

# Development Banks and Industrialisation in Zimbabwe

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**ABSTRACT:** Development banks' role in the development of less developed regions is well recognised but inadequately emphasised as these institutions help to promote, nurture and support industrial development. The main objective of this paper is to determine the role of development banks in promoting industrialisation in Zimbabwe. Multivariate regression analysis using e-views 3.1 was engaged to analyse time series data on the roles of development banks in Zimbabwe. As statistically verified, development banking activities have not been so influential on fixed capital investment. For this reason, if national development banks are to partner with the regional development banks, there is likelihood of structuring long term funding, allowing the country to target meaningful industrialisation projects.

**KEYWORDS:** Development bank, Industrialisation, Fixed capital investments, Development investment credits Zimbabwe

## I. INTRODUCTION

Development banks are financial institutions that are concerned with the provision of long term loans towards both profitable and non profitable projects including socially beneficial ones. The rapid industrialization in many countries in the 19th century was achieved by state provision of long term loans to risky projects via development banks (Diamond, 1957; Boskey, 1961). While some financing or microcredit does exist for business development at the village level in Africa, there is nothing to help small businesses expand into the "missing middle," Duggan (2006). The advent of liberalisation the world over has seen state involvement in the financial sector gradually diminished in line with the neo-liberal shift in economic policies. Financial activities have been directed by free market dynamics rather than regulated and directed markets.

In the Zimbabwean banking and financial intermediation history from the days of Rhodesia, it reveals the evolution from an oligopolistic banking sector that only opened up in the early 1990 with the advent of the Economic Structural Adjustment Programme (ESAP) liberalisation economic blueprint. Prior to this, the state directly concerned itself with the provision of capital finances and the management of developmental economics as a centralised economy under the Growth with Equity economic charter that survived from 1981 to 1991 succeeded by ESAP. ESAP gave way to ZIMPREST in 1996-2001, whose main objective was the creation of a stable macro-economic environment which allows increased savings and investment in order to achieve higher growth and improvement in the standard of living for all Zimbabwe. Although ZIMPREST major achievement was in marked improvement in Zimbabwe's fiscal

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performance, its shortcomings emanated from the depreciation of the Zimbabwe Dollar in 2008 which marks the origin of the country's economic free fall which saw inflation reaching world record levels of 231,000,000% in July 2008 (ZIMSTATS). The Indigenization and Economic Empowerment Act of 2007, which requires that black Zimbabweans own 51 percent of companies, further inhibits the financial integration of the financial system with that of any foreign country. Several other economic blue prints were authored and gathered dust without seeing any day light as well. This begets the search for alternative catalysts to spur the stagnant at best but generally regressing economic development trajectory of Zimbabwe.

Based on Wruuck (2015), development banks can play a countercyclical role, helping to mitigate the impact of economic shocks, that is, helping to cope with the crisis and act as a stabiliser. They can also serve as a catalyst, promoting structural change in economies and helping to address longer-term challenges. In this paper, the focus is more on the repercussions of the crisis, for instance addressing shortages of financing for long-term investment. Currently, Zimbabwe government has introduced the Zimbabwe Agenda for Sustainable Socio-Economic Transformation (Zim Asset), its economic blue print for 2013-2018- as the answer to the country's economic woes. Since 2013 to date (2017), nothing has materialised due to lack of funding. Zim Asset is a cluster based Plan, reflecting the strong need to fully exploit the internal relationships and linkages that exist between the various facets of the economy. These clusters are as follows; Food Security and Nutrition; Social Services and Poverty Eradication; Infrastructure and Utilities; and Value Addition and Beneficiation. The present challenge is to secure funding to fulfill one of the pillars of Zim Asset which is infrastructure and Utilities.

## II. LITERATURE REVIEW

### Development banks

Development banks are financial institution designed to provide medium- to long-term capital for productive investment. Development banks are mostly state-backed financial institutions that are concerned with the provision of long term loans to not only profitable projects but also to socially beneficial ones (Oztuck et al., 2009: 2). They typically provide a source of long-term financing to industries deemed important for economic development but which might not otherwise be funded by the private sector. They may also serve to finance other projects consistent with state policies (Amyx and Toyoda, 2006). Government-backed financial institutions are typically established when private sectors are either unable or unwilling to provide services deemed important by the government. Central to the success of such entities at the time of their creation is typically the preferential regulatory treatment they receive and their lower capital procurement costs. These banks can be a National Development Bank (NDB), Regional Development Bank (RDB) or a Multinational Development Bank (MDB). These banks may make loans for specific national or regional projects to private or public bodies or may operate in conjunction with other financial institutions. Some of the main activities of development banks include the recognition and promotion of private investment opportunities, upholding economic development and growth, and to improve the living standards of citizens, through the development of infrastructure, developing institutional capacity in undertakings and enterprises of all kinds in the economy and to support development projects and programmes in infrastructure sectors of the economy.

