UNIVERSITY OF ZIMBABWE

Faculty of Law

"A state of permanent indebtedness"

A critical analysis of the laws governing debt financing by State Owned Entities in Zimbabwe.

By

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CHAPTER ONE

1.1. RESEARCH BACKGROUND

Zimbabwe, despite having obtained political independence on the 18th of April in 1980, has remained a low income and slow-developing country 40 (forty) years after attaining political autonomy. The economic development of the Country has meandered through cyclical episodes of booms and depressions in an equal but largely detrimental fashion. The stunted economic growth has in the result led to a distinctive reliance by the Government of Zimbabwe on debt (both domestic and external) as a means of financing Government activities, infrastructure development, securing social security and as an economic life-support system in order to avert an otherwise imminent collapse of the State and Government[1].

The majority of these Government activities have been implemented through State Owned Entities (SOEs) - commonly referred to as “Parastatals”, which have become a typical vehicle through which Government accesses various credit facilities from institutions within and outside the Country. As at 30 May 2020, Zimbabwe’s foreign/external debt stood at **USD9,5 Billion[2],** the bulk of which is owed to International Multi-lateral Financing Institutions (IMFIs) from global capital markets such as the World Bank, International Monetary Fund, Export-Import Bank of China and the India Export Import Bank. In terms of composition by creditor, 44% of external debt is owed to the Paris Club creditors, 31% to multilateral creditors, 20% to non-partisan creditors and 5% to bilateral creditors[3]. The “local/domestic debt” was reported to be in the sum of **$149 (One Hundred and Forty Nine) Billion** Zimbabwean Dollars **(ZWL)** after a controversial conversion of all debts and obligations denominated in USD prior to 22 February 2019 to be recognised as being denominated in Zimbabwean Dollars at a parity rate of 1:1.

[1] Research by the African Forum and Network on Debt and Development (AFRODAD) on Zimbabwe’s high debt service requirements in 2020. It was AFRODAD’s finding that Zimbabwe’s debt service requirements have inhibited potential future investment in social expenditure such as education and health, thereby perpetuating low productivity and poverty.
[2] Ministry of Finance and Economic Development, Mid-Term Policy Review Statement – June 2020
[3] Ministry of Finance and Economic Development, Mid-Term Policy Review Statement – June 2020

Normal as Zimbabwe's survival on debt-financing may appear, there has been limited legal discourse or insufficient jurisprudence regarding the extent and manner in which Government can be allowed to borrow in order to finance the operations by SOEs. This scenario is compounded by restrictive legal scholarship on how the Zimbabwean Government, as the principal Shareholder of all SOEs, is controlled by law from meddling in insatiable debt-financing of its activities through the corporate vehicle of SOEs. Limited as the law and jurisprudence on debt financing by the State might be, it is imperative to acknowledge the existence of certain legislative instruments which are instructive on the subject of public debt financing. These include the Constitution of Zimbabwe[4], Public Debt Management Act[5], Public Finance Management Act [6], Public Entities Corporate Governance Act[7], and the Reserve Bank of Zimbabwe Act[8]. In broad terms, the Constitution sets a limit on the extent of borrowing by Government in order to fund various projects through SOEs. Other enactments such as the State Loans and Guarantees Act[9] and the Sovereign Wealth Fund of Zimbabwe Act[10] provide for the statutory authority of Government to encumber the State's assets through issuing Sovereign guarantees as security for the repayment of public debt financing.

Although the debt management legal framework of Zimbabwe as set out above is rated quite strongly by development partners such as the World Bank and the Macroeconomic and Financial Management Institute (MFMI) as one that meets minimum standards for debt management, the government has been failing to comply with the law[11]. This finding begs the question whether the alleged non-compliance with the laws on public debt financing is a result of unadulterated ignorance by those charged with the obligation to comply or deliberately done on the pretext that the law has no sanction/penalty for its violation? It further motivates the question whether the debt management legal framework praised by the aforementioned development partners is truly adequate, if its defiance is as palpable as it currently is in Zimbabwe? These questions establish the impetus and objective of this dissertation, *viz* to make

[4] Amendment (No. 20) Act of 2013
[5] [Chapter 22:21]
[6] [Chapter 22:19]
[7] [Chapter 10:31]
[8] [Chapter 22:15]
[9] [Chapter 22:13]
[10] [Chapter 22:20]
[11] Research by the African Forum and Network on Debt and Development (AFRODAD) on Zimbabwe's high debt service requirements in 2020.

an enquiry into the correct standing of the laws governing debt financing by the State as well as the extent to which Government and the SOEs as juristic persons, have complied with such legislation.

Preferential buyer's credit loan facilities, concessional loans and Government to Government Lines of Credit (LOC) facilities are terms which have been used interchangeably in Zimbabwe to mean one thing – **"DEBT FINANCING".** These flowery but obligatory corporate financing instruments seem to have been used without limit or due regard to the country's legal framework on the same, let alone its ability to repay the debts. By instinctively and incessantly borrowing through SOEs, Government has effectively encumbered the future generations to an obligation of retiring the soaring national debt whose true value seems to be understated. Without authoritatively stating the position of the law on the borrowing powers of SOEs through Government, a real risk or possibility exists that Zimbabwe may find itself in a *"state of permanent indebtedness"*.

With the foregoing in mind, this dissertation intends to critically investigate, analyse and synthesise the position of the law in Zimbabwe with respect to debt financing by the State and through the corporate vehicle of SOEs. Such debt financing modality is loosely referred to herein as "public debt financing". This research intends to establish the legality of a proliferation of "Lines of Credit" and other debt-financing instruments of similar calling which have laden various SOEs at the instance of Government. To a limited extent, this debt financing has led to notable infrastructure developments in the last decade[12], but it remains imperative to question whether the debt utilised in financing these "National Projects" has been acquired and utilised in accordance with the requirements of the law. More critical to this enquiry is the question whether SOEs are governed by the same conventional Corporate Finance laws which determine debt/equity financing in private companies.

[12] The construction of the 300MW Kariba South Hydro Power Station at a cost of **USD514 Million**, refurbishment of the Plumtree to Mutare Highway at a cost of **USD206 Million**, construction of the new Parliament Building at a cost of **USD97 Million** and the refurbishment of the Robert Gabriel Mugabe International Airport at a cost of **USD153 Million** are notable examples of infrastructure development recorded over the last decade.

1.2. RESEARCH QUESTIONS

As a matter of global practice and given the centrality of law to public debt management, sound public debt financing policies and debt management practices require robust legal underpinnings in order to achieve corporate and government development[13]. From this premise, this dissertation also seeks to assess the soundness of Zimbabwe's legislation that relates to Sovereign debt financing. The adequacy or otherwise of these laws will be benchmarked against practises in other developing and developed jurisdictions. The findings thereof will be synthesised with a discussion on the extent to which tenets of Corporate Finance Law are enforceable against the Government in its capacity as the principal Shareholder in every SOE.

The following research questions become unavoidably important in the formulation of a well analysed and synthesised scholarly view of the subject;

a) Is the legal framework on debt financing by SOEs adequate to protect and/or promote the interests of Zimbabwean citizens?
b) To what extent is such legislation *intra vires* the Constitution? – An interpretation of the relevant statutes *vis-à-vis* the Constitution will be imperative.
c) To what extent are the SOEs complying with the provisions of such laws regulating public debt financing?
d) To what extent does the law governing debt financing by public entities promote good corporate governance?
e) What are the remedies, if any, enforceable against the Government where it is found to be in breach of the applicable legislation?
f) What is the nature of the security(s) used as collateral for the repayment of the debt acquired by the Government on behalf of SOEs?
g) To what extent does the corporate finance laws of Zimbabwe allow for such encumbrances on Zimbabwe generally as a State, but more particularly on the individual (or collective) SOEs?
h) How do other jurisdictions in the region and internationally enforce legislation on public debt financing?

[13] ZIMCODD Statement on the Public Debt Management Act, October 2015.

These are the key research questions which arise on this subject, for which this dissertation attempts to answer. In the course of answering the above research questions, an enquiry into the various canons of interpretation of statutes will be key in determining whether the Acts of Parliament promulgated to address debt financing by SOEs are *intra vires* the Constitution. Further, principles of good corporate governance will also be examined in the course of analysing the adequacy of the laws which govern debt financing by SOEs.

In answering to these fundamental research questions, a consultation of key Statutes, Regulations and other legal instruments shall be critical in order to measure the extent to which public debt financing by SOEs passes the legality test. The extent of the application of these pieces of legislation within the Zimbabwean context shall be demonstrated through case studies of particular SOEs who have borrowed from foreign entities to implement Government projects. Consultation of the legislation of other jurisdictions as well as international scholarly articles on the subject matter shall form the basis of an opinion on how the Zimbabwean Government can gravitate towards the international standards of controlling debt financing by SOEs.

