9.6% in 2010 and 10.6% in 2011. However, economic growth is estimated to have declined to 4.4% in 2012 and is projected to grow by a modest 3.4% in 2013 (MoF, 2013).

In the multicurrency system, mining and agriculture have anchored the growth process, while the manufacturing sector has been characterised by sluggish growth. Annual inflation has stabilized to single-digit levels of below 5% and currently ranks amongst the lowest in the SADC region. In the multicurrency period, there has been price stability, which is favourable for the economic growth process.

Notwithstanding these positive growth developments, there is still limited credit availability in the economy since the adoption of the multicurrency system. In addition, there is still some money circulating outside the formal banking system, a phenomenon that is largely associated with weak depositor confidence in the formal banking system, among other factors. Various unconfirmed estimates (for example, US$2.5 billion) of cash circulating outside the formal banking system have been suggested by financial analysts and media reports. In addition, some individuals and corporate (for example, schools and shops) have lost large sums of money to robbery, further suggesting that people and institutions are holding cash rather than banking it in the formal system. However, there has been high growth of both bank deposits and lending recently, which suggests that financial intermediation, is improving.

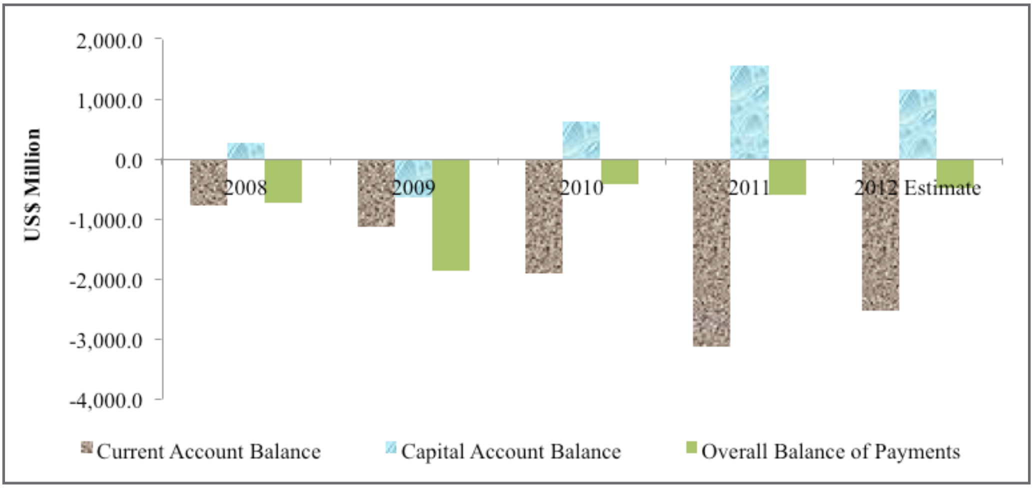
Nevertheless, a continued lack of confidence with the local banking system, and in the economy generally, provides incentives to companies, individuals and non-governmental organisations to keep some of their financial assets off-shore. These developments were associated with various factors, which include, among others, loss of funds in the banking system by both individuals and corporate during the Zimbabwe dollar period; lack of confidence in the stability of the banking system; low deposit and savings rates; high bank charges and uncertainty surrounding the tenor of the current multicurrency system beyond 2015.

Historically, Zimbabwe has had quite strict controls on capital movements, especially capital outflows. However, the capital account was partially liberalized in 2009, following the introduction of the multicurrency regime (MCR). There have been some calls for full liberalization of the capital account, which could have some potential economic benefits, by improving investor confidence and stimulating capital inflows. It is also in line with the SADC and COMESA conventions that Zimbabwe is a signatory to. According to the SADC Trade Protocol which advocates for free movement of people, goods and capital among member countries, member countries are encouraged to liberalise their capital accounts. Full convertibility of currencies within SADC is also a commitment under the SADC Finance & Investment Protocol (FIP). Furthermore, it is unusual for a country that does not have its own currency (and hence uses foreign currency or foreign currencies) to impose capital controls. Nevertheless, there are concerns that fully liberalizing the capital account could result in capital outflows from Zimbabwe. Given that the economy requires capital for company re-tooling and re-capitalization; working capital; new equipment financing and new projects such as in infrastructure and energy development, there are concerns that capital outflows would constrain investment and potentially destabilise the banking system by undermining the deposit base.

According to the Reserve Bank of Zimbabwe (RBZ, April 2013), some controls still remain on the capital account to achieve the following objectives:

- To ensure efficient management and monitoring of capital account transactions in order to minimize capital flight;
- To ensure timeous repatriation of the country's foreign currency receipts, which will in turn help improve market liquidity;
- To ensure the effective mobilization of foreign exchange, as a result the pressures on the country's Balance of Payments (BOP) are minimized;
- To monitor foreign currency remittances so as to curb externalization and/or capital flight; and
- To create an effective and efficient system for processing foreign investment proposals that will ensure the smooth implementation of investment projects.
- In terms of its position, the capital account balance in Zimbabwe is currently positive (Figure 1).

Figure 1: Zimbabwe Capital Account Balance

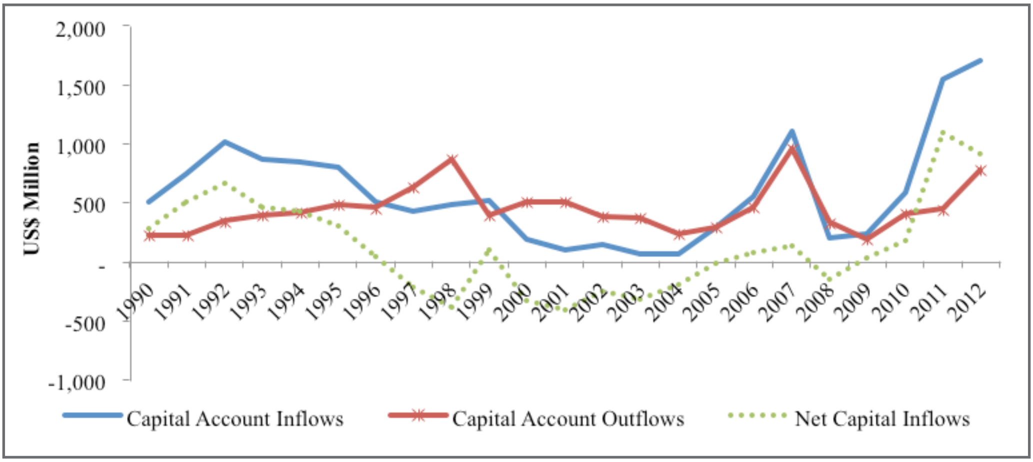


Source: Reserve Bank of Zimbabwe

The capital account, which recorded a surplus of US$272.7 million in 2008, had a negative balance of US$656.5 million in 2009. However, in 2010 and 2011, the capital account recorded positive balances of US$617.5 million and US$1,561.1 million, respectively. In 2012, the capital account was estimated to have recorded a surplus of US$1,148.1 million.

Net capital inflows in recent years have helped to offset the large deficits on the current account, although they have been insufficient to yield an overall surplus on the balance of payments (BOP)[1]. Nevertheless, although capital has been flowing into Zimbabwe, it may not have been as much as would be expected if there were no capital account restrictions, and if other risks in Zimbabwe were lower. In terms of inflows and outflows of capital, the situation of Zimbabwe is characterized as shown in figure 2.

Figure 2: Trend in Capital Account Flows in Zimbabwe



Source: Reserve Bank of Zimbabwe

Figure 2 suggests that net capital inflows declined to US$926 million in 2012, from US$1.1 billion in 2011. The decline was associated with an increase in capital outflows from US$450.3 million in 2011 to US$786.6 million in 2012, as inflows increased from US$1.6 billion in 2011 to US$1.7 billion in 2012. The increase by US$336.3 million in capital outflows in 2012 was largely associated with increase in (a) direct investments in the form of equity capital outflows, which increased from US$13.6 million in 2011 to US$46 million in 2012 and (b) ZSE portfolio outflows, which increased from US$80 million in 2011 to US$131 million in 2012. Factors attributed to the increase in outflows include, among others, political uncertainty regarding national elections; wait-and-see attitude among investors, which is associated with the implementation of the indigenization and economic empowerment policy.

[1]The huge statistical discrepancy (errors & omissions) item is of concern in the interpretation of the BOP accounts.

