

The Intertemporal Approach to the Sustainability of Zimbabwe's Current Account Deficit

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Abstract

The recurrence of sizeable current account deficits on the back of subdued capital inflows and depleted foreign exchange reserves has generated extensive debates among policy makers as corrective policy measures are sought to effectively deal with the burgeoning current account deficit. Within the auspices of the multiple currency system adopted by the Zimbabwean Government in 2009, adverse external sector developments have had negative effects on liquidity conditions in the domestic economy in a manner that has hamstrung the attainment of fast paced economic growth and development. As such, this study uses the Inter-temporal approach to determine the sustainability of Zimbabwe's current account deficit. The results of the stationarity tests performed on Zimbabwe's the current account balance over the period 1990-2012, reveals lack of mean reversion. Cointegration tests also performed on exports and imports reflect that the two are not co-integrated. As such, these two tests indicate that Zimbabwe's current account deficit is not sustainable. Other indicators examined in the study also attests to the non-sustainability of Zimbabwe's current account deficit. This is largely so as the continued accumulation of non-concessionary debt and external payment arrears, depressed foreign direct investment inflows, growing import dependency, reliance on humanitarian assistance, lack of reserve adequacy and a burgeoning current account deficit in excess of 5% of gross domestic product all point to a current account deficit that is not sustainable.

Keywords: current account deficit, current account sustainability, inter-temporal approach, balance of payments, trade balance, capital account.

INTRODUCTION

Increased global trade flows precipitated by the gradual removal of trade barriers and endemic liberalization of capital accounts have transformed the international trade landscape in the last few decades. These developments have, however, been accompanied by intermittent currency and financial crisis that have engulfed the global economy. In Zimbabwe, the incurrence of persistent current account deficits since the turn of the century has ignited extensive debate on the sustainability of the current account of the balance of payments. The continued accumulation of external payment arrears that is symptomatic of an unsustainable debt burden, the rising import bill and lack of budgetary and balance of payments support are indicative of adverse external sector developments that have affected economic performance since the turn of the century. These negative developments have occurred at a time when the country's export performance has remained subdued, on account of low industrial capacity utilization and episodes of commodity price deflation that has accompanied successive bouts of global financial turbulences that have plunged the global economy into a recession of historic proportions.

The recurrent and widening current account deficit has grown to be an albatross around the Zimbabwean economy, with hemorrhaging effects on the liquidity conditions within the auspices of the multiple currency system. Additionally, persistent current account deficits in Zimbabwe have raised concerns about the sustainability of the current account and the ability of the country to service outstanding external debt obligations in the medium to long term. Additionally, the accumulation of external payment arrears and the deterioration in the country's investment climate have severely hamstrung efforts to meaningfully attract both debt and non-debt creating capital flows to Zimbabwe. It is against this background that the country's external sector position has remained precarious, typified by persistent current account deficits which cannot be offset by capital account inflows. These adverse external sector developments have culminated in the incurrence of substantial balance of payments deficits, a development that does not bode well for the accumulation of foreign exchange reserve buffers, as well as efforts to expand the country's deposit base. In turn, this has negatively affected the attainment of fast paced economic growth which remains key in employment creation, foreign currency generation

and the improvement of the general standards of living.

On the other hand, the Indigenization Regulations enacted in 2010 have severely dented investor confidence, and further depressing foreign direct investment inflows. In consequence, the country has been unable to attract adequate non-debt creating capital flows critical for sustained growth, relying instead on long term non-concessionary debt as well as volatile short-term debt creating flows which can abruptly dry up. Against the background of the precarious external sector position, largely emanating from the current account, this study assesses the sustainability of the country's current account deficit and explores alternative policy measures that can be pursued to correct the situation.

Current Account Developments in Zimbabwe

Despite inheriting a strong industrial base established in the pre-independence era in the aegis of the import substitution and industrialization strategy, the new millennium has seen significant de-industrialization and the concomitant decline in capacity utilization levels. These negative developments created attendant supply gaps as price controls accentuated significant reduction in production. This resulted in growing import dependence as export performance remained subdued on account of rising production costs on the back of speculative and replacement cost pricing models adopted by input suppliers in the domestic economy. The deterioration in macroeconomic conditions which was typified by acute foreign exchange shortages and the depletion of foreign currency shortages, further undermined export competitiveness and viability. It is against this background that the country's once sustainable current account balance has been plunged into perpetual deficits (as shown in Figure 1 below), with profound effects on deposit and credit growth under the multiple currency system adopted since 2009.