1.3. RESEARCH METHODOLOGY

In resolving the research questions posed herein, the researcher adopted a predominantly qualitative methodology. To the extent that the research questions mainly revolve around an analysis of the laws which govern debt financing in Zimbabwe, the research was concentrated on;

a) Identifying the sources of the law(s) which relate to sovereign debts and debt financing generally and extent to which these sources of the law has influenced the scheme of Zimbabwe's legislation on the subject in particular. This exercise involved a thorough research into the historical development of the concept of debt financing. It also involved a meticulous comparison of the historical jurisprudence of the concept of Sovereign debt financing and tracing its development and application in the modern legal and socio-economic order in different jurisdictions;

b) The research was also inductive in the sense that a particular theory, hypothesis, explanation, and conceptualization of the research problem was created. As the full dissertation will demonstrate, a hypothesis that the laws on debt financing in Zimbabwe are inadequate and require modification to suit international practise and standards was arrived at after consideration of a number of case studies. These case studies demonstrate a similar pattern or conduct of repetitive contempt. This position has been corroborated by the learned submissions of professionals in the Public Debt Management Office, Parliament of Zimbabwe and the Ministry of Finance and Economic Development[14].

c) The research was also conducted through case studies of 3 (three) major projects[15], wherein the Government of Zimbabwe is implementing these using borrowed funds. The study of these specific projects was motivated by the high values associated being financed through public debt and are in excess of 30% of the Country's Gross Domestic Product[16].

[14] These Professionals have been engaged through a series of oral interviews pertaining to the sufficiency or otherwise of the laws on debt financing. Fact finding and gathering was also through questionnaires and research cards filled in by the professionals.

[15] The **USD1,4 Billion** 600 MW Hwange Power Station Expansion Project, the **USD3 Billion** Command Agriculture Project and the **USD300 Million** TelOne Recapitalisation Project.

[16] According to an IMF 2020 Article IV Consultation Report on Zimbabwe, Domestic and External debt to GDP was 37% during the last quarter of 2019, which was significantly high compared to that of regional counties which is lower than 20%.

CHAPTER TWO

INTRODUCTION: A HISTORY OF SOVEREIGN DEBT FINANCING LAW

1.1 Historical overview of the law on Public Debt Financing.

A concise history on the legal framework that regulates public debt financing internationally is a condition precedent to understanding the current state in which various jurisdictions, particularly Zimbabwe, have shaped their laws in order to manage the financing of Government owned companies through debt. The law on sovereign debt financing is historically traceable from both common law and civil law jurisdictions, although its footprints are most visible in the common law Countries. The major conclusion in most literature is that the common law system generally provided a more favourable basis for financial development and economic growth than civil law tradition, which was seen as the least favourable in this respect[17].

1.1.1. United Kingdom

Mercantile Law, during the advent of industrialisation in mediaeval England, established the formative legal framework which governed the financing of trade by merchants on behalf of the Crown. There was little difference between the Queen and Government, both of whom were mostly financed by the prominent banking houses of the times, such as the Knights Templar and the de Medici and Fugger families[18]. According to Barry Eichengree (et al)[19], Britain financed the Napoleonic Wars primarily by borrowing and, in their latter stages, by raising taxes. Once gold convertibility was suspended in 1797, Britain relied as well on the Bank of England as a purchaser of government securities. But the increase in the Bank's holdings was limited by law. The British Monarchy managed to maintain the real value of its obligations by continuing to amortize debt through the Sinking Fund of 1786.

From a legal perspective, such financing was generally governed by bilateral loan agreements between the sovereign borrower and the lender, but without any particular Act of the Crown which regulated the extent to which the Monarch could borrow in

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[17] Michael Graff, *Law and Finance: Common-law and Civil-law Countries Compared,* 2006 Journal.

[18] John T. Flynn, *Men of Wealth : The Story Of Twelve Significant Fortunes From The Renaissance To The Present Day*, Mises Institute Journal, 1941.

[19] Barry Eichengreen, Asmaa El-Ganainy, Rui Pedro Esteves and Kris James Mitchene, *Public Debt through the Ages, 2018*

order to finance various causes. This structure has however evolved through centuries and the laws on public debt financing have now been codified into various legislation[20].

1.1.2. United States of America

In the United States of America, the law on public debt financing is as old as its supreme law, the Constitution[21]. Article 1, Section 8 of the U.S. Constitution grants Congress exclusive authority to manage Federal debt: *"The Congress shall have Power To lay and collect Taxes, Duties, Imposts and Excises, to pay the Debts ... of the United States; ... and ... To borrow Money on the credit of the United States."* Debt financing by Federal Governments has since time immemorial been regulated by Acts of Congress such as the Public Debt Act of 1954.

Prior to 1917 however, the United States did not have a public debt financing ceiling, with Congress either authorizing specific loans or allowing Treasury to issue certain debt instruments and individual debt issues for specific purposes. Sometimes Congress gave Treasury discretion over what type of debt instrument would be issued. Between 1788 and 1917, Congress would authorise each bond issue by the United States Treasury by passing a legislative act that approved the issue and the amount. In 1917, during World War I, Congress created a debt ceiling with the Second Liberty Bond Act of 1917, which allowed Treasury to issue bonds and take on other debt without specific Congressional approval, as long as the total debt fell under the statutory debt ceiling.

What is key to note under the American system is that any borrowing for public purposes is statutorily subject to approval by Congress and is restricted to a predetermined threshold beyond which, even with the approval of Congress, cannot be legally enforced by Treasury. The invention of borrowing limits is strictly adhered to in the United States of America, to the extent that where emergency situations demand the State to borrow, such borrowing would be subject to the enactment and

[20] National Debt Act 1889, The National Debt Arrangement Scheme Amendment Regulations 2019 No. 315 and the National Loans Act of 1968.
[21] McCaffery, Edward J, *Major Acts of Congress: Public Debt Acts*, 2016

ratification of a law allowing the USA Treasury Department to exceed their borrowing limits as may have been previously approved by Congress.[22]

1.1.3. South Africa

With respect to corporate finance law, South African law generally mirrors English law. Corporate Finance law has existed in South Africa since 1861, beginning with the Joint Stock Companies Limited Liabilities Act No 23 of 1861 of the Cape Colony, which, along with other provincial company legislation, was a carbon copy of its equivalent English legislation. The current framework of South African corporate finance law is therefore built on foundations, which were put in place in Victorian England in the middle of the nineteenth century. Since the introduction of the 1926 Companies Act there has been only one significant review of corporate finance law, which was initiated in 1963 and culminated in the Companies Act, 1973. The revised Companies Act, 2008 is still based on the framework and general principles of the English law.[23]

The Constitution of the Republic of South Africa[24] now mandates the National Treasury to ensure transparency, accountability and sound financial controls in the management of public finances. To that extent, the supreme law of South Africa mandates its National Treasury with the obligation to manage debt financing of State activities through SOEs. The National Treasury's legislative mandate is also stipulated in the Public Finance Management Act (1999) (PFMA). Section 66(2)(a) of the PFMA gives the Minister of Finance powers to commit the National Revenue Fund to future financial commitments by borrowing money, issuing a guarantee, indemnity or security, or entering into any other binding transaction.

Under this Act, the Minister can borrow *"to finance a national budget deficit, refinance a maturing debt or a loan paid before the redemption date, obtain foreign currency, to maintain credit balances on the bank account of the National Revenue Fund, regulate internal monetary conditions should the necessity arise,* ***to raise working capital for***

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[22] The United States Public Debt Act of 1939 eliminated separate limits on different types of debt. The Public Debt Act of 1941 raised the aggregate debt limit on all obligations to US$65 billion, and consolidated nearly all federal borrowing under the U.S. Treasury and eliminated the tax-exemption of interest and profit on government debt.
[23] Department of Trade and Industry (DTI), *South African Company Law for the 21st Century* –2010 Report.
[24] Chapter 13

***an entity or entities owned by the State**, or for any other purpose **approved by the National Assembly** by special resolution."*

What is peculiar to South Africa's legislative framework on public debt financing is that the PFMA specifically mandates the Minister of Finance to obtain, on behalf of the Shareholder (the Government) instruments of debt financing as a mechanism to inject working capital in a SOE.

More often than not, the primary obligation to pay these debts remains on the SOE, notwithstanding the fact that the Government of South Africa would be the principal debtor and obligor thereof. By virtue of such sweeping powers vested in the Minister to incur debt on behalf of Government companies, it is the submission of the writer that the SOE as a separate juristic *persona* resultantly becomes a permanently indebted entity, whose operations, production and profit will primarily being for the purposes of servicing debt and interest thereon.

1.1.4. Zimbabwe

The history of Zimbabwean legislation on corporate finance law generally and public debt management and debt financing by the State in particular is rather obscure and not fully documented. However, like South Africa, the legislation relating to public/sovereign debt financing was founded on English law as it was in 1861 at the Cape Colony[25]. Traces of Roman and Roman-Dutch law have also been marginally contained in Zimbabwe's history of corporate finance law although it was mostly limited to the laws relating to the issuance of sovereign guarantees through the encumbrance of State property as security for repayments.

Zimbabwe's public finance legislative architecture was inherited from the Rhodesian Government at independence in 1980.[26] During the late 1970s and early 1980s, Zimbabwe amassed huge foreign public debt, which it subsequently found problematic to repay in the late 1990s, prompting a series of debt servicing reforms but very limited legislation to regulate public debt financing.[27] By inheriting a substantial public debt

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[25] Department of Trade and Industry (DTI), *South African Company Law for the 21st Century* –2010 Report
[26] John D. G. Nhavira, Evengelista Mudzonga and Everisto Mugocha, *Financial Regulation and Supervision in Zimbabwe: An Evaluation of Adequacy and Option* - 2018 Zimbabwe Economic Policy Analysis and Research Unit (ZEPARU) Journal.
[27] International Monetary Fund Report on Zimbabwe, 2001.

with limited legislation on its amortisation, Zimbabwe's woes in managing public debt financing commenced.