1.1 Statement of the Research Issue

In Zimbabwe, the capital account remains partially restricted as some exchange controls are still in place. In theory and in practice, controls have both benefits and costs to an economy. The study recognises a need to examine the effectiveness of the controls in achieving the intended objectives as defined by the Exchange Control Authority. In addition, it is critical that any negative repercussions of the controls be highlighted so that the authorities can do fine tuning of the measures. The study recognises that there could be challenges facing industries in complying with and adhering to the exchange controls.

To investigate these challenges, the study seeks answers to the following research questions regarding to the status of capital account regime in Zimbabwe.

1.2 Key Research Questions

- Which capital account restrictions are still in place in Zimbabwe in the multicurrency period?
- Are the capital account controls effective in achieving the intended objectives as defined by the Exchange Control Authority?
- What are the de-facto capital account restrictions in Zimbabwe?
- How have the capital account controls affected various sectors of the economy (e.g. banks, insurance and pension funds, the stock exchange, corporates and individuals)?
- Does Zimbabwe still need to use controls within the context of the multi-currency system, and what would happen if the controls were removed?
- Should authorities force market participants to keep money onshore by maintaining exchange controls or should the Government attempt to improve economic conditions that incentivise and enhance liquidity inflows into the country and curb externalization?
- Are the challenges in attracting foreign capital associated with capital account controls or other macroeconomic and political conditions in Zimbabwe?

1.3 Objectives of the Study

- To identify capital account controls that are still in place in Zimbabwe;
- To examine the effectiveness of the capital account restrictions in keeping money in Zimbabwe and other intended objectives as defined by the Exchange Control Authority; and
- To explore any possible loopholes within capital account regime that likely lead to unintended capital outflows (leakages) and any unintended distortions caused by the capital account regime; and
- To make appropriate policy recommendations to enhance the effectiveness of capital account restrictions and to moderate others where this is found appropriate.

The focus of the study is on multicurrency period, which commenced in February 2009.

1.4 Significance of the Study

This analysis is expected to inform policy discussion on the appropriate exchange control regime within the context of the multicurrency system. It is imperative that an assessment of the net positive or negative impact on the economy and the purpose that exchange controls are playing or should play be done as the country grapples to attract new capital into the country to support economic growth.

As noted above, Zimbabwe is in need of investment capital to restore and develop the productive capacity of the economy, and to ease the prevailing liquidity constraints. It is widely acknowledged that domestic sources of investment are insufficient to meet investment needs, hence there is need for net inflows of foreign investment to boost economic growth. The drive to attract foreign investment will be successful when the capital that is attracted stays longer in the economy. There is also a challenge to ensure that domestic savings remain onshore, and hence available to finance investment. The challenge of stemming capital outflows and reducing the volatility of capital markets provides incentives for monetary authorities to institute capital controls. The intention is to plug any latent loopholes and leakages in the system. However, such policy measures may create other unintended distortions and thus, result in unintended policy outcomes, and may discourage capital inflows or provide an incentive for economic agents to use "unofficial" channels to externalise financial assets.

2. STUDY METHODS AND DATA ISSUES

Both desk research and survey methodologies were used. The study initially involved desk research on the exchange controls and other restrictions that have effect on the capital account in Zimbabwe. The study team reviewed the exchange control catalogue from the RBZ's Exchange Control Division. The catalogue indicates all the capital account controls that are still in place.

In addition to the desk research, interviews were conducted with a number of key stakeholders to assess the effect of the exchange controls and other restrictions on the operations of their businesses. The key stakeholders interviewed included financial sector players (banks; insurance companies; pension funds; financial sector associations; industry representatives (for example, the CZI committee on Economics and Banking); Zimbabwe Stock Exchange (ZSE) and financial sector regulators (Securities Commission of Zimbabwe (SECZIM), Insurance and Pension Funds Commission (IPEC) and the Reserve Bank of Zimbabwe (RBZ)) and some corporates. The list of the institutions that participated in the interviews is shown in Appendix 1.

The level of participation in interview discussions was good. Most stakeholders were very keen to discuss the issues, particularly those that have tended to hurt their respective sectors. They were keen to have sticking issues and challenges highlighted to the Exchange Control Authorities resolved.

3. RELATED LITERATURE

Among other factors, controls on capital account transactions seek to shield a country from risks associated with fluctuations in international capital flows. There are other possible reasons for maintaining controls on either inflows or outflows of capital. For instance, in a country with a weak and fragile banking system, high degree of policy and political uncertainty, and poor investment climate, allowing firms to invest abroad freely could result in an outflow of domestic savings, an outcome which can easily jeopardize banking system viability. Short-term capital inflows can be easily reversed when a country faces adverse macroeconomic shocks, which could destabilise the exchange rate. Some developing countries use capital controls to steer the composition of inflows towards more stable forms, such as foreign direct investment (FDI). In practice, countries tend to favour FDI because it is usually associated with capital flows that are relatively long-term and not subject to rapid reversals associated with changes in investor sentiments (Kose and Prasad, 2012). Some countries have used selective capital controls to induce a shift from shorter-to-longer-term inflows by imposing an implicit tax on capital inflows reversed within less than a year (Kose and Prasad, 2012).

Capital account liberalization is expected to result in a higher degree of financial integration of a country with the global economy through higher volumes of capital inflows and outflows. In practice, however, the outcomes may vary. Sometimes formal controls are ineffective and a country can be integrated into the global economy even with controls in place. For example, in the 1970s and 1980s, Latin American countries found it difficult to contain capital outflows in times of economic distress despite apparently pervasive controls (Kose and Prasad, 2012). Estimates at the time indicated that the volume of capital flight, despite strong controls, was sufficient to pay the entire debt overhang in most Latin American countries. In contrast, many developing countries, including a few in Africa, have no significant controls but have experienced only minimal inflows. In addition, there are challenges in measuring capital controls and the extent to which the degree of capital account liberalization could be undertaken. Ideally, capital account liberalization should allow for more efficient global allocation of capital from capital-rich industrialised countries to capital-poor developing economies. This should have widespread benefits by providing a higher rate of return on people's savings in industrialised countries and by increasing growth, employment opportunities, and living standards in developing countries.

Capital account liberalization may also be interpreted as signalling a country's commitment to good economic policies. For a country with an open capital account, a perceived deterioration in its policy environment could be punished by domestic and foreign investors, who could suddenly take capital out of the country. This was one of the main motives for successful capital account liberalization in Indonesia in the 1970s. The other motive was ineffectiveness of the controls. This provides a strong incentive for policymakers to adopt and maintain sound policies, with obvious benefits in terms of long-term growth. Inflows stemming from liberalization should also facilitate the transfer of foreign technological and managerial know-how and encourage competition and financial development, thereby promoting growth.

However, capital account liberalization can aggravate risks associated with imprudent fiscal policies by providing access to excessive external borrowing. Premature opening of the capital account also poses serious risks when financial regulation and supervision are inadequate. Where the banking system is weakly regulated and there are distortions in domestic capital markets, foreign capital inflows and outflow could create challenges.

Much of the literature on capital controls discusses the potential adverse impact of capital flows on the exchange rate (both real and nominal). This can be negative in several ways. One example is that excessive capital inflows can cause the real exchange rate to appreciate and therefore undermine competitiveness. This is unlikely to be a problem in Zimbabwe. A second concern is that exchange rate volatility could impact on banks and corporates that have balance sheets with different currency composition of assets and liabilities, and hence, exchange rate changes can cause balance sheet problems. Again, this cannot be a challenge in Zimbabwe as there is no domestic currency or exchange rate. Of course there are still important exchange rate movements that affect the economy, notably the ZAR/USD. Zimbabwean authorities have no control over movement of these rates. In short, most of the challenges highlighted in the literature, as emanating from capital account liberalisation, cannot apply in a dollarised economy.

Literature indicates that concerns in other countries have often focused on exchange rate appreciation (in the case of capital inflows) or depreciation (in the case of capital account outflows) and balance sheet effects for banks and corporates where they have assets and liabilities denominated in a mixture of local and foreign currencies, which can give rise to solvency problems in the case of exchange rate volatility. In the case of Zimbabwe, these challenges are not relevant in the multicurrency period as Zimbabwe currently has no exchange rate policy and no domestic currency.