Although the efforts of the majority of development banks are directed toward the industrial sector, some are also concerned with the primary sectors especially agriculture like the Agriculture Development Bank of China.

### The Zimbabwean Experience in Development Banking

The history of development banking in Zimbabwe dates back to 1924 with the establishment of the Land and Agricultural Bank in the then Southern Rhodesia. This institution has changed over the years, in 1971 the Land and Agricultural Bank was transformed into the Agricultural Finance Corporation. It was converted into a fully-fledged Commercial Bank in December 1999 as Agribank. In October 2003 Government decided to transform the Bank further into an Agricultural Development Bank but with loan granting and deposit taking functions. This has meant that it has since ceased to be a development bank but a commercial bank whose target market is agriculture.

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In 1983, the Zimbabwean government established the Zimbabwe Development Bank (ZDB). The ZDB's underlying objective was to contribute to the Government of Zimbabwe's efforts at rehabilitating and modernizing the industrial sector as well as to intensify its development of small and medium scale enterprises. In the context of the latter, special attention was to be given to fostering the emergence of indigenous small and medium-scale enterprises. ZDB started lending operations during the financial year 1985/86 and since then, both the volume and value of lending has undergone significant expansion. After a steady build up in the bank's operations during its formative years, there was a sharp increase in both commitments and disbursements with effect from 1989. Between 1986 and 1989, ZDB's commitments registered an average annual growth rate of 16.0 per cent compared to a corresponding annual growth rate close to 200.0 per cent between 1989 and 1992. Overall, with an average annual inflation rate below 15.0 per cent, real growth in the bank's operations was sustained over the period up to 1995. Development investments credits disbursements also exhibited the same pattern of growth during the review period, registering a steady build up until 1989 but increasing sharply thereafter. Between 1986 and 1992 the ratio of cumulative disbursements to cumulative commitments stood at 76.0 per cent, clearly suggesting that well over three quarters of the committed loans were actually disbursed which is commendable. However, a significant decline in operations was experienced in 1993, due to a combination of drought and a difficult macroeconomic environment. But there were indications of substantial recovery in years 1994 to 1999.

During the initial years of its operations, ZDB's lending was predominantly to existing companies for replacement and modernization and funding was almost completely in foreign currency. From 1988 onwards there has been a gradual shift to a more balanced portfolio with financing of an increasing number of new and expansion projects. There also has been noticeable diversification in sectoral allocation of lending. Whereas the earlier five-year average sectoral distribution through 1992 indicated that manufacturing accounted for over 80 per cent, the year average through June 1994 show that manufacturing's share has fallen to about 70 per cent. Increased lending to agriculture (including horticulture), construction, tourism and transport services has been taking place.

In 2005, ZDB was restructured to the Infrastructure Development Bank of Zimbabwe (IDBZ), now being streamlined to focus on infrastructure, but unlike Agribank it remained a development bank. The Infrastructure Development Bank of Zimbabwe (IDBZ) was repositioned by the Government of Zimbabwe as a vehicle for the mobilisation of infrastructure development in Zimbabwe, with finance from both domestic and international sources. The Bank's mandate is to mobilize financial and technical resources of appropriate duration and cost for public and private institutions involved in infrastructure development and to facilitate investment in infrastructure. These sources of these funds are the MDBs and RDBs, central government and multilateral lending institutions.

## II. METHODOLOGY

This study used the descriptive and explanatory research designs to examine the role of development banks in promoting industrialization in Zimbabwe. The study also used the deflated development investment credits (DIC) and gross fixed investment (FI) variables as proxies. By doing so, the extent of the contribution of the development banking facilities to local industrialization was explored. Multivariate analysis and E-views 3.1 was used for data analysis. Augmented Dickey-Fuller (ADF) unit root tests were applied to determine the stationarity properties for each variable. The objective was to examine the existence of a co-integrating relationship for the variables between FI and DIC using the Engel-Granger test regressions. The error correction model was also applied to characterize the long- and short-term relationship between investment and credits. The linear regression model applied in this study was expressed as follows:

$$\begin{aligned}RFI_t &= \beta_1 + \beta_2 RDIC_t + \varepsilon_t \\RFI_t &= \beta_1 + \beta_2 RTC_t + \varepsilon_t \\RFI_t &= \beta_1 + \beta_2 ROTHERCR_t + \varepsilon_t\end{aligned}$$