Zimbabwe has been judged by history as materially lacking adequate legislation that governs public debt management. It was only on the turn of the millennium that the Reconstruction of State Indebted Insolvent Companies Act[28] was promulgated in 2004, with the principal intention of managing domestic public debt servicing commitments. The Act provides for the reconstruction of state-indebted enterprises that are incapable to repay amounts made to them from public funds. The thrust of the Act was to curtail the rising domestic public debt servicing burden, which was springing from loss-making public enterprises and other Government guaranteed projects.[29]

Since 2009 however, Zimbabwe stepped up measures to strengthen its public debt financing legislation through a wide array of fiscal and legal reforms. In 2013, Zimbabwe adopted a new Constitution[30], whose provisions of public debt financing established a new trajectory on the subject. The adoption of the new Constitution of Zimbabwe created an enabling foundation upon which a strong public finance management system should be premised[31]. This is confirmed by the enactment of the Public Finance Management Act [Supra], Public Procurement and Disposal of Public Assets Act[32], the Public Debt Management Act [Supra], Statutory Instrument 135 of 2019[33] and Statutory Instrument 144 of 2019[34].

Despite the admirable enactment of various laws which govern public debt, this legislation, primarily the Public Finance Management Act [Chapter 22:19], has not been aligned to the Constitution six years after its adoption. More so, the Constitution is not cross referenced with other legislation that has direct and indirect implications on sustainable fiscal policies and debt finance management. This disconnect has raised various issues of interest to this research. Of note, is the legal standing of public debt finance legislation which is *ultra vires* the provisions of the Constitution of Zimbabwe. The disharmony of the aforementioned laws further places into question

[28] [Chapter 24:27]
[29] Saungweme, T. Odhiambo, N.M, *A critical review of the dynamics of government debt servicing in Zimbabwe*, 2018
[30] Amendment (No. 20) Act of 2013.
[31] Section 298 of the Constitution outlines the principles of public financial management.
[32] [Chapter 22:23]
[33] Public Finance Management (General) Regulations
[34] Public Finance Management (Treasury Instructions), 2019

the adequacy of the legal framework on debt financing by SOEs in protecting and/or promoting the interests of Zimbabwean citizens.

This research delves in greater detail and additionally analyses the extent to which SOEs are complying with the provisions of such laws regulating public debt financing. The research is broadened by an enquiry into the remedies, if any, enforceable against the Government where it is found to be in breach of the applicable legislation. Drawing lessons from other jurisdictions in the region and internationally, this research further examines the nature of the security(s) used as collateral for the repayment of debts incurred by the Government on behalf of SOEs.

CHAPTER THREE

FINANCING OF CORPORATE ENTITIES OWNED BY GOVERNMENT

2.1. THE LEGAL STATUS OF ENTITIES OWNED BY GOVERNMENT

In understanding the thrust of this research, it is imperative to set out clearly the corporate status of entities that are wholly or mostly owned by Government in Zimbabwe. It is from this premise that the relevance of the research questions would be fully comprehended within the context of the study of Corporate Finance Law. An in-depth analysis of the statutory demands upon the Zimbabwean SOE(s) as a juristic person *vis-à-vis* the use of such SOE(s) as a vehicle through which Government incurs debt in order to implement projects for development and profit becomes the cornerstone of the enquiry. A proper determination on the adequacy or otherwise of the legislative framework on public debt financing will therefore be correctly informed by the findings thereof.

2.1.1. Are Parastatals/SOEs in Zimbabwe regarded as juristic persons at law?

A correct understanding of the legal status of Zimbabwe's SOEs or "Parastatals" is fundamental to the comprehension of the liabilities which accrue to them by virtue of incorporation. These liabilities are derived from both statutory and common law.

The jurisprudence and theory on juristic personality has been established since the early Roman law to justify the existence of legal persons other than the human.[35] The State, religious bodies and education institutions had long been recognized as being legal entities distinct from the members[36]. However, the decision of House of Lords in ***Salomon v A Salomon & Co. Ltd***[37] has had a lasting influence on the jurisprudence of a legal entity of beings other than the human. This case is often credited with firmly establishing the principle of a company having a separate legal existence. A company, as defined in the Salomon case, is a legal person a with its own corporate entity separate and distinct from other companies, its directors or shareholders, with its own property rights and interests which it alone is entitled to[38].

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[35] Romit Bhattacharjee, *Concept of Legal Personality in Jurisprudence* - https://medium.com/the-thinking-press/concept-of-legal-personality-in-jurisprudence-532ae30c3952
[36] Ibid
[37] [1897] AC 22
[38] Position has also been accepted Zimbabwe. See *Beta Holdings v Rio Zim Ltd. HH 397-17*.

The Companies and Other Business Entities Act[39] vaguely defines a company as "*a company incorporated under this Act or a repealed law or a foreign company, to the extent that the provisions of this Act apply to such companies."* The Act however draws a distinction between a "private company" and a "public company"[40]*.* A private company is defined as *"a company other than a co-operative company, which by its articles restricts the right to transfer its shares, limits the number of its members to fifty, and prohibits any invitation to the public to subscribe for any shares or debentures of the company."* A public company is lightly defined as *"any company, including a co-operative company, which is not a private company or a company limited by guarantee".*

Judging by results of a survey carried out under this research, the incorporation of SOEs in Zimbabwe can be divided in to 3 (three) broad categories as follows;

i. Private Companies:- Despite being wholly owned and incorporated by the Government, the companies are registered privately. Examples of these companies include, but are not limited to, ZESA Holdings (Pvt) Limited and all its subsidiaries, Zimbabwe United Passenger Company (Pvt) Limited; Central Mechanical Department (Pvt) Limited, Dairiboard Zimbabwe Private Limited, POSB Bank (Pvt) Limited, Printflow (Pvt) Limited and Willowvale Mazda Motor Industry (Pvt) Limited. Notwithstanding the registration/incorporation of these companies as "private companies", the management and control depicts that of a "public entity" due to the substantial controls by Government on the day to day running of the Company

ii. Public Companies established by Acts of Parliament:- These companies have been confused with the typical "parastatals". Examples of these companies include, but are not limited to the Agricultural and Rural Development Authority, Consumer Council of Zimbabwe, Environmental Management Authority of Zimbabwe, Postal and Telecommunications

[39] [Chapter 24:31], Section 2
[40] Section 85

Regulatory Authority of Zimbabwe and the Zimbabwe National Water Authority.

iii. Parastatals:- A Parastatal is a body established by a special Act of Parliament to carry out a particular undertaking for the benefit of the public. It neither has shareholders nor share capital. It has only nominal members who are appointed and removed by appropriate Minister. The Minister acts in place of a shareholder where Parastatals are concerned. In almost all Parastatals the appropriate Minister has been given statutory power to give directions of a general character, which are considered to be in the national interest. In the execution of his or her powers, the Minister is the guardian of the public and in particular of the taxpayer, and user of the Parastatal services. Viewed from this perspective, a Parastatal is a body corporate, created by a special Act of Parliament which defines its powers, functions and relationships with government among other stakeholders[41]. Ordinarily, a Parastatal is fully owned by government, possess its own funds and employees and it works on business principles.

The nature of the SOE seems to fit in all categories but whether it is considered a private company, public company or Parastatal will be determined by the form of its registration. Outside these broad categories, SOEs have been defined as financially semi-autonomous bodies created by enabling Acts of Parliament[42]. Another school of thought defines an SOE as 'an organisation established by government under public or private law as a legal personality which is autonomous or semi-autonomous and produces/ provides goods and services on a full or partial self-financing basis, and in which government or a public body/agency participates by way of having shares or representation in its decision making structure'[43]. Simply put, SOEs are institutions which are owned by the state or in which the state holds a majority interest, whose activities are of a business in nature and which provide services or produce goods and have their own distinct management.[44]

[41] Hadebe S, Mandaza I, Moyo G, Mutondoro F, and Ncube M. J, *Annual State of Corruption Report: Focus on State-Owned Enterprises*, 2015
[42] Babaita 2001:32
[43] Kauzya 2008:91
[44] Effange, 1987 in Adeyemo, 2005:223

To the extent as discussed above, the difference between a Parastatal and a State Enterprise is that a Parastatal is a body established by a special Act of Parliament to carry out a socioeconomic mandate for the benefit of the public while a state enterprise is a government owned entity which is registered in terms of Companies Act and it operates on commercial basis just like private enterprises. The subsidiary of such a company is also a State Enterprise for example the Zimbabwe Electricity Distribution and Transmission Company (ZEDTC a subsidiary of ZESA is a state enterprise, so is Zimbabwe Power Company (ZPC). What remains common from the foregoing is that whether the SOE is incorporated as a private entity or is a parastatal established by the promulgation of an Act of Parliament, it remains considered at law a juristic *persona* whose existence is separate and distinct from that of its incorporators/members.