Changing IMF Stance on Capital Account Liberalization

Previously, the IMF promoted free flow of global capital and argued for the benefits of capital account liberalization, which freed up inflows and outflows on the capital and financial account of the balance of payments (BOP). The IMF argued that free flows of capital would:

- Lead to efficient allocation of investment resources in the world, which is a similar argument to the one in favour of free trade;
- Impose macroeconomic discipline on Governments, which cannot get away with bad policies because they will be punished by investors; and
- Allow individuals and businesses to diversify and thus reducing investment risk.
- The IMF also argued that it was futile for governments to try to control flows of capital with capital controls. The basis was that people usually found ways to evade the controls and these led to corruption as officials are bribed to turn a blind eye on these activities.

Most developing countries are cautious about the benefits of capital account liberalization. These challenges were highlighted by the crisis in East Asia in 1997-98, when several countries, including South Korea, Thailand, Indonesia and Malaysia, suffered currency devaluations and debt crises, which caused major economic recessions. For example, one of the key causes of the East Asia crisis was capital account liberalization, which led many observers to conclude that the East Asian economies were not yet sufficiently developed to allow free flows of capital in and out of their countries.

While previously the IMF was very much in favour of full liberalisation, the institution is now much more focused on sequencing. The changing policy advice particularly reflects concerns about capital flows (and the impact on the real exchange rate and competitiveness) and the potential volatility of short-term capital flows. Table 1 above shows examples of the capital account liberalization in African countries and the corresponding policy responses.

Table 1: Experiences of Capital Account Liberalization in Africa

Country	Status of Controls as of 2009	Status/ Sequencing/ Exchange Rate Management System	Impact of Capital Inflows Policy Challenges	Policy Responses to Capital Account Liberalization Policy Recommendations
Cameroon	**2000 to 2009** 2000: Harmonization of national foreign exchange regulations and liberalization of capital flows within the CEMAC. Prudential limits on banks' net open foreign currency positions Residents' foreign exchange deposits prohibited. Continued administrative restrictions remained on most capital outflows. Had no immediate plans for further opening.	Fairly open. Hard peg.	Oil export receipts dominated private debt inflows. Inflows helped build international reserves, but had little impact on money growth and inflation REER appreciated in line with the euro. With low and stagnant private sector credit and high excess liquidity, challenge was to improve financial intermediation.	Responsibility for monetary policy rested with the regional central bank. **Key Policy Recommendations Made** 1. Maintain fiscal sustainability. 2. Strengthen the financial sector. 3. Improve business environment. 4. Improve legal framework and judicial system.
Nigeria	**1985-2006** Economic reforms initiated in mid-1980s Reforms were subsequently reinvigorated in mid-1990s. Started with treatment of dividends and profit repatriation. Later removed controls in other areas such as derivatives and real estate; some remaining administrative restrictions. Foreign exchange market reformed at various points from mid-1980s to wholesale Dutch auction system initiated in 2006. Growing importance of the inter-bank market. Effective unification of the parallel and official exchange rates.	Partially open. Managed float. Reserve Money target.	Oil export receipts dominate inflows. FDI and portfolio flows became more important. Inter-bank foreign exchange market was deeper and had become the primary measure of exchange rate developments. Forward foreign exchange contracts were offered. Interest rates on government paper were reduced. Bank capital increases prompted inflows. REER appreciated. Capacity to monitor private capital inflows was limited. Exchange rate became more flexible, Country was in transition to an inflation targeting regime.	**Key Policy Recommendations Made** • Authorities should maintain a prudent fiscal stance to avoid additional domestic demand pressure. • Short-term movements in the naira rate should ensure that investors perceive two-sided exchange rate risk. • Strengthening banking supervision and monitoring of flows recommended.

Uganda	**1997** Liberalization was part of a broad package of market oriented reforms, privatization and trade liberalization.	Fully open. One-step Opening. Managed float. Reserve money target.	Surge in inflows since 2004, causing appreciation pressures. Policy trilemma with constraints on how much fiscal contraction could be implemented. Inflows persisted, tensions between open capital account, monetary policy independence and a competitive exchange rate would be heightened.	Mix of sterilized intervention. Sterilized intervention was the first line of defence, but was incomplete, leading to a large increase in base money. Increase in base money and nominal appreciation occurred. Some appreciation was allowed, but concerns about high sterilization costs and export competitiveness prompted, for a short period, unsterilized intervention. This caused a temporary but large increase in reserve money.
Zambia	**1990-1995** 1993-94: Liberalization of capital transactions. 1995: Banks were allowed to accept foreign currency deposits. Capital account liberalization was of part of broad reforms focused on economic stabilization, competitiveness and debt restructuring, accompanied by financial market reforms.	Fully open. Sequenced opening. Managed float. Reserve money target.	Inflows complicated the conduct of monetary and exchange rate policy. Their onset coincided with a surge in copper prices that led to a large initial appreciation, in the absence of sterilization. Temporary reversals in inflows, associated first with the uncertainty before the 2006 elections and then with the subprime crisis in August 2007 caused by a sharp depreciation. Challenges arose from the cost of sterilization, limited availability of monetary policy instruments and difficulty of selling foreign exchange when the currency was appreciating. In spite of good capital flows data, the authorities had difficulty forecasting the government's cash flow.	Policy response after large appreciation has been to intensify sterilization operations (to meet reserve money target), but was costly. Monetary policy was helped by 1. Under execution of the budget in 2007. 2. Transfer of government funds in commercial banks to the Bank of Zambia. • Steps to increase monetary policy instruments, though liquidity management remained a problem. • An active inter-bank market to manage liquidity should be developed.

Ghana	**1995-2006** Mid-1990s: Partial liberalization of portfolio & direct investment 2006: Foreign Exchange Act, allowing non-residents to buy government securities with maturities of three years or longer, minimum holding period of one year. Liberalization following economic stabilization and debt restructuring: parallel reforms in the primary government debt and stock markets; efforts to develop interbank money and foreign exchange markets and to strengthen financial sector. supervision and soundness.	Sequenced opening. Partially open.		
Tanzania	**1990 to 1998** 1990: Start of FDI liberalization. 1997: Full liberalization of FDI flows. 1998: Supporting foreign exchange regulations. Continuing restrictions on portfolio investments (government securities). FDI liberalization coinciding with privatization program, creation of a one-stop shop and investment promotion policy.	Partially open.		
Senegal	**1999 to 2009** 1999: Elimination of controls on inward FDI and foreign borrowing by residents Continuing administrative restrictions remain on capital outflows to non-WAEMU countries.	Fairly open.		

Source: Adapted from IMF (2009), Table A3.3, pp.72-73, in Murinde (2009)

Although exchange controls have been lifted in most African countries, there are still some administrative or bureaucratic procedures in place, which limit capital flows (Murinde, 2009). Capital controls are significantly restricting in Cameroon, partial in Nigeria and South Africa and are non-existent in Uganda and Zambia.

According to Murinde (2009), while policy challenges associated with private capital inflows have been similar across countries, policy responses have varied, depending on institutional factors, monetary and exchange rate regimes. Challenges and policy responses have been associated with four exchange rate policy regimes. These include countries with a hard peg such as Cameroon, and countries with a managed float and reserve money target. By 2009, Nigeria, Uganda and Zambia were in the process of moving towards an inflation target.

According to Murinde (2009), in countries with hard pegs, capital inflows have not had a substantial impact on inflation or the real exchange rate. This has been because domestic structural weaknesses in the credit markets have been such that domestic credit growth has not responded and excess liquidity has increased. In countries with a managed float, the key policy challenge has been to contain inflation without rapid depreciation of the exchange rate. The policy response has been to allow more flexibility in monetary or exchange rate targets.

In view of capital account liberalization and policy, Murinde (2009), recommended that African countries should redesign their capital account liberalization regimes, alongside their institutional and financial sector policies in order to tilt the composition of inflows toward longer-term flows. Murinde (2009) showed that Tanzania, Uganda and Zambia were able to lengthen maturities held by foreign investors by issuing long-term instruments, facilitated by financial sector reforms and the ability to maintain a credible, stable macroeconomic and political environment. Murinde (2009) further argued that it was important to lengthen the term structure of investments to help reduce both roll-over risks and maturity mismatches in the financial sector. This was because long-term bonds better matched the liability structure of domestic institutional investors. In addition, the long-term view of instruments was a better risk management strategy than short-term instruments in face of a financial crisis because of the probability of huge capital out-flows in the case of short-term investments.