Where

*RFI*: Real Fixed Investments

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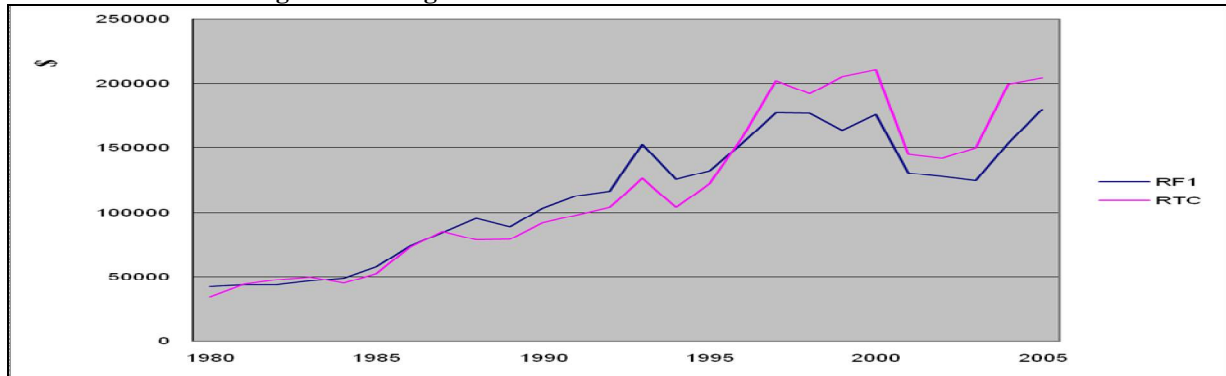
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*RDIC*: Real Development-Investment Credits  
*RTC*: Real Total Credits  
*ROTHERCR*: Real Credits Other than Development-Investment Credits  
 $\epsilon$ : Represents the error term

## IV. DATA, RESULTS AND ANALYSIS

**Figure 1. Change in Total Credits and Fixed Investments over Time**



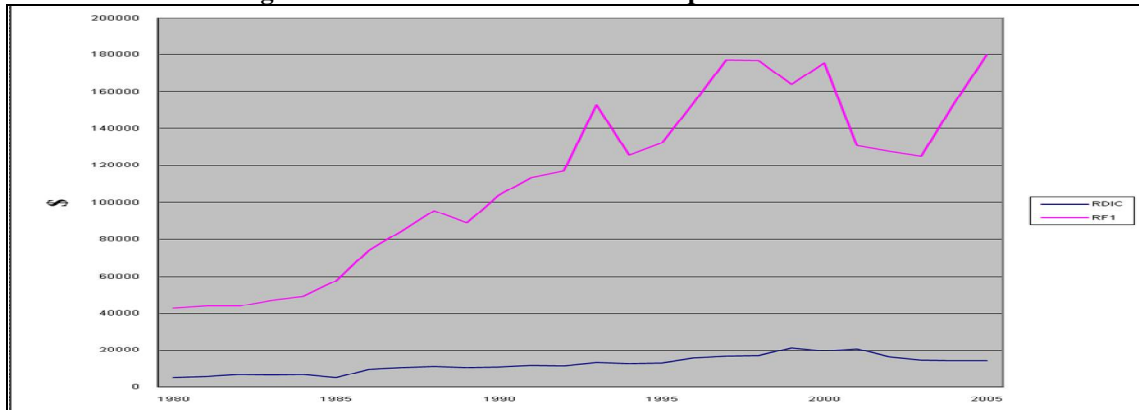
Source: *Zimstats*

Year

This set of results shows that in Zimbabwe Fixed investment are dependent on total credits and is consistent with the General theory of employment, interest and money (Keynes, 1936). Under the Keynes' theory, the economy would need prodding if it was to head in the right direction, and this meant active intervention by the government to manage the level of demand.

Using the results in both graph 1 and Engel-Granger's co-integration test, it is acknowledged that real fixed investments and real total credits follow a similar pattern. As it could be observed from the test results (Engel-Granger's Co-integration test), these series are, in fact have a long-run relationship.

**Figure 2. Fixed Investments and Development Investment Credits**



Source: *Zimstats*

Year

This shows that in Zimbabwe if we increase development investments credit this will result in a sustained growth in fixed investments over a long period of time that is permanent investments to the nation. However, the large gap