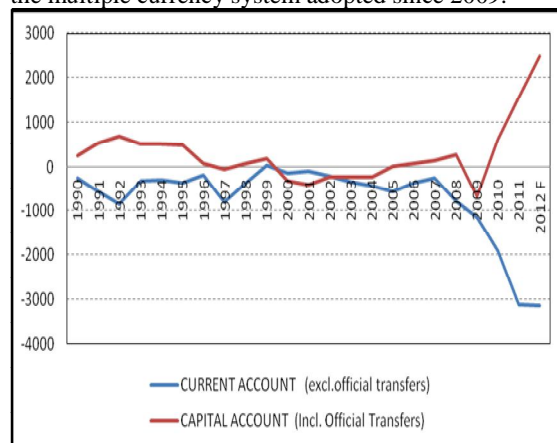


Figure 1: Current and Capital Account Balances (US\$M)

Source: Ministry of Finance and Reserve Bank of Zimbabwe (2012)

Contribution of the Study to the Existing Body of Knowledge

This study which analyses the sustainability of the current account deficit in Zimbabwe is a critical case study for dollarised economies. Moreover, the intensification of regional integration initiatives in Africa and other continents, notably Latin America, the EU, and Asia among others should carefully consider the adverse effects of exogenous shocks and deteriorating external sector positions on domestic liquidity conditions and economic growth prospects at large. This is largely so as one of the ultimate objectives of regional integration is the creation of a monetary union in which a single currency is adopted. As such, this study is expected to broaden the knowledge on precautions and appropriate policy measures that countries in various trade configurations should take cognisance of in order to minimise accompanying external vulnerabilities to domestic economic development.

LITERATURE REVIEW

Basics of the Current Account

According to the IMF Balance of Payments Manual (1993 and 2008), the current account balance is a component of the balance of payment accounts, which systematically summarizes, transactions in goods, services, income and transfers between residents of an economy and the rest of the world in a given time period, usually a year. The current account balance comprises of the following components:

The balance on goods, which records exports and imports of physical, relocatable merchandise;

The balance on services, which records transactions relating to the provision of invisible services such as transport, travel and insurance across national frontiers;

The balance on investment income, which records transactions corresponding to the provision of factors of production notably:

- Compensation of employees in return for labour services;
- Investment income (in respect of FDI and Portfolio investment flows); and
- Interest receipts and payments in respect of debt creating loan flows.

The balance on current transfers, which records transactions relating to the exchange of goods, services, cash or other items of value between residents and non-residents that are intended for immediate consumption without any corresponding payments or exchange of other goods or services. Current transfers largely comprise of Diaspora remittances and humanitarian assistance that are usually one-sided as there are no cash movements or goods supplied in return.

The current account balance can also be expressed in equation form as follows:

$$CAB = X^{g/s} - M^{g/s} + Y_f + TR_f \quad 1$$

Where: CAB is the current account balance
 $X^{g/s}$ – represents exports of goods and services
 $M^{g/s}$ – represents imports of goods and services
 Y_f - represents net income (receipts minus payments)
 TR_f - represents net current transfers

Theoretical Perspectives

Typically, the current account may not self finance, but instead relies on surplus financial flows in the capital account as well as the running down of foreign exchange reserves. The former is associated with an increase in the rest of the world’s claims on the country (liabilities), while the later is associated with depletion of reserve assets to finance the current account deficit. The following equation also captures this relationship:

$$-CAB = \Delta FI + \Delta RES \quad 2$$

This relationship is derived from the overall balance of payments identity that states that:

$$CAB + \Delta FI + \Delta RES = 0 \quad 3$$

Thus, the balance of payments must always balance, barring statistical discrepancies and inaccuracies that usually epitomize data generation processes. The equations above demonstrate that all economies face an inter-temporal budget constraint. As such, the incurrence of persistent current account deficits implies that a country becomes a net debtor, thereby tying up future foreign exchange earnings to the servicing of external debt obligations. In the event that the current account fails to balance, the resultant imbalances are an important signal on the health of the economy. If a country’s current account is in surplus, it indicates the accumulation of foreign exchange reserve buffers and possibly stellar export performance and curtailment of imports through increased capacity utilization and self sufficiency.

It is within this context that studies have considered the sustainability of the current account balance as an indicator, showing that the country is spending beyond its means (Calvo and Vegh, 1999). The sustainability of the current account deficit is usually determined by the source of the deficit, whether it is temporary (e.g commodity price declines) or permanent, resulting from underlying structural challenges in the economy. In general, if a major policy change has to be adopted to correct the current account imbalance, then the current account is considered to be unsustainable and a source of worry for policy makers.