Uganda's experience with capital account liberalization shows that policy makers should strengthen regulation, reporting requirements and data collection systems. They should be able to design market-friendly instruments to facilitate more appropriate management of a liberalized economy, while reducing volatility in capital flows.

Strengthening of banking supervision and monitoring of flows has been recommended in most countries (Murinde, 2009). Policy recommendations have also been centered around maintaining fiscal sustainability, strengthening of the financial sector, improving the business environment, strengthening of legal frameworks and the judicial systems.

4. PRESENTATION AND ANALYSIS OF RESULTS

4.1 Post-Dollarization Status of Capital Account Controls as of April 2013

The post-dollarization capital account restrictions, as defined by the Exchange Control Authority are as follows (Table 2):

a. Inward Investments by foreign investors in unlisted companies;
b. Remittance of disinvestment proceeds by foreign investors in unlisted companies;
c. Inward investments by foreign investors in companies listed on the ZSE;
d. Money market investments;
e. Outward investments;
f. Participation on the external stock exchanges;
g. Operation of Nostro Accounts; and
h. Opening of Offshore Accounts.

It is important to note that these restrictions only apply to corporates and institutions, and not to individuals or households.

Table 2: Zimbabwe Capital Account Restrictions as at April 2013

TRANSACTION SUBJECT TO RESTRICTIONS	DESCRIPTION OF RESTRICTIONS	RATIONALE
• **Inward investments by foreign investors in unlisted companies**	1. Foreign investors permitted to invest up to 40% of issued shares in existing projects; 2. Investments which can take the form of dilutions, mergers, acquisitions and rights issues are all subject to approval by the Exchange Control Review Committee (ECRC); 3. Investments beyond 40% and 49% (from indigenization law) thresholds are considered on a case by case basis.	The 40% threshold is meant to encourage Greenfield investments as opposed to investing in already existed companies.

• **Remittance of disinvestment proceeds by foreign investors in unlisted companies**	• Remittance of all disinvestment proceeds from unlisted companies require prior Exchange Control approval;
	• Disinvestment proceeds arising from pre-May 1993 are eligible for re-investment on the domestic market for a period of 5 years prior to remittance;
	• However, Exchange Control conditions of accelerated remittance apply if:
	  • The disinvestment proposal results in localization of ownership; or
	  • The sale of foreign shares to locals is discounted by at least 10% of the company's net asset value and dividend savings.
	  • Prior to the multi-currency period, disinvestment proceeds from pre-May 1993 investment were blocked and invested into 6% 20-year Government of Zimbabwe bonds for which remittances would be effected at maturity.
	• Disinvestment proceeds arising from post-May 1993 investments are fully remittable after Exchange Control approval;
	• In cases were disposal of shares is to locals, the minimum requirement is that the shares be disposed of at par or discount.
		The policy on limiting remittances for disinvestment proceeds from pre-May 1993 investments is meant to curb serious capital flight since most of the investments were undertaken prior May 1993.

• **Inward investments by foreign investors in companies listed on the Zimbabwe Stock Exchange (ZSE)**	• Foreign investors can participate, without prior Exchange Control approval, on the ZSE provided they finance the purchase of shares by inward transfer of foreign currency through normal banking channels; • The purchase of shares is limited to 40% of the total equity of the company with a single investor acquiring a	

	maximum of 10% of the shares on offer; 3. Authorized Dealers receive foreign investors' funds and transmit the funds to Stock Brokers for the purchase of shares; 4. Proceeds realized upon disinvestment on the ZSE are fully remittable subject to relevant withholding tax deductions; 5. Investors enjoy 100%dividend remittance rights and Authorized Dealers can process the remittances without prior Exchange Control approval; 6. Dual listing requires Exchange Control approval.	
• **Money market investment**	• Foreign investors are allowed to take up a maximum of 35% of the primary issuance of bonds and stocks on the money market, subject to the purchase being funded by an injection of foreign currency through normal banking channels; • Foreign participation in excess of 35% is subject to Exchange Control approval on a case by case basis; • Foreign investors cannot purchase bonds and stocks on the secondary money market; • Foreign investor participation in any other money market instruments is permitted without any restrictions and no Exchange Control approval is required except where the threshold of 35% of primary issuance of bonds and stocks is exceeded. • No prior Exchange Control approval is required for disinvestments in the money market.	
• **Outward investments**	1. Prior Exchange Control approval is required for proposals of establishing offshore branches and subsidiaries and consideration is done on a case by case basis; 2. Individuals who hold free funds do not require Exchange Control approval; 3. Corporates with approved cross border investments are not allowed to create liabilities or exposures which have a reducing effect on their shareholding or create foreign positions for the country in the event of default. In cases where such borrowings become necessary, prior Exchange Control approval is required.	

• **Participation on external stock exchanges**	• Zimbabwean corporate entities are not permitted to acquire shares on external stock exchanges in terms of the existing Exchange Control regulations; • Investors such as pension funds may not invest their funds offshore; • Requests by local entities to invest offshore are considered on a case by case basis depending on the merits of the proposals; • Individuals with free funds do not require any Exchange Control approval to invest offshore.	To curb capital flight.
• **Operation of Nostro Accounts**	• Authorized Dealers are allowed to open and maintain any number of Nostro Accounts with correspondent banks of their choice for purposes of facilitating cross-border payments on behalf of their clients; • Authorized Dealers are allowed to keep Nostro Account balances not exceeding 30%. 70% of their balances are kept onshore.	
• **Opening of offshore accounts**	• Corporates are not allowed to open offshore accounts without prior approval.	This is meant to reduce instances of externalization as well as promoting liquidity onshore.

Source: Summarised from a detailed document from the Reserve Bank of Zimbabwe (April 2013)

In the surveys conducted, most stakeholders demonstrated understanding as to why there were still some exchange controls. This was mainly based on their extent of understanding of the challenges of liquidity constraints in the economy. However, there are specific exchange control measures such as the restrictions on offshore investments by insurance and pension funds, that seem to be generally considered negatively by most stakeholders, in that particular sector and by other stakeholders outside the sector.

According to the RBZ Exchange Control Regulations, if a company is unable to comply with standard exchange controls, there is provision for application for exemption, on a case-by-case basis. It is understood from the RBZ that there have not been many such cases where companies have requested for exemptions. Stakeholder feedback also indicated that in most cases, approval has been obtained for such applications, where there was justification for the application.

Notably, most of the existing controls are of the form that “permission is needed” for certain transactions. However, the impact of controls in practice depends on whether or not permission is granted and the time it takes to grant or decline permission. Stakeholder views on the time it takes to be granted and denied permission were mixed. Some noted that there were no hassles in getting permission while others expressed concern that the process took long. In some instances permission was not granted, resulting in a loss of investment opportunities. The outcomes of the requests for permission also partly depend on the nature or complexity of the requests.

4.2 Analysis of Capital Account Restrictions

a. Inward Investments by Foreign Investors in Unlisted Companies

The restriction that foreign companies are permitted to invest up to 40% of issued shares in existing projects is favourable in the sense that it encourages Greenfield investments as opposed to investment in already existing companies. However, some stakeholders expressed concern that restricting inflows of foreign direct investment (FDI) into existing enterprises is counterproductive, given the economy’s desperate need for investment inflows. However, some view exchange controls as being less relevant in view of the adverse impact on investor confidence of the indigenisation policy in Zimbabwe. Investors consider policy inconsistency, political risk, and the general investment climate in their decision matrix.