The detailed discussion on the corporate standing of SOEs/Parastatals/Public Entities is fundamental to the question on whether the conventional laws relating to corporate financing are indeed applicable to Government owned entities too. On the strength of the consulted legislation, it is apparent that the laws on corporate finance are as applicable to private companies as they are to SOEs/Parastatals/Public Entities. It follows that the law on debt/equity financing of private companies is more or less the same law that is applicable to SOEs/Parastatals/Public Entities in Zimbabwe. The requirements of debt financing of private companies have no exception in their application to SOEs/Parastatals/Public Entities. In the ensuing discussion on the laws which govern debt financing by SOEs, it is of an overbearing importance that these SOEs be consistently viewed in their correct legal status as juristic persons who enjoy an autonomous existence.

2.1.2. Corporate Financing through debt/equity – Understanding the theory.

Every company requires adequate financing in order to be operational and for it to invest capital with an anticipation to gain revenue and retain profits from the business venture. The capital investment into the business of any company is the domain of "corporate financing". Studies on corporate financing have sought to provide explanations on the manner in which firms build their debt-equity mix in order to

finance investments[45]. In the financing of a company's business investments, the Company[46] reserves the option to either utilise its own resources to finance or capitalise an investment or incur an external or internal debt in order to finance the company's investment.[47] The choice often depends upon which source of funding is most easily accessible for the company, its cash flow, and how important maintaining control of the company is to its principal owners. The debt-to-equity-ratio shows how much of a company's financing is proportionately provided by debt and equity.

2.1.2.1. Equity Financing

Equity financing involves selling a portion of a company's equity in return for capital[48]. The main advantage of equity financing is that there is no obligation to directly repay the money acquired through it. In most cases though, equity investors normally receive dividend payments if declared, as the return on their investment, but without required payments or interest charges, as is the case with debt financing.

Equity financing places no additional financial burden on the company. Since there are no required monthly payments associated with equity financing, the company has more capital available to invest in growing the business. However, this does not imply that equity financing does not have its limitations. In fact, the downside is more material. More often than, the incorporators of the Company will be required to give the equity investor a stake or equity hold in the company as a condition precedent to gain funding. Equally, the incorporators will become mandated to share profits and consult with the equity partners prior to the making of any decision(s) affecting the company. The only way to remove the equity investors is to buy them out, but doing so will likely be more expensive than the value of the equity originally injected by the capital.

[45] Ang, J. (1992), "*On the theory of finance for privately held firms",* Journal of Small Business Finance, Vol. 1, No. 3, pp. 185-203

[46] Here referred to as a company the broad sense that includes the Board of Directors and the company's Shareholders.

[47] Brealey, R.A., Myers, S.C., Allen, F., *Principles of Corporate Finance, 8th edition, McGraw Hill, New York*, (2006)

[48] Hovakimian, A., Opler, T., Titman, S. *"The debt-equity choice"*, Journal of Financial and Quantitative Analysis, Vol. 36, No. 1, pp. 1-24, (2001).

2.1.2.2. Debt Financing and its theories.

An alternative and more popular method of financing corporate investments is through debt-financing. Debt finance has a long history that continues to be transformed as technology develops, keeping it an all-time viable and popular option for business owners[49]. In its simple and literal meaning, debt financing is a method of capital raising by a company by utilising funds obtained through debt. The debt can be incurred through loans, mortgages, corporate bonds and debentures. Financing through debts has asserted itself over time as an important source of capital and sustenance funds for both new and existing ventures as compared to equity financing.

Debt financing comes with various advantages such as a reduced possibility of disclosing value-creating intellectual property to competition and the retention of ownership or control of the business enterprise. Considering the significance of debt financing to Corporates and invariably Governments, as well the fact that there are problems that need to be curbed for debt financing to be a good rather than a bad phenomenon, it is necessary that the field of debt financing be thoroughly explored so as to make informed decisions.

Debt financing is most prevalent in Zimbabwe although it has over the years been applied with brazen disregard of the laws that govern its theory and objectives. Having established that SOEs are juristic persons, the incurring of debt by SOEs in order to fund Shareholder (Government) investments/projects perfectly suits the definition of debt financing by SOEs, for which this research thoroughly enquires into and reviews the governing legislation thereof. In the result, where Government borrows **USD514 Million** to fund construction of the 300MW Kariba South Hydro Power Station through ZESA Holdings (Pvt) Limited, this method of financing the implementation of the power generation project falls within the purview of debt financing by a public entity/SOE.[50]

Debt financing as a fundraising vehicle of any company should, before its consideration, be informed by certain needs of the Company. Whilst there is no universally accepted criteria/yardstick that determines whether a company should

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49 Umaru Zubairu, "*A Systematic Review of the Field of Debt Financing",* 2018
50 The Kariba South Power Station project was funded through a Preferential Buyers Credit Concessional Loan Facility from the Export Import Bank of China. The Government of Zimbabwe however onlended the Loan to Zimbabwe Power Company (Pvt) Limited, a company wholly owned by Government but privately registered with the Registrar of companies.

finance its activities through debt, corporate financing practise has long accepted certain theories as authoritative in the consideration to debt financing[51]. The accepted theories start with the celebrated *"capital structure irrelevance"* proposition by Modigliani and Miller[52], developed in 1958. This theory opines that the market value of any firm is independent to its capital structure and is given by capitalizing its expected return at the rate appropriate to the risk class[53]. Simply put, the debt financing level of the firm has no effect on the value of the corporation. The proposition was theoretically very sound but was based on the assumptions of perfect capital market and no tax world, which are not valid in reality.

Another theory of debt financing is the Trade-off theory. According to the theory, a firm's optimal debt financing level is determined by a trade-off between the costs and advantages of borrowing, holding the firm's assets and investment plans constant[54]. It therefore means that the company should seek debt financing levels that balance the tax advantages of additional debt *vis-à-vis* the possible bankruptcy costs[55]. This theory has been hypothesised as easily accepted because it explains why firms do not use excessive debt. The distinction of the theory has been challenged by Hackbarth, Hennessy and Leland[56] who argue that *"existing trade-off models analyse the optimal amount of debt, but provide no guidance on debt structure, i.e. the mix of market versus non-market debt and specification of priority"*.

The third and most popular theory is *"Pecking order theory"*. This theory was also developed by Stewart Myers and Nicholas Majluf who postulated that *"a company will use debt financing, rather than issuing equity, when internal cash flow is not sufficient to finance investment expenditure"*[57]. The theory postulates that equity is a less preferred means to raise capital because when managers (who are assumed to know better about true condition of the firm than investors) issue new equity, investors

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[51] Micah Odhiambo Nyamita, Hari Lall Garbharran, Nirmala Dorasamy**,** *Factors Influencing Debt Financing within State-owned Corporations in Kenya,* Journal of Economics and Behavioural Studies Vol. 6, No. 11, pp. 884-905, November 2014.
[52] Franco Modigliani and Merton Miller, *Theories of capital structure***,** 1958, p. 268
[53] Ibid
[54] Myers, Stewart C. Majluf, Nicholas S. (1984). "*Corporate financing and investment decisions when firms have information that investors do not have".* Journal of Financial Economics. 13 (2): 187–221
[55] Ibid
[56] Dirk Hackbarth, Christopher A. Hennessy, Hayne E. Leland, *Can the Trade-off Theory Explain Debt Structure?*

[57] Myers, Stewart C. Majluf, Nicholas S. (1984). "*Corporate financing and investment decisions when firms have information that investors do not have".* Journal of Financial Economics Pg 81.

believe that managers think that the firm is overvalued and managers are taking advantage of this over-valuation. As a result, investors will place a lower value to the new equity issuance. The theory also posits that companies prioritize their sources of financing, first preferring internal financing, and then debt, lastly raising equity as a "last resort"[58]. Hence, internal financing is used first; when that is depleted, then debt is issued; and when it is no longer sensible to issue any more debt, equity is issued. This theory maintains that businesses adhere to a hierarchy of financing sources and prefer internal financing when available, and debt is preferred over equity if external financing is required (equity would mean issuing shares which denotes 'bringing external ownership' into the company)[59]. Thus, the form of debt a company chooses can act as a signal of its need for external finance.

2.1.2.3. The Debt/Equity Debate

An analysis of the above theories demonstrate the existence of jurisprudence on the subject and that most of the jurisprudence is influenced English law. It has also been the primary basis of the "Debt/Equity debate"[60] in contemporary corporate finance theorem. In the Zimbabwean context of corporate finance law, this research found that most companies have been applying the Pecking Order theory on debt financing to its letter, but oblivious to its existence. Most SOEs in Zimbabwe revert to the Pecking Order theory by default, owing to their precarious financial positions. Rarely would one find a company in Zimbabwe that considers the probity of one theory over the other before accepting or implementing financing through debt.

It is submitted that the Debt/Equity debate should not only be seen in the context of its scholarly reasoning. Rather, the debate should inform the laws which relate to debt financing by both private and public companies in Zimbabwe. With particular application on debt financing by SOEs, the debate is fundamentally relevant in the development of corporate finance laws applicable to SOEs in the following respects;

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[58] Brealey RA, Myers SC, and Allen F, *Principles of Corporate Finance* – 9th Edition, (2008). McGraw-Hill/Irwin, New York.