Inter-temporal Approach: Empirical Studies

The sustainability of the current account can also be determined using the solvency approach as well as the inter-temporal approach. The inter-temporal approach employs econometric techniques to

determine the stationarity of the current account or trade deficits of an economy using the unit root tests (Augmented Dickey Fuller Test). Under this approach, the current account balance is considered to be sustainable if it follows a stationary process and is thus mean-reverting. In this respect, the inter-temporal approach entails testing for the stationarity of the current account balance.

Within this context, a study by Wu (2000) adopted a panel data unit root analysis to test for the mean reversion of current account balances in major industrial countries. About 10 OECD countries were included in the sample notably; Canada, Japan, France, Germany, Italy, the Netherlands, Spain, Australia, the United States and the United Kingdom (UK).The study found mean reverting properties of the current account, which lent credence to the inter-temporal approach to the current account.

Cointegration tests can also be run to determine the long-run relationship between exports and imports. In this regard, Wu J-L etal (2001) ran panel co-integration tests, to ascertain whether exports and imports drift from one another in the long-run. The study used the following model:

$$X_t = a + bM_t + \pi_t \quad 4$$

Where X is the exports of goods and services, and M is the imports of goods and services plus net interest payments and net transfer payments and π is the error term. For a sustainable current account deficit, b should be equal to one and π should be stationary.

The study found that exports and imports are cointegrated and the cointegrating coefficient is not significantly different from 1. As such, the findings are consistent with that of Wu (2000) who supports the stationarity of current accounts by using a panel unit-root test.

METHODOLOGY

Based on the synthesis of the literature reviewed in the foregoing, this study employs a unit root analysis of Zimbabwe’s current account deficits over the period 1990-2012. In addition, the study seeks to re-enforce the findings of the unit root tests with a cointegration analysis of the country’s export and imports to ascertain their long-run relationship and implications for current account sustainability. As such, the model as adopted by Wu (2001) as follows will be used in this study;

$$X_t = a + bM_t + \pi_t \quad 5$$

The long-run relationship between exports and imports will, however, be determined by testing for the stationarity of π_t which is a residual in the equation above. As such, the residuals approach to con-integration analysis will be used as opposed to the Johansen procedure. In this regard, a regression of

the equation above will be run in levels using the Ordinary Least Squares Method. Subsequently, the residuals will be generated in E-Views, before unit root tests are performed to ascertain the stationarity of the residual. If the residual is stationary, it implies that exports and imports drift together and, therefore, there exists a long run relationship which guarantees current account sustainability. Conversely the non-stationarity of the residual implies that imports and exports drift away from one another in the long-run, thereby implying lack of current account sustainability.

The study also comprehensively analyse the following indicators of current account sustainability:

- The sources of the current account deficit;
- The size of the current account deficit relative to GDP;
- Composition of capital account inflows and other major current account inflows;
- Foreign exchange reserve adequacy; and
- External debt developments as well as evolution of external payment arrears.

Data Sources

This study makes use of secondary balance of payments data as computed by the Reserve Bank of Zimbabwe in close collaboration with Zimstat and the Ministry of Finance.

Limitations of the Study

The study analyses the sustainability of Zimbabwe’s current account deficit from a historical perspective. As such, the study can be enriched by considering balance of payments projections in the foreseeable future in terms of expected capital account surpluses as well as developments in the current account. In this regard, the present value of expected current and capital account balances would better inform conclusions on the sustainability of the current account in a holistic manner.

The study can also benefit from a co-integration analysis of all current receipts relative to all current payments. In this regard other current account transactions, notably services, income and current transfers would also be incorporated to enrich the co-integration analysis.

RESEARCH FINDINGS

Sources of the Current Account Deficit

Evidently, there has been a close association between the current account and the trade balances since 2002. The trade account deteriorated into deficit levels since 2002, thereby pulling the current account deficit with it as illustrated in Figure 2 below.

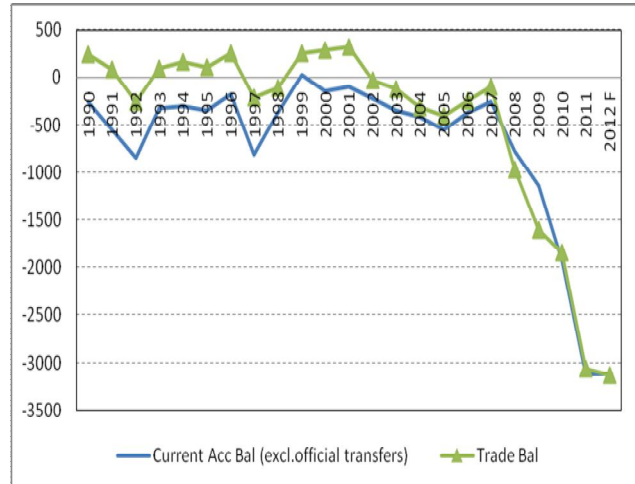


Figure 2: Current and Trade Balances (US\$M)
Source: Reserve Bank of Zimbabwe and Ministry of Finance (2012)