In Zimbabwe, foreign investments beyond 40% and 49% are subject to Exchange Control approval, on a case-by-case basis. This measure restricts foreign ownership of domestic assets, and capital inflows from non-residents. In the event of macroeconomic instability or shocks, these restrictions ensure that there is no sudden huge outflow of capital from Zimbabwe. Foreign investors tend to be very sensitive to adverse shocks on investments. However, FDI tends to be much less volatile than short-term portfolio investments, given that FDI generally flows into illiquid assets and cannot be easily withdrawn from the economy. If a majority of shareholders are local, future outflows in the form of dividends will also be limited by this measure. However, the economy is also deprived of much-needed capital inflows.

b. Remittance of Disinvestment Proceeds by Foreign Investors in Unlisted Companies

According to the RBZ, the restriction on remittances for disinvestment proceeds from pre-May 1993 investments is meant to curb capital flight since most of the investments were undertaken prior May 1993. According to RBZ, these investments have been given more attention as their disinvestments would have a major impact on the financial sector and the economy in general. This argument is valid given the prevailing liquidity constraints in the economy. However, on a negative note, this disadvantages the investors from benefiting from the proceeds from their investments. Some investors may consider this provision as being punitive as it denies them an opportunity to relocate their investment to more lucrative investment destination following the disinvestment in Zimbabwe.

c. Inward Investments by Foreign Investors in Companies Listed on the Zimbabwe Stock Exchange (ZSE)

Foreign investors intending to participate on the ZSE do not require prior Exchange Control. This is favourable in that it encourages portfolio capital flows into Zimbabwe. However, while there are no restrictions on capital inflows it is important to note that speculative capital inflows (hot money) are highly volatile and can destabilise the financial system when there are huge and unanticipated outflows.

In the multicurrency system, foreign participation on the ZSE has been increasing (see Table 3). Foreign participation had declined from 30% in 1997 to as low as 2% by 2008 (ZSE, 2009). The decline in foreign participation has been associated with weak foreign investor confidence in the hyperinflationary period. Foreign participation recovered and stood at 6.6%, 14.4% and 23.0% in 2010, 2011 and 2012, respectively. The participation levels suggest a steady increase in investor confidence in the multicurrency period stimulated by the stable macroeconomic environment.

Table 3: Trading Foreign Participation on the Zimbabwe Stock Exchange

Year	Turnover Volume	Number of Shares Traded by Foreigners	Foreign Participation on the ZSE (%)
2010	6,800,155,462	898,944,547	6.6
2011	4,610,008,413	1,326,944,097	14.4
2012	3,513,176,891	1,614,240,521	23.0

Source: Zimbabwe Stock Exchange

Decline in domestic participation on the ZSE over the same period has been driven by a different set of factors, which include among others, low average incomes due to underperformance of most sectors of the economy; dwindling financial savings; and economy-wide liquidity constraints. Dual listing, which entitles companies to list on other foreign stock exchanges, still requires Exchange Control Approval. The rationale of this restriction is based on the need to curb externalization of funds from Zimbabwe. Premature removal of this restriction may cause an outflow of capital from Zimbabwe, through arbitraging. Possible net capital outflows would have a negative effect on Zimbabwe's Balance of Payments (BOP) position.

However, trading in US dollars on the ZSE under the multicurrency system has reduced arbitrage opportunities arising from price/exchange rate differentials in different countries as opposed to the Zimbabwe dollar era. Arbitrage opportunities are driven more by varying economic conditions/fundamentals in other countries and less to do with prices/exchange rates under the multi-currency system.

Foreign investors are allowed to participate on the ZSE without prior Exchange Control approval provided they finance the purchase of shares by inward transfer of foreign currency through normal banking channels. This restriction is intended to improve liquidity in the local banking system as foreign investors would use local banks to facilitate their transactions.

However, the ZSE authorities observed that restrictions on foreign share ownership limit capital inflows into the ZSE. This restriction, limits the amounts of capital that can be mobilised from global funds into Zimbabwe. In this respect, the view of the ZSE is that Zimbabwe would be more attractive without this restriction. According to the ZSE, in a competitive global environment, there has to be a true reflection of value without any market distortions. In their view, controls distort market values and limit capital inflows given the stiff competition for global funds. In this regard Zimbabwe needs to adopt policies and rules that would make the ZSE more competitive in attracting funds from global market at a time when returns on investment in other markets are low.

The restriction that proceeds realized upon disinvestment on the ZSE are fully remittable subject to relevant withholding tax deductions is unfavourable because the ZSE levies a flat fee of 1% as withholding tax, regardless of whether a profit or loss was made by the foreign investor. In other countries, there is consideration as to whether a loss or profit was made by the foreign investor. Where a profit was made, withholding tax is applied but where a loss was incurred, the condition is applied differently in recognition of the profit/loss situation (SECZ, 2013). The fee is lower where a loss was made.

d. Money and Capital Market Investments

According to industry representatives, the restriction that foreign investors are allowed to take up a maximum of 35% of primary issuance of bonds and stocks on the capital market, subject to the purchase being funded by an injection of foreign currency through normal banking channels is subject to monitoring challenges in Zimbabwe's capital market environment (SECZ, 2013). What emerged from the stakeholder consultations was that it tends to be difficult to ensure enforcement of this control by the individual stock brokers (SECZ, 2013).This is because the ZSE still uses a manual trading and settlement system, which is not centralized to ensure compliance and to be able to detect violations by players at any point in time. Zimbabwe still has no central security depository system (CSD), where violations could be detected. With a CSD, programming would be done to ensure compliance and detection of any violations. In the current situation, monitoring for compliance is still not very tight (SECZ, 2013).

In addition, other stakeholders queried the rationale of the restriction on foreign investors' participation in primary bond issues and on the secondary market. To a large extent, this restriction is logical as Zimbabwe has concerns about the volatility of short-term capital flows.
In the multicurrency period, there are limited money market instruments in Zimbabwe with features that are favourable to prospective investors (See appendix 3). There is also a lack of risk-free assets. For example, the Zimbabwe Treasury Bills (TBs) that were re-introduced in October 2012 were not considered risk-free by market participants and market analysts. This was mainly because stakeholders queried Government capacity to pay given the huge debt (domestic and external) overhang. In addition, in the multicurrency system, the capacity of the RBZ, which is also debt-ridden to monetize Government debt, has been curtailed. The RBZ can longer print money to bailout Government should it default at maturity. However, so far and on the contrary, indications are that all the TBs that were issued in the multicurrency system have been honoured at maturity (See Appendix 3). Notwithstanding this, the market participants still do not have confidence in Government's credit worthiness. Stakeholders still hold strong perceptions that Government may default and they are still uncertain regarding the tenor of the multicurrency system.

It is also important to note that in the multicurrency system, money market interest rates are relatively higher in Zimbabwe than elsewhere. According to industry representatives and market data, some of the money market returns locally are higher than what can be obtained offshore, largely reflecting perceptions of higher risk in Zimbabwe; restrictions on foreign investors and the lack of investment funds locally. Some of the investments are now more attractive locally than what would obtain elsewhere. In addition, market indications were that some companies are also not very keen to invest offshore as Zimbabwe currently has higher returns and the domestic investors are familiar with the local business conditions. However, asset diversification into offshore markets would spread investment risks and reduce concentration.

Given the relatively higher interest rates in Zimbabwe, capital is expected to flow into Zimbabwe, but because of other factors such as country risk, the amounts may not necessarily be as expected. In this case, the views of industry were that to some extent, the de-facto exchange controls have become a major impediment to capital inflows into Zimbabwe. Foreign investors who are risk averse, would not invest in Zimbabwe. This also makes a strong case for locals to diversify risk, for instance, by allowing insurance and pension funds to invest a portion of their assets offshore. The logic of the restriction that foreign participation in excess of 35% is subject to Exchange Control approval on a case-by-case basis is debatable. The prevailing liquidity constraints deter local investors from taking up to 65%. Given the current macroeconomic conditions, there is scope in reviewing foreign participation threshold upwards to improve the liquidity situation in Zimbabwe or to keep the restriction as is. However, too much foreign participation is risky in the sense that should there be adverse developments in the economy (political or economic), foreigners may quickly leave the market, resulting in its sudden collapse.

e. Outward Investments

The restriction that outward foreign direct investments by Zimbabwean residents into foreign or offshore markets is subject to Exchange Control criteria keeps money in Zimbabwe and reduces possibilities for externalization of funds. Similarly, the requirement that cross border investments in the form of establishment of offshore branches or subsidiaries and that these require prior Exchange Control approval, where consideration is on a case-by-case basis, reduces externalization of funds possibilities. However, in respect of these restrictions, some corporates raised concerns that applications on establishing offshore branches and subsidiaries tend to take long, and thus denying the respective corporates, of investment opportunities that arise in offshore markets.