[59] Shyam-Sunder, Lakshmi; Myers, Steward C. (1999). *"Testing static trade-off against pecking order models of capital structure". Journal of Financial Economics.* 51 *(2): 219–244.*

[60] Glen Arnold, *The Handbook of Corporate Finance - A Business Companion to Financial Markets, Decisions and Techniques,* 2005 and Ferran, *Principles of Corporate Finance Law,* Page 151.

- Creating mandatory rules through corporate finance legislation on debt/equity financing;
- Providing restrictions on particular forms of financing by SOEs.
- Establishing specific rights to shareholders and creditors in circumstances where debt or equity financing is utilised respectively.

The theories on the debt/equity financing should therefore be popularised and considered as the premise of every law that regulates the incurring of debt especially by SOEs. The discussed theories which underpin the debt/equity debate are therefore imperative in the creation of a legislative framework that guides responsible debt management by SOEs and ultimate control of the extent of public debt.

CHAPTER FOUR

AN ANALYSIS OF THE DEBT FINANCING LEGISLATION IN ZIMBABWE

3.1. The Constitution

There are various pieces of legislation that govern debt financing by SOEs in Zimbabwe. However, the Constitution of Zimbabwe is the supreme law of the land[61] and its provisions on the subject are quite instructive. Section 300(1) of the Constitution obliges the legislature to cause the promulgation of an Act that set limits on borrowings by the State, the public debt and debts/obligations whose payment or repayment is guaranteed by the State. Section 300(3) prescribes the Minister responsible for Finance to gazette the terms of a loan agreement or sovereign guarantee concluded by the Government or its wholly owned companies within 60 (sixty) days from the date of its conclusion. Section 300(5) requires the same Minister to present a comprehensive statement of the public debt of Zimbabwe biannually before Parliament. The Constitution also stipulates major guidelines on borrowing, maintenance, extinction of the debt, definition of contingent liabilities, exposure of government, borrowing powers of the Minister as well as the Minister's powers to give guarantees, borrowing by local authorities and public entities among other issues.

An analysis of the provisions of the Constitution demonstrates structural legal weaknesses in the enforcement of Section 300 of the Constitution. This has invariably led to a loss in the objective and spirit of the Constitution in as far as the debt financing of SOEs is concerned[62]. Undoubtedly, to have the supreme law of the land provide for limits to debt financing of Government owned corporates is commendable. However, this provision will have full legislative value if the required enactment will fully provide for the borrowing limits on SOEs and cap the extent to which Government can guarantee debts or obligations of SOEs. A reading of the legislation purportedly meant to conform to the requirements of the Constitution leave a lot to be desired.

This position is concurred to by other scholars who have also researched on the subject and equally concluded that, *"The major issue at hand is why Zimbabwe is*

[61] Section 2 of the Constitution
[62] African Forum and Network on Debt and Development. (2011-2012). *Country Debt Profiles*: Zimbabwe. Harare, AFRODAD.

failing to sustain its external debt stock whilst it has a Constitutional legal framework that focuses on debt management[63]*.* Notwithstanding the Constitutional legal frameworks providing for the institutional set up to undertake debt management and provide for the legality of loan contraction, the Constitutional legal frameworks are inadequate on other matters relating to debt management. These include loan contraction exclusivity, non-specification of the loan contraction process, ambiguity on external borrowing limits and the absence of a provision on the circumstances under which borrowing is permissible. Such limitations in the Constitutional legal framework has fuelled financial indiscipline by the Government itself, in its capacity as the Shareholder of all SOEs.[64]

The Constitution also lacks in providing for the pivotal role of Parliament in the loan contraction process but only requires it during the ratification process where it simply rubberstamps the decision to contract the loan without exercising due diligence.[65] Such absence of a clear loan contraction process has thus resulted in a situation where by debt issues are fragmented in different departments of government Ministries, thereby making it difficult to trace liabilities across levels of government. Loan contraction has in the result been carried out in a random and chaotic manner, creating a breeding ground for corrupt public officers to take advantage of this situation to derive personal gain. The course of the research demonstrated this by the existence of contract loans unknown to the Ministry of Finance.

From the foregoing, it is the submission of this research that whilst the 2013 Constitution is commendably progressive by providing for a framework within which debt financing by Government, the provisions are not adequate. This inadequacy has manifested itself through the unpalatable practise by SOEs of negotiation the terms of loans without the Parliament's knowledge. Despite the requirement in Section 300(3) that the Minister responsible for Finance gazettes the terms of the loan agreements,

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63 Alouis Chilunjika, Rangarirai Chikova, Dominique Uwiyizeyimana, *Reflections on the Constitutional Legal Debt Management Frameworks in Zimbabwe,* IOSR Journal of Economics and Finance (IOSR-JEF). Volume 7, Issue 3. 2016, PP 44-54

64 Examples of financial discipline that has contributed to the debt crisis in Zimbabwe includes payment of hefty packages to war veterans by Government using borrowed and unbudgeted public funds in 1997, the **US$30 million** of debt owed to Britain by Zimbabwean police to buy Land Rovers (Jones 2011:6) and the 2011 loan in Chinese Yuan worth US$98 million for the construction of a defence college (Jones ibid). These loans had no social impact on the citizens of Zimbabwe, but utilised to the economy's detriment. Such cases epitomise the inadequacies of the Constitutional legal framework on debt financing by SOEs in Zimbabwe.

65 Godfrey Kanyenze, Prosper Chitambara and Judith Tyson, *The Outlook For The Zimbabwean Economy*, 2017.

such gazetting is only done **after** Government has concluded the loan agreement or guarantee. The publication of the terms is *ex post* facto and therefore do not serve any purpose other than informing the public of what Government as the Shareholder of SOEs would have committed itself to. This puts paid to the assertion that conditions of such loans taken by Government through SOEs are not exposed to the public but instead conducted behind a smokescreen[66]. The Constitution in that regard falls short of providing adequate legislation on debt financing by SOEs.

Where the terms of any financial encumbrance on Government are not properly negotiated, the State runs the risk of being contractually bound to onerous terms which do not serve the interests of both the SOE and the general populace. Even more risky is that loan agreements whose negotiation processes are not disclosed for public scrutiny more often include repayment terms that are arduous. SOEs rarely negotiate these credit financing agreements with an objective view to serve the national interests. Rather, most SOEs limit their interests to the short-term benefits of debt-financing without paying due regard to the risks associated with breach for failure to repay[67]. This has invariably led to Zimbabwe being in a perennial state of indebtedness as Government is incessantly saddled by an increasing current and long-term debt account, owing to the excessive borrowing by SOEs in the name of Government investments.

Although the Constitution is silent on the loan contraction process and inadequate in promoting transparency and accountability, it however establishes the Ministry of Finance as the institution with the mandate to deal with all finance issues and debt management is also classified under finance.[68] To this end, there are other institutions engaged in debt management but are not directly mentioned in the Constitution. These

66 Alouis Chilunjika, Rangarirai Chikova, Dominique Uwiyizeyimana, *Reflections on the Constitutional Legal Debt Management Frameworks in Zimbabwe,* IOSR Journal of Economics and Finance (IOSR-JEF). Volume 7, Issue 3. 2016, PP 44-54

67 A classic example of this submission is the current default in repayment of the **USD514 Million** Preferential Buyer Credit Loan Agreement entered into between ZESA and the Export Import Bank of China for the construction of the 300MW Kariba Hydro Power Station. The loan agreement was negotiated privately and only to be presented to Parliament for ratification in 2014. The repayment terms of the loan (including payment of interest) are prohibitive as the SOE (ZESA) is in breach of the same. The SOE risks foreclosure of its generating units which were ceded in favour of the lender as security for repayment.

68 Alouis Chilunjika, Rangarirai Chikova, Dominique Uwiyizeyimana, *Reflections on the Constitutional Legal Debt Management Frameworks in Zimbabwe,* IOSR Journal of Economics and Finance (IOSR-JEF). Volume 7, Issue 3. 2016, PP 44-54

institutions include the Office of the Attorney General, the External Loans Committee (ELC) and the Reserve Bank of Zimbabwe.

The above notwithstanding, it remains the scourge of the Constitution that absence of constitutional provisions on debt financing in the supreme law has created room for manipulation and abuse of public loans.

3.2. Public Debt Management Act[69] and Regulations[70]

A reading of the Public Debt Management Act and its Regulations gives a strong impression that the enactment was motivated by the provisions of Section 300 of the Constitution. The purpose of the Act is to *"provide for the management of public debt in Zimbabwe, to establish the Public Debt Management Office on a statutory basis and provide for its functions and administration, to provide for the raising, administration and repayment of loans by the State and for the giving of guarantees in respect of certain loans."* What appears to be conspicuously absent on the purpose of the Act is limiting the borrowing powers of Government in accordance with Section 300(1) (a) of the Constitution. A deeper analysis of the Act and its Regulations is provided for below.