Undoubtedly, the country’s current account deficit largely emanates from the trade account as export performance declined and import intensity grew substantially since the turn of the century. In this regard, the country’s current account balance is unsustainable as it is trade- induced, a development which is indicative of underlying structural impediments. As depicted in Figure 3 below, the country’s export performance remained subdued in the new millennium on account of an overvalued exchange rate that taxed exporters, export surrender requirements, escalating production costs, acute foreign currency shortages, and frequent power outages among other constraints.

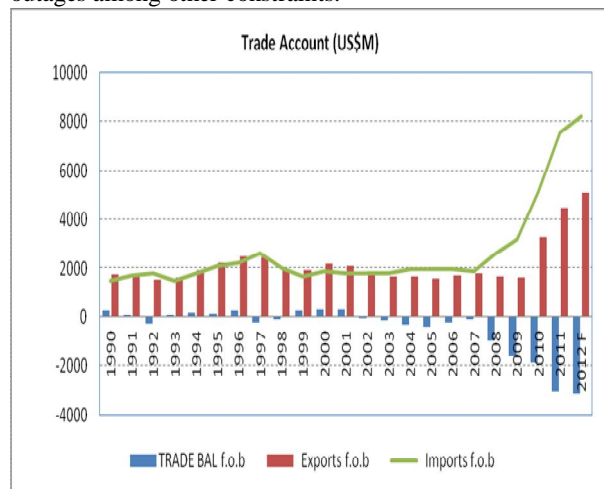


Figure 3: Trade Account (US\$M)
Source: Reserve bank of Zimbabwe and Ministry of Finance (2012)

On the other hand, the economic downturn experienced over the period 2000-2008 resulted in the retardation in economic activity, resulting in the widening of capacity gaps in the economy. In turn,

persistent supply gaps created a thriving market for imports of finished goods of a consumptive nature. Against this background, the trade balance deteriorated continuously as export recovery even under the multiple currency system remained languid, while imports have burgeoned significantly. Although net service and income payments were incurred over the period of analysis, the country also absorbed significant amounts of current transfers on the back of compromised food security and increased Diaspora inflows.

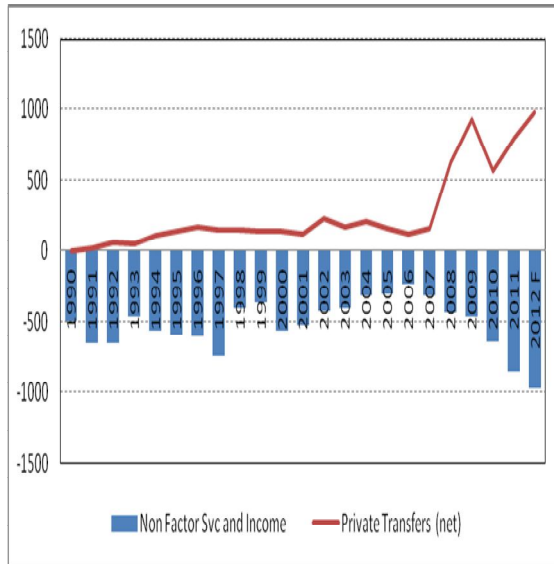


Figure 4: Non Factor Services, Income (net) and Current Transfers (US\$M)

Source: Reserve Bank of Zimbabwe and Ministry of Finance (2012)

This notwithstanding, the country's increased reliance on current transfers to finance part of the current account also compromised the sustainability of the current account as shown in Figure 4 above. This is particular so, as the donor community is shifting focus towards more crisis prone countries in the Sahel region as well as the Horn of Africa.

Size of the Current Account

Against the background of an insatiable appetite for imported finished goods particularly from the region and the Far East, the country has developed a chronic import dependency syndrome. In this regard, while export performance has remained subdued, the country continues to absorb inordinate amounts of imports. Against this background, the country's trade and current account deficits widened significantly, culminating in recurrent balance of payments disequilibria.