The granting of permission to individuals who hold free funds to invest offshore without Exchange Control approval encourages outflow of free funds to attractive offshore investment opportunities. Inflows from these offshore investments come in later in the form of dividends. The resulting inflows, however, depend on the exchange controls in the countries where the individuals would have invested their money.

f. Participation on External Stock Exchanges

In Zimbabwe, investors such as pension funds may not invest off-shore. This restriction is in line with the Insurance Act and the Pension and Provident Funds Act (Chapter 24:09), which compels these institutions not to invest any assets offshore. The benefit of this control in the multicurrency regime is that money is kept onshore, which is crucial in an economy facing liquidity challenges. However, if insurance companies and pension funds were allowed to invest a portion of their assets offshore, they would diversify investment risk, benefit from investment opportunities in other countries and therefore be able to increase payouts to the pensioners, some of whom lost money in the hyper inflationary period. Investing offshore by insurance and pension funds would likely have long-term benefits, but in the short-term, it would likely lead to a capital outflow, which could be detrimental in an economy with liquidity constraints. On a comparative basis, this restriction is partial in some African countries and very generous in a few countries such as Botswana, Namibia and Swaziland where the local capital markets are not well developed (Figure 5). However, it is unusual not to allow any offshore investments by pension funds.

Figure 5: Comparative Off-Shore Investment Restrictions on Insurance & Pension Fund Assets

Country	Off-Shore Investments (Insurance & Pension Funds)
Zimbabwe	0%
Brazil	10%
South Africa	25%
Kenya	15%
Ghana	15%
Nigeria	Not more than 25%
Botswana	70%
Namibia	70%
Swaziland	70%

Sources: Eyamba (2012), CAFD (2012) & EIU (2012)

In the current macroeconomic environment, characterized by liquidity constraints, the logic of this type of control is to keep money in Zimbabwe. Pension funds and insurance companies are custodians of pension and insurance funds. If this control was to be removed, there is concern among the authorities that there could be a possible huge outflow of these funds to competitive offshore markets, where there is diversity and competitiveness.

However, there is a strong case for allowing a percentage of these funds to be invested in secure markets offshore, solely for the benefit of the pensioners in the long-term. Prohibiting Pension Funds' investments offshore is highly restrictive and likely to severely penalise Pension fund members, given the limited investment instruments/paper with suitable features in Zimbabwe.

In Zimbabwe, some of the money held by insurance and pension funds is currently being lent to banks, for on-lending to corporates and individuals. For example, in July 2012, the Ministry of Finance and the RBZ negotiated that the lending rates by these institutions (Old Mutual and NSSA) to banks be reduced from 10% to 7% per annum. The reduction was done in a bid to reduce average lending rates in the economy. The reduction in lending rates by Old Mutual and NSSA to the banks became effective on 1 February 2013. To this effect, a Memorandum of Understanding (MOU) was signed by the concerned parties. While this reduced lending costs to banks, with an expected average reduction in lending rates in the economy, this reduced interest income to the insurance and pension funds.

According to the Minister of Finance, the 7% lending rate by NSSA and Old Mutual is in line with their other investments. Notwithstanding the positive effects of a reduction in lending rates to the banks, to the lending insurance companies and pension funds, the measure has been considered as financial repression. The prescribed interest rates on NSSA and Old Mutual funds to banks are not based on market fundamentals. Left to themselves they would ordinarily not lend at these rates.

It is critical to note that in the multicurrency period, insurance companies and pension funds have become a targeted source/captive market of funds for Government. For example, in March 2013, and in accordance with prescribed asset ratio that insurance and pension funds should invest a certain portion (25% for short-term insurers and pension funds, 30% for life insurers and Old Mutual for both) of their assets in Government securities, the Government issued NSSA and Old Mutual with TBs worth US$40 million at a negotiated coupon rate of 7% per annum. The issued TBs have a tenor of 365 days with details for repayment at maturity to be contained in the 2014 National Budget. While this issuance was in line with the prescribed asset ratios, this outcome suggests that a removal of this exchange control could negatively affect Government funding from insurance and pension companies.

In this regard, the market views were that fiscal constraints have become a de-facto exchange control in that Government needs to maintain a captive market for government securities even when the rate of return is not attractive to the institutional investors. In addition, the arrangement was entered into while Government reserved the finer details till the 2014 budget time, in which case some of the conditions may turn out to be unfavourable to the creditors. However, on the other hand, there is a crowding out effect associated with the measure. If Government commandeers these funds, they are not available for lending to the private sector. This is especially serious with long-term funds that characterise pension and insurance company assets.

In addition, industry concerns were that the credit worthiness of Government in the multicurrency system is weak. As a result, most institutions are reluctant to lend to Government because they are not sure about Government capacity to repay. There are security risks concerns in lending to Government.

In terms of investment opportunities, according to the insurance and pension funds, the control on offshore investments has hindered possible and beneficial diversification of asset investment portfolios. According to industry representatives, this restriction is a huge limiting factor in view of the global financial developments. Externally, these institutions would benefit from diversification and safety of investments as there is lack of viable investment opportunities locally. Restriction from investing offshore limits product offering. For instance, if they were allowed offshore investments, some insurance and pension funds would invest in unit trusts in South Africa (SECZ, 2013).

In the business environment, there is need to balance asset portfolios. In this regard, it makes sense to invest both onshore and offshore. For example, the bond market in Zimbabwe is not as developed as in other similar African countries. In this case, investors would not want to lose possible investment opportunities that arise in external markets from time to time. In the multicurrency period, there is concentration of investment risk in Zimbabwe, whereas there are sovereign risk issues to be considered in investment analysis. At any point in time, some countries have less risk than others. Diversification would therefore spread the sovereign risk.

As much as this move curbs capital flight, the pensioners' funds would be suppressed from multiplication. In the event of serious market failures or economic melt-down, these investors would be adversely affected. The policy has serious repercussions to the pensioners, who are the beneficiaries of the investment proceeds. The pensioners already lost benefits because of hyperinflation during the economic crisis of 2000-2008, which reduced values of their benefits.

While there are general concerns that the removal of the control would likely result in possible capital outflow, according to the insurance and pension funds, if this control was to be removed, it may not be a given that there would be an outright outflow of capital from Zimbabwe. The investors would weigh the possible risks and opportunities. In particular, not all investors would prefer offshore investments. For example, currently, returns are higher in Zimbabwe than in most other countries, suggesting that capital should ideally flow into Zimbabwe. However, there may be other considerations such as diversification objectives, political and sovereign risk factors to consider, against opportunities that arise offshore.

According to insurance and pension funds, there are very limited investment options in Zimbabwe as the domestic market currently lacks diversification and instruments on offer have unattractive features. For example, the TB auctions in the multicurrency system were only restricted to banks as participants. In this regard, according to insurance and pension funds, Government should open TB market to more participants, such as insurance and pension funds. However, pension and insurance companies need to find longer-term investments. Money markets are good for ready cash but not for matching maturities of assets and liabilities.

A number of Government instruments have been issued since the adoption of the multi-currency system and some of them were poorly subscribed (See Appendix 2). This implies that there are other challenges, other than the claimed lack of investment instruments on the money market. Some of the insurance and pension funds have indicated that the timing of these instruments and the announcements made have made them unwind their investments at the ZSE in an attempt to participate. In addition, in some of the cases, after unwinding the investments, which is a premature termination of investment with attendant losses, these institutions have been short-changed as the Government instrument offers are closed before the unwinding process is completed. This tendency has resulted in the respective institutions getting reluctant to participate in future offerings. In addition, the Ministry of Finance refused to let the market set the yield. If the Ministry insists on a below-market yield, this results in under-subscriptions.

In the multicurrency system, some big insurance companies and pension funds have funds, but smaller ones do not have adequate funds to participate with. Some are reported to be struggling to make payouts to pensioners because of liquidity challenges. Most of these institutions are still trying to recover from the 2000-2008 economic crisis, which resulted in them losing huge sums of money due to hyperinflation and other adverse developments in the financial system. This is one of the reasons why these companies are lobbying to be allowed to invest a certain percentage of their assets offshore. Suggestions have been thrown around 10-15% by most stakeholders that we interviewed.

It is important to note that the restriction on offshore investments has always been there even in the Zimbabwe dollar period. However, in the multicurrency period, the restriction has proved to be more inhibitive, on the back of several factors. For example, the changeover from the Zimbabwe dollar to the multicurrency system affected insurance and pension funds. They lost most of the money market investments during the Zimbabwe dollar crisis and only managed to retain investments in terms of stock market shares and buildings. Of course, some years before the peak of the economic crisis, pension funds had already reduced their portfolio of financial assets to a minimum, as a hedge against hyper inflationary effects on financial assets.