The Public Debt Management Act was enacted in 2015. The Act expanded the role of the Public Debt Management Office (the **"PDMO"**) that is housed within the Ministry of Finance and Economic Development[71]. The scope of the PDMO was expanded to now include the following;

i. To prepare and publish an annual borrowing plan which includes a borrowing limit, and participate in the preparation of an issuance calendar of Government securities in line with the annual borrowing plan;
ii. To advise the Minister on all Government borrowings, and participate in all negotiations with creditors on Government borrowings and guaranteed loans;
iii. To assess the credit risk in any lending, and prepare reports on the method used for each assessment and the results thereof for the attention of the Minister;

[69] Supra
[70] Statutory Instrument 79 of 2019
[71] Section 5 of the Act

iv. To prepare reports on the debt of local authorities and public entities; as well as assess, monitor and keep track of debt levels of all local authorities and public entities; and
v. To analyse requests from local authorities and public entities for borrowings.

The scope provided for above is not exhaustive of the full scope and mandate of the PDMO. However, they have been deliberately selected for examination on the extent to which the scope of the Act is adequate in managing debt financing by SOEs in particular. What is glaring from the scope of the Act in general and the PDMO in particular is that it is obliged to *"publish an annual borrowing plan which includes a borrowing limit, and participate in the preparation of an issuance calendar of Government securities in line with the annual borrowing plan."* A reading of this statutory provision appears *ex facie* to be addressing the requirements of Section 300(1) of the Constitution adequately. In reality however, the annual borrowing plan and borrowing limits which are set thereon relate to domestic debt only.[72] This is so because the borrowing plan is correlated to the Annual Budget and the provision of liabilities being incurred by Government is limited to the domestic lenders. The Act therefore does not provide for a borrowing plan, neither does it set a borrowing limit with respect to external debts.

This explains the why Zimbabwe is consistently in a position to enter into loan agreements from foreign lenders in order to fund infrastructure development projects, amoungst other investments by the State. This has been labelled "attraction of Foreign Direct Investment" (FDI), yet in real essence it is the acquiring of additional debt obligations by Government through the vehicle of SOEs outside the acceptable limits. The insatiable appetite of Government to obtain foreign loans feigned as FDI is an indictment on the already precarious debt situation within Zimbabwe[73]. There is need for the applicable laws to be amended in order make it peremptory for the annual debt plan and debt limits to be applicable to both domestic and external debt.

[72] Chadambuka, T. *A Critical Review of the Legal Loan Contraction and Debt Management System in Zimbabwe*. 2009, ZIMCODD.
[73] Jones, T. *Uncovering Zimbabwe"s Debt: The Case for a Democratic Solution to the Unjust Debt Burden*. 2011, United Kingdom. The Tawny Press.

Leo and Moss[74] have also observed that the debt limit as defined in the Public Debt Management Act is a dynamic phenomenon that vacillates on an annual basis depending on the annual debt plan adopted by the Ministry of Finance. The philosophical basis of setting up debt limits as a statutory requirement is to ensure that the limit is static and maintains a balance on the Debt : GDP ratio[75]. Where the debt limit is made a derivative of the debt plan of a particular year, it is likely that the liabilities arising from debt will eventually outweigh the capacity by Government to repay the loan obligations. As discussed in Chapter 4, international best practise demands that the debt limits should be a coefficient and fixed amount from and informed by the GDP and domestic capacity to service the debt obligations by the Government. The linking of the debt limits to debt plan is a creation of the Public Debt Management Act. Read from a literal standpoint, the Constitution[76] requires that an Act of Parliament should be promulgated in order to provide a specific debt limit which should not be exceeded by Government without Parliamentary prior approval. There is need to revisit the law on the debt limits as this is now being abused and has resulted in the undoing of the significant legislative developments on the subject that were achieved through the Constitutional provisions.[77]

It was also observed during the course of the research that despite the availability of legislation that demands the publication or gazetting of an annual debt plan and the respective debt limits, the Ministry of Finance and Economic Development has not been complying with this requirement. The last debt plan was gazetted in 2018. The return of the local currency through promulgation of the Reserve Bank of Zimbabwe (Legal Tender) Regulations, 2019[78] has been cited as having complicated the capacity of the PDMO in drafting a pragmatic debt plan denominated in the local currency. The introduction of an interbank exchange rate has allegedly compounded the practicality of gazetting the annual debt plan and limit. The practicality or otherwise of a statutory requirement is not a justifiable ground to violate its provisions. The wanton disregard

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74 Leo, B. and Moss, T. *Moving Mugabe"s Mountain: Zimbabwe"s Path to Arrears Clearance and Debt Relief.* 2009, Washington DC: Center for Global Development.

75 AFRODAD. *Borrowing Charter: Principles and Guidelines on Sovereign Financial Borrowing for Sub- Sahara African Countries.* AFRODAD, 2011a.

76 Section 300 (1) (a)

77 This position is typified by the 2020 National Budget Statement – Para 611, where the Ministry of Finance and Economic Development confirmed that, *" ….legislation does not specify conditions for granting tax exemption, which include the maximum level of debt financing, shareholding in the Recipient Firms as well as the level of development of business to which venture capital funds can be provided, among others."* Pg 155-156.

78 Statutory Instrument 142 of 2019

of the Act and legislative obligation on the PDMO to publish the annual debt plan and debt limits seems not to have any consequence on those flouting the Act. There is therefore need to provide for a sanction or penalty on the responsible Authority within the PDMO.

On several occasions, the Parliament of Zimbabwe in 2019 highlighted non-compliance by the Ministry of Finance to the Constitution with regards to the gazetting of loans contracted, guarantees issued as well as failure to present a report on loans raised and guarantees issued by the State on public debt[79]. Parliament highlighted breaches of many provisions in the Public Debt Management Act by the Minister of Finance. This has been described as a perennial problem in the national debt management framework in the Country. This is demonstrated by the number of previous attempts to address the debt problem in Zimbabwe as elaborated below.

Between 2001 and 2008, the Government embarked on a Domestic Debt Restructuring policy. It, however, did not produce intended results due to the poor performance of the economy. The other was Sustainable and Holistic Debt Strategy of 2010. No debt was, however, paid following the intervention. Government also formulated the Zimbabwe Accelerated Arrears Clearance Debt and Development Strategy in considering a debt relief mechanism under the Heavily Indebted Poor Countries (HIPC) initiative and make use of fresh financing from international institutions and mineral wealth to achieve sustainable development. This initiative did not bear fruit. There was also the Lima Strategy of October 2015, yet another attempt Zimbabwe made to clearing debt arrears. It was premised on a non-HIPC debt resolution strategy designed to clear debt arrears amounting to US$1.8bn owed to IMF, World Bank Group and the African Development Bank as the first step towards seeking a debt treatment by the Paris Club after which the government would commence negotiations towards a resolution with the Paris Club. Zimbabwe cleared its overdue obligation to the IMF in October 2016. However, the country cannot acquire new debt from the international financial institutions and other creditors until they clear all the arrears they owe to creditors showing the deep-rooted challenges of the country with debt management.

[79] African Forum and Network on Debt and Development (2018 - 2019). *Country Debt Profiles: Zimbabwe.* AFRODAD

Section 11(2) of the Act provides that, *"The aggregate of the amounts that may be borrowed in terms of subsection (1) in any financial year by way of loans shall not exceed the limit fixed by National Assembly,* ***which limit the Minister may propose*** *to the National Assembly for approval by resolution or by means of a provision in a Finance Bill".* The use of the word "may" makes the proposal of the limit to the National Assembly optional at the instance of the Minister. This presents a material lacuna of the law that is open to potential abuse.[80]

Equally of concern under Section 11(1) of the Act is the power conferred upon the President to authorise the Minister *"to borrow a sum of money for purposes stipulated in section 12."* However, the legislation gives vast powers to only two offices regarding the authorisation of loans making loan contraction exclusive[81]. Exclusiveness in loan contraction imposes the risk of abuse of power by the President and the Minister of Finance and also makes them unaccountable to anyone. Ultimate power in the hands of a few is detrimental on transparency and accountability. In addition to this, viewpoints from other parties are not taken into consideration[82]. Closely related to the above is the notion that it is the President or the Minister who determines circumstances for which borrowing is permissible. The conditions deemed expedient to the two may not be in public interest as Parliament is not given the chance to scrutinize the rationale for the loans. It can thus be noted that loans contracted by the Zimbabwean government are driven by political and individual interests.[83] In this regard, the Act lacks mechanisms to enquire and verify the purposes for the loans before they are signed. This legislative cavity gives room to have some loans being contracted in the name of development and/or investment by SOEs yet the funds will end up diverted for personal use by corrupt ministers. Documentary research has also revealed that absence of clear circumstances where borrowing is permissible weakens the state's negotiation position as the Minister may follow the dictates of the lenders

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[80] Appearing before the Parliamentary Portfolio Committee on Public Accounts in March 2020, the Minister of Finance, Prof. Mthuli Ncube defended the allocation of **USD1.3 Billion** to Sakunda Energy in 2018 under the Command Agriculture Scheme using borrowed funds not approved by Parliament. It was the Minister's argument that Section 11 of the Public Debt Management Act does not compel him to propose a debt limit to the National Assembly. Thus the allocation of the **USD1.3 Billion** did not call for Parliamentary ratification.