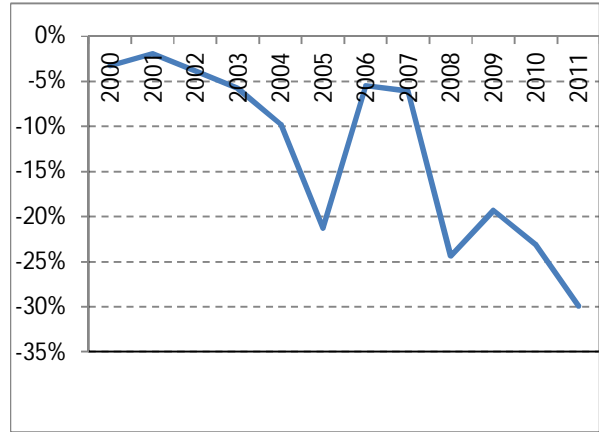


Figure 5: Current Account Deficit as a % of GDP
Source: Ministry of Finance and Reserve Bank of Zimbabwe (2012)

In consequence, the country's current account balance widened significantly from 5% of GDP in 2003 to 30% of GDP in 2011 as shown in Figure 5 above. Using the SADC macroeconomic convergence target of a current account deficit of less than 9% of GDP, the country's current account deficit, thus became unsustainable since 2004.

Composition of the Capital Account Inflows

In the backdrop of suspension of balance of payments and budgetary support since the turn of the century, capital inflows into Zimbabwe, both debt and non-debt declined precipitously. Accordingly, long term and short term loans and FDI virtually dried up over the period 2000-2008 as depicted in Figure 6 below.

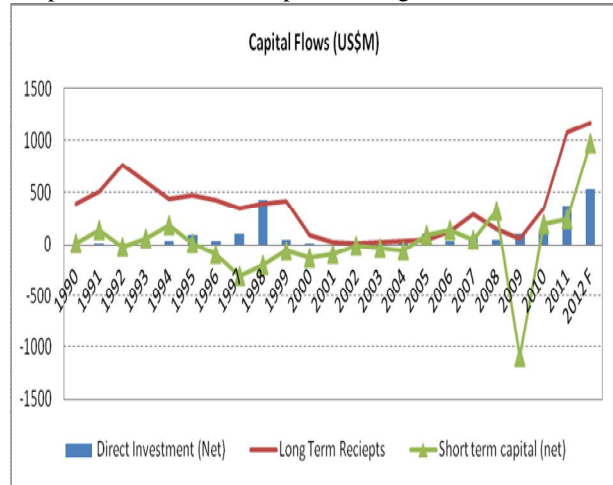


Figure 6: Capital Flows (US\$M)
Source: Reserve Bank of Zimbabwe and Ministry of Finance (2012)

Despite a rebound in capital flows since the turn of the century, the country has largely remained dependent on non-concessionary long term and short term debt. On the other hand, foreign direct investment inflows have remained subdued,

particularly in view of the indigenization and economic empowerment initiatives that further compromised the country's investment climate. As such, over-reliance on debt creating long term and short term debt in the presence of a recurrent current account deficit, thus further compromised the sustainability of the current account in Zimbabwe, even under the multiple currency system.

Foreign Exchange Reserves

A recurrent current account deficit combined with subdued capital inflows to culminate in the incurrence of a recurrent overall balance of payments deficit. These negative external sector developments depleted the country's foreign exchange resources to levels of less than 1 month of import cover since 2003, which compares markedly with 4.5 months of import cover attained in 1997.

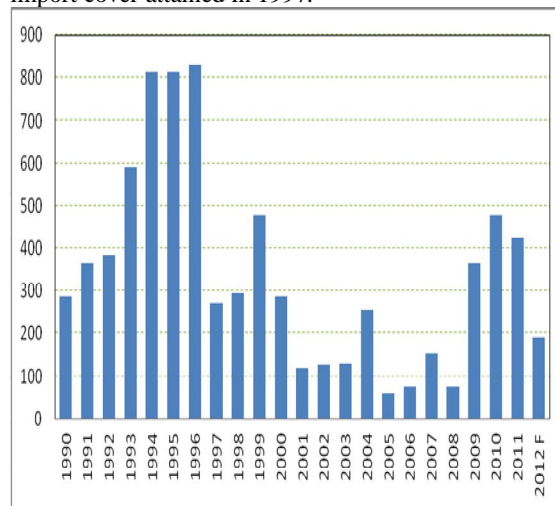


Figure 7: Gross Official Reserves (US\$M)
Source: Reserve Bank of Zimbabwe and Ministry of Finance (2012)

In view of the precarious reserve levels, as shown in Figure 7 above, the country's external sector position and the current account in particular, remains unsustainable. This explains why the country is resorting to non-concessionary borrowing to finance the burgeoning current account deficit.