These companies lost assets in the form of Government bonds, municipal stocks and cash. With hind sight these companies are arguing that, if they had been allowed to spread the country risk, and invest offshore they would at least have been cushioned during the economic crisis. According to insurance and pension funds, offshore investments would be less costly and more competitive as the external markets are more widely diversified and more liquid.

According to IPEC, there is need to safe guard these investments as not all investments done offshore are lucrative. Accordingly, caution is therefore an absolute must. In view of the constraints imposed by the prohibition to invest offshore, the Association of Insurance Companies has also made representations (proposals) to the Ministry of Finance to consider the removal of this restriction. The proposal was included in the 2010 Review of legislation guiding the operations of insurance and pension funds (IPFA). However, so far, it is not yet clear when the outcomes of the proposal would come into effect. This proposal to allow offshore investment had been made earlier by stakeholders as far back as the late 1980s, in 2002 and more recently in 2010.

On the asset management side, companies such as Old Mutual manage money predominantly on behalf of pension funds. The key controls that affect these investments include lack of offshore investments and lack of full fungibility of for example, Pretoria Portland Cement (PPC) and Old Mutual shares.

The lack of full fungibility for PPC and Old Mutual has resulted in the local listed shares trading at a discount to their values on the Johannesburg Stock Exchange (JSE) as well as the London Stock Exchange (LSE) for Old Mutual. This means that local holders of these securities are not realizing full value on the shares. Old Mutual on the ZSE, as an example, is trading at a discount of 30% to the price on the JSE. Giving these shares full fungibility would correct this unfavourable position. However, according to other industry representatives, in the multicurrency system, the fungibility of shares challenge has become less prominent in the sense that arbitrage opportunities have narrowed as compared to the Zimbabwe dollar period. Arbitrage opportunities tend to be large where the economic conditions are widely varied.

The restriction that requests by local entities to invest offshore are considered on a case-by-case basis, depending on the merit of the proposal has been doubted by most industry representatives. There seems to be lack of awareness on such approvals. Getting approval for some of the cases has met with challenges.

Overall, a balance needs to be struck between the needs of institutional investors (and there customers) and the economy. In most countries, this balance entails permitting institutions to invest a portion of their portfolios offshore. In Zimbabwe's case, it would be appropriate to move gradually in this direction, so that institutional investors can slowly diversify their investment portfolios without causing a major shock of capital outflows from the economy.

It should also be noted that even in countries without exchange controls, it is often the case that restrictions are imposed on the ability of pension funds, banks and other financial institutions to acquire foreign assets. These restrictions are driven by the need for prudential regulation and broader development objectives. Hence, even if Zimbabwe's capital account controls are liberalised, it would still be possible to manage the offshore investments of pension funds.

g. Operation of Nostro Accounts

According to industry representatives, there is need to understand why banks would prefer to keep money offshore. Much of this practice has to do with confidence issues in the Zimbabwean economy. However, the money in banks does not belong to the banks. It belongs to corporates and individuals. It is the individuals and corporates who decide which banks to keep their money with. Where and in which banks individuals decide to keep their money is largely affected by confidence levels in the formal banking system.

In February 2012, the RBZ directed that banks that held money offshore repatriate 75% to Zimbabwe and keep up to 25% offshore, effective 1 March 2012. The amount retained offshore was increased from 25% to 30% in June 2012. When this measure was implemented, about US$266 million was estimated to have been held by banks in Zimbabwe in their offshore accounts (MoF, 2012). The repatriation of the offshore excess balances was meant to improve the liquidity levels and availability of credit to the productive sectors of the economy. However, increased lending to the productive sector depended on whether banks found it viable to increase lending. Some of the banks that were interviewed indicated that this directive resulted in increased lending by some international banks which were lending at lower rates than local banks. Banks did not consider capital account controls as the major constraint to the development of the sector and their capacity to lend. For example, banks are no longer required to seek approval for small value transactions. Since the introduction of the multicurrency system, the RBZ has liberalized and reviewed some of the capital account restrictions. For most banks, no applications have been turned down by the RBZ. The restrictions (such as approval of foreign loans of US$1 million) assist banks in assessing the source of money and there by thwarting any potential dirty money in the banking system.

However, it was observed that there are other deep- seated challenges such as country risk and weak confidence in the banking system that are stifling growth of the sector and inhibiting mobilisation of sufficient financial savings. Confidence in the banking system is still weak following the change over from the Zimbabwe dollar to the multicurrency system which reduced to zero accumulated savings for both individuals and corporates. This experience has dampened the motivation by economic agents with excess funds to place them with banks due to uncertainty on the tenor of the multicurrency system. It is important to note that the idle money with banks belongs to depositors. Depositors choose the banks that they would like to bank with. For example, if Bank A offers 0% on deposits and Bank B offers 10%, but depositors go to Bank A, it means that depositors likely have reasons for going to Bank A and not to Bank B. If Bank A is forced to lend the money, this would scare away depositors.

The fragility being witnessed in the banking system as evidenced by accumulating non-performing loans is also working against the drive to attract new capital in the banking system. This is happening at a time when some banks have not fully compiled with the RBZ minimum capital requirements for banking institutions.

Banks acknowledge that the RBZ is flexible with regards to the enforcement of this directive. There are provisions for banks to ask for permission to operate above stipulated limit if they can provide proof that their foreign obligations are high. In this case banks can apply for exemptions. However, banks also observed that off-shore FCA Nostro restrictions tend to undermine the confidence by international correspondence banks. Lower offshore deposits by banks in Zimbabwe may be interpreted to imply weak financial strength or challenges in the Zimbabwean economy. The restriction implies a lower level of financial security and lowers confidence in the economy as viewed by the outside world. The impact of this measure on the economy is considered by banks as negligible given that it avails small pockets of money into the economy when considered against the country's capital requirements. The country requires huge injection of new capital to boost credit to the productive sectors of the economy. The other critical challenges in Zimbabwe that need urgent redress are the widening Balance of Payments (BOP) deficit and the debt overhang.

h. Opening of Off-Shore Accounts

The capital account restriction that corporates are not allowed to open offshore accounts without prior approval is good in curbing externalization of funds from Zimbabwe and keeping money onshore. However, since controls are a market distortion, some corporates are reportedly using underground channels to evade this measure.

i. Foreigners Deposits in Zimbabwe

Foreigners are allowed to hold deposits in Zimbabwe. This is favourable for liquidity purposes, given the liquidity constraints in Zimbabwe.

4.3 De-Facto Exchange Controls in Zimbabwe in the Multicurrency System

The stakeholder consultations indicated that the following factors have become de-facto capital account restrictions in Zimbabwe in that they have tended to influence capital account movements. These include, uncertainty regarding the implementation of the Indigenization and Economic Empowerment Policy (IEEP); uncertainty regarding the tenor of the multicurrency system beyond 2015; uncertainty in the political environment; fiscal constraints; huge external debt burden; uncertainty regarding elections, and political sanctions. These factors militate against capital inflows into Zimbabwe.

4.4 Challenges Facing Industry in Complying With the Controls

Industry representatives noted that there seems to be a lack of deep understanding of industry operations by Exchange Control Authorities which acts against the industry. The issues that were raised as inhibiting the smooth operation of business include: too much financial control of business operations; delays by the RBZ in taking decisions on applications for outward investment approvals; too much bureaucracy; application declines and RBZ's tendency to task junior officials to make decisions on critical investment plans.

These tendencies have, in some cases, resulted in lost investment opportunities as indications were that some companies have lost the opportunity to invest in the companies where they had won management contracts with companies that had been turned round and were viable. According to industry representatives, in some cases, the RBZ has simply indicated that the companies could not invest where there was business opportunity. It was observed that these controls and delays in making investment approvals impedes the proper functioning of companies and undermines the economy's growth prospects. It was noted that regulatory institutions may not have the requisite expertise to appreciate the complexity of business operations and the cost of delayed decisions or indecision. In this regard it was suggested that there is need for adequate dialogue which will enable regulators to appreciate fully and at the right levels of decision making the requirements of industry. On the basis of the issues raised by industry representatives, the following conclusions were made.