[81] Alouis Chilunjika, Rangarirai Chikova, Dominique Uwiyizeyimana, *Reflections on the Constitutional Legal Debt Management Frameworks in Zimbabwe,* IOSR Journal of Economics and Finance (IOSR-JEF). Volume 7, Issue 3. 2016, Pg 50-51

[82] Ibid

[83] Ibid

and bound by them[84]. All the above loop holes in the Public Debt Management Act (Supra) have led to failure to contain Zimbabwe's external debt stock. Poor debt policy has resulted in the contraction of more multilateral loans that are non-concessional. However, SOEs to whom Government has on-lended the debt obligations now face a real risk of foreclosure on the securities offered to the lenders as collateral for the loans.

Despite the above limitations of the Public Debt Management Act (Supra), it is worthy highlighting that the Act also has very progressive provisions. These include Section 18 (1), which prohibits the public officers of SOEs from signing loan agreements in the absence of written authority of the Minister of Finance, Section 24 which indemnifies the State from the repayment of any unauthorised loan obtained by an SOE and Section 32 which provides for the setting up of sinking funds[85]. The Regulations are also very progressive by the provisions on setting up of an External and Domestic Debt Committee (EDDC), procedure for debt assumption and the process of obtaining a borrowing certificate by an SOE before it can enter in a loan agreement with a domestic or external lender.[86] These provisions compliment the Constitution's objectives to provide for a prudential legislative framework that provides adequate checks and balance on the debt financing by the Government and more particularly though SOEs.

3.3. Public Finance Management Act (Supra)

Public finance management systems are premised on the notion that the effective management of public resources, money or property is the basis for sustainable national social and economic development[87]. Accordingly, section 298(1)(b) of the Constitution requires that a public finance system be directed towards national development and as such, the burden of taxation must be shared fairly, revenue raised nationally, shared equitably between the central government and provincial and local tiers of government and expenditure directed towards the development of

[84] Chadambuka, T. *A Critical Review of the Legal Loan Contraction and Debt Management System in Zimbabwe,* 2009 - ZIMCODD.
[85] A fund containing funds set aside or saved to pay off a debt or bond and established in terms of Section 74 of the Public Finance Management Act (Supra).
[86] Sections 3, 4, 8 and 11 of Statutory Instrument 79 of 2019
[87] AFRODAD, *Alignment of Legislation Impacting Public Finance Management (PFM) in Zimbabwe*, 2019

Zimbabwe.[88] Public debt management is a key component of good public financial management. However, this Act relates to a larger extent to the management of the public funds as may have been acquired through debt. It is worth noting that Public Finance Management Act (Supra) is not cross referenced with the Public Debt Management Act despite public debt management being a key component of an efficient and effective public financial management system.

3.4. Interpretation of debt finance legislation in Zimbabwe.

As observed in 3.1 and 3.2 above, there exists

3.5. Conclusion

The foregoing analysis of the legislation that governs debt financing by Government as the shareholder of SOEs demonstrates their inadequacies. There is need to urgently align all the laws which are relevant to debt financing of SOEs and the Government itself. The primary legislative instrument, the Public Debt Management Act (Supra) requires amendment in order for it to be *intra vires* the Constitution of Zimbabwe as well as comply with international best practices on debt financing of SOEs. It is recommended to consider amending this Act in order for it to provide specific limits to the debt which SOEs can incur in order to fund Government investments. Such limits should not be reviewed on an annual base as is the obtaining scenario as this leads to an uncapped debt limit. It is also apposite to ensure that the authority to borrow should be vested in Parliament as opposed to the President and the Minister responsible for Finance. For example, the United States Congress is empowered under that Country's Constitution *"to borrow money on the credit of the United States*.[89] Similarly, Australia's Parliament is authorized to borrow *"money on the public credit of the Commonwealth."*[90]

An extensive comparative analysis of the Zimbabwean legislation on debt financing is set out in Chapter 4.

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[88] Ibid
[89] U.S. Constitution, Article 1 Section 8.
[90] Australian Constitution, Article 51

CHAPTER FIVE

PUBLIC DEBT FINANCING LEGISLATION IN OTHER JURISDICTIONS: A COMPERATIVE ANALYSIS

The adequacy or otherwise of Zimbabwe's legislation governing debt financing by SOEs can only be measures against the laws governing the same in various jurisdictions. By juxtaposing Zimbabwe's laws to those of other jurisdictions, the intention is to draw advanced legislative provisions with a view to motivate for their adoption locally. By reforming and modernising the legislative framework on debt financing through adopting the frameworks of other jurisdictions, the ability to reduce the debt burden on the Government and on individual SOEs will become a practical possibility. This Chapter gives an analysis of and draws comparison from Liberia and Nigeria.

4.1. Liberia

The effectiveness of Liberia's debt management can be attributed to its Public Finance Management Act of 2009. The Act is provides for the role and authority of various contracting actors as well as a system which must be adhered to in respect of how loans are procured and debt managed.

The Act authorizes the Minister of Finance and the Debt Management Office (DMO) to approve loans after the legislature has inquired the purpose of the loans before they are acquired[91]. This position is at a variance with that of Zimbabwe's Public Debt Management Act (Supra). In Zimbabwe, the National Assembly does not participate in the loan contraction process, but will be requested to approve a loan already entered into. The Minister of Finance is vested with sweeping powers which include the gazetting of the terms of State loans after 60 (sixty) days from the date they are entered in.

[91] Section 21

Liberia's Public Finance Management Act also provides that all proceeds from government borrowing should be credited to the Consolidated Fund. On reporting, the Act specifies that the minister has to maintain up to date record of all debt[92].

The role of the President on matters relating to financial or economic management is limited to guaranteeing and restricting government guarantees, loans to state owned enterprises, delegate responsibility to the Minister of Finance to borrow. The president also has a supervisory responsibility over the Ministry of Finance.[93] This is a progressive statutory provision as compared to Section 11(1) of Zimbabwe's Public Debt Management Act (supra) which vests the President with power to authorise the Minister *"to borrow a sum of money for purposes stipulated in section 12."* By doing so, the legislation gives vast powers to only two offices regarding the authorisation of loans making loan contraction exclusive[94]. Exclusiveness in loan contraction imposes the risk of abuse of power by the President and the Minister of Finance and also makes them unaccountable to anyone.

In Liberia, debt management is also guided by the Debt Management Strategy adopted in 2009. The strategy imposes a ceiling on central government borrowing. Both domestic and external government borrowing is limited to 3% of the previous year's GDP. The policy also maintains that public debt will be contracted on highly concessional terms with a grant element of at least 50%. This is also an admirable provision as it derives the debt ceiling from a scientifically calculable basis. Unlike in Zimbabwe, the debt financing limit is not left to the discretion and whims of the Minister of Finance and does not change on an annual basis.[95]

Liberia's Debt Management Committee (DMC) is the supreme institution on debt matters. It ensures that strict rules and oversight functions are established to ensure prudent borrowing. The DMC is composed of the Minister of Finance as the chair, Governor of the Central Bank, Minister of Justice and the Minister of Planning and Economic Affairs. The concept of a Debt Management Committee with an inclusive constitution is very progressive. Dissimilar to the Zimbabwe's set up where the

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[92] Section 32

[93] African Forum and Network on Debt and Development. (2011-2012). *Country Debt Profiles: Liberia. AFRODAD.*

[94] Alouis Chilunjika, Rangarirai Chikova, Dominique Uwiyizeyimana, *Reflections on the Constitutional Legal Debt Management Frameworks in Zimbabwe,* IOSR Journal of Economics and Finance (IOSR-JEF). Volume 7, Issue 3. 2016, Pg 50-51

[95] Section 5 of the Public Debt Management Act (Supra)

department of the Ministry responsible for Finance constitutes the Public Debt Management Office[96], Liberia's inclusion of the Central Bank, Ministry of Justice and Ministry of Planning and Economic Affairs in their Debt Management Committee creates diversity and maintains the debt financing priorities of the State.

The core responsibilities of Liberia's DMC are to develop **three year** government debt management strategy that is embodied into the overall macro-economic development strategy review and approve loans for State enterprises and to set government borrowing limits. In addition the DMC will monitor borrowing and debt, make input to the borrowing process and debt policies and approve certain and specific types of loans that are made by and in government[97]. Contrasting this to Zimbabwe, a three year debt strategy is more objective and realistic as compared to the annual borrowing plans and limits which are susceptible to interminable changes.

Article 34 section d (iii) of Liberia's Public Finance Management Act prohibits loan contraction without the approval of the House of Representatives and the Senate. it reads,

"No loans shall be raised by the Government no behalf of the Republic or guarantee given for any public institution or authority otherwise than, by or under the authority of a legislative enactment".

Implied here is the notion that the Legislature has to enquire the purpose of the loans before it is **negotiated and signed** and that no loans are contracted without the approval of both the House of Representatives and the Senate. This is at variance with Zimbabwe, where Parliament only receives a report by the Ministry of Finance on the terms of a loan already negotiated, and in most cases, signed.