Growing External Debt Burden

Against the background of dwindling foreign exchange reserves and declining export performance on account of recurrent exporter viability challenges, the country defaulted on debt repayment obligations to both multilateral and bilateral creditors since 1999.

In response to the accumulation of external payment arrears, remedial measures were evoked by multilateral creditors resulting in the suspension of balance of payments and budgetary support to Zimbabwe. Bilateral creditors and the donor community at large followed suit and suspended disbursements on on-going projects in the health,

education, transport, water and infrastructural development.

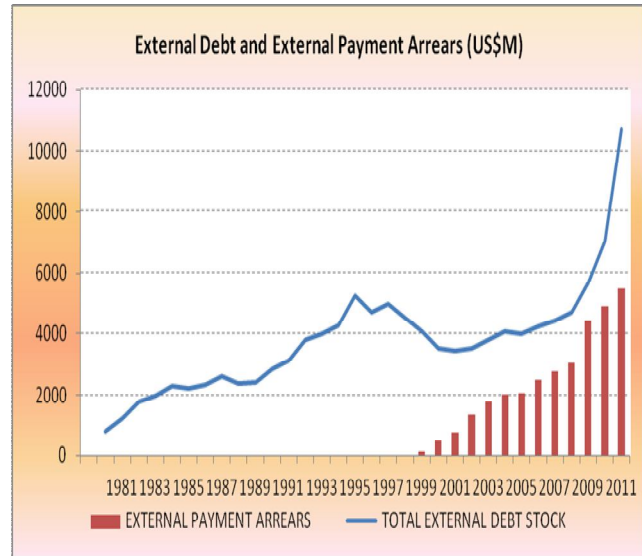


Figure 8: External Debt and Arrears (US\$M)
Source: Reserve Bank of Zimbabwe (2012)

These negative developments conspired to accentuate the country's external sector position, deterred foreign capital inflows, and further deplete foreign exchange reserves to precarious levels in the new millennium. Additionally, both long and short term capital inflows virtually dried up as the country's risk premium was further elevated by deteriorating macroeconomic conditions that were typified by episodes of high inflation. All these external sector developments combine to indicate that the country's current account deficit is largely unsustainable.

Growing Errors and Omissions

Although in theory, the balance of payments should balance, the data generation process is usually fraught with statistical errors. These are derived as a residual when the balance of payments is computed from below the line, where financing items can be computed with a reasonable degree of accuracy. In the Zimbabwean case, a sizeable errors and omissions amounting to US\$888.2 million in 2010 and US\$964.1 million in 2011, has emerged. While computationally, the errors and omissions are subsumed in the overall BOP (computed from below the line), the following are possible sources of these errors:

- Zimbabweans in the Diaspora (estimated at over 3 million) finance imports of vehicles, passenger cars, buses and haulage trucks from the resources that they generate from abroad. As such, it becomes a one sided transaction that customs authorities (ZIMRA) record as imports without any corresponding movement in reserves in the domestic economy to complete the double entry;

- According to the Bank of International Settlements (BIS) reporting banks, Zimbabweans held in excess of US\$1 billion as at end 2011, in offshore accounts, which they can potentially use to finance imports;
- During the Zim-dollar era, the overvalued exchange rate presented lucrative arbitrage opportunities for exporters to transfer-price and hive off their earnings in foreign banks. These funds can be repatriated back into the country in the form of imports of machinery, vehicles and equipment among others; and
- The computation of the balance of payments using BPM4 (currently used in Zimbabwe) excludes an important item named trade credits, where exporters export on credit and receive payment in the subsequent period. In the same vein, Zimbabwean entities can import goods in the current period and make payments in the subsequent period. The former scenario gives rise to an asset as foreign entities owe resident suppliers, while the later gives rise to a financial liability as the rest of the world's claims on Zimbabwe increase. Although there is an offsetting effect which should never be underestimated, the omission of such a transaction results in one-sided transactions whose net effect emerge in errors and omissions.

According to the IMF Balance of Payments Manual 5 and 6, a huge errors and omission relative to the size of the economy are a cause for concern as they undermine the credibility of the balance of payments statistics. This said, it is a serious conceptual oversight to assume that the overall BOP deficit is financed by errors and omissions. Errors and omissions are part of the overall balance of payments, and as such cannot finance it separately. Going forward, projected current account deficits remain large at US\$3,025.1 million (24.4% of GDP) in 2013, US\$2,941.6 million (22.8% of GDP) in 2014 and US\$2,893.2 million in 2015 (21.6% of GDP). It is, however, noteworthy that the computation of projected balance of payments statistics does not allow for the estimation of errors in the forecast period.