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## Error Correction Model

**Table 2: Error correction Model estimation results see APPENDIX 5**

Variable	Coefficient (Std. Error)	Variable	Coefficient (Std. Error)	Variable	Coefficient (Std. Error)
<b>DRFI11</b>	<b>-0.084852</b> (0.287248)	DRF11	-1.096803 (0.406089)	<b>DRF11</b>	<b>-0.280587</b> (0.269775)
<b>DRDIC</b>	<b>2.503811</b> (2.4190989)	DRTC1	0.921488 (0.306782)	<b>DROTHERCR</b>	<b>0.610612</b> (0.100624)
<b>DRDIC2</b>	<b>-4.599346</b> (1.844985)	DRTC2	-0.090762 (0.165048)	<b>DROTHER1</b>	<b>0.337070</b> (0.207539)
<b>E1</b>	<b>-0.057920</b> (0.294708)	E2	0.116358 (0.264144)	<b>E3</b>	<b>-0.161621</b> (0.153721)
<b>Constant</b>	<b>7295.121</b> (4107.996)	Constant	5276.146 (0.264144)	<b>Constant</b>	<b>1014.096</b> (2070.937)
<b>R-squared</b>	<b>0.276362</b>	R-squared	0.366359	<b>R-squared</b>	<b>0.7772945</b>
<b>F-Statistic</b>	<b>1.718578</b>	<b>F-statistic</b>	<b>2.601814</b>	<b>F-statistic</b>	<b>16.17002</b>

Source: *E-Views 3.1*

We have seen that a long-run relationship between real fixed investments and other variables is given by a co-integrating relationship. On its own, a co-integration relationship sheds no light on short-run dynamics, but its very existence indicates that there must be some short-term forces that are responsible for keeping the relationship intact, and that it should be possible to construct a more comprehensive model that combines short-run and long-run dynamics. Thus an error correction model was engaged to resolve the issue of disequilibrium in the short-run.

The E-views 3.1 output in the table above, shows the results of fitting an error correction model for the relationship between real fixed investment with real development- investment credits, real total credits and real credits other than development-investment credits using Engel-Granger procedure on the assumption that there is a co-integrating relationship. The error terms (E) in the above specifications show the error terms that are obtained from the related Engel-Granger test regressions. Parameter estimates for this term will signal the speed of adjustment for short-term deviations from the long-run equilibrium.

Although co-integrated, DFI11 and DRDIC variables do not have casual relationship (Table above). This may be an indicator of a potential external factor that affects both variables in the same way. Reverting to the results for the TC and other credit regression results, both these variables have a significant positive impact on DFI11. A change in DFI11 that is observed one period back decreases the change in RFI observed at this period. None of the parameter estimates for the error-correction terms is significant. The short run disequilibrium reflects the lump nature of development investments credit hence their impact will lagged over time.

## V. CONCLUSIONS AND RECOMMENDATIONS

As statistically verified by the coefficients, the development banking activities have not been so influential on fixed capital investments unlike commercial credits do. Total fixed capital investments were mainly financed by commercial loans and the development banking activities have not been decisive in financing development in Zimbabwe. These findings validate the seemingly stunted industrialisation growth in Zimbabwe. Furthermore, the findings in Zimbabwe are also consistent with those obtained in a similar study done in Turkey with the central conclusion that developing country industrialisation is being financed by short term funding sources as depicted by the nature of the majority of commercial banks deposits. Attempts to predict the future almost always fail, even when formal mathematical models



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are available. Intuition (or guesswork) based on detailed knowledge of an economy often provides as good a guide as any, but only if neglected factors such as liquidity shortages, policy uncertainty, obsolete infrastructure, debt overhang, low aggregate demand, high unemployment and energy shortages would be addressed to support the projected growth rate do not turn out to be significant. The summarised findings on development banks show that for Zimbabwe's quest for industrialisation especially in face of stiff competition from cheap Asian imports lies in its activation of its development banks. Hence, The IDBZ stands a good chance of linking up with regional development banks in the mould of DBSA, PTA, Afreximbank and AFDB. If a national development bank were to partner with the regional development banks, there is a clear possibility of structuring long term funding with requisite government guarantees and assurances thus allowing the country to target meaningful industrialisation projects like the ZDB model from mid '80s to mid '90s. However this can only be feasible if there is a vibrant portfolio of development banking and the willingness to let them pursue their fundamental objective.

However, another notion which is apparent is the general distrust of government involvement in economic activities a factor which gave credence to the liberalisation of world economies. This has also contributed to the sidelining of development banks as champions for industrialisation a case all too apparent in Zimbabwe. However, with the undoubted merit of development banks they can be champions for Public-Private Partnerships. They are a form of agreement between public and private parties that contributes to achieving international and national development goals for health, basic education, water and sanitation. Private companies can invest through concession agreements, in which financial commitments are shared and financial risks are transferred to private investors. Other PPPs involve private sector delivery of public services, under specific construction, management or service contracts, often defined as private sector participation (PSP) rather than PPP. PPPs represent a very significant potential for investment in infrastructure as they can contribute to leveraging important amounts of financial resources. In that regard, they account for a growing share in NDBs' strategy for financing infrastructure projects. National development banks can make good use of PPPs to transfer risks and encourage large scale financing operations in developing countries. Just as regional or multilateral development banks, some NDBs can act as facilitators, promoters or even investors. New funding packages are put forward to support PPPs, including equity financing, loan assistance, technical assistance and project debt finance, which for instance are all being implemented by South Africa's DBSA.

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