4.2. Nigeria

In Nigeria, the Debt Management Office Establishment Act of 2003 is the premier legislation regarding debt management. Part 2 of the Act establishes the Debt Management Office (DMO) as the "*sole agency responsible for the management of the country's debt*." Part 3 provides for the functions of the DMO as to maintain a reliable database of all loans and guaranteed loans, preparation and submission of a

[96] Section 4
[97] AFRODAD. 2011b. *Review and Analysis of the Loan Contraction Process and Management in Liberia. Harare: AFRODAD*

forecast of loan service obligations and to prepare and implement plans for efficient management of external and domestic debt obligations and participate in the negotiations. The act also authorizes the DMO to issue and manage federal government loans and issue guidelines for smooth operation. It is the composition of the DMO that is most progressive as it draws members from various Ministry's such as Finance, Economic Development and Federal State Entities. This gives a balanced input to the borrowing plans and guidelines.

On external borrowing, the Act states that the DMO advises Government on the financing gap and the amounts to be borrowed[98]. This advice forms the basis for national borrowing programmes. The DMO also participates in negotiations and acquiring of the loans. The 2003 Debt Management Office Establishment Act also states that "*no external loans shall be approved or obtained unless its terms and conditions shall be laid before the National Assembly*[99]. In contrast, Liberia Public Finance Management Act of 2009 Section 28 clearly provides for the role and authority of various loan contracting actors and the process to be adhered when loan guarantees are procured and the debt managed. Zimbabwe however, provides for neither of the two.

The Debt Management Office the Debt Management Office Establishment Act (Supra) also allows for civic organisations to perform a watchdog role in evaluating the quality of recommendations given by the DMO[100]. This provides adequate checks and balances on the sufficiency of the laws on debt financing.

4.3. Conclusion

The foregoing analytical comparison demonstrates the deficiencies in the Zimbabwe's legislation on debt financing by State Entities and the Government generally. What remains key is the need to establish efficient checks and balances to the debt management process. This includes limiting the influence of the President and Minister of Finance in borrowing on behalf of the State and its entities, requiring the public debt approvals by Parliament a condition precedent to the negotiation and signing of all loan agreements in which the State has an interest or is required to guarantee and the

[98] Part 6, Section 35(2)
[99] Section 17B
[100] Article 34 Section 2 (b)

providing of debt limits which are methodically calculated and remain constant over a medium to long term basis.

The currency in which the debt is denominated is also a key consideration, with foreign-currency denominated debt classified as external debt. Lastly, external debt could be defined by reference to the jurisdiction in which the debt is issued and the governing law for the transaction. In such cases, transactions issued outside the sovereign's jurisdiction and governed by foreign law are designated as external debt.[101]

[101] Sections 9 (2) and 10 of Sierra Leone's Public Debt Management Act 2011, which requires the terms and conditions of securities issued outside Sierra Leone and loans contracted from a foreign lender to be approved by Parliament.

CHAPTER SIX

CONCLUSION AND RECOMMENDATIONS

The main objective of this research was to critically analyse and evaluate the laws which govern debt financing by State Owned Enterprises in Zimbabwe. State Enterprises represent the Government and as such the law governing debt financing by SOEs generally applies to how the State should incur debt in any other facet or sphere of Government. This research has outlined an overview on the jurisprudential history of public debt financing in different jurisdictions. A nexus between the legal status of the SOEs and the corporate finance law theorem on debt financing was also created and synthesised. The Debt/Equity Debate was revisited and its theories discussed within the context of the Zimbabwean laws governing debt financing by SOEs. A comparative analysis of Zimbabwe's laws governing public debt financing was also carried out under Chapter 4.

5.1. Findings

Taking in to account all the enquiries as mentioned above, it is the conclusion of this research that the primary laws governing sovereign debt financing such as the Constitution, the Public Debt Management Act and Regulations (Supra) and the Public Finance Management Act (Supra) do not adequately promote transparency and accountability. This conclusion is derived from the consideration that the legislation limits the borrowing powers to the President and Minister of Finance whilst reducing the role of the Public Debt Management office to administrative and clerical roles of preparing reports to Parliament. Under existing legislation, the conditions of the loans binding the State through SOEs are not exposed to the public as represented by Parliament. There are no formal mechanisms for performance measurement by the public and no ex-post evaluation of government's debt portfolio. Further, exclusion of Parliament in loan contraction processes hinder public participation in matters regarding debt management.

The research however noted some legislative provisions which are progressive. These include Section 18 (1), which prohibits the public officers of SOEs from signing loan agreements in the absence of written authority of the Minister of Finance, Section 24

which indemnifies the State from the repayment of any unauthorised loan obtained by an SOE and Section 32 which provides for the setting up of sinking funds[102]. The Regulations are also very progressive by the provisions on setting up of an External and Domestic Debt Committee (EDDC), procedure for debt assumption and the process of obtaining a borrowing certificate by an SOE before it can enter in a loan agreement with a domestic or external lender.[103] These provisions compliment the Constitution's objectives to provide for a prudential legislative framework that provides adequate checks and balance on the debt financing by the Government and more particularly though SOEs.

5.2. Recommendations

a) Borrowing Authority and role of the Legislature

A key legal question that needs to be answered in the design of the legal framework is who exercises borrowing authority on behalf of the state. As demonstrated in the research, the authority to borrow on behalf of Government should be vested in the Legislature. It is recommended that Zimbabwean law be amended in order to clearly provide for this position. The current law is obscure as it appears to delegate the powers to borrow to the Minister of Finance and the President. It is recommended that where such authority is delegated to the Minister of Finance, to borrow on behalf of the State, the conclusion of any public debt should be subject to Parliament's approval.

Parliament must not only be involved in the ratification process, but must also be consulted before loans are contracted and scrutinize the purpose and a condition of the loans before they are contracted. It must be given the chance to consider how the loans are going to be repaid. Reports on utilization of loan resources, currency, maturity, interest rates and progress on debt payment must also be laid before the public for scrutiny. Delays must also be minimized. There must also be formal mechanisms for performance measurement by the public and ensuring ex post evaluations of government's debt portfolio are done against the set targets.

The greater involvement of Parliament and the establishment of a standing committee renders the loan contraction process more inclusive. There must be mechanisms for

[102] A fund containing funds set aside or saved to pay off a debt or bond and established in terms of Section 74 of the Public Finance Management Act (Supra).
[103] Sections 3, 4, 8 and 11 of Statutory Instrument 79 of 2019

the National Assembly to monitor and control expenditure by SOEs. The legal framework must make loan contraction inclusive and reduce the vast powers given to the President and the Minister. More parties must be included in the loan negotiations there by creating checks and balances that ensure accountability and transparency. Other oversight bodies such as the Public Accounts Committee and the Parliamentary Portfolio Committee on Finance, Budgeting and Investment Promotion must also be consulted in determining the need for borrowing. All loans to be contracted need to be scrutinized by an independent committee or Parliament before they are authorized by the President or the Minister of Finance. Parliament's rubber stamping role can be eliminated if it is involved in all stages of the loan contraction process.

b) Debt Audit

As demonstrated in this research, there exists a disparity in the total debt obligations of the State and the extent of the guarantees issued thereunder. A number of SOEs have been receiving financing through debt which has not been approved by Parliament[104]. A number of securities in the form of Notarial General Covering Bonds have been issued by SOEs as security for the repayment of debts without the approval of Parliament. As such, the current extent of debt and guarantees as recorded in the Public Debt Management Office does not reflect the correct extent of actual debt that a number of SOEs are encumbered by. It is therefore recommended that a debt audit be conducted so as to come up with an accurate figure of the debt and to determine what the loans were used for.

c) Need for a clear loan contraction process.

The Constitution, as the supreme law upon which all debt management activities are be anchored must clearly outline a detailed debt management framework which sets out the loan contraction process and the actors in that process. The loan contraction process must state the different steps to be adhered to when contracting loans. From this process different actors and their functions and roles regarding debt management can be established. A clear loan contraction process makes monitoring and evaluation of loan contraction easy and effective. A clear loan contraction process also

[104] 2018 Accountant General's Report

consolidates all the debt management activities in a holistic and comprehensive manner.

d) Need for clear definition of all institutions to undertake debt management under the Public Debt Management Act (Supra)

It is recommended that all the institutions (primarily SOEs) that undertake debt management must be provided for in the Public Debt Management Act and its Regulations. Roles and functions of each institution must be broadly spelt out. The roles and duties of key institutions like the Reserve Bank of Zimbabwe and Office of the Attorney General must be clearly provided for in the management of debt financing as this assists in minimizing conflict of roles and duties within the Ministry of Finance.

e) Limit on external borrowing

It is recommended that legislation on debt management must specify the limits on external borrowing. The limits must be on the number of public and publicly guaranteed loans. Just like on domestic borrowing, there is the need to establish a ceiling on external borrowing depending with the GDP of the previous year. The relevant Act must also specify the amounts that can be acquired externally. There is need to set and maintain a certain level of concessionality and grant element of the loans to be acquired. For example, the Act can restrict foreign debt financing by SOEs to concessional loans only with a grant element of at least 60%.

There is also need to clearly specify in the relevant laws the conditions under which external borrowing is permissible. These conditions act as the basis for justifying external borrowing. It is proposed that before engaging in external borrowing, the purposes of the loans must be weighed against the defined conditions. If they fail to meet criteria provided for in the legislation, then the will not be approved.

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