Thus, without errors and omissions in the forecast period, the country's overall balance of payments remains unsustainable on account of the huge current account deficit which remains in excess of 20% of GDP.

Consistent with the analysis in the foregoing, Zimbabwe's current account deficit is largely unsustainable on account of the following factors:

- i. At 30% of GDP in 2011, the current account deficit by far exceeds the regional thresholds of less than 9% under SADC

- ii. macroeconomic convergence targets and the conventional 5% threshold;
- iii. Continued accumulation of external payment arrears as well as a rising debt burden currently in excess of US\$10 billion are an indication of an unsustainable current account deficit;
- iv. Financing of the current account through non-concessionary debt creating flows, notably long term and volatile short term facilities;
- v. Lack of balance of payments and budgetary support;
- vi. Depleted foreign exchange reserves of less than 1 month of import cover which fall below the SADC threshold of 3 months;
- vii. Subdued capital inflows on account of an investment climate that compares unfavourably with regional and international peers;
- viii. The need for a substantial policy shift to correct the situation, shed off import dependence and rejuvenate the country's manufacturing sector;
- ix. The hemorrhaging effects of the current account deficit on the liquidity situation under the multiple currency system as the foreign exchange generated by exports is employed to finance a growing import bill in excess of US\$8 billion; and
- x. If the country continues with the current policy stance into the indefinite future, the liquidity situation will be accentuated, resulting in the further accumulation of external payment arrears and growth in the country's external debt burden.

Although to a limited extent the current account has remained vulnerable to adverse terms of trade shocks, the recurrent deficits in the trade account are indicative of a permanent rather than a temporary problem.

If the country was using its local currency, the unsustainability of the current account deficit would manifest itself through acute foreign currency shortages and incessant pressures to devalue the local unit. This explains the precipitous decline in the value of the local unit over the period 2000-2008 as evidenced by the widening parallel market premium. In a dollarized environment, however, where multiple currencies are used, the unsustainable current account deficit manifests itself through the erosion of the country's foreign exchange resources as well as curtailment of deposit and credit growth. This in turn hampers the attainment of accelerated economic growth which creates employment, generates foreign exchange resources and transforms the livelihoods of the general populace. It is against this background that the country has been experiencing jobless growth

as the jobs are exported to South Africa and the Far East which supply the bulk of the country's imports. In the backdrop of subdued agricultural production as a result of intermittent droughts, the country has immensely benefitted from humanitarian assistance and aid flows in the new millennium. This coupled with Diaspora remittances has shored up current transfers to offset net outflows in the income and services accounts.

This notwithstanding, the partial financing of the current account through humanitarian assistance and Diaspora remittances creates sustainability challenges in the long run. This is particularly so, given the close relationship between these two sources of finance and performance in the global economy. The deterioration in global macroeconomic conditions reduces employment opportunities for Diasporants

and the capacity of the donor community to extend aid and grants to the developed world. This in turn exposes the country, as the developing world is not obliged to assist, particularly when conditions in their own economies deteriorate.

Stationarity of the Current Account Balance

According to Wu (2000), a current account is sustainable if it is stationary (mean reverting). As such, a sustainable current account balance reverts towards its steady state levels. In this regard, the unit root test is performed on the current account balance to determine the presence of a unit root. In line with this method, the results of the unit root tests performed using the conventional Augmented Dickey-Fuller tests (in E-Views) on Zimbabwe's current account, yields the following results:

Augmented Dickey-Fuller Unit Root Test on Current Account Balance (1990-2012)

Null Hypothesis: CAB has a unit root

Exogenous: Constant

Lag Length: 0 (Automatic based on SIC, MAXLAG=4)

	t-Statistic	Prob.*
Augmented Dickey-Fuller test statistic	0.928344	0.9939
Test critical values:		
1% level	-3.769597	
5% level	-3.004861	
10% level	-2.642242	

*MacKinnon (1996) one-sided p-values.

Based on the results in the table above, the test statistic of 0.928344 is less in absolute terms than the critical values at 1%, 5%, and 10% levels of significance. Accordingly, we conclude that

Zimbabwe's current account deficit is not stationary and, therefore, unsustainable. An extension of the analysis to cover a longer series from 1980 as well as projections up to 2015 yields the following results:

Augmented Dickey-Fuller Unit Root Test on Current Account Balance (1980-2015)

Null Hypothesis: CAB has a unit root

Exogenous: Constant

Lag Length: 0 (Automatic based on SIC, MAXLAG=9)

	t-Statistic	Prob.*
Augmented Dickey-Fuller test statistic	0.083406	0.9598
Test critical values:		
1% level	-3.632900	
5% level	-2.948404	
10% level	-2.612874	

*MacKinnon (1996) one-sided p-values.