5. CONCLUSIONS

- Economic conditions in Zimbabwe are still not ripe for full liberalization of the capital account. There are still concerns that full liberalization could result in net capital outflows, which could cause major problems for the economy and the banking system, hence, the various controls that are still in place. There is no urgency to liberalize, given the current state of the economy.

- Zimbabwe cannot liberalize the capital account overnight, if there was need to liberalize. The process can only be gradual, given the current constraints.

- The current controls restrict outward investments by residents. This is reflective of the concern over the prevailing liquidity challenges in the economy and attempts to curb externalization of funds. The controls on outflows aimed at keeping liquidity in the banking system are probably justified, given the liquidity situation and the need for a stable deposit base in the banking system.

- However, the existing controls also restrict inward investments by non-residents. Restrictions on inflows into unlisted and listed companies reduce the potential inflows of much-needed capital. The general environment of exchange controls and uncertainties in their application adds to risk and uncertainty that deters foreign investment in Zimbabwe.

- From a market perspective, there is need to remove controls and to allow capital to move freely. The capital account control affects capital flows to the country as the country currently needs capital and any restrictions to flow of capital drives capital away.

- There is also a question regarding the effectiveness of exchange controls. In instances where firms can find ways around the controls, the controls become ineffective. This calls for an audit of the effectiveness of the current Exchange control restrictions.

- The overall point remains that Zimbabwe's economic challenges are much greater than those resulting from exchange controls. The riskiness of the overall economic environment is more of a deterrent to foreign investment than exchange controls. The uncertainty regarding the implementation of the indigenisation policy emerged as one of the main factors deterring capital inflows. There is need to provide clarity and avoid conflicting policy pronouncements with regard to the implementation of this policy. Relaxation of exchange controls in an environment of uncertainty is likely to lead to net capital outflows.

- Zimbabwe needs extensive policy reforms that will improve the economic and business environment, addressing for instance, fiscal challenges, foreign debt burden, banking sector fragility, underdeveloped capital market, and strengthening security for property rights. Capital account liberalisation should form part of this reform process, and be implemented gradually to integrate Zimbabwe into regional and international capital markets at the same time as improving investor confidence.

- Nevertheless, even in the short-term, there is scope for relaxation of some exchange controls, notably removing restrictions on the inflow of foreign investment, especially FDI, and allowing pension funds and other institutions to gradually invest a portion of their investment funds offshore.

- It can be concluded that the capital account controls are not a solution to the country's liquidity woes but sound and coherent policies are a panacea to these challenges.

6. POLICY RECOMMENDATIONS

Broadly, the country needs to strike a balance between the intended objectives of the controls and the costs or losses brought by such controls. More specifically,

- Policies adopted should concentrate more on FDI attraction; consumer and business confidence in financial markets and business security. Such policies will guarantee the financial sector and the whole economy with stable liquidity flows.

- The RBZ needs to review its limit on the foreign loans which require approval, to US$5 million that was initially the case to reduce the inconvenience to investors.

- There is need to speed up the process of on-going work on reviewing the restriction that forbid insurance and pension funds from investing offshore. A certain percentage of their assets could be invested offshore as is the case in other countries (Brazil (10%); South Africa (25%); Kenya (15%); Ghana (15%); Botswana (70%); Namibia (70%); Swaziland (70%) and Nigeria (not more than 25%)). Zimbabwean pension funds and insurance companies, could be allowed to invest offshore at least up to 25%. With a growing confidence in the domestic economy, institutions can choose to invest less offshore to take advantage of higher local interest rates.

- There is need to develop money and capital markets and to have risk-free Government investment instruments to lessen costs of restricting investors from investing offshore while there are limited investment options onshore.

- Instead of using controls, there is need to find attractive and risk-free assets in the money and capital markets. For Government securities, the amount of TBs to be offered must be planned very carefully and payment at maturity should be done to instil confidence in Government, the RBZ and the economy. In addition, the TBs must bear a market-determined yield. Holding the yield below the market rate undermines voluntary purchases.

- The Government should undertake a broad-based economic reform programme, which should address the constraints to investment and growth, fiscal stability and the debt burden, of which capital account liberalisation should be a part.

- There is need for Zimbabwe to improve the policy mix with respect to macroeconomic balances and political stability.

- Non-profit making public and state enterprises should be restructured, commercialised or privatized to make them viable and/or release redundant capital. Implementation of the restructuring, commercialisation or privatization of the public and state enterprises can create a conducive environment to attract new capital.

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APPENDIX 1: LIST OF CONSULTED INSTITUTIONS

Banks
Agribank
AfrAsia Kingdom Bank
BancABC

Insurance Companies
Fidelity Life
Old Mutual

Pension Funds
National Social Security Authority (NSSA)
Old Mutual
Fidelity Life

Financial Sector Regulators
Reserve Bank of Zimbabwe (RBZ)
Insurance and Pensions Commission (IPEC)
Securities Commission of Zimbabwe (SECZIM)

Capital Market
Zimbabwe Stock Exchange (ZSE)

Associations
Zimbabwe Association of Pension Funds (ZAPF)
Bankers Association of Zimbabwe (BAZ)

Industry Representatives
Confederation of Zimbabwe Industries - Economics and Banking Committee (Chairperson)

APPENDIX 2: 2012 TREASURY BILL AUCTION RESULTS

Auction Details	04 Oct-2012	24 Oct-2012	24 Oct-2012	26 Oct-2012	06 Nov-2012
Amount on Offer (US$ million)	15	15	15	15	30
Bids (US$ Million)	7.7	6.5	4.7	11.05	8.65
Number of Bidders	9	6	6	12	13
Uptake (Bids/Offers) %	51.33	43.33	31.33	73.67	28.83
Accepted (US$ Million)	0	0	0	9.85	0
Amount Rejected (US$ million)	7.7	6.5	4.7	1.2	8.65
Tenor (Days)	91	91	91	91	91
Minimum Interest Rate (%)	5.5	5	5	5	8.5
Maximum Interest Rate (%)	15	14.5	14.5	13	12

APPENDIX 3: MONEY AND CAPITAL MARKET INVESTMENT INSTRUMENTS IN ZIMBABWE

	Zimbabwe Dollar Period	Multicurrency Period
Money Market Instruments		
Treasury Bills (TBs)	Widely used	Government Treasury Bill Issues • 91-day TBs issued to banks (4 Oct. 2012; 24 Oct. 2012; 26 Oct. 2012 & 6 Nov. 2012 - US49.85 million) • 365 day TBs issued to NSSA & Old Mutual (March 2013 – US$40 million) Payment at maturity have been honoured.
Bills of Exchange Bankers Acceptances (BAs)		The BAs are still predominantly used.
Commercial Paper		
Government bonds (< 1 year)		
Central Bank Paper OMO bills		Not in use in the multicurrency period.
Parastatal Paper Guaranteed by Govt.		1.1 IDBZ Infrastructure Development Bond • US$30 million was offered and only US$17.8 million was allotted at 10%. 1.2 Agri-Bills • Private placement guaranteed by CBZ & Government • US$4.5 million guaranteed by CBZ • US$17.6 million guaranteed by Government • 270 days • US$10 million was offered and US$5.8 million was allotted • Interest rates of 7-12% • 1st batch paid in full at maturity on August 17, 2012 • 2nd batch matured on 10 October 2012 1.3 AMA bills • US$25 million was offered and US$12.5 million was allotted at 10.5% interest • Bill s issued for soya bean support • Included tap issue (continuous float) • Tender opened on 13 December 2013 • Minimum application of US$50,000 in multiples of US$10,000 1.4 US • US410 million was offered • US$1.04 million was allotted • Interest rates of 10-14%

		• US410 million was offered • US$1.04 million was allotted • Interest rates of 10-14%
Negotiable Certificates of Deposits (NCDs)		Not in use in the multicurrency period.
Capital Market Instruments		
ZSE Shares		Commonly used.
Debentures		Debentures are in use in the multicurrency system.
Government bonds		
Government stock		Worth US$81 million Converted from statutory reserves 2-year (2.5%); 3-year (3%) and 4-year (3.5%) Payments at maturity have been honoured. Interest payment is semi-annually.
Public Enterprises bonds		ZESA Bonds (10 years) AMA bills

Source: Reserve Bank of Zimbabwe, Banks and ZSE rdgraphix +263 772 403 625

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