The current account deficit is also unsustainable as evidenced by the low test statistics (0.083406) relative to critical values at 1%, 5% and 10% significance levels, which also confirm that the

current account deficit remains non-stationary. As such, in the foreseeable future through to 2015, the country's current account deficit will remain unsustainable if current policies continue. The results obtained in the foregoing are also consistent with

other indicators that the country's current account deficits cannot be comfortably carried into the future without compromising the country's creditworthiness and external debt burden. The mode of financing the current account notably in the form of non-concessionary debt, and accumulation of external payment arrears is not sustainable. Undoubtedly, given that the capital account is registering modest surpluses, persistent disequilibrium in the balance of

payments is attributed to the huge current account deficit, which is, therefore, unsustainable.

Cointegration Analysis

A cointegration analysis of exports and imports yields the following results for the accompanying residuals:

Null Hypothesis: RESID01 has a unit root
 Exogenous: Constant, Linear Trend
 Lag Length: 1 (Automatic based on SIC, MAXLAG=4)

	t-Statistic	Prob.*
Augmented Dickey-Fuller test statistic	-3.106968	0.1301
Test critical values:		
1% level	-4.467895	
5% level	-3.644963	
10% level	-3.261452	

*MacKinnon (1996) one-sided p-values.

Augmented Dickey-Fuller Test Equation
 Dependent Variable: D(RESID01)
 Method: Least Squares
 Date: 09/13/12 Time: 17:52
 Sample (adjusted): 1992 2012

Similarly, the ADF test statistic of 3.107 is less in absolute value to the critical values at 1%, 5%, and 10%. As such, the results show that the residuals are not stationary reflecting lack of a long run relationship between exports and imports. This divergence explains why the country's trade and current account balances have been widening over the years. Thus, the results from the stationarity tests and the co-integration tests attest to the fact that the country's current account deficit is unsustainable.

CONCLUSION

Undoubtedly, the country's current account deficit and the external sector position at large remains unsustainable. This situation has presented serious developmental challenges for Zimbabwe and has negatively affected the attainment of fast-paced economic growth and recovery which is necessary to create employment and meaningfully improve living standards. The debilitating effects of the unsustainable current account deficit has had pronounced effects of curtailing deposit and credit growth, a development that militates against economic recovery initiatives under the multiple currency system.

Against this background, bold policy measures must be expeditiously adopted to improve industrial capacity utilization, reduce import dependence and retain the foreign exchange generated from exports, Diaspora remittances, and non-debt creating capital inflows such as FDI. Most importantly, the timely implementation of the Zimbabwe Accelerated Arrears Clearance Debt and Development Strategy (ZAADDs) as well as the commencement of the IMF Staff Monitored Program (SMP) will help improve the country's creditworthiness and unlock affordable credit lines that are critical in turning around the economic fortunes of Zimbabwe.

RECOMMENDATIONS

Within the context of the multiple currency system, possible corrective measures required to remedy the unsustainable current account deficit include the following:

- Adoption of measures that improve industrial capacity utilization in order to plug attendant supply gaps and shed off the country's high import dependence;
- Diversify the country's export basket through value addition initiatives notably, the refinement of minerals such as platinum, nickel and gold into high value export products that are not susceptible to commodity price fluctuations, polishing and

cutting of diamonds, as well as agro-processing of fruits and vegetables;

- The amicable resolution of the country's external debt in order to reduce the country risk and meaningfully attract loans from bilateral, commercial and multilateral creditors; and
- Improving the country's investment climate by benchmarking investment regulations to best international practices.

In view of the strong bearing that the trade deficit has on the unsustainable current account deficit for Zimbabwe, there is a strong temptation to adopt protectionist measures to discourage imports and promote the resuscitation of the local industry. Although this might appear like the viable option for Zimbabwe at the moment, the country should take cognizance of its commitments within the aegis of regional integration initiatives under SADC, COMESA and EU-ACP Economic Partnership Agreements.

Although a special dispensation can be sought, it can only be applied for a limited time period as regional integration places great prominence on the phasing down of both tariff and non-tariff barriers, promote the creation of a free trade area, customs union and eventually a common market as well as a monetary union. Given these attendant limitations, the country should adopt drastic policy measures geared at promoting import substitution and industrialization. This would help in the recapitalization of industry, promote the local production of basic commodities and create employment opportunities in the domestic economy